

SCHOOL DISTRICT ACCOUNTABILITY INITIATIVE

2005 ANNUAL REPORT

OFFICE OF THE
NEW YORK STATE
COMPTROLLER

ALAN G. HEVESI

*Our mission
is to improve
the condition
of local
governments
and the
communities
they serve*



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OFFICE OF THE STATE COMPTROLLER

DIVISION OF LOCAL GOVERNMENT SERVICES AND ECONOMIC DEVELOPMENT

MISSION AND GOALS

Our mission is to improve the condition of local governments and the communities they serve.

Our goals are to:

- Enable and encourage local officials to maintain or improve fiscal health by increasing their governments' efficiency and effectiveness; managing costs and improving service delivery; and accounting for and protecting assets.
- Promote government reform and facilitate economic development across New York State.

A Message from the New York State Comptroller



Alan G. Hevesi

In 2004, New Yorkers were shocked by a growing education scandal on Long Island. In the Roslyn Union Free School District, school officials had stolen millions for years. At the William Floyd School District, two school officials were arrested for taking more than \$1.1 million in taxpayer funds. To date, 13 individuals in six school districts have been arrested in connection with thefts and other crimes in Long Island schools – with more expected.

As taxpayers' concern and mistrust grew, they took action at the ballot box, defeating a record number of school budgets.

Education is the key to New York State's economic future, and to the future of all our children. But the efforts to strengthen our education system could be undermined if parents and taxpayers do not believe that their money is being properly and appropriately spent.

The school scandals presented New York State government with a sharp challenge. This is a report on how our government reacted to these circumstances, and it details how at every level – and in most cases – school and local officials have risen to this challenge. This is a positive example of government rapidly and effectively responding to a crisis. It is a story of a successful partnership and an appropriate response from school boards and administrators, the Legislature, Governor, accounting profession, State Education Department, the law enforcement community and my Office.

The key to preventing fraud is strong internal controls. My Office forged a coalition with the New York State School Boards Association, New York State Council of School Superintendents, New York State Association of School Business Officials, and the New York State Society of Certified Public Accountants. In consultation with the State Education Department, we developed a program to help every school district strengthen its ability to prevent and find fraud. By October 2004, we jointly announced a five-point program, which was passed by the Legislature and signed by the Governor.

As our audits have found, many school districts did not wait for the five-point plan to be enacted into law. They started implementing changes immediately.

We also began working with education organizations to provide training to school officials on how to identify and prevent fraud and implement strong internal controls. At the time of this writing, we have provided 33 events with more than 5,000 participants.

In addition to strengthening internal controls, there is clearly a need for increased external oversight. The Comptroller's Office stopped doing regular school audits about 25 years ago. Last year, we immediately responded to the scandal by redirecting more than \$2 million in existing resources to initiate audits in Long Island school districts. So far, we have completed 18 school audits. My Office also has worked with the law enforcement community to ensure that those who are found guilty of fraud are properly punished.

A Message from the New York State Comptroller

With the support of the school community, my Office requested funding to hire an additional 89 staff so that we could audit all 821 school districts, BOCES and charter schools in the State over five years. That plan was approved by the Legislature and the Governor through legislation enacted in July. The new law requires annual reports on those school audits, and this is the first of those reports.

In sum, all the responsible parties came together to quickly and effectively address this problem. However, this does not mean that the work is done. In fact, it has just begun. OSC is now engaged in school district audits across the State. The audits in this report demonstrate that many districts have begun the job of improving their operations, but many still have a variety of management and financial issues.

The report I release today summarizes the problems we have found, as well as the success stories, and it provides practical advice for school districts as they review their internal controls.

Most school officials and school board members are honest, hard-working people dedicated to providing an excellent education to our children. But what the school scandals demonstrate is that when there is no oversight, when no one is watching, some schools will be well run, some will be poorly run, and in some there will be fraud and corruption.

We owe it not only to our children, their parents and all taxpayers, but also to teachers and administrators to ensure that schools are run effectively and that our limited resources are well spent. This means providing school boards and officials with the tools they need to do their jobs, and providing oversight to help them.

As this report shows, we are well on the way to restoring confidence in the operations of our schools and letting educators focus on education. I pledge that my Office will continue to make this one of our top priorities, and we will continue to cooperate with the entire education community.

Sincerely,

Alan G. Hevesi

School Financial Accountability Overview

This report fulfills the Comptroller's statutory requirement under Chapter 267 of the Laws of 2005 to "inform and advise the governor and the legislature in December of each year regarding a review of all school districts, Board of Cooperative Educational Services (BOCES) and charter schools audits conducted during the preceding twelve months and any other pertinent information that the comptroller deems appropriate." This is the first Chapter 267 report issued by the Comptroller since the enactment of the law in July 2005, and covers audit work occurring through December 2005.

Fiscal Accountability

Honesty and accountability are the cornerstones of effective government. Taxpayers have a right to expect that their tax dollars are well-spent and well-managed. Allegations of fraud and mismanagement can undermine the public's trust in governmental stewardship of taxpayer resources. Without the public's trust, government cannot marshal the support needed to adopt and implement difficult policy choices, and both financial and program-based performance can suffer as a result.

Starting in 2004, scandals in Long Island school districts – most notably the embezzlement of school district funds by district officials in the Roslyn Union Free School District – threatened public confidence in our schools. The Office of the State Comptroller (OSC) responded immediately to the problems on Long Island by redirecting more than \$2.1 million in existing resources for audits and training efforts, beginning with audits in 23 school districts on Long Island. OSC had not regularly audited school districts since the late 1970s when budget cutbacks resulted in OSC discontinuing these types of audits. Then Comptroller Edward Regan's rationale for removing OSC's audit presence was that school districts were required to have an annual independent financial audit from a certified public accountant (CPA) firm and were overseen by the State Education Department (SED). However, there is a need to restore our audit presence in schools, as demonstrated by the Long Island scandals.

Auditors from the Division of Local Government Services and Economic Development conducted an in-depth audit of the Roslyn School District and it soon became apparent that the size and scope of the fraud there was breathtaking – more than \$11 million had been stolen during more than eight years. Audits of the William Floyd, Uniondale and Hempstead school districts, while less dramatic than the Roslyn case, showed that these issues were not isolated concerns.

To institute an effective audit presence for schools, OSC requested resources to hire and train 89 staff members to audit all school districts in the State. The 2005-06 enacted State budget provided initial funding for this program, and legislation was passed (Chapter 267 of the Laws of 2005) specifying that each school district, BOCES, and charter school be audited within five years. The Comptroller is required to report annually on this initiative; this is the first such report.

The scandals also are a reminder of the importance of ensuring a culture of integrity in the workplace and maintaining proper financial controls within governmental organizations. Like other local governments, most school districts employ honest, hard-working professionals who do their very best to ensure that their schools are well managed. Unfortunately, fraud and mismanagement, where it occurs, can undercut their effectiveness.

School Financial Accountability Overview

The best way to prevent fraud is to develop sound financial checks and balances, educate policymakers about their financial oversight roles and responsibilities, ensure that the financial statement audits completed by independent CPA firms are meaningful and accurate, and punish wrongdoing swiftly and severely when it is uncovered. Starting in the fall of 2004, OSC convened a coalition of school district and accounting stakeholders to address the need for district-level reform. We worked with the New York State School Boards Association (NYSSBA), New York State Society of Certified Public Accountants (NYSSCPA), New York State Council of School Superintendents (NYSCOSS), New York State Association of School Business Officials (NYSASBO), and the State Education Department (SED). This group produced a school oversight initiative – known as the “Five-Point School Financial Accountability Plan” – which is designed to promote strong internal controls, improve school district audits, and strengthen the role of school boards in conducting appropriate oversight. This initiative, along with significant efforts to increase OSC training and information for school districts, has already begun to affect the way districts operate. Our more recent school district audits have found that school boards are beginning to undertake a thorough review of their existing financial policies and procedures to ensure that their districts’ assets are safeguarded from fraud and abuse.

Legislation

The State Legislature passed bills to implement the Five-Point Plan and provide additional funding for school audits in June 2005, and the Governor signed them into law in July. OSC now faces the challenge of auditing 821 school districts, BOCES and charter schools over the next five years. These audits will help deter fraud, expose fraud where it exists, and point out best practices in districts that are well-run that can serve as models for other districts. The Five-Point Plan will help prevent fraud and mismanagement from the inside by ensuring that district officials have the information and understanding they need to recognize and prevent existing or potential fraud and abuse.

Fiscal Audits of School Districts (Chapter 267, Laws of 2005)

The Office of the State Comptroller responded immediately to the problems on Long Island by redirecting more than \$2.1 million in existing resources for audits and training efforts, beginning with audits in 23 school districts on Long Island. These 23 audits included in-depth audits of internal controls over financial operations in nine districts, and administrative expense audits in 14 other districts.

However, in the long term, OSC could not continue to audit school districts regularly without neglecting other local governments, unless funding for school district audits was restored. To add an effective audit presence for school districts, OSC requested resources to hire and train 89 staff members to audit all school districts in the State within a five-year period. The 2005-06 budget provided \$2.9 million in initial funding for this program – half of the \$5.8 million expected annual budget for this initiative – which was to be expended in accordance with chapter law that had not yet been written. This legislation became Chapter 267 of the Laws of 2005, which was passed by the Legislature in June 2005 and signed into law on July 19, 2005.

School Financial Accountability Overview

The law requires that the Comptroller audit each school district, BOCES, and charter school at least once by March 31, 2010. Thereafter, OSC will decide which schools to audit based on a risk-assessment process that may include investigations of alleged improprieties, previous audit findings, or other financial indicators. OSC is required to provide reasonable prior notice to districts before conducting these audits.

Other provisions of the legislation require all audit reports to be made available to the public by OSC, and by the audited districts, BOCES and charter schools. These audited entities must post these audits to their websites, and retain them on the websites for at least five years. The legislation also requires the Comptroller to refer any criminal misconduct to the appropriate authorities.

The purpose of OSC school audits is to review the internal controls, financial practices and operations of school districts to help ensure that there is adequate protection against fraud, theft or professional misconduct. These audits help strengthen school district accountability for the use of public resources and the efficient delivery of educational services, and can be used as a tool in the development of school district internal controls. When undertaking these audits, OSC examines and evaluates financial documents, assesses current financial practices, and determines whether adequate protections exist against abuse.

OSC school audits do not duplicate the work performed by the school districts' independent auditors. For example, OSC audits do not express an opinion on the reliability of financial statements as an audit done by a CPA firm would. Rather, OSC audits focus on whether school districts' internal controls are adequate to safeguard assets in areas such as cash receipts and disbursements, purchasing, claims approval, payroll, consumable inventories, and fixed assets.

Five-Point School Financial Accountability Plan (Chapter 263, Laws of 2005)

In response to the Long Island scandals, the Comptroller assembled a group of school district and professional groups – including the NYSSBA, NYSSCPA, NYSCOSS, NYSASBO, and SED – to examine ways to strengthen school district accountability and fiscal oversight. In the fall of 2004, this group produced the Five-Point School Financial Accountability Plan, which is designed to promote strong internal controls, improve school district audits, and strengthen the role of school boards in ensuring that school district tax dollars are being effectively protected.

The Five-Point Plan was enacted into law as Chapter 263 of the Laws of 2005. The legislation strengthens school district financial accountability, requires adoption of additional fraud prevention and deterrence measures, expands deterrence mechanisms already in place, and increases awareness of these issues among school board members. The effectiveness of these measures will be monitored through an OSC expanded audit presence.

School Financial Accountability Overview

Some of the best ways to ensure sound fiscal management in school districts, and in any enterprise, include: (1) developing sound financial checks and balances; (2) educating board members about their financial oversight roles and responsibilities; (3) ensuring that audits are meaningful and accurate; and (4) facilitating the discovery and prevention of wrongdoing. This legislation is designed to help achieve these goals while accommodating the varying needs and circumstances of school districts, and is crafted to provide flexible solutions that will ease implementation.

The main components of the Five-Point Plan are:

- Strengthen the internal claims auditor function. Many boards of education delegate to an internal claims auditor the duties of reviewing and authorizing payment for district expenses. Nonetheless, these boards ultimately are still responsible for approving all payments. The new law emphasizes this responsibility by requiring that the internal claims auditor report directly to the board of education.
- School board member financial oversight training. All school board members elected or appointed on or after July 1, 2005 must now complete at least six hours of training on their financial oversight, accountability, and fiduciary responsibilities. The training must be completed within a year of their election and can be provided by any SED-approved trainer.
- More rigorous external audit standards. The law requires that the external auditor present the annual audit report directly to the school board, and that the board prepare a corrective action plan in response to any findings from that report or a State Comptroller's report. The law also requires all districts to use a competitive request for proposal (RFP) process for selecting external audit firms. After a district has selected an external audit firm, it may engage that firm annually for up to five years, at which point it must repeat the RFP process. The law does not forbid districts from hiring the same firm for consecutive five-year engagements as long as the RFP process is followed.
- New internal audit requirements. The law requires all but the smallest school districts¹ to establish an internal audit function by July 1, 2006, to be in operation by no later than the end of the calendar year. This function must include developing, annually updating, and reporting on a risk assessment of district operations. At a minimum, the risk assessment must include a review of financial policies and procedures, and the testing and evaluation of district internal controls. Many larger districts already have this function, and smaller non-exempt districts can use existing district staff, shared services agreements, or contract for the service. SED is expected to issue guidance to school districts on the internal audit function requirements shortly.

¹ This section of the law defines the smallest school districts as those with fewer than eight teachers, less than 300 students, or under \$5 million dollars in annual expenditures.

School Financial Accountability Overview

- Required audit committees. The law requires all but the smallest districts² to establish an audit committee by January 2006 to assist the school board with its financial oversight responsibilities. This committee may be made up of all or some of the members of the board of education, but it also can be made up in part or wholly of non-board members. In fact, so long as they have requisite experience, committee members do not need to be residents of the district. The guiding principal is that this committee should be able to help the board in its responsibility to select and oversee external and internal auditors, exercise its financial oversight responsibility, and implement any necessary corrective reforms.

The Five-Point Plan would have helped address the problems in the Roslyn School District in several ways. A well-trained board would have asked questions about the district's financial procedures, internal controls, and external audits, and would certainly not have gone along with the superintendent's proposal to let the assistant superintendent for business leave quietly without a full investigation. An internal audit function that includes a risk assessment, a review of financial policies and procedures, and tests of internal controls would surely have detected the anomalies in Roslyn. A competitive RFP process for auditors would have produced more thorough discussion and scrutiny of the annual external audit, and perhaps a different selection process.

Although the Five-Point Plan may require additional resources, these should not be excessive, and will pay for themselves if they help avert fraud and mismanagement. A number of districts already have implemented all aspects of the Plan. These districts recognized the need to ensure accountability and oversight and acted quickly.

²This section of the law defines the smallest school districts as those with fewer than eight teachers.

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Audit Activity and Findings

Summary of Issued Reports

Internal Control Audits	19
Budget Review Audits	8
Audits of School Districts' External Audits	3
Special Subject Matter Audits	22
Total	52

In response to the significant crisis that developed as a result of the fraud at the Roslyn Union Free School District, Comptroller Hevesi reassigned more than \$2.1 million in staff resources to increase our audit presence in schools even prior to the adoption of the new legislation. The Division of Local Government Services and Economic Development (Division) spent more than 8,535 staff days from existing resources conducting various audits of schools. These audits included audits of financial operations and school district budgets, as well as performance audits of various aspects of school district operations, in an attempt to identify revenue enhancements or possible cost savings. The results of these initial efforts have resulted in 52 individual audit reports issued as of December 31, 2005. Refer to Appendix A for a copy of each audit report. These audits were completed without the benefit of any real impact of the new staff resources that will be provided by the school accountability legislation.

Audits Related to the Special School District Legislation

The legislation calls for audits of the fiscal practices of each school district, including assessing the current financial practices and determining whether the school districts have adequate internal controls to prevent fraud, theft or professional misconduct. The Division has issued 30 audits covering 27 school districts that specifically conform to the new school district audits statute Chapter 267 of the Laws of 2005. We conducted 19 audits that addressed internal controls in school districts, and eight audits that focused on the districts' budgets and financial condition issues. In addition, because the external annual audit is a significant part of the internal control process in each district, while conducting an audit on internal controls we also performed an audit of the independent audit services that three districts received.

Internal Control Audits

Internal control audits relate to the establishment of internal controls over specific areas of operations, including expenses incurred on behalf of school district managers and members of the boards of education. These audits focused on high-risk areas identified through our risk assessment process and based on complaints, letters and requests from taxpayers and local and State officials. Although some districts had strong internal control systems, we often found pervasive weaknesses in internal controls in the areas audited. Many of these weaknesses were directly related to the "tone at the top," the actions or inactions of the top officials of the school districts.

Audit Activity and Findings

We audited the internal controls in the following school districts:

Baldwin Union Free School District
Central Islip Union Free School District
East Islip Union Free School
East Meadow Union Free School District
Elmont Union Free School District
Hempstead Union Free School District – Internal Controls
Lawrence Union Free School District
Locust Valley Central School District
Manhasset Union Free School District
Massapequa Union Free School District
Miller Place Union Free School District
North Shore Central School District
Plainedge Union Free School District
Riverhead School District
Roslyn Union Free School District – Anatomy of a Scandal
Syosset Central School District
Westbury Union Free School District
Windham-Ashland-Jewett Central School District
Wyandanch Union Free School District

Budget Review Audits

A budget review is an audit of a district's budget prior to its adoption to determine whether information contained within the preliminary budget is supported, and whether estimates are reasonable and balanced. The audit includes gaining and documenting an understanding of the internal control environment and the specific controls that are significant to the budget process, and then assessing the reasonableness of major revenue and expenditure areas. A budget review audit is mandated by the State Legislature when a school is authorized for deficit financing (borrowing to pay off an accumulated deficit).

We performed mandated budget reviews in the following school districts:

Enlarged City School District of Troy
Fabius-Pompey Central School District
Greater Amsterdam School District
Liberty Central School District
Monroe-Woodbury Central School District
Rochester City School District
Roosevelt Union Free School District
Schenectady City School District

Audit Activity and Findings

Audits of School Districts' External Audits

School districts in New York State are required by law to contract for an annual audit by an independent public accountant. This independent audit must be performed in conformity with generally accepted government auditing standards (GAGAS). The independent audit is considered to be a significant part of school district internal controls. The following school district audits relate to the acquisition of audit services and the audit work performed by their independent public accountants. We found that the school district audits did not meet professional standards in varying degrees.

We audited the annual external audits in the following school districts:

Roslyn Union Free School District – Independent Audit Services
Lawrence Union Free School District – Independent Audit Services
Manhasset Union Free School District – Independent Audit Services

Response to Audits

Most school districts have responded positively to our audit findings and district officials have taken action to fulfill our recommendations, which were based either on direct audits of their own districts, or on audits of other districts. Many officials have realized that any implementation costs needed to establish strong controls will be offset by cost-savings and the prevention of fraud.

The audits themselves, and the resulting dialogue, are all about improving the public's support for education, and the education of children. The audits that provide recommendations for improvements, and others that indicate a district is performing well, all serve a purpose by providing the public with vital information to allow them to participate in the system – either at meetings or through their votes for school board members or on school budgets.

Educational leaders, including board members and administrators, may sometimes view administrative policies and practices in areas such as travel reimbursement and cellular telephone usage as minor bureaucratic details. Because they see these issues as not being the primary business of schools, they may feel that controlling costs in these areas as not being worthy of significant attention. While this viewpoint may be understandable, it is unfortunate, because the research on fraud shows that it develops and grows over time. That is, the first actions by persons engaged in fraud are usually small, like padding a travel expense voucher. However, once the person engaging in fraud experiences success, the actions are repeated and expanded. This is why a strong internal control environment and “tone at the top” are extremely important in fraud prevention.

Audit Activity and Findings

For example, although school administrators may feel that the absence of a travel reimbursement policy is not a crucial element of running a district, the Comptroller's audits look at appropriate rules and standards that districts should follow and gauge the districts' compliance with those regulations. We look to the districts' senior managers to address these types of issues, and when we find noncompliance, we include those concerns in our audit reports and press releases. However, we do provide school district officials with opportunities throughout the audit process to communicate with our auditors and discuss the results of the audit. We do this to ensure that the facts are accurate and complete, and to allow school officials to provide input and their views on the findings and recommendations. In addition, before the audit report is finalized, school officials are given the opportunity to respond in writing to the findings and recommendations in the draft report. During this process, we always reflect on criticisms made and, at times, we have corrected errors in our press materials or worked with officials to otherwise change our procedures. In many instances, our audit reports include appendices where OSC assesses community complaints about school districts.

There is a concern among some that a negative audit report may make it more difficult for school officials to convince the public to vote for school budgets. However, oversight and evaluation of school districts' performance are part of the public process. Parents, teachers, administrators, board members and taxpayers have a right to know what the audit reports say, how they are prepared and why. This is all part of the process that results in people casting their vote. Overall, we hope to find through our audits that most districts are well run. But when there are problems, the public must know that they are being addressed – and are not being swept under the carpet.

Some school officials are concerned that our audit reports do not take into account changes that many districts are now making in response to general problems. Audits have definite time periods. The end of field work and preparation of a written report takes time. School officials, particularly new ones, are anxious to address old problems and get on with the work of education. While audits review and test specific time periods, as much as possible our audits have attempted to highlight when districts have taken steps to implement new policies and procedures. We are aware of changes in administration and board leadership and describe through our reports how new reforms, including personnel changes, are taking place. We recognize that all communities have a history that informs the current senior management ranks and board composition, and we are sensitive to those issues.

Audit Activity and Findings

Summary of Audit Findings Related to the Special School District Legislation

Fraudulent Activity

The following audits contained indications of fraud and were referred to local law enforcement agencies. These audits focused on high-risk areas identified through our risk assessment process and were based on complaints, letters and requests from taxpayers and local and State officials. We found pervasive weaknesses in internal controls in the areas audited that led to the fraudulent activity occurring and not being detected in a timely manner.

Roslyn Union Free School District – Anatomy of a Scandal (Report No. 2005M-21)

We found that more than \$11 million of District funds were used for personal expenses of school officials and 26 other individuals. This misappropriation occurred because the Superintendent and Assistant Superintendent for Business in the District could override the system and process payments outside of the normal flow of most transactions. The Board abdicated its oversight role and did not monitor the District's financial operations. In fact, when the misappropriation was initially brought to their attention, the Board chose to hide it rather than refer it to the appropriate authorities.

The breadth and depth of the fraud at the District were astounding. The District paid almost \$6 million for purchases and cash withdrawals made on the personal credit cards of the Superintendent, Assistant Superintendent for Business, Account Clerk and at least 10 of their family members and friends. More than \$1 million of District funds were used to make payments on private mortgages and loans. Payments of more than \$1.3 million were made to businesses established by District officials, or their family members or friends. Excessive salary and benefit payments of more than \$549,000 were made to certain District officials. Automobiles, computers, food, postage and travel costs totaling more than \$1.3 million were purchased for District officials and their families and friends.

Hempstead Union Free School District – Internal Controls (2005M-62)

We found that controls did not exist over most of the District's operations and that any number of District employees could purchase supplies or services totaling thousands of dollars with no central oversight or approval. This uncontrolled use of the District's funds occurred at a time when District school buildings had closed or were in significant need of repair; classrooms were overcrowded; and many students were housed in inadequate, temporary classrooms. We received complaints alleging criminal misconduct in the District and our Division of Investigations is working on these matters with the Office of the Nassau County District Attorney.

The District paid \$1.1 million to three employment agencies for temporary employees. We found no evidence that District officials had determined that hiring temporary employees was cost effective, or that they had requested proposals from various providers of these services. The District also paid \$900,000 on 18 professional service contracts awarded without

Audit Activity and Findings

competitive proposals. Certain professionals were paid more than the amounts specified in their contracts or Board resolutions, and certain contracts did not adequately delineate the services to be provided. In addition, \$117,145 was paid to three Assistant Superintendents, a District Treasurer and a District Clerk for accrued and unused leave time upon termination of services, even though there was no contract or Board resolution entitling them to such payments.

Roslyn Union Free School District – Independent Audit Services (2004M-84)

The District did not effectively procure its annual audit services. The District did not comply with its own policies to obtain requests for proposals (RFPs) for professional audit services. Instead, the District contracted with the same certified public accountant (CPA) firm each year, for a dozen years, without seeking competitive offers from other firms.

We found that the annual audit of the District did not meet nine of 22 required professional standards for such an audit. The audit was significantly deficient in planning and execution. In addition, we believe that the CPA firm that performed the audit was not independent. As a result of the numerous deficiencies we identified, a multi-million dollar fraud by District personnel was not identified, *even when the CPA firm was aware that a fraud had occurred.*

Manhasset Union Free School District – Independent Audit Services (2004M-89)

The District did not effectively procure its annual audit services. The District did not comply with its own policies to obtain requests for proposals for professional audit services. Instead, the District contracted with the same CPA firm each year, for more than ten years, without seeking competitive offers from other firms. In addition, we believe that the CPA firm that performed the audit was not independent.

We found that the annual audit of the District did not meet many of the required professional standards for such an audit. The audit was significantly deficient in planning and execution. For example, the audit planning did not assess the possibility of fraud or illegal acts and plan audit tests accordingly. There is no evidence that the audit planning considered the existence of related party transactions, nor was there any indication that the CPA firm considered the District's use of a computerized accounting system when planning audit tests.

Audit Activity and Findings

Serious Internal Control Deficiencies

The following school district audits identified serious internal control deficiencies that could easily lead to theft and misappropriations of taxpayer assets. These audits focused on high-risk areas identified through our risk assessment process and were based on complaints, letters and requests from taxpayers and local and State officials. We found pervasive weaknesses in internal controls in the areas audited.

Plainedge Union Free School District (S8-4-129)

Our audit disclosed significant weaknesses in how District officials structured and carried out the internal claims audit function during our audit period. We found that the internal claims auditor, who also was the secretary of the Deputy Superintendent, did not report directly to the Board of Education and did not review claims for reasonableness. We also found that in July and August 2004 the District paid more than \$8.1 million in claims that were not audited or approved. The District paid almost \$23,000 in travel-related expenses for managers and members of the Board even though many claims did not have the conference approval forms, travel vouchers and/or itemized receipts required by District policies. We also found deficient documentation to support two claims totaling \$4,429 submitted by the former President of the Board of Education for a trip to Orlando, Florida.

In addition, we found that the Superintendent and Deputy Superintendent did not attach itemized invoices or sale receipts to their District credit card claims totaling about \$16,400. Also, the District reimbursed five members of the Board and the Superintendent almost \$2,700 for the cost of high-speed Internet services in their homes, spent about \$7,100 on 10 cellular telephones, and expended about \$20,000 for meals and refreshments at more than 200 meetings. The Board has not adopted a written policy that presents a business rationale for providing Internet services, describing who needs cellular telephones and how they should be used to conduct business, and when it is appropriate to provide meals and refreshments to employees.

Central Islip Union Free School District (S8-5-11)

The Board of Education failed in its basic fiduciary duty of safeguarding taxpayer moneys by not establishing and maintaining a proper “tone at the top.” As a result, Board members sometimes charged abusive and excessive travel expenses to the District. The audit identified excessive, questionable and unsupported travel and other expenses for school board members, including a \$399 per night hotel suite and extended trips at out-of-state conferences. Auditors found that the District lacked basic internal financial controls, had inadequate policies governing spending, and had few receipts to verify expenses. The audit findings have been referred to the Suffolk County District Attorney.

Audit Activity and Findings

The audit specifically identified \$75,581 dollars of questionable expenses including:

- \$56,620 in credit card charges not supported by receipts or invoices; of these, \$9,500 could not be traced to a legitimate business purpose, and \$3,258 was spent on extended travel at out-of-state conferences.
- \$8,326 in payments improperly made to the superintendent and assistant superintendent as reimbursement for vacation time. As a result of the audit, the District recovered these funds.
- \$6,900 in payments for mileage reimbursement that lacked detailed information to justify that travel was for school purposes.
- \$3,735 spent on Internet and phone service for board members.

Lawrence Union Free School District (2005M-38)

We found many instances where the Board had either not established critical internal controls, or controls that had been implemented were improperly designed or operating ineffectively. As a result, the District is vulnerable to the possibility of errors and/or irregularities occurring and not being detected in a timely manner. The District's internal auditor was not provided with written job duties and instead of reporting to the Board, reported to the Assistant Superintendent for Business. We noted numerous instances of insufficient documentation or errors in the area of claims processing, and non-compliance with Board policy or laws relating to procurement. This raises serious questions about the quality of the claims review and approval process.

Our audit disclosed several significant control weaknesses relating to computer operations. These deficiencies include the lack of written policies and procedures to guide day-to-day operations, weak or non-existent controls relating to access to computer programs and data, and the ability to alter previously entered information.

Westbury Union Free School District (S8-5-4)

Our examination of the District's internal controls over administrative expenses disclosed weaknesses in the internal control environment which allowed the Superintendent to receive almost \$15,700 for 20 unused sick leave days. These payments were not allowed under the terms of her employment contract. Internal control weaknesses also allowed her to charge the District for personal expenses, including airfare for her husband. We found that other officials and Board members also had charged the District for personal expenses.

Audit Activity and Findings

Itemized invoices or receipts for approximately \$13,400 in credit card charges for the Superintendent and two Assistant Superintendents were not available for audit. We also found that district officials have not recently assessed the benefits of providing 73 cellular telephones to employees. The District spent more than \$103,000 on cellular telephone service during our audit period. Finally, the District did not adopt a written policy outlining when it was appropriate to provide meals and refreshments to employees attending District meetings. The District expended \$80,700 for such at 421 meetings and events during the audit period.

Manhasset Union Free School District (2005M-33)

We found many instances where the Board had either not established critical internal controls, or controls that had been implemented were improperly designed or operating ineffectively. These weaknesses in internal controls could lead to errors or irregularities occurring and not being detected in a timely manner.

Our audit disclosed several significant control weaknesses relating to computer operations, including lack of written policies and procedures, weak or non-existent controls over access to programs and data, and the ability to alter previously entered information. We also found where certain duties of several employees in the Treasurer's office were not properly segregated to ensure that no single person controls most or all phases of a transaction. We found instances where claims processing and procurement controls need to be strengthened. Master purchase orders were allowed to be issued excessively and the approval process for purchase orders could be circumvented. District officials did not ensure that capital assets were protected from loss by ensuring that the Board's adopted Capital Assets Accounting Policy was strictly adhered to. The District did not maintain any inventory records nor perform periodic physical counts for inventories of consumable items, such as auto parts and cafeteria foods.

Internal Controls in Need of Improvement

The following audits identified school districts that need to improve various internal control procedures, including establishing clear and effective policies for various expenses. While internal controls could be improved at these schools, our testing of numerous payments, transactions and other aspects of the districts' operations did not reveal any significant wrongdoing.

Baldwin Union Free School District (S8-4-128)

Our audit revealed a need for more policy guidance by the Board of Education for some expenses. In addition, we noted an opportunity for the Superintendent and other managers to improve the District's control environment by always including itemized receipts that detail the amounts they claim for reimbursement. However, with the possible exceptions of some meal expenditures, we did not identify any significant exceptions with the District's administrative expenses.

Audit Activity and Findings

Specifically, we found that the District expended more than \$43,000 on travel and conference expenses, about \$48,800 for meals and refreshments, about \$13,000 on 20 cellular telephones, and about \$2,100 for gasoline charged on credit cards. The Board has not adopted a detailed written travel policy that outlines which expenses it will reimburse, or sets limits to what it will pay. The Board also has not adopted a written policy outlining when it is appropriate to provide meals to employees, a written policy outlining which District employees need cellular telephones to conduct business and how they should use them, and a written policy on the use of gasoline credit cards.

East Islip Union Free School (S8-5-45)

Our audit disclosed an independence impairment concerning the CPA firm that performed the District's annual audit. The same CPA firm served as both the internal claims auditor and the external auditor, resulting in an impairment of independence under GAGAS.

We also observed a need for more policy guidance from the Board of Education for some expenses, and the need for the District to limit the compensation and benefits provided to managers to amounts formally authorized by the Board. The District compensated some managers for working overtime or on special assignments. The District lacked adequate policies for the following expenses: credit cards, travel and conference, meals and refreshments, and cellular telephones.

East Meadow Union Free School District (S8-5-6)

Our audit disclosed weaknesses in how the Board structured and carried out the internal claims audit function and in how officials complied with the Board of Education's travel and meal policies. The Board did not review each claim, and the internal claims auditor only examined a sample of five to 10 claims on each warrant. During our audit period, the District expended nearly \$67,000 on travel and conference expenses for its managers and members of the Board. Various claims did not comply with the District's policies, including eight claims for airfare and hotel totaling \$2,100 that were supported only by personal credit card statements. In addition, the Board did not set a reimbursement limit for lodging, and its daily meal reimbursement rate of \$118 significantly exceeded the Federal per diem meal rates. Further, the District reimbursed four members of the Board for the full cost of their airfares to Albany despite the reimbursement being contrary to the District's travel policies, because flying was significantly more costly than other available transportation choices.

The District expended about \$61,350 for meals and refreshments during our audit period. The claims generally did not provide enough documentation to determine whether officials followed the District's policy requirements. The claims did not indicate why it was necessary to hold the meetings at mealtime, or to provide food to attendees at the District's expense.

Audit Activity and Findings

Massapequa Union Free School District (S8-5-5)

Our audit found that the Board of Education did not have a policy outlining when it is appropriate to provide meals and refreshments to employees. The District expended about \$60,050 for meals and refreshments at 552 meetings or events during our audit period. The claims supporting these expenses generally did not show who attended the meetings or the reasons why attendees required meals and/or refreshments.

The District paid about \$20,400 charged to four credit cards that were assigned to the Superintendent, Deputy Superintendent and two Assistant Superintendents during our audit period. The Board had not adopted a written policy outlining how District officials should use the credit cards.

Syosset Central School District (S8-5-7)

Our audit disclosed a need for more policy guidance from the Board of Education for some administrative expenses. In addition, we noted opportunities for the managers to improve the District's control environment by always following Board-approved contracts, resolutions and policies, and including itemized meal receipts and mileage statements that detail the amounts they claim for reimbursement.

The Board had not adopted a written policy outlining when it is appropriate to provide meals and refreshments to employees attending District meetings and events. The District expended about \$125,000 for these items at 983 meetings and events during our audit period. The Superintendent, Deputy Superintendent and Director of Business Operations used from three to five personal leave days each per year that the District did not provide them under the terms of their written employment contracts. The combined 22.5 days of personal leave had a cash value of about \$23,700. The Deputy Superintendent, Director of Business Operations and Elementary Curriculum Coordinator submitted claims for mileage reimbursements that totaled more than \$18,000. The claims showed only the total number of miles driven during a period, usually a month.

Windham-Ashland-Jewett Central School District (2005M-55)

We found that internal controls over purchasing were not appropriately designed and operating effectively. We found that the District's procurement policy did not address the need to solicit RFPs for professional services as required by General Municipal Law and the District's policy manual. This resulted in District officials neglecting to solicit written RFPs for auditing services, architectural and engineering costs, and renovation projects.

We also found that the Board of Education had not established written procedures for the audit of claims, or defined the responsibilities of the internal claims auditor. Claims were added to the cash disbursements schedules after the schedules had been approved by the Board. The District's inventory of capital assets had not been maintained on a current basis, and periodic physical inventories had not been taken as required by the District's policy manual.

Audit Activity and Findings

Wyandanch Union Free School District (S8-5-46)

Our audit disclosed weaknesses in how District officials structured and carried out the internal claims audit and treasury functions. We found a need for more policy guidance from the Board for some administrative expenses. We also noted opportunities for the District to improve its control environment by always following Board-approved contracts, policies and resolutions, and limiting compensation and benefits provided to managers to amounts formally authorized by the Board.

The District did not have a proper internal claims auditing function for eight months when the internal claims auditor resigned. The District did not enforce its policy for cash advances by requiring school officials to submit receipts and/or repay the cash advances in a timely manner. The District provided compensation and fringe benefits to some managers without proper authorization from the Board. For the period March 2003 to July 2004, the District combined the positions of the Accountant and Treasurer without providing a system of internal controls to provide sufficient checks and balances over financial transactions. The District lacked adequate policies for the following expenses: travel and conference, meals and refreshments, and cellular telephones.

Some Schools Are Well-Managed

The following audits identified schools that were generally well-managed. District officials had taken practical steps to address various issues. Internal control systems were generally well-designed and operating as intended to provide reasonable assurance that district-established policies and procedures were being followed. However, these audits did identify some areas that could still be improved.

Elmont Union Free School District (S8-5-9)

District officials had strengthened financial oversight and adopted policies to limit spending on meals, travel and other administrative expenses after an independent financial review of the District's financial operations identified areas for improvement. Our examination of the District's internal controls over administrative expenses identified possible improvements in how District officials structured and carried out the claims audit and treasury functions. In addition, we found a need for more policy guidance by the Board of Education for some expenses, and noted opportunities for the Superintendent and other managers to improve the District's control environment by always including itemized receipts that detail the amounts incurred by the use of credit cards. We did not identify any evidence of wrongdoing and found that the District had already addressed many of the control weaknesses identified.

Audit Activity and Findings

Locust Valley Central School District (S8-5-44)

The District assessed internal controls over administrative expenses recently and has taken positive steps to strengthen controls. For example, the District canceled its two general-purpose credit cards, engaged a CPA firm to conduct a review of internal controls, hired an accounting firm as the internal claims auditor, and adopted new written policies for travel, cellular telephones, and meals and refreshments.

We did note that the District could improve its documentation for credit card payments for travel expenses. While District policies required receipts, 20 percent of the claims we tested did not contain complete documentation to support the expenses.

Miller Place Union Free School District (S8-5-10)

Although we found that the District is generally well-managed, we did identify a need for more policy guidance by the Board of Education for some expenses. In addition, we noted opportunities for the Superintendent, other managers and members of the Board to improve the District's control environment by always including itemized receipts and supporting documentation that details the amounts and business reasons for the expenses they claim for reimbursement, and by following existing Board policies for travel. The District expended more than \$53,000 on travel-related expenses for its managers and Board members. While the District has policies that require travelers to submit documentation to support their claimed expenses, officials did not always follow these policies.

North Shore Central School District (S8-5-32)

In February 2005, the District adopted written policies for cellular telephones and meals at meetings. In addition, the District strengthened internal controls over cellular telephones in October 2004 by initiating a new process to track and monitor cellular telephone usage and to adjust the cellular telephone plans accordingly.

Riverhead School District (S8-5-8)

The District is generally well managed but internal controls and policies could be improved in some areas. We did identify weaknesses in how District officials structured and carried out the internal claims audit function, and in how officials complied with the Board of Education's travel-related policies. The internal claims auditor reported directly to the Assistant Superintendent for Business, not to the Board; did not review claims for appropriateness; and forwarded questionable claims to the Treasurer and/or accounts payable clerk for resolution, rather than to the Board. Because the Treasurer and accounts payable clerk are involved in the cash disbursement process, they cannot provide the independent review of claims transactions necessary for good internal controls.

Audit Activity and Findings

Independent Audit Service Audits Need Improvement

The following school district audits relate to the acquisition of audit services and the audit work performed by their independent public accountants. Not only did we find weaknesses within the districts' procurement procedures for professional services, we also found that the school district audits did not meet professional standards in varying degrees.

Lawrence Union Free School District – Independent Audit Services (2005M-29)

We found that the District's written purchasing policy and regulations applicable to procuring professional services is not adequate because it does not contain sufficient guidance on criteria for the procurement of audit services, including the maximum contract period for those services. In addition, based on the limited documentation available to assess the process used for the procurement of audit services, we concluded that District personnel did not comply with the District's procedures because RFPs were not available to show that the contract for audit services had been awarded to the lowest responsible bidder.

We found that the annual audit of the District could be improved. The CPA firm did not comply with auditing standard requirements relating to the consideration of fraud. Also, relating to the District's use of information technology, the CPA firm did not comply with the second standard of field work which states that a sufficient understanding of internal control is to be obtained. Finally, the CPA firm's audit programs and workpapers supporting testing of expenditures and fixed assets were not properly designed and executed to enable the CPA firm to obtain sufficient and competent evidential matter on District expenditures.

Manhasset Union Free School District – Independent Audit Services (2004M-89) Refer to the description of this audit in the "Fraudulent Activity" section.

Roslyn Union Free School District – Independent Audit Services (2004M-84)

Refer to the description of this audit in the "Fraudulent Activity" section.

Budget Review Audits

A budget review is an audit of a district's budget prior to its adoption to determine whether information contained within the preliminary budget is supported, and whether estimates are reasonable and balanced. The audit includes gaining and documenting an understanding of the internal control environment and the specific controls that are significant to the budget process, and then assessing the reasonableness of major revenue and expenditure areas. A budget review audit is mandated by the State Legislature when a school is authorized for deficit financing (borrowing to pay off an accumulated deficit).

Audit Activity and Findings

Enlarged City School District of Troy (B5-5-6)

We found the revenue and expenditure projections in the tentative budget to be reasonable and the District's budget structurally balanced. We noted that the District appropriated \$1,346,677 for its liability to the Teachers' Retirement System (TRS). However, based on information we obtained from TRS, the District should appropriate \$1,840,106 for these costs. The District's proposed budget estimates State aid revenue of \$39,921,813. However, the budget approved by the State Legislature includes State aid of approximately \$40.9 million.

Based on the District's tentative budget for 2005-06, the District could retain 2 percent of \$76,609,503, or \$1,523,190, as unreserved fund balance at the end of the 2004-05 fiscal year. The District's 2005-06 budget includes an appropriation of \$2,137,445 from unreserved fund balance. The District's independent audit report for fiscal year 2003-04 reported an unreserved/unappropriated fund balance of \$2,758,531 at year end.

Fabius-Pompey Central School District (B3-5-04)

The District's revenue and expenditure projections in the proposed 2005-06 budget are reasonable and the budget is structurally balanced. However, our audit disclosed that the District incurred an operating deficit of \$606,773 for the 2003-04 fiscal year resulting in an accumulated general fund deficit of \$170,659 on June 30, 2004. District officials are projecting an operating deficit of about \$753,000 for the 2004-05 fiscal year which would, should it occur, increase the accumulated general fund deficit to about \$924,000 on June 30, 2005.

The District has requested the State Legislature to authorize the issuance of bonds and bond anticipation notes, up to \$1.5 million, to liquidate a projected accumulated deficit in its general fund at the close of its fiscal year ending June 30, 2006. This preliminary amount was chosen to provide the District with a cushion should the District experience an unexpected occurrence that would further deplete its fund balance during the remainder of the 2004-05 fiscal year and the 2005-06 fiscal year.

Greater Amsterdam School District (B5-5-8)

We found the revenue and expenditure projections in the tentative budget to be reasonable and the District's budget structurally balanced. Based on the District's tentative budget for 2005-06, the District could retain 2 percent of \$42,828,247, or \$856,565, as unreserved fund balance at the end of the 2004-05 fiscal year. The District's 2005-06 budget includes an appropriation of \$903,118 of available fund balance. The District's independent audit report for fiscal year 2003-04 reported an unreserved/unappropriated fund balance of \$2,039,665 at year end.

Audit Activity and Findings

Liberty Central School District (B4-5-10)

We found the revenue and expenditure projections in the tentative budget to be reasonable and the District's budget structurally balanced. We requested the District's tentative budget and analyzed the composition of revenues and expenditures to determine if the revenue and expenditure estimates are reasonable, and if the budget is structurally balanced so that recurring costs are financed with recurring revenues. The District's tentative 2005-06 budget includes appropriations from the general fund of \$31.7 million, with matching estimated revenues from real property taxes and other non-property tax revenues. In addition, the tentative budget includes appropriations from the food service fund of \$780,380, with matching revenues from sources other than real property taxes.

Monroe-Woodbury Central School District (B6-5-2)

District officials project a general fund balance of approximately \$2.6 million on June 30, 2005. The 2005-06 fiscal year proposed budget includes the appropriation of \$2 million of fund balance to help finance operations. If 2005-06 results of operations equal the proposed budget, fund balance would not be replenished and, therefore, would not be available to finance the 2006-07 budget. Consequently, the Board will have to identify other recurring revenues or reduce appropriations in the 2006-07 budget to replace the \$2 million of fund balance that will not be available to finance future budgets.

The proposed budget for the fiscal year 2005-06 estimates State aid revenue of \$31,193,441. We noted that the budget approved by the State Legislature includes State aid of \$34,787,275 for the District. We urged the District to monitor the State budget proceedings, including the status of proposed education aid, and be prepared to take proper action if final State aid appropriations are known before the adoption of the District's budget.

Rochester City School District (2005M-7)

Although the District had a healthier accumulated fund balance as of June 30, 2004 than in prior years, we believe that the numbers reported overstate the true financial condition of the District, primarily because of a 2002 Appropriation Authority of State aid which did not provide the District with cash resources. Therefore, although the District has a stated fund balance of more than \$50 million at June 30, 2004, the District does not have enough cash resources to operate and must still rely on short-term borrowings to provide enough cash to pay its bills.

We found the revenue and expenditure projections in the 2004-2005 adopted budget, as amended on October 26, 2004, to be reasonable. That budget is balanced only through the District's receiving the 2004 State aid spin-up. The District used approximately \$8.3 million of the additional \$20 million of the State aid to balance its 2004-2005 budget. The District's intention for the balance of \$11.7 million of this aid is to use it to finance the 2005-2006 fiscal year budget. This revenue source is non-recurring revenue, and will not be available to balance the District's 2006-07 budget.

Audit Activity and Findings

Roosevelt Union Free School District (B7-5-5)

We found the revenue and expenditure projections in the tentative 2005-06 budget to be reasonable and the budget structurally balanced. However, the tentative budget includes an appropriation of \$2 million out of the projected balance of \$2.1 million on June 30, 2005. As a result, there will be no fund balance available as a financing source during 2005-06 should the District incur unusual expenditures, or if revenues fall short of budget. In addition, if 2005-06 operations mirror the proposed budget, there will be no available fund balance on June 30, 2006. Therefore, in the 2006-07 budget, the Board will have to reduce appropriations or find another financing source to replace the \$2 million appropriated fund balance that will not be available.

We also found that \$410,000 of projected State building aid of \$1,011,609 is contingent upon the District incurring certain capital expenditures in the fiscal year 2004-05. The District should determine if the aid eligibility criteria will be met. We also noted that the District's tentative budget included State aid of \$31,089,215, which is \$1,011,609 less than the amount included in the tentative State budget. The District should determine the amount that it will receive in State aid and adjust the budget.

Schenectady City School District (B6-5-3)

The 2005-06 fiscal year proposed budget includes the appropriation of a little more than \$6 million of fund balance to help finance operations. This amount is \$3 million more than the amount of fund balance appropriated in the prior year. Although the District's trial balance on February 28, 2005 indicates that more than \$15 million in fund balance may be available, we caution District officials about their decision to finance an increasing amount of operating expenditures with non-recurring revenue sources, such as fund balance.

The proposed budget for the fiscal year 2005-06 estimates State aid revenue of \$51,070,115. We noted that the budget approved by the State Legislature includes State aid of \$54,454,410 for the District. We urged the District to monitor the State budget proceedings including the status of proposed education aid, and be prepared to take action if final State aid appropriations are known before the adoption of the District's budget.

Specific Subject Matter Audits

In addition to the 30 audit reports that were directly related to the legislation, we issued another 22 audits that were directed toward particular operations in some school districts. These audits did not cover the specific financial areas called for by the legislation so we do intend to return to these districts sometime within the five-year period to address financial areas. However, these audits demonstrate our ongoing commitment to improving school performance by identifying operational improvements that could help districts enhance revenue or reduce costs. Two of these audits were of individual school districts: we audited the data collection process for a State aid program in the Buffalo City School District and found that Buffalo could receive as much as \$3 million more in State aid if the District corrected some flaws in their system, and we audited claims processing in the Syracuse City School District self-insured employee health insurance program and found a small error rate.

Audit Activity and Findings

The other 20 school districts were audited as part of broader efforts where we audited the same issue in multiple school districts. For example, we audited eight districts' procedures for obtaining reimbursement for services that they provide to Medicaid-eligible students.

We performed specific subject matter audits in the following school districts:

Acquisition of Athletic Fields, including the following school districts:

- Eastchester Union Free School District
- Greenburgh Central School District
- Valhalla Union Free School District

Buffalo City School District – Free and Reduced-Price Lunch Program Data Collection and Reporting

School District Medicaid Reimbursement, including the following school districts:

- Beacon City School District
- Coxsackie-Athens Central School District
- Greenville Central School District
- Hudson City School District
- Hunter-Tannersville Central School District
- Kingston City School District
- New Paltz Central School District
- Rondout Valley Central School District

School Energy Efficiencies, including the following school districts:

- Binghamton City School District
- Cortland City School District
- Greene Central School District
- Middleburgh Central School District
- Schoharie Central School District
- Sidney Central School District

Syracuse City School District – Health, Dental and Vision Claims

Audit Activity and Findings

Summary of Audit Findings Related to Specific Subject Matter Audits

The Greenburgh, Valhalla and Eastchester School Districts – Acquisition of Athletic Fields (2005-MR-8)

The three Districts did not acquire their athletic fields in an appropriate manner or at a reasonable cost. We found that in an attempt to acquire fields at no cost, the three Districts generally avoided seeking or obtaining required taxpayer approval, did not comply with competitive bidding requirements, entered into unauthorized equipment-lease agreements, and did not acquire appropriate approval and permits from State agencies. As a result, these athletic fields will cost the Districts well in excess of \$1 million. In addition, the Greenburgh and Eastchester School Districts were left with mounds of dirt and construction and demolition (C&D) debris that cannot be used as athletic fields until the Districts receive environmental approval, which will cost them considerably more to obtain. The Eastchester District has already expended in excess of \$478,000 on remediation work. Valhalla voluntarily closed its completed natural-grass field pending further testing of the soil. It appears that the only parties to profit from this scheme are the dirt haulers who received cost savings of between \$6.5 million and \$16 million for dumping C&D debris on District properties.

The following school districts were included in this report:

Eastchester Union Free School District (P6-5-1)

The District agreed to accept the C&D material from the dirt haulers in exchange for the dirt haulers renovating three existing athletic fields. In total, the dirt haulers deposited approximately 250,000 cubic yards of C&D material on District property. As a result of these transactions, the athletic fields that were originally to be donated ended up costing the District more than \$480,000 in remediation work for the high school football field alone. In addition, the District has two other athletic natural-grass fields that have environmental issues that must be resolved before they can be used. Resolving the environmental issues will cost the District additional moneys. District taxpayers were not included in the decision-making process for these contracts, District officials ignored various legal statutes, and the only parties that profited from this transaction were the dirt haulers who accrued savings of between \$3 million and \$7.5 million for not disposing of the C&D debris in licensed disposal facilities.

Greenburgh Central School District (P6-5-2)

The athletic fields that were originally to be donated ended up costing the District more than \$400,000. In addition, the District has one other athletic field with environmental issues that must be resolved before it can be used. Resolving the environmental issues will cost the District additional moneys. District taxpayers were not included in the decision-making process for these contracts, District officials ignored various legal statutes, and the only parties that profited from this transaction were the dirt haulers who accrued savings of between \$2.4 million and \$6 million for not disposing of the C&D debris in licensed disposal facilities.

Audit Activity and Findings

Valhalla Union Free School District (P6-5-3)

C&D debris was used to construct a baseball/softball field on top of a pre-existing soccer field by filling and leveling the slope on the site adjacent to the Kensico School. All the labor and materials relating to the projects were donated. However, the synthetic covering was not provided as promised. Approximately 90,000 cubic yards of C&D material was deposited on District property. District officials indicated that after work and delivery of the fill had commenced, the dirt broker informed the District that funding for the fields had run out, thereby obligating District taxpayers to complete the fields with public funds. As a result of these transactions, the athletic field that was originally to be donated ended up costing the District more than \$215,000. In addition, the District may have an athletic field with environmental issues that must be resolved before it can be used. Resolving the environmental issues may cost the District additional moneys. District taxpayers were not included in the decision-making process for these contracts, District officials ignored various legal statutes, and the only parties that profited from this transaction were the dirt haulers who accrued savings of between \$1.08 million and \$2.7 million for not disposing of the C&D debris in licensed disposal facilities.

Buffalo City School District – Free and Reduced-Price Lunch Program Data Collection and Reporting (2005M-42)

The District received approximately \$780,000 less in Extraordinary Needs Aid (ENA) than it should have received as a result of not accurately reporting and verifying certain data submitted to the State Education Department (SED). Failure to take corrective action could result in the District not receiving another \$2.2 million in ENA in the current fiscal year.

Established policies and procedures for data collection and reporting are not consistently applied throughout the District resulting in the inefficient operation of the free and reduced-price lunch data collection and reporting process. The entire process requires a significant amount of effort and documentation to collect and report the data. Communication between the various departments involved in the free and reduced-price lunch program is inadequate. We found no indication that the various departments involved in data collection worked in a cohesive manner to create an efficient and effective process.

School District Medicaid Reimbursement (2005-MR-2)

As school districts struggle to fund educational programs with limited resources, Medicaid reimbursements for services provided to eligible special education students are important potential revenue sources. For example, the 36 school districts in the four counties of Dutchess, Greene, Columbia and Ulster claimed more than \$13,528,000 in Medicaid reimbursements for such services in 2002-03 and 2003-04. Our audit disclosed that the eight school districts involved in the audit failed to claim at least \$2.8 million of Medicaid reimbursement for related services, Targeted Case Management (TCM) reviews, and ongoing service coordination provided to special education students. As a result, the school districts did not receive at least \$700,000 in Medicaid reimbursement revenues, which was their share (25 percent) of the eligible services that district officials could have claimed.

Audit Activity and Findings

The following school districts were included in this report:

Beacon City School District (P6-5-24)

Our review of the District's process and procedures for claiming Medicaid reimbursement for the School Supportive Health Services Program (SSHSP) disclosed that the District failed to claim \$286,210 of reimbursement for related services and TCM ongoing service coordination. As a result, the District did not receive its share (25 percent) of Medicaid revenue of \$71,553. In addition, the District does not process claims for reimbursement in an efficient manner. We noted in our review that the District contracts with the Dutchess County Board of Cooperative Educational Services (BOCES) and REHAB for related services. Appropriate documentation of related services is not submitted to the clerk designated to perform the Medicaid process in a timely manner, if at all, even after several formal requests. As a result, the preparations of the claims for reimbursement of Medicaid are not timely.

Coxsackie-Athens Central School District (P6-5-25)

We found that the District failed to claim \$111,437 of Medicaid reimbursement for related services and TCM ongoing service coordination. As a result, the District did not receive its share (25 percent) of Medicaid revenue of \$27,859. In addition, the District uses Federal moneys to pay a portion of the salaries for the Director of Special Education, the school psychologist, and the secretary to the Director of Special Education. Therefore, the District cannot claim reimbursement for TCM reviews and psychological evaluations. However, if the District uses these Federal moneys for other District services, this would allow the District to submit a claim for TCM reviews and psychological evaluations for Medicaid as well.

Greenville Central School District (P6-5-26)

We found that the District failed to claim \$112,928 of Medicaid reimbursement for related services and TCM ongoing service coordination. As a result, the District did not receive its share (25 percent) of Medicaid revenue of \$28,232. The District does not process claims for reimbursement in an efficient manner. Some of the District's related service providers and BOCES do not submit documentation of related services to the billing clerk in a timely manner, if at all, even after several formal requests. In addition, we also noted that the billing clerk was unaware that she could provide a list of the Medicaid eligible students to the related service providers. As a result, the billing clerk is unnecessarily receiving service documentation on all classified students. This, and the fact the District had also experienced changes in key personnel, have contributed to the late filing of claims for reimbursement.

Hudson City School District (P6-5-27)

We found that the District failed to claim \$312,496 of Medicaid reimbursement for related services and TCM ongoing service coordination. As a result, the District did not receive its share (25 percent) of Medicaid revenue of \$78,124. The District does not process claims for reimbursement in an efficient manner. We noted that the District contracts with the Capital Region BOCES for related services. However, documentation of services is not submitted to the billing clerk in a timely manner, if at all, even after several formal requests by the clerk.

Audit Activity and Findings

Hunter-Tannersville Central School District (P6-5-28)

We found that the District failed to claim \$68,682 of Medicaid reimbursement for related services and TCM ongoing service coordination. As a result, the District did not receive its share (25 percent) of Medicaid revenue of \$17,171. The District does not process its claims in an efficient manner. We noted in our review that the District contracts with BOCES for related services. Appropriate documentation of related services is not submitted to the billing clerk in a timely manner, if at all, even after several requests. In addition, the District had not obtained signatures from the outgoing social worker/CSE chair for counseling services. Therefore, the billing clerk cannot claim the related services provided until the signed documentation is received.

Kingston City School District (P6-5-29)

We found that the District failed to claim \$1,000,000 of Medicaid reimbursement for TCM ongoing service coordination. As a result, the District did not receive its share (25 percent) of Medicaid revenue of \$250,000. The Director of Pupil Personnel Services told us that she was unaware that TCM ongoing service coordination was a reimbursable service. We calculated \$500,000 of unclaimed reimbursement for the 2002/03 school year and \$500,000 for the 2003/04 school year. This amount is an estimate based on information provided by the District regarding the number of classified Medicaid eligible students. The District has failed to submit claims for reimbursement in a timely manner due to significant staff turnover. A claim for reimbursement was submitted in June 2004 for \$587,000 that included claims of service for the 2002/03 school year. While increasing the risk of losing revenue due to the two-year limitation, the District is also not effectively using its staff resources. In addition, the District uses software for its individualized education programs (IEPs) and claims, but had not trained their providers to use the software as intended, resulting in additional work for the billing clerk that should have been performed by others, causing the late preparation of claims for reimbursement.

New Paltz Central School District (P6-5-30)

We found that the District failed to claim \$524,609 of Medicaid reimbursement for related services and TCM ongoing service coordination. As a result, the District did not receive its share (25 percent) of Medicaid revenue of \$131,152. The District does not have a speech pathologist on staff, nor do they contract for a speech pathologist to oversee and perform "under the direction of" services for speech services. As a result, the District will lose its share of Medicaid revenue for all speech services, unless the District uses a speech pathologist to oversee the service as outlined in the guidelines. The District does not process claims for reimbursement in an efficient manner. We noted that the District contracts with Ulster County BOCES for services. However, documentation of services is not submitted to the Treasurer in a timely manner, if at all, even after several formal requests.

Audit Activity and Findings

Rondout Valley Central School District (P6-5-31)

We found that the District failed to claim \$386,810 of Medicaid reimbursement for related services, TCM reviews and ongoing service coordination. As a result, the District did not receive its share (25 percent) of Medicaid revenue of \$96,703. The reimbursement process is handled by the District's business and special education departments; however, the Business Official and the Pupil Personnel Director do not agree regarding which office should perform each aspect of the process. Without proper oversight, the staffs in both departments were unsure of their responsibilities. As a result, the District does not process claims for reimbursement in an efficient manner.

School Energy Efficiencies (2005-MR-7)

Some school districts in New York have saved hundreds of thousands of dollars in energy costs by monitoring and controlling daily energy use. This audit covered the period of July 1, 2002 through June 30, 2004 and focused on whether six school districts in New York had policies and practices in place to conserve energy. We found that while all six districts had at least some informal practices to conserve energy, four districts had effective energy monitoring systems in place: Binghamton, Cortland, Greene, and Sidney. Two districts, Cortland and Binghamton, used a computerized system that tracked energy use and costs on a monthly and yearly basis for individual district buildings.

As an example of efficient energy source practices, our audit found that the Cortland City School District staggered the start-up times of heaters, lighting, and large motors during peak demand times; switched off lights in unoccupied classrooms; shut off computers and monitors when they were not being used; and shut down some systems on evenings and weekends. We determined that these measures reduced the school's natural gas consumption by 17 percent and electricity by 22 percent, saving \$200,000. In the Binghamton City School District, officials replaced old equipment, installed motion sensors that turned lights on and off, and regularly surveyed buildings. The District also hired a consultant to evaluate its energy conservation measures. We determined that the District saved about \$284,000.

We also identified some areas for improvement. For example, none of the six districts audited had a comprehensive written policy to help control energy costs, or compared their energy use against that of other school districts or against industry standards. We recommended that all of the districts adopt a written energy conservation program, designate an employee to serve as an energy manager, and be aware of new practices to save energy.

The following school districts were included in this report:

Binghamton City School District (P4-5-13)

Our audit found that District officials and staff performed numerous practices and procedures used to conserve energy and also had a good monitoring system. This monitoring system was used to analyze energy consumption and costs and to measure performance to established benchmarks, which indicated that energy savings were achieved and the cost effectiveness of the energy conservation measures taken. The District saved approximately \$284,000 in energy costs.

Audit Activity and Findings

Cortland City School District (P4-5-14)

We found that District officials had adopted and documented five practices and procedures that helped District officials reduce natural gas consumption by 17 percent, reduce electricity usage by 22 percent, and reduce total energy costs by approximately \$200,000 from 2003 to 2004. Further, we found that District officials had a good monitoring system that was used not only to analyze energy consumption and costs, but to measure the cost effectiveness of the energy conservation measures that were taken. We commended District officials for their efforts in energy conservation. However, we found that the Board of Education had not adopted a formal written comprehensive energy conservation policy that addressed energy savings on an ongoing day-to-day basis. Also, we noted that the District did not compare energy consumption or costs to industry standards and/or other school districts, and it did not attempt to establish any benchmarks on which to measure performance except for comparing energy consumption and costs on a yearly basis.

Greene Central School District (P4-5-12)

We found that while the Board of Education had adopted a policy on Energy Conservation, this policy was not comprehensive. The policy was limited to a one-sentence statement of the District's objective to conserve energy. Also, while District officials informed us that they performed certain practices and procedures to conserve energy on an ongoing day-to-day basis, we were not provided with documentation showing the nature and extent of these practices and procedures. Lastly, we note that the District did not compare energy consumption or costs to industry standards and/or other school districts, and it did not attempt to establish any benchmarks on which to measure performance except for comparing energy consumption and costs on a yearly basis. On a positive note, we did find that District officials had adopted a one-sentence energy and water conservation policy statement of the District's objective to analyze, develop and initiate conservation measures to reduce energy consumption. Further, the District had a good monitoring system that was used to analyze energy consumption and costs on a monthly and yearly basis. Lastly, we note that the District was able to determine the cost effectiveness of the energy conservation measures that were taken.

Middleburg Central School District (P4-5-15)

We found that the Board of Education had not adopted a formal, written, comprehensive energy conservation policy that addressed energy savings on an ongoing day-to-day basis. Also, while District officials informed us that they performed certain practices and procedures to conserve energy on an ongoing day-to-day basis, we were not provided with documentation showing the nature and extent of these practices and procedures. Lastly, we found that the District did not have a good monitoring system to analyze energy consumption and costs, and to measure performance and the cost effectiveness of any energy conservation measures taken. District officials told us that they performed an analysis of energy consumption and related costs only at budget time and that they reviewed the monthly bills from the District's utility companies. Also, we note that the District did not compare energy consumption or costs to industry standards and/or other school districts, and it did not attempt to establish any benchmarks on which to measure performance except for comparing energy consumption and costs on a yearly basis.

Audit Activity and Findings

Schoharie Central School District (P4-5-16)

We found that the Board of Education had not adopted a formal written comprehensive energy conservation policy that addressed energy savings on an ongoing day-to-day basis. Also, while District officials informed us that they performed certain practices and procedures to conserve energy on an ongoing day-to-day basis, we were not provided with documentation showing the nature and extent of these practices and procedures. Lastly, we found that the District did not have a good monitoring system to analyze energy consumption and costs, and to measure performance and the cost effectiveness of any energy conservation measures taken. District officials informed us that they had to request consumption and cost data from their utility company (when we requested the information), and that such information is not reviewed on a regular basis or maintained by the District. Also, we noted that the District did not compare energy consumption or costs to industry standards and/or other school districts, and it did not attempt to establish any benchmarks on which to measure performance.

Sidney Central School District (P4-5-17)

We found that the Board of Education had not adopted a formal written comprehensive energy conservation policy that addressed energy savings on an ongoing day-to-day basis. Further, while District officials had a good monitoring system to analyze energy consumption and costs, this system did not measure performance and the cost effectiveness of energy conservation measures taken. Also, we noted that the District did not compare energy consumption or costs to industry standards and/or other school districts, and it did not attempt to establish any benchmarks on which to measure performance. We were not provided with documentation indicating that District officials or staff determined the cost effectiveness of energy conservation measures taken.

Syracuse City School District – Health, Dental and Vision Claims (2005M-1)

The District's internal controls that related to its health, dental and vision benefits were not appropriately designed and operating effectively to help ensure that payments made to a third-party administrator (and subsequently to two sub-contractors for the administrator) were proper. The District's claims auditor did not audit the third-party administrator's statements and check registers. Furthermore, District personnel were not aware of certain charges on the administrator's documents and, when asked, could not explain what these charges represented. Even if District personnel had wanted to perform tests of the administrator's claims, they did not possess the detailed supporting records for these claims to perform such tests.

Despite the internal control weaknesses we identified, our testing of the claims paid by the system identified an extremely low error rate. For example, we found that the District paid 110 duplicate claims, but these claims represented only \$10,900 out of \$46.3 million in claims paid, which is an overpayment of 0.02 percent.

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The School Financial Accountability legislation requires the Comptroller to audit every school district, Board of Cooperative Educational Services (BOCES) and charter school (821 in total) in the State by March 31, 2010. In addition to the audit responsibilities described in this legislation, the Comptroller's authority to oversee local governments and school districts is contained in the State Constitution³ and General Municipal Law⁴.

New York State Schools	
School Districts	699
Charter Schools	84
BOCES	38

Given that there are currently 821 school districts, BOCES and charter schools, and that the legislation calls for the Office of the State Comptroller (OSC) to perform all of these audits in five years, we plan to conduct about 160 audits per year when we are fully staffed with our new resources. The order in which the Comptroller's Office selects individual school districts, BOCES and charter schools for audit during the coming year will be influenced by relevant information that comes to our attention through newspaper articles, taxpayer complaints and allegations of improprieties, or certain financial indicators. School districts with pressing current issues will be selected for audit sooner, while other school districts will be selected for audit simply to ensure full coverage. The Comptroller's Office also could choose to audit an individual school district, BOCES or charter school more than once before March 31, 2010, if we determine that a particular entity has significant issues and could benefit from another audit.

OSC conducts all audits in conformance with generally accepted government auditing standards (GAGAS) as promulgated by the Comptroller General of the United States in the *Government Accounting Standards* publication commonly referred to as the "Yellow Book." Among other things, these standards contain requirements to ensure the integrity of an audit's results by addressing the independence of the audit organization and individual auditors, the competence and training of the audit staff, the sufficiency of the work performed, and the existence of quality control systems to review the audit work. These external standards, along with OSC's internal quality assurance systems, help produce audit reports that are thorough, balanced and objective.

When conducting audits in school districts, the Comptroller's staff has examined and evaluated financial documents, assessed current financial practices, and determined whether adequate protections exist against fraud, theft or professional misconduct. Audit staff members will continue using these processes and procedures during the audits of each school district, BOCES and charter school. Our overall audit approach assesses risk in many financial areas, including cash receipts and disbursements, procurement (including travel-related and credit card expenditures), claims auditing and approval, payroll (including administrators' contracts and leave records), fixed assets, and certain large consumable inventories. The planning procedures used by the audit teams to review these financial areas include interviews with officials, walk-through tests of transactions, and reviews of independent

³Article 5, Section 1

⁴Article 3

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audit reports. In addition, the auditors examine the minutes of the proceedings of the boards of education; review policies, financial records and contracts; and consider any allegations of improprieties provided to us by taxpayers or school district officials. After reviewing the information gathered during planning, the audit teams discuss where weaknesses exist, and where the potential risks that fraud, theft and/or professional misconduct could occur. The examiners then refine the audit's objectives and scope to select any areas at risk, and perform additional audit work on those areas.

To increase the effectiveness of our audits, the Comptroller's Office uses electronic auditing software and makes assessments of school districts' computerized operations. With the help of school personnel, examiners obtain information directly from the districts' computerized financial databases and then analyze it electronically using audit software. Our work with this information during audit planning provides us with additional issues to consider, which are based on the school districts' financial entries into their databases. In addition, during the audit planning we perform an in-depth review of the school district's internal controls over and procedures for the computerized financial databases, to help ensure that the information produced by such systems is reliable.

Before starting an audit at any school district, BOCES or charter school, the Comptroller's audit staff provides the school district's superintendent with a written notice. In addition, before beginning any fieldwork, we hold an entrance conference with the superintendent, board of education members and other district officials to discuss the audit process and to offer them opportunities for input. After we have completed the on-site fieldwork, we schedule an exit conference and send a draft report of our written findings and recommendations to the superintendent and board members. The exit conference meeting provides district officials with the opportunity to clarify issues that we intend to include in the final report. Further, we request that the school district, BOCES or charter school formally respond in writing with its official position concerning the audit report's findings and recommendations. We include this response letter as an appendix in our audit reports to provide balance for the views of school officials.

Our final reports are public documents that are available to anyone requesting them. However, we provide the final audit reports to the school district before making them available publicly through our press office and website. Our press office provides most final reports to media representatives, some with accompanying press releases.

Although our school audits may review the same records, the Comptroller's Office does not duplicate the work performed annually by a school district's independent auditor. Our audit tests using these records are different, because we are not providing an opinion on the reliability of the district's financial statements, and we are not reviewing controls over Federal moneys as part of the Single Audit Act⁵. Instead, our audit work focuses on whether a school district's internal controls are adequate to safeguard its assets. If our audits find indications that a fraud, theft or conduct constituting a crime has occurred in a school district, BOCES or charter school, the Comptroller's Office will refer the applicable findings to the Commissioner of Education, Attorney General, United States Attorney, or to the district attorney who has jurisdiction for appropriate action.

⁵ <http://www.osc.state.ny.us/agencies/acmanual/special/50200.htm>

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General Audit Design

The Yellow Book standards that OSC's Division of Local Government Services and Economic Development (Division) follows include the general standards, and field work and reporting standards for performance audits. The remaining standards in the Yellow Book refer to other aspects of accounting, such as financial statement audits, that are not applicable to the Division's audits. The following contains information about these standards, and the Division's policies and procedures for implementing and monitoring compliance with them.

General Standards

The four general standards encompass: the independence of the audit organization and individual auditors; the exercise of professional judgment in the performance of work and the preparation of related reports; the competence of the audit staff, including their continuing professional education; and the existence of quality control systems and external peer reviews.

Independence

OSC audit staff must prepare and file an Annual Independence Certification form in which they disclose any actual or potential personal independence impairments of which they are aware, or attest to the absence of knowledge of such impairments. Also, all staff assigned to an audit engagement must complete an Individual Assignment Independence Certification form reporting any independence issues (personal or external impairments) they may experience regarding the individual engagements to which they are assigned.

Exercise Professional Judgment

The Division has developed and maintains a *Comprehensive Audit Manual* (CAM) that presents policies, procedures and other guidance specific to each of the general, field work, and reporting standards, and that represents the basic elements of professional judgment for performance audits. It helps Division auditors ensure that:

- The audit scope and methodology, and the tests and procedures used in the audit are adequate to provide reasonable assurance that the audit objectives are accomplished. The audit scope indicates such things as the time period covered, the particular aspect/functional area that was audited, the kinds and sources of evidence gathered and examined, and any problems that may have occurred with the evidence.
- Appropriate auditing skills and experience are applied to the audit.
- Findings and conclusions are based on an objective evaluation of evidence.

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- Findings and conclusions are fully supported by sufficient, competent, and relevant evidence obtained or developed during the audit.
- An effective supervisory review is made of completed work, the judgments made in the audit, and of the audit report.

Competence

The Division has the following procedures in place to accomplish the GAGAS for the professional proficiency of its auditors:

- Hiring and promoting – The Division maintains a personnel system to select qualified staff members. For promotions, a candidate’s ability to perform the job functions required by the higher position is tested and assessed.
- Supervisory review of audit work – The examiners-in-charge (EICs) and audit supervisors review the audit work of assigned staff upon the completion of each assignment.
- Training requirements – GAGAS require each employee who is responsible for planning and conducting audits to receive at least 80 hours of continuing professional education every two years. The Division has a system to provide this training to all staff auditors.
- Staff learning plans – Learning and training plans are developed for each staff member to help ensure that all staff will be trained to possess the skills necessary to perform in a competent and professional manner.

Quality Control and Assurance

The Division maintains the following policies and procedures to meet the elements of quality control:

- Audit manual – The CAM provides written guidance for staff on applicable government auditing standards and describes the policies and procedures necessary to comply with those standards.
- Supervision – Each audit supervisor is responsible for ensuring that the audit is conducted in accordance with the Division’s policies and procedures, and key provisions of auditing standards.
- Quality control policies and procedures checklist – A standardized checklist is prepared for each audit prior to release of the report to ensure compliance with Division policies and procedures, and key provisions of auditing standards.
- Post-issuance review monitoring – The Division’s Professional Standards Unit conducts post-audit quality reviews of a representative sample of audit reports and related workpapers.

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- Participation in the National State Auditors Association (NSAA) quality control review program – This program requires the Division to have an on-site external peer review every three years that is performed by supervisory-level personnel from other governmental audit agencies. The last peer review for the Division, performed in February 2004, resulted in an unqualified opinion – which means that the Division complied in all respects with the applicable professional standards.

Field Work Standards

The four field work standards for performance audits include planning the audit; supervising staff; obtaining sufficient, competent, and relevant evidence; and preparing audit documentation.

Planning the Audit

The Division requires its auditors to perform adequate and careful planning for audit activities, which involves determining the purpose for audit activities, defining the specific audit objectives, developing the audit scope, and selecting appropriate audit methodologies to accomplish the audit's purpose and objectives. The audit team prepares a written audit plan that describes how they addressed each aspect of audit planning required by the standard, which includes a timeline for completion of the audit. The audit's objectives, scope, and methodology used during the audit all flow logically from audit planning.

Supervision

Each Division audit has a staff member designated as the examiner-in-charge (EIC) of the engagement, along with a job supervisor and an audit manager. The EIC is the first-line supervisor for assigned staff and is responsible for reviewing their work, overseeing the day-to-day audit activities, and ensuring that all appropriate auditing standards are followed during the audit.

Audit supervisors oversee an entire work unit, such as an individual regional office. They are responsible for supervising the work of the EICs, reviewing and approving audit plans, and maintaining direct involvement with each audit to ensure that the audit objectives are accomplished. Audit supervisors monitor the progress of the audit work, and determine that quality control policies and procedures have been met regarding audit planning, conducting and documenting work performed, and reporting the results.

Audit managers are responsible for maintaining sufficient involvement to ensure that audits are supervised effectively by the audit supervisors and EICs, audit objectives are accomplished, and that audit activities are performed in accordance with GAGAS.

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Evidence

The approach to determining the sufficiency, competence, and relevance of evidence depends on the source of the information which constitutes the evidence, and the methods used to gather that information. In each audit, the audit team develops an audit program that contains the specific audit tests describing the work to be done and the extent of testing that they will perform. If evidence is drawn from computer-based systems, the audit team will assess the reliability of those data, typically through review, inquiry and testing of general and application controls over the data.

Audit Documentation

The Division's CAM contains documentation guidance relative to the preparation and content of workpapers (audit documentation). EICs and audit supervisors have the responsibility for ensuring that the workpapers include:

- The planning memo that addresses the objectives, scope, methodology, and any other material issues associated with the audit.
- A written audit program of the work performed to support significant judgments and conclusions, including descriptions of transactions and records examined.
- Evidence of supervisory review of the work performed (conducted before the report is issued) that supports the findings, conclusions and recommendations.
- The Division's quality control policies and procedures checklist (prepared by the EIC and reviewed and approved by the audit supervisor) which is designed to ensure that the auditors met the audit objectives and complied with the Division's policies and procedures, and key provisions of the auditing standards.

Reporting Standards

The four reporting standards for performance audits address the form of the audit report, the contents of the report, report quality, and the issuance and distribution of reports.

Form

The Division's auditors prepare and issue a written audit report to communicate the audit results. The audit team also verbally communicates audit results to school officials throughout the course of the audit to keep them informed about the progress and status of the audit.

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Report Contents

The Division's audit reports include the audit objectives, and the scope and methodology used for achieving the audit objectives. The audit report contains the audit results and the findings that relate to each audit objective. GAGAS also require that the report include relevant information concerning significant weaknesses in internal controls found during the audit; all significant instances of fraud, illegal acts, or other types of noncompliance (e.g., violations of provisions of contracts, or grant agreements); and all significant instances of abuse that were found during or in connection with the audit. OSC auditors also report the views of school officials concerning the auditors' findings and recommendations.

Report Quality

Writers and reviewers of OSC audit reports are responsible for making certain that the audit report contains all of the necessary facts and explanations that are needed to support a sufficient and correct understanding of the findings or recommendations. The report must provide enough information to give the reader a proper perspective on the degree or significance of each of the audit findings and recommendations, and the relationship of the findings and recommendations to the entity's operation.

Each audit report is cross-referenced to the examiner's workpapers. Each statement in the report that presents a fact regarding the school, or the audit work conducted, is referenced to the workpaper that supports that statement.

Report Issuance and Distribution

Audit reports are distributed to school officials (the district's fiscal officer and clerk) pursuant to the provisions of General Municipal Law, Section 35. Copies are provided to the district's chief executive officer and other school officials who are responsible for taking action on the audit findings and recommendations. In addition, copies may be provided to agencies outside the school audited that have legal oversight authority.

The final reports are public documents that are available to anyone requesting them. However, OSC provides the final audit reports to the school districts before making them available publicly through its press office and website. The press office provides most final reports to media representatives, some with accompanying press releases.

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Division Audit Process

The Division's auditors follow a basic protocol when conducting an audit. This process includes:

- Entrance conference – Before performing work at any school district, BOCES or charter school, the Comptroller's audit staff provides the school superintendent with a written notice that includes a copy of OSC's publication *Understanding the Audit Process* (Appendix C). This booklet provides school officials with an explanation of the audit process from the earliest stages to the final report. In addition, the auditors hold an entrance conference with the superintendent, board of education members and other district officials to discuss the audit process. The conference is used to communicate information regarding the time frames for the audit and to introduce the audit team who will be working on the engagement. In addition to communicating information at the beginning of the audit, the audit staff keeps school officials informed about the audit throughout the course of the engagement.
- Preliminary discussions – Before the official exit conference (at the end of the audit process), audit staff members have ongoing discussions with school officials relating to the audit report findings. These discussions improve the accuracy of the report and prevent misunderstandings from surfacing after the release of the report.
- Exit conference – Once the draft report has been prepared and appropriately reviewed, the auditors send the draft to the district and then contact the superintendent to schedule an exit conference. Governing board members and other district officials (as appropriate) also are notified. The purpose of the exit conference is to communicate and discuss the results of the audit, ensure that the facts are accurate and complete, and allow school officials to provide input and their views on the findings and recommendations. Draft reports are considered confidential. They are not publicly released because the draft is one last opportunity for school officials to review our proposed findings and provide any corrections or further information that we should consider before we draw our final conclusions and make recommendations.
- School officials' written response – Before the audit report is finalized, school officials are given the opportunity to respond in writing to the findings and recommendations in the draft report. School officials are allowed 30 days from the date the draft report is issued to provide a written response. If received on time, the written response is incorporated in the appendix section of the final audit report.

School District and BOCES Audits

When conducting audits, examiners will review and evaluate financial documents, assess current financial practices, and determine whether adequate protections exist against fraud, theft or professional misconduct in each school district visited. Audit examiners will perform these steps using the recently developed standard procedures, contained in one report and two questionnaires, to ensure completeness and uniformity. Despite using an approach with standard documents and procedures, examiners still will be expected to exercise professional judgment and modify the standard planning approach to fit an audit's circumstances and risks. For example, if taxpayer complaints raise concerns

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about the legitimacy of fees charged by the school district's architect on a building capital project, the audit team would perform additional procedures to ensure that the billed fees were appropriate and met the terms of an approved agreement. Similarly, if the audit team ascertained that significant weaknesses existed over extra-classroom activity moneys, they would review these controls and perform additional procedures and testing to ensure accountability over the moneys.

To increase the efficiency and effectiveness of our audits, we use computer-assisted auditing software to analyze the school districts' financial databases. The auditing software reviews every entry in the school districts' computer databases and then identifies high-risk transactions for further analysis and review. This type of information gives the audit team a broader perspective of each school district's finances than they would obtain solely from traditional planning and financial testing. Examples of the high-risk transactions that would be flagged by the computer auditing software include vendors that have more than one name, address, or tax identification number in the master vendor list used to process payments; vendors and employees who use post office boxes instead of permanent addresses; duplicate payments made to vendors and employees during the audit period; and significant payments that do not conform to Benford's analysis.⁶ In addition, examiners receive information from the school districts that includes the number of payroll checks issued to employees, highest dollar amounts paid to vendors, and the names of employees who receive non-payroll checks for expenses and the amounts of those checks.

Analyzing the information in the school districts' computer databases would not be useful if the information were unreliable. Therefore, our examiners will make assessments of the internal controls over the school districts' computer systems to help ensure that the information is reliable. Examiners will obtain information from school officials about the main computer applications that district personnel use for various business functions, and the policies related to the computers and their use. The examiners will then review access controls such as passwords, the segregation and structure of rights assigned to user accounts, physical controls to the server room and other computer equipment, security against external threats (e.g., firewalls), back-up and disaster recovery plans, user training, and certain application controls. During audit planning, examiners will make an overall assessment of the reliability of these controls and the information produced by the computer systems.

Our assessments of a school district's computer systems and the information produced by them will often happen in more than one location. School district computer operations sometimes are performed off-site. Many BOCES districts provide computer support and processing services to school districts. Because BOCES are service organizations that serve the school districts, we would review the controls over computer operations at the BOCES and include this information in our assessment of the school district's computer controls and the information produced by the computer systems.

Examiners also will employ a more traditional questionnaire with suggested procedures that will help guide them through the internal controls over a wide range of school district financial operations and

⁶Benford's Law was developed by Dr. Frank Benford, a physicist who noticed that within a large enough universe of numbers that were naturally compiled, the first digits of the numbers would occur in a logarithmic pattern. This statistical oddity provides auditors with the expected digit frequencies in tabulated data. By examining the digit and the number frequencies, auditors can gain data insights that might be missed using traditional analytical procedures and sampling methods. The digit and number patterns could point to number invention, systematic frauds, data errors, or biases in the data. (www.cfenet.com/pdfs/Benfords%20Law%20TOC.pdf)

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issues. The questionnaire requires examiners to thoroughly review areas such as financial condition and oversight, the control environment, cash receipts and disbursements, purchasing, claims auditing and approval, payroll and personal services, and capital assets and consumable inventories. When completing the questionnaire in these areas, examiners will interview officials, perform certain walk-through tests of transactions, and review reports, documents and policies. In addition, they would consider any allegations of improprieties provided to the Comptroller by taxpayers or district officials.

When reviewing the financial condition and oversight, and control environment areas, the audit team will look for deficit fund balances and assess any board of education financial plans designed to improve the school district's financial condition. In addition, examiners will check for audit committees, training programs for board of education members, periodic competition for external auditors, and other procedures and processes that supply oversight to the school district's financial operations. Further, they will make sure that board members receive periodic financial reports (prepared internally by the independent auditor), and review the adequacy of the duties of the internal claims auditor and the board-adopted policies over financial operations. The "tone at the top" set by the superintendent, board of education and other school officers is a critical control that helps safeguard assets. As a result, the examiners will review it thoroughly during this part of the audit.

After assessing the overall control environment, the audit team will assess whether weaknesses exist in the cash receipts and disbursements functions. They will review controls over receipts and deposits, on-line banking, electronic funds transfers, and check-signing operations. In addition, examiners will evaluate whether duties are properly segregated, review recent bank reconciliations, and test hand-drawn checks and other selected transactions. This type of internal control work consists of the more traditional role of an accountability audit, but it can become complicated in today's environment of widespread use of computers and electronic processing equipment. During our planning work, we consider this complexity as we review controls.

One of the broadest-ranging segments in the questionnaire is the purchasing area. The audit team reviews a myriad of issues in this area, including purchase orders, credit cards, cellular telephone expenses, travel and conference expenses, and meal and refreshment expenses at meetings. When reviewing these issues, the auditors will examine school district policies, scan warrants and vendor histories for unusual payments, and test selected transactions. Internal controls in school districts over this important segment of operations are often weak. Our Long Island school district audits found needed approvals and documentation missing, inappropriate or unreasonable expenses, or expenses that did not conform to board-adopted policies.

Another significant area included in our standard questionnaire is personal services and employee benefits. Our audit teams will review policies, employee handbooks, collective bargaining agreements,

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and administrators' contracts. They will assess whether duties are properly segregated, test authorizations for selected payments, review leave records and payments for unused leave and retirements, and check whether school officials certify payrolls. Payroll and employee benefits often can comprise nearly 80 percent of a school district's operating expenditures.

Finally, the standard questionnaire leads the audit team through a review of capital assets and consumable inventories. Examiners will review each school districts' policies for safeguarding and disposing capital assets, assess the adequacy of perpetual inventory records, check physical safeguards over equipment that is particularly vulnerable to theft (such as laptop computers and digital cameras) and consumable inventories (such as food and fuel), and test some recent purchases into the records and view them on-site. Unfortunately, our Long Island school audits showed that controls and perpetual inventory records over capital assets and consumable inventories were often lacking in these school districts.

After gathering all of the information developed during planning, the audit teams will discuss with their supervisors where they think that weaknesses exist, and assess potential risks where fraud, theft and/or professional misconduct could occur. The examiners then will refine the audit's objectives and scope to select any areas at risk, and perform additional audit work on those areas. For the areas audited in depth, our written reports will include findings that describe the weaknesses noted, a discussion of the causes and effects of those weaknesses, and recommendations to school district officials on how they can make improvements. If our audits find indications that a fraud, theft or conduct constituting a crime has occurred in a school district, BOCES or charter school, the Comptroller's Office will refer the applicable findings to the Commissioner of Education, Attorney General, United States Attorney, or to the district attorney who has jurisdiction for appropriate action.

Charter School Audits

In December 1998, New York State authorized the creation of charter schools by instituting Article 56, Section 2850 through Section 2857 of the Education Law, which is known as the New York Charter Schools Act of 1998 (Act). Charter schools provide opportunities for teachers, parents and community members to establish and maintain schools that operate independently of existing schools and school districts. They are intended to provide increased learning opportunities for all students, especially those with serious academic deficiencies. In addition, charter schools are exempt from most State and local laws, rules and regulations, except for those governing health, safety, civil rights, and student assessment. They are funded on a per student basis from the local public school districts from which their enrollments are drawn.

Audit Plans for 2006

The Act authorizes the State Board of Regents (Regents) and the State University of New York Board of Trustees (SUNY Trustees) to review and approve charter school applications, and to grant up to 50 charters each. SUNY's Charter Schools Institute (Institute) reviews applications submitted to the SUNY Trustees. The State Education Department's Charter Schools Unit reviews applications that are submitted to the Regents. In addition, the Institute and the Charter Schools Unit are responsible for monitoring the operations of the charter schools to ensure their compliance with applicable laws, rules, regulations, and provisions of their charter agreements.⁷

As of 2005, there were 84 charter schools in New York State, which were located in the following cities:

Charter Schools in New York State During 2005	
Location	Number of Charter Schools
New York City	49
Buffalo	16
Albany	7
Rochester	5
Hauppauge	3
Syracuse	2
Glens Falls	1
Newburgh	1
Total:	84

Charter schools get their name from the fact that they are schools operated according to a charter or plan that describes how they will function, including their educational philosophy and approach, and their financial operation. The Act does not designate an upper limit on the number of students the charter school may serve, but it requires that the school have at least 50 students. There also is no upper limit on the number of teachers that may work at a charter school, although there is a minimum requirement of three teachers. Charter schools may not select students on the basis of any criteria other than the students' ages or grade levels.

The law stipulates that an application to establish a charter school must provide several kinds of information. Such information includes the mission of the proposed school and its educational program and student achievement goals, information on how the school would be organized and its budget and fiscal plan, the number of students proposed to be served in the school, and the school calendar and proposed school day schedule. Charter schools may be located in part of an existing public school building, a private work site, a public building, or any other suitable location.

⁷ <http://nysosc3.osc.state.ny.us/audits/allaudits/093003/093003-m/01s22.pdf>

Audit Plans for 2006

A charter school may not discriminate against students or employees and may not limit admission on the basis of any ability or other condition. However, a charter school may be a single-sex school. Any student who is qualified to attend a public school also is qualified for admission to a charter school – if he or she is in the age range of the students the charter school applies to serve. The school district of residence of students attending a charter school may, but is not required to, allow such students to participate in athletic and extracurricular activities. Services for disabled students may be provided by the charter school, by the school district where the charter school is located, or by contract with another provider.⁸

The Act also requires that charter schools contract for an annual independent fiscal audit. Each audit must meet the following minimum standards:⁹

- An independent and licensed certified public accountant (CPA) or public accountant should perform the audit.
- The audits should be conducted in accordance with generally accepted auditing standards and GAGAS.
- If the charter school spends \$500,000 or more in federal funds during the fiscal year, an independent audit as prescribed in the Federal Office of Management and Budget Circular A-133 must also be completed and filed with the Federal Government and the State Education Department.

During the coming year, our audit teams will focus primarily on auditing school districts and BOCES. These entities comprise the vast majority of the units that are subject to the legislation's audit requirements, and this initial focus will allow the Comptroller's Office to get an effective start toward completing the necessary audits by March 31, 2010. However, during 2006 we will begin developing a revised audit approach for charter schools that will allow us to examine those units' more specialized operations. We will begin by gathering information about their unique operations, and then design an approach similar to the risk-based audits being conducted in school districts and BOCES.

⁸ <http://www.emsc.nysed.gov/psc/charterschoolsinfo.html>

⁹ <http://www.emsc.nysed.gov/psc/GuidelinesforAudits.htm>

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Five-Point Plan: OSC Activities and Implementation

Although regular audits of school districts provide both a deterrent and a mechanism to identify fraud, they are not a substitute for a culture of integrity and proper financial controls. The best way to prevent fraud is a combined approach that develops sound financial checks and balances, educates policymakers about their financial oversight roles and responsibilities, ensures that audits are meaningful and accurate, and punishes wrongdoing swiftly and severely when it is uncovered.

Starting in the fall of 2004, OSC convened a coalition of school district and accounting stakeholders to address the need for district-level reform. We worked with the New York State School Boards Association (NYSSBA), New York State Society of Certified Public Accountants (NYSSCPA), New York State Council of School Superintendents (NYSCOSS), New York State Association of School Business Officials (NYSASBO), and the State Education Department (SED).

Together with this coalition, OSC drafted the Five-Point Plan legislation and advocated for its successful passage and signing into law in July 2005. Chapter 263 of the Laws of 2005 will strengthen school district financial accountability, require adoption of additional fraud prevention and deterrence measures, strengthen deterrence mechanisms already in place, and increase awareness of these issues among school board members. It seeks to accomplish all these objectives while accommodating the varying needs and circumstances of school districts through flexible solutions that will ease implementation.

OSC is an integral part of the plan's implementation and the State's overall response to school district fraud, corruption and mismanagement. The Office's main roles in implementing the Five-Point Plan are threefold:

- Consulting with SED. SED is responsible for promulgating regulations and approving school board member trainers and curricula. OSC is consulting closely with SED on these responsibilities, as required by the legislation.
- Providing information to stakeholders. Knowing that many school district staff view our auditors as the most visible embodiment of school accountability, we have developed resources for school district officials who want information on various aspects of the Plan (Appendix C). We also have developed several guides – which are available on our website¹⁰ and in hard copy – that cover a number of the requirements of the new law, such as the different responsibilities of the internal, external and OSC auditors, and how to establish an audit committee. In addition, we also worked with NYSSBA, NYSASBO, and NYSCOSS to help them develop their own materials.
- Training officials. Training is one of the most important services offered by OSC to all local government officials. In support of the school financial accountability initiative, OSC collaborated with a coalition of school district organizations to develop curriculum and provide training to school district officials, including workshops focused on promoting a healthy financial environment, fraud detection, and strengthening internal controls. Total attendance exceeded 4,300 for these sessions.

¹⁰ <http://www.osc.state.ny.us/localgov/schoolsfa.htm>

Five-Point Plan: OSC Activities and Implementation

School Board Member Financial Oversight Training

School board members are the first line of defense against fraud: they provide governing policies and an atmosphere of integrity that affect the rest of the district. As the taxpayers' representatives, they also have the strongest incentive to prevent fraud. However, board members have not always realized the extent or importance of their financial oversight, accountability, and fiduciary responsibilities. Thus, the new law requires all school board members elected or appointed on or after July 1, 2005 to complete at least six hours of training on these responsibilities within a year of election. Well-trained board members will ask the right questions of their auditors and be more able to participate in the design and implementation of any changes to internal controls that are necessary to protect the district.

OSC is consulting with SED on the curriculum for training school board members. In this capacity, OSC has reviewed several curricula submitted by potential training providers, including NYSSBA. However, we also have recommended that SED develop a comprehensive curriculum that could be used by all approved training providers. SED approves all trainers as well.

OSC also is helping local school districts comply with the training requirement at the lowest possible cost by providing technical assistance to low-cost, convenient trainers such as NYSSBA and its affiliates, and by working with SED and NYSSBA on alternative methods, such as Internet training opportunities. In addition, OSC has provided staff to conduct related training for school business officials on topics such as "Red Flags for Fraud" and "Internal Controls."

Strengthened Internal Claims Auditor Function

The board of education is responsible for authorizing payment for all district expenses. However, many boards delegate the mechanics of this task to an internal claims auditor. The new law emphasizes this direct chain of accountability by requiring that the claims auditor report directly to the board, rather than to the superintendent.

The law also changes this function from a civil service position to an exempt position which is appointed by the board of education. However, these new requirements pertain only to newly established internal claims auditor positions, or new hires within an existing system. In addition, the law allows districts to contract for this function, rather than hiring a full-time employee.

Because this portion of the law only makes changes to a position that is already existing and optional, there are relatively few implementation steps needed on the local or State level. Districts with internal claims auditors have changed their reporting arrangements, and OSC audits of internal controls will confirm this change.

Five-Point Plan: OSC Activities and Implementation

More Rigorous External Audit Standards

The new law requires districts to engage certified public accounting (CPA) firms through a request for proposals (RFP) process at least once every five years to ensure that the districts are getting the best value for their audit expenditure, and to prevent the relationship between auditor and auditee from getting too “cozy.”

The law also ensures direct board participation in the auditing process by requiring that the CPA firm present the annual audit to the board, and by requiring that the board respond to the audit with a formal corrective action plan.

On the local level, many school districts already have implemented the RFP provisions of the law either by issuing an RFP by July of 2005, or by virtue of having done so in recent years. Any district that is in the middle of a multiyear engagement with a firm whose services were procured by another process is required to issue an RFP at the expiration of that agreement. To assist districts with this requirement, OSC has created and posted to its website guidance on designing a competitive RFP, with a link to a sample blank RFP designed by SED.

Although OSC auditors have not yet found through their audits any evidence of direct board participation in the receipt of the annual external audit, or of a board response to an external audit in the form of a corrective action plan, auditors already note when a board is not directly involved in the process.

More Rigorous Internal Audit Standards

The law requires all but the smallest districts¹¹ to establish an internal audit function by July 1, 2006, to be in operation by no later than the end of the calendar year. The internal auditor will conduct an ongoing risk assessment of district operations, testing for weaknesses in internal controls and developing ways to overcome these. A good internal audit process can make a district much less susceptible to fraud and abuse.

Many larger districts already have this function, making it easy for them to comply with the new law. Smaller non-exempt districts can use existing district staff, shared services agreements, or can contract for the service – as long as the internal auditor is independent of school business functions and the external audit. Neighboring small districts might choose to share the hiring of an individual and split that person’s time, with one district paying the salary and the other district reimbursing for time used. Or a district could hire the services of an outside CPA firm to perform this function, as long as that does not cause a conflict with the external audit.

¹¹ This section of the law defines the smallest school districts as those with fewer than eight teachers, less than 300 students, or under \$5 million dollars in annual expenditures.

Five-Point Plan: OSC Activities and Implementation

The trick is to find the right balance of cost-effectiveness, independence, and understanding of the internal workings of the system. Because of the complexity involved in attaining such flexibility, SED is still refining regulations about who may perform this function. OSC is consulting closely with SED on these and other proposed regulations relating to this function, with an eye toward achieving balance between flexible standards and specific requirements that will result in an independent, effective and affordable internal audit function.

In the meantime, working intensively with our coalition partners, we have developed an informational question-and-answer guide that addresses the broad issues of this function, which is now posted on OSC's website.

Required Audit Committee

All but the smallest school districts¹² must establish audit committees by January 1, 2006 to help them with their financial oversight responsibilities. This committee can include all or some of the members of the board of education, and it can consist in part or wholly of non-board members. In fact, as long as they have requisite experience, committee members do not need to be residents of the district. The guiding principal for this committee is that it should be able to help the board in its responsibility to select and oversee external and internal auditors, exercise its financial oversight responsibility, and to implement any necessary corrective reforms.

OSC has posted guidance and sample audit committee charter language on its website¹³ to help board members set up their committees in compliance with the law. Also, OSC is consulting with SED regarding various details to be addressed by districts in these regulations.

2006 Activities

OSC will be working closely with SED as that agency develops regulations that cover all aspects of the Five-Point Plan, and particularly the internal audit function. SED will address areas that are not covered by the regulations in a detailed question-and-answer document that OSC will have input into.

So far, OSC has consulted with SED on its proposed draft regulations, but other stakeholder organizations will be consulted informally as well. The proposed regulations will be presented to the Board of Regents' Committee on Elementary, Middle, Secondary and Continuing Education/Vocational Education Services for Individuals with Disabilities. After the draft regulations are approved by the Committee, the regulations will be presented to other stakeholders around the State for comment. The final regulations will be compiled and presented to the full Board of Regents for adoption after the commentary process has ended. This process may extend into 2006.

¹² This section of the law defines the smallest school districts as those with fewer than eight teachers.

¹³ <http://www.osc.state.ny.us/localgov/schoolsfa.htm>

Five-Point Plan: OSC Activities and Implementation

Training

OSC is planning to assist coalition members in providing training, both for school board members and for business officials. As we have done since 2004, we will send trainers who are well-versed in internal controls, fraud, and other pertinent issues, to coalition-member conferences. OSC also is working with NYSSBA and its other partners on providing alternative school board member training methods, such as teleconferences and on-line training sessions. Next spring, we will be partnering with NYSASBO on a series of financial management workshops that are geared toward school business officials, which will be held at various locations throughout the State.

OSC will continue to work with its coalition partners, update the schools accountability section of its website and otherwise disseminate information and guidance on various aspects of the Five-Point Plan.

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OSC Budget/Implementation Efforts

The Office of the State Comptroller (OSC) responded immediately to the problems on Long Island by redirecting more than \$2.1 million in internal resources to perform audits of school districts on Long Island (and elsewhere), and to conduct in-depth training for school officials around the State. To add an effective audit presence in the schools, OSC requested \$5.8 million in resources to hire and train 89 staff members to audit all school districts in the State within a five-year period, and expand our investigations capability. The 2005-06 enacted State budget provided initial funding of \$2.9 million for this program, and legislation was passed (Chapter 267 of the Laws of 2005) specifying that each school district, Board of Cooperative Educational Services (BOCES) and charter school be audited by March 31, 2010. The Comptroller's budget request for the 2006-07 fiscal year includes an adjusted appropriation for the annualization of the full costs of these efforts (Appendix C).

The increased staffing and related non-personal services will allow OSC to audit approximately 160 school districts, BOCES and charter schools each calendar year. We pledged that as soon as these resources were provided, we would immediately begin to hire staff, provide training, and begin audits. During the start-up process, we estimated that we would be able to complete as many as 40 audits during 2005, 100 in 2006, and that we should be fully staffed and operational by the end of 2006. We are working through the initial administrative start-up challenges with the Department of Civil Service (Civil Service) and the Division of the Budget (DOB), and we remain confident that we can meet the ambitious five-year audit requirement established by Chapter 267 of the Laws of 2005.

OSC had not regularly audited school districts since the late 1970s when budget cutbacks resulted in OSC discontinuing these types of audits. Then Comptroller Edward Regan's rationale for removing OSC's audit presence was that school districts were required to have an annual independent financial audit from a certified public accountant (CPA) firm and were overseen by the State Education Department (SED). However, there is a need to restore our audit presence in schools, as demonstrated by the Long Island scandals.

OSC moved rapidly to respond to the school financial accountability crisis using its own resources. In addition to conducting the Roslyn Union Free School District audit and other school district audits on Long Island (Appendix A), OSC led the effort to shape and secure passage of the Five-Point School Financial Accountability Plan (Section 4). OSC also developed a comprehensive training program working cooperatively with a coalition of school and professional groups. We participated in many hands-on training seminars during the 2004-05 school year, and provided training to school officials on internal controls, fraud prevention and detection, and auditing standards. At the time of this writing, we have provided 33 events with more than 5,000 participants. We also updated our existing training manuals and reference guides, and created new materials.

In addition, OSC increased its fraud-detection process through more traditional investigative strategies. This process included initiating intensive financial background investigations of suspected subjects, conducting interviews with witnesses and informants who might not have been readily available to our auditors in the course of their efforts, using forensic fraud analysis, and conducting surveillances and other covert activities to monitor, detect and develop evidence of fraud. In this way, we will be able to build on the collaborative partnerships we currently share with law enforcement agencies and prosecutorial offices throughout the State.

OSC Budget/Implementation Efforts

Appendix B summarizes the Comptroller's efforts to respond dynamically to the school financial accountability crisis, and it documents our efforts to secure additional resources for audits and to strengthen school oversight through the adoption of the Five-Point Plan.

OSC continues to absorb other costs associated with the school financial accountability effort. For example, the new Chapter 267 law requires all school board members who are elected or appointed on or after July 1, 2005 to complete at least six hours of training on their financial oversight, accountability, and fiduciary responsibilities within a year of their election. OSC is assisting in these training efforts for school board members and for school business officials. OSC also is working with the New York State School Boards Association (NYSSBA) and other school and professional groups on alternative cost-effective methods of delivering training, such as teleconferences and on-line training sessions. In addition, school and professional groups continue to work with SED to review training curricula and regulatory guidance, and to offer technical assistance and support to school districts.

Internally, OSC has dedicated significant staff resources to develop a "training academy" for all of its new hires, so that these auditors can productively contribute to school auditing efforts as quickly as possible.

Hiring

Hiring has been a major part of the initiative undertaken by OSC to help it perform the school oversight function. This Office has worked closely with Civil Service and DOB to obtain the necessary approvals to hire the positions requested in our budget request package. As soon as the Legislature adopted the school oversight legislation and the Governor signed it into law in late July, the Division of Local Government Services and Economic Development (Division) and Office of Human Resources (OHR) staff began drafting a classification package that contained information explaining the school audit background and mission, and provided justifications for the positions requested. We submitted the classification package to Civil Service in two parts: we requested 57 entry-level examiners on August 23, 2005, and then the 32 remaining positions on August 31, 2005. In addition, we submitted a classification request for eight hourly positions – to assist in training the new examiners – on November 4, 2005, and the request has been approved.

To expedite hiring and allow the Division to audit more school districts, we used several unfilled positions to begin hiring. In July 2005, the Division appointed a small project team whose full-time responsibility was to work on different aspects of the school financial accountability initiative. The team was charged with undertaking a massive recruiting effort, which included conducting interviews, checking references, and making hiring recommendations to work-unit managers. Although the Division has received more than 600 resumes and interviewed more than 180 potential candidates, not all identified candidates elect to participate in our Civil Service exam process, which can take several months from time of interest to appointment. In addition, the field of candidates who meet our accounting requirements has diminished over the past few years as the number of college accounting majors has steadily declined. However, our months of recruiting efforts are now paying off with approximately 20 reachable candidates being added to our Civil Service list each month. Since August, the Division has hired 30 new auditors and identified more than 20 additional candidates that it plans to hire by December 31, 2005. New hires also will be needed to replace retirements and normal attrition.

OSC Budget/Implementation Efforts

Delays in Hiring Approvals

As of the date of this report, OSC has received Civil Service approval for 57 of the 89 positions requested. Of the 57 positions that have received Civil Service approval, 30 have received waivers from DOB. The other 32 positions in the classification package are new supervisory positions needed by the Division to restructure its supervision and management levels to accommodate expanded staffing and to perform the school oversight functions. We responded to Civil Service requests for additional information on the package, including providing material explaining supervisory staffing ratios, and answering questions pertaining to the audits and school environments in which the examiners would be working. Promotions within the Division, combined with back-filling the positions vacated by the promotions, will provide us with the full complement of auditors needed to conduct school audits.

Obtaining approvals for the supervisory- and management-level positions is vital to our ability to complete the required school audits. Due to the arrival of large numbers of new employees in our relatively small Division, we will need effective supervision and management to conduct sound school audits, and to help us develop the skills of our newly hired entry-level auditors. The Division has lost many experienced supervisors and managers during the last five years to retirement, which has left us with a large percentage of inexperienced auditors in many positions.

To help mitigate these experience losses and bolster further staff development, the Division has developed training to enhance the skills of its new auditors, and has used OSC's Strategic Leadership Institute (SLI) training program to prepare current supervisors and managers for their increased responsibilities. The Division already has trained more than 50 examiners who have less than two years of audit experience with the Division. We plan to continue this training for the new auditors the Division hires through 2006, as needed. In addition, anticipating Civil Service approval of the supervision and management positions in the classification package, we have worked with OHR to design training for our new supervisors and managers to enhance their skills in overseeing audits, and in promoting staff development and team building. In order for the Division to be successful in carrying out the legislative requirements, it is crucial that it receives approval soon for its anticipated promotions, and that it moves forward with its training efforts.

As of the release of this report, we still are awaiting Civil Service approval of the rest of the classification package. To help remedy these needs, OHR has arranged a meeting with representatives from Civil Service to discuss the classification package. We continue to expect approval for these positions.

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Conclusion and Recommendations

In New York State, public education is a \$41 billion investment – and it continues to grow. To provide the best education for our children, we must ensure that every school district has an effective financial monitoring system in place.

State law now requires the Office of the State Comptroller (OSC) to audit every school district, Board of Cooperative Educational Services (BOCES) and charter school over the next five years to bring greater public accountability to our schools. The law also requires school districts to implement the Five-Point School Financial Accountability Plan to strengthen auditing, training, and financial oversight by school officials. In addition to reporting on our audit activity, the new law also asks the Comptroller to advise the Governor and Legislature on any policy issues arising from his new audit and oversight efforts.

The Division of Local Government Services and Economic Development is refining its school audit approach as its auditors gain more experience from their initial audits. Our audits to date have generally focused on internal controls and operations, such as whether a school district's financial controls are adequate in areas including cash receipts and disbursements, purchasing, claims approval, payroll, and fixed assets. As we gain experience in auditing school districts, the scope of our recommendations may expand to other school district financial activities.

In general, we do not see a need for any additional statutory changes at this time. Implementation of the Five-Point Plan is in its initial stages, and some of our recommendations should be addressed as part of that process. Some issues may be addressed by the State Education Department (SED) as part of its regulatory oversight role. Some recommendations do not require any statutory or regulatory action to implement, and can be addressed immediately during school districts' efforts to improve accountability and oversight. We strongly recommend that school districts take prompt action on these recommendations.

The timeline for implementing the Five-Point Plan is as follows:

- Modifications to the internal claims auditor reporting relationship – Immediate implementation expected.
- School board member training – Implementation expected within a year of board members being elected, starting with those elected or re-elected to terms beginning July 1, 2005.
- Competitive request for proposal (RFP) process for selecting audit firms – Implementation required by July 1, 2005.

Conclusion and Recommendations

- Audit committees – Implementation expected by January 1, 2006.
- Internal auditor function – Implementation expected by July 1, 2006, and to be operational by December 31, 2006.

Written Policies and Procedures

Our audits of school districts to date indicate that they need to establish comprehensive written policies and procedures in a number of areas. School boards should create or strengthen policies and procedures for conference attendance, travel, mileage, meals and refreshments, and any other area where benefits are provided to board members or senior school district officials, such as retirement and fringe benefit enhancements, vehicles, and Internet access. Written administrative procedures should cover documentation and verification for all of these areas. School officials should prohibit employees' personal use of district credit cards, and school boards should institute policies that restrict employees' personal use of school district resources such as computers, cellular telephones, and other equipment. School employees should reimburse the district for incidental costs incurred for personal use of these resources, as appropriate.

Educational leaders, including board members and administrators, may sometimes view administrative policies and practices in areas such as travel reimbursement and cellular telephone usage as minor bureaucratic details. Because they see these issues as not being the primary business of schools, they may feel that controlling costs in these areas as not being worthy of significant attention. While this viewpoint may be understandable, it is unfortunate, because the research on fraud shows that it develops and grows over time. That is, the first actions by persons engaged in fraud are usually small, like padding a travel expense voucher. However, once the person engaging in fraud experiences success, the actions are repeated and expanded. This is why a strong internal control environment and "tone at the top" are extremely important in fraud prevention.

The New York State School Boards Association (NYSSBA) and other groups have developed model school board policies that can be useful for school boards as they address these issues. Board policies and other written procedures are an essential element of strong internal controls. These model policies and procedures – combined with the guidance provided below – can provide a starting point for district officials to develop or amend their written policies and procedures. In addition, training is available through OSC and other school and professional groups on proper internal controls and fraud detection.

OSC understands the need to tailor such policies to the circumstances existing in each district, but we believe that it is important that such policies be written, adopted, made public, and be widely distributed so as to promote transparency and understanding by district officials, employees and the public.

Conclusion and Recommendations

Credit Cards

Credit card abuses were a prominent feature of the Roslyn School District fraud. Districts should establish policies and procedures for the use of credit cards to promote accountability and responsibility, and to prevent improper use. The credit card policies and procedures should specifically include:¹⁴

- Procurement methods for obtaining credit cards for employee use
- Criteria for who will be issued credit cards
- Transaction limits for each credit card issued
- Proper and improper use of the credit cards
- Repercussions for improper use, including liability for damages and/or loss
- An acknowledgement form – stating that the employee understands and will comply with the established credit card policies and procedures – for employees to sign
- Required documentation/receipts to be submitted in support of credit card usage, and the timetable for submission of this supporting documentation
- Required recordkeeping that must be maintained by credit card users, such as a user's log of purchases
- A description of the separation of duties required between purchasing, payments and reconciliation functions related to credit card usage
- A description of necessary periodic reviews of credit card usage, which includes the need to assess reasonableness of the nature and number of purchases.

Cellular Telephones

To promote accountability and control costs, school districts should establish policies and procedures for employee use of district-owned cellular telephones. The cellular telephone policies and procedures should specifically include:¹⁵

- Procurement methods for obtaining cellular telephones for employee use
- Criteria for who will be issued cellular telephones

¹⁴ *The Ohio Auditor of State's Best Practices*, Volume 1, Issue 2, Winter 2004 (<http://www.auditor.state.oh.us/Publications/BestPractices/ASOBestPractices-Winter2004.pdf>), and the NYSSBA Sample Policy 8334 – Use of Credit Cards

¹⁵ *The Ohio Auditor of State's Best Practices*, Volume 1, Issue 1, Spring 2004 (<http://www.auditor.state.oh.us/Publications/BestPractices/ASOBestPractices-Spring2004.pdf>), and the NYSSBA Sample Policy 8332 – Use of Cell Phones

Conclusion and Recommendations

- Descriptions of who can authorize cellular telephone purchases and assignments
- Proper and improper use of the cellular telephones
- Procedures for how personal use of the cellular telephones will be monitored, and by whom
- Repercussions for improper use, including required employee reimbursement of the district for their personal use of the cellular telephones, and liability for damages and/or loss
- Descriptions of necessary periodic reviews of cellular telephone usage – which includes an assessment of the cost and necessity of cellular telephone usage, and the effectiveness of the cellular telephone policies and procedures.

Travel Expenses

To help manage and facilitate travel requests and reimbursement processes, school districts should establish policies and procedures for conference and travel expenses. The travel-related policies and procedures should specifically include:¹⁶

- Descriptions of the pre-approval process that employees must follow to gain authorization for travel expenses
- Definitions of travel expenses that are reimbursable (such as hotel room charges, mileage, taxi expenses, rental car expenses, and meals), and of those that are not (such as charges for in-room movies and alcohol beverages)
- Definitions of day and overnight trips, and descriptions of what types of travel expenditures are reimbursable for each type of trip
- Maximum reimbursement rates for various types of travel expenditures, including a reasonable maximum per diem rate for lodging and meals. It is acceptable for school boards to include provisions for exceptions to these maximums under certain circumstances.
- Descriptions of employee responsibilities for non-reimbursable costs
- Required documentation/receipts to be submitted in support of different types of travel expenditures, and the timetable for submission of this supporting documentation

¹⁶ *The Ohio Auditor of State's Best Practices*, Volume 1, Issue 1, Spring 2004 (<http://www.auditor.state.oh.us/Publications/BestPractices/ASOBBestPractices-Spring2004.pdf>), and the NYSSBA Sample Policy 6830 – Expense Reimbursement

Conclusion and Recommendations

- Descriptions of the process that employees must follow to be reimbursed for allowable travel expenses, including necessary forms and paperwork
- Directives for the use of “sales tax exempt” forms, as applicable.

Meals and Refreshments

To promote accountability and control costs, school districts should establish policies and procedures for providing meals and refreshments at meetings. The meals and refreshments policies and procedures should specifically include:¹⁷

- Definitions of when meals and refreshments expenses will be authorized
- Definitions of what constitutes authorized meals and refreshments expenses, with examples provided of acceptable and unacceptable items
- Descriptions of who can authorize meals and refreshments expenses, with an explanation of the authorization process
- Required documentation/receipts to be submitted in support of meals and refreshments expenditures, which includes information that proves that the meals and/or refreshments met the criteria for authorization
- Descriptions of the difference between meals and refreshments expenditures and meal reimbursements that are related to travel expenses.

Strengthen Internal Controls

Our audits of school districts to date have identified a number of areas where school districts need to strengthen their internal controls. Poor internal controls can result in mistakes that are potentially costly and can produce bad information and poor decisions. Strong internal controls also help detect and prevent fraud and abuse. Written policies and procedures are an effective way for school officials to communicate internal control practices and expectations to staff no matter when they join the organization. The requirement that school districts develop an internal audit function also will strengthen the control environment. Finally, newly required school board member training will highlight the need for effective management controls and help the board set the appropriate “tone at the top.”

¹⁷ NYSSBA Sample Policy 9170 – Meals and Refreshments

Conclusion and Recommendations

Proper segregation of duties between district treasurers, business administrators and finance employees is essential to ensure proper review and approval of financial activities. For example, districts should not have the same person collect cash, record it in their accounting system, and deposit it in the bank. Transactions should be regularly reconciled and periodically verified by different staff members.

Similarly, the role of the internal claims auditor is essential to verifying that expense claims contain enough supporting documentation to ensure that each is a legitimate school business expense. Changes enacted as part of the Five-Point Plan should help ensure that board members are directly informed of approved and disapproved claims, and that the internal claims auditor position is staffed by competent personnel.

In today's interconnected environment, controlling access to electronic information is much more involved than simply locking the doors to control physical access. School districts should focus attention on improving the controls over access to their computer systems by ensuring that their systems have adequate password controls, control unused accounts, restrict access to administrator accounts, restrict users' computer activities to function only within their job responsibilities, and provide audit logs (change logs) that track when changes have been made to the system.

Sound internal controls do not have to be burdensome and bureaucratic; they are simply good management practices that provide common sense protection. Many of the activities of the internal audit function will strengthen internal controls, beginning with a risk assessment. Districts should periodically step back and examine summary documents, bank statements, budget information, and financial policies and procedures to assess their effectiveness, and to identify those processes that are most vulnerable to problems. These reviews can clarify who is responsible for what function and help determine appropriate limits to authority. Using the results of a risk assessment, districts can then amend policies as needed and train their staffs on any new procedures. After these changes are implemented, transactions records should create an audit trail that demonstrates that the new procedures are being followed, and that financial activities are being properly managed.

Safeguard Assets and Computer Systems

School districts manage and safeguard significant assets, often from multiple locations. Assets held at remote locations may be more at risk for loss or misuse because fewer people are present to protect those assets. Asset security should be part of a district's internal control risk assessment process.

There are a number of simple steps that districts can take to safeguard assets. First, districts should establish an inventory record of all fixed assets, periodically physically inventory these assets, and properly tag assets as district property. Missing items should be investigated and appropriate action should be promptly taken. Access to petty cash, credit cards, books and records, and other valuable assets should be restricted to authorized personnel. Locks, passwords and other devices should be used to protect these assets from unauthorized use, and these safeguard devices should be changed periodically. Districts should review their insurance policies to make sure they are adequately protected from fraud or theft, and that all authorized employees are bonded.

Conclusion and Recommendations

Computer systems form the backbone of school district financial operations and their access rights must be carefully restricted. Districts should conduct a comprehensive review of computer operations and immediately address any vulnerable risk areas. School boards also should conduct a periodic audit of district computer controls to ensure that they are operating properly.

Strong Oversight

OSC audits have established the importance of effective school board oversight and control. There is no substitute for an active board that asks good questions, establishes sound policies, communicates effectively, and holds management accountable for performance.

Newly required training for school board members on their fiduciary obligations should help educate board members on the scope of their fiscal responsibilities. This is particularly important because school board members are elected for reasons that very seldom have to do with financial oversight, yet once elected they must spend significant amounts of time on these issues.

The new requirement to establish an audit committee will be beneficial. This committee can help select the external auditor, provide oversight of external and internal audit work, and ensure that the work of the auditors meets professional standards. An audit committee also can help the school board understand the scope and limitations of the external financial audit.

The requirement that school districts use a competitive process for selecting auditors and solicit new proposals at least every five years should help ensure that the quality of the external financial audit is adequate. Both OSC and SED have provided model templates for requests for proposals (RFPs) that can help districts select audit firms or individuals. Once selected, the contract to provide professional audit services should clearly stipulate the scope of services and the amount of compensation. If audit services are needed that are not covered by the annual external financial audit, then district officials should consider a separate contract for these services so as to avoid any professional conflicts.

Training to ensure that school board members understand their financial oversight responsibilities helps equip board members with the knowledge to ask questions about the district's financial procedures, internal controls, and external audits. An internal audit function that includes a risk assessment, a review of financial policies and procedures, and tests of internal controls will help detect anomalies and lower risk. A stronger relationship between the external and internal auditors and the board – through its audit committee – will help ensure that the annual financial audit is effective. Finally, OSC's audits will promote fraud prevention and deterrence by strengthening local processes and identifying best practices.

We look forward to providing additional information on the results of our 2006 auditing efforts, and an analysis of the efforts of school districts to implement the Five-Point Plan.

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