

School District Auditing Information Guide

The State Legislature recently passed legislation which the Governor signed into law that strengthens oversight in school districts through improved auditing, training and financial reporting. The new law:

- Requires six hours of training for school board members on their financial oversight responsibilities.
- Establishes an internal audit function within each school district.
- Creates audit committees in school districts.
- Mandates a competitive RFP process for selecting audit firms at least every five years.
- Improves the effectiveness of annual external audits by requiring direct school board involvement and a formal response to issues raised in an audit.

In addition, the Office of the State Comptroller (OSC) was provided funding to audit all school districts, BOCES and charter schools statewide during the next five years.

The State Education Department (SED) will be issuing regulations to provide guidance on implementing the requirements under the new law. The purpose of this document is to explain some of the new financial oversight provisions and clarify the roles of the various audit functions, each of which plays a complementary role in assuring strong fiscal oversight.

Although it is the board of education's responsibility to maintain a school district's fiscal health and ensure adherence to all legal mandates, auditors play a crucial role in providing fiscal oversight. Boards of education, school administrators and staff will now encounter *claims auditors, internal auditors, audit committees, external auditors and auditors from the Office of the State Comptroller*. Each plays a major role in assisting the board of education in fulfilling its fiscal responsibilities.

Claims Auditor

Question: *What is the role of the claims auditor?*

Answer: Auditing a school district's bills before they are paid is the responsibility of the board of education. However, a board may adopt a resolution establishing an office of claims auditor and appoint an individual who holds this position subject to the pleasure of the board. The claims auditor then assumes the powers and duties of the board with respect to claims auditing. A claims auditor approves vouchers or invoices submitted to the district prior to payment by the district treasurer to ensure that proper original documentation is attached, and that the payment is for a legal purpose and was properly authorized. In essence, the claims auditor is the person who ensures all payments are proper and legal before they are paid.

Question: Who does the claims auditor report to? Who can hold this position?

Answer: The new legislation clarifies that the claims auditor reports directly to the board even though he or she can be a district employee. The claims auditor may not be a member of the board, the clerk or treasurer of the board, the superintendent of schools or any other official of the district responsible for business management (such as the purchasing agent or other personnel directly involved in accounting or purchasing functions of the district). The position is now classified as an exempt title for civil service purposes, although current claims auditors will maintain their existing civil service status.

Question: Does the claims auditor have to be a resident of the district?

Answer: Under the new law, the claims auditor is not required to be a resident of the district. As an alternative to hiring an individual, a board can delegate the claims audit function to an outside entity or firm or use inter-municipal or shared services agreements (to the extent authorized by law). However, the board must consider the independence issues associated with the procurement of such services in order to ensure that an outside entity or firm does not audit its own invoices. Additional guidance with respect to this independence issue will be provided by SED.

Internal Auditor

Question: What is the role of the internal auditor and where does this position report?

Answer: The new law requires that by July 1, 2006 districts establish an internal audit function to be in operation by December 31 of that year. (Districts with less than eight teachers, expenditures of less than \$5 million or enrollment of less than 300 students are exempt from this requirement.) The internal audit function assists the board in ensuring that proper internal controls are in place and are working. Internal audit activities include: the development of a risk assessment of district financial operations; the preparation of reports which analyze significant findings, recommend changes for strengthening internal controls and reducing identified risks; and an annual review and update of this risk assessment. SED will be issuing regulations and additional guidance with respect to this function. Personnel performing this function also report directly to the board, even though they can be employees of the district.

Question: Are there restrictions on who can serve as the internal auditor?

Answer: Yes. If a district uses a district employee to fulfill this function, that person cannot have any responsibility for other business operations in the district. The district is also permitted to use inter-municipal or shared services agreements (to the extent authorized by law) or hire independent contractors. In each instance the board must

consider the independence issues associated with the internal auditor in order to prevent any perceived or actual conflicts of interest.

Question: *What kind of qualifications does the internal auditor need to have?*

Answer: Before a board hires an internal auditor, it should ensure that the person or firm being hired has or can develop expertise in school district financial operations, legal mandates, purchasing and investment policies, accounting systems and procedures, and other areas that are deemed necessary. The board needs to ensure that the internal auditor receives training in these areas as appropriate.

Audit Committee

Question: *What is an audit committee? What will it do?*

Answer: School districts, like many organizations, are required to have annual financial audits. An audit committee helps organizations understand and manage the annual audit process. The new law requires that every district (except those with fewer than eight teachers) establish an audit committee of at least three members by January 1, 2006. The role of the committee is advisory and its responsibilities are to: provide recommendations regarding the appointment of the external auditor (see below); meet with the external auditor prior to the beginning of the audit; review and discuss with the external auditor the risk assessment developed as part of the auditor's responsibilities; receive and review the draft audit report and management letter and assist the board in interpreting these documents; make a recommendation to the board on accepting the annual audit report and review any corrective action plans developed by the district. The committee also assists in the oversight of the internal audit function.

SED and OSC have developed guidance for school district audit committees. These documents can be found on the OSC and SED websites.

Question: *Who can serve on the audit committee?*

Answer: The committee may be comprised of the entire board, a subcommittee of the board or a separate committee. Any separate committee may be composed in part (or even entirely) of non-board members if such membership is advisable to provide accounting and auditing expertise. These members cannot be employees of the district but can be non-residents of the district.

External Auditor

Question: *With all these new requirements, why do I still need an external auditor?*

Answer: The external auditor is an independent certified public accountant (CPA) hired by the district to perform the legally-required financial statements audit in accordance

with Government Auditing Standards. The objective of the audit is to render an opinion that the financial statements are fairly presented. In other words, the auditor determines if the district's financial statements are accurate and consistent with accounting standards so that the board can have confidence in using them to assess the financial condition of the district. The new law now requires each district to prepare a corrective action plan in response to any finding contained in the audit report or management letter.

Question: How should the district go about hiring an external auditor?

Answer: The new legislation requires that as of July 1, 2005 all school districts must utilize a competitive request for proposal (RFP) process when contracting for the annual audit. No engagement can be for a term longer than five consecutive years. This portion of the legislation applies to districts as they complete the final year of a previous audit engagement so as to not require them to abrogate an existing agreement. The external auditor cannot be the internal auditor or claims auditor for the district.

OSC has [guidance](#) available for school district officials on procuring external audit services using a competitive RFP process, and SED has developed a [template](#) for districts that wish to use it.

Question: What experience does the external auditor need to have?

Answer: As with the internal auditor, the board should ensure that the person or firm being hired has the proper experience needed to conduct a school audit. A board should obtain information about the education and experience of the audit staff, outcomes of any peer reviews, reputation of the firm and its familiarity with school auditing.

OSC Auditor

Question: What is the role of the OSC auditor?

Answer: Based on the authority to oversee the fiscal affairs of local governments contained in the State Constitution and General Municipal Law, auditors from the State Comptroller's Division of Local Government Services and Economic Development conduct performance audits in accordance with Government Auditing Standards. OSC audits review the internal controls, financial practices and operations of the 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.

Legislation recently signed into law requires that every school district, BOCES and charter school be audited at least once by March 31, 2010 pursuant to a plan developed by the State Comptroller. Thereafter, OSC will decide which schools to audit based upon a risk assessment process that may include investigations of alleged improprieties,

previous audit findings or other financial indicators. When undertaking these audits, OSC will examine and evaluate financial documents, assess current financial practices and determine that adequate protections exist against fraud, theft or professional misconduct.

Question: What should I expect from an OSC audit?

Answer: OSC school district audits do not duplicate the work performed annually by school district's independent auditor. OSC audit tests will be different because the audits do not opine on the reliability of the financial statements. Instead, OSC audit work will focus on whether the school district's internal controls are adequate to safeguard assets in areas such as cash receipts and disbursements, purchasing, claims approval, payroll, certain consumable inventories and fixed assets. Based on conclusions about the reliability of the internal controls in place, OSC will make decisions regarding which areas need further scrutiny and then design audit work accordingly.

The Comptroller's audit staff will provide the superintendent with written notice before starting an audit. In addition, before beginning fieldwork, OSC staff will hold an entrance conference with the superintendent, board members and other officials to discuss the audit process and offer opportunities for input. After the on-site work has been completed, OSC will schedule an exit conference and send a draft report of written findings and recommendations to the superintendent and board members. The exit conference meeting provides the opportunity to clarify issues that are to be included in the final report. OSC will request that the school district formally respond in writing with its official position concerning the audit findings, and include this response letter as an appendix in the final audit report.

OSC final reports are public documents available to anyone requesting them. OSC will provide the final report to the school district before making it available publicly. Most final reports are provided to media representatives, some with accompanying press releases.