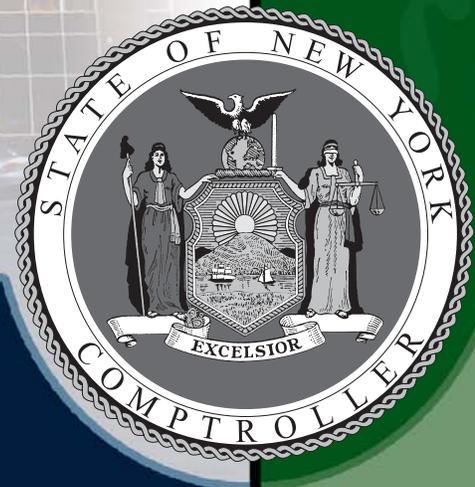


# SCHOOL DISTRICT ACCOUNTABILITY INITIATIVE

2006 ANNUAL REPORT

OFFICE OF THE  
NEW YORK STATE  
COMPTROLLER

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



**“Making a Difference”**

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**OFFICE OF THE  
NEW YORK 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.

# STATE OF NEW YORK OFFICE OF THE STATE COMPTROLLER

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## Executive Summary

Many school districts throughout the state have made considerable improvements to their financial controls over the last year. Generally, the school districts that we audited have implemented the Five-Point School Accountability Plan, as well as the Commissioner of Education's recent regulations and guidance. As a result, school boards have adopted and improved needed financial policies and procedures. In addition, based on what we have learned from our audits, many boards, appointed committees and administrators are now regularly providing oversight of financial operations.

To be sure, there are still opportunities for school districts to improve financial operations, and we continue to find occasional instances of serious problems and potential fraud. But school officials have turned the tide and are moving in the right direction in re-establishing public trust in school finances through strong internal controls.

The Legislature – and more importantly, the New York State taxpayer – should be pleased with the success of this initiative. Faced with scandals and growing taxpayer distrust in the public school system's ability to manage its finances properly, OSC and the Legislature moved to aggressively address the problem. This report details some of the success stories encountered during our audits. It demonstrates how the legislation passed by the Legislature and signed by the Governor, coupled with the efforts of this Office, the New York State School Boards Association, New York State Council of School Superintendents, New York State Association of School Business Officials, New York State Society of Certified Public Accountants and the State Education Department, has resulted in better school district financial management. It also identifies additional opportunities for school districts to improve controls over information technology, employee benefit payments, claims auditing, no-bid contracts, capital assets and segregating duties. Finally, the report discusses an emerging issue on outsourced information technology services that school district officials and their external auditors should address in the coming year.

This report emphasizes a consistent theme: oversight, coupled with structural reform and supported by training, makes a difference. We are pleased to submit this 2006 annual report, and our office looks forward to working on these issues in the future.



## SECTION 1:

# SCHOOL FINANCIAL ACCOUNTABILITY OVERVIEW

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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 second Chapter 267 report issued by the Comptroller since enactment of the law in July 2005, and covers audit work occurring through December 2006.

The legislation was enacted in response to a number of scandals in school districts that threatened public confidence. It restored the Office of the State Comptroller's (OSC) audit presence in schools and ensures that school district officials have the information and understanding they need to recognize and prevent existing or potential fraud and abuse.

## Legislative Requirements

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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 2005. The legislation charged OSC with auditing more than 800 school districts, BOCES and charter schools within five years. These audits help deter fraud, expose fraud where it exists and point out best practices in districts that are well run and can serve as models for other districts. The Five-Point Plan helps 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 law requires the Comptroller to 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 the audit reports 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 accountability by reviewing how public resources are used, and can be used as a tool in the development of school district internal controls. When undertaking

# SCHOOL FINANCIAL ACCOUNTABILITY OVERVIEW

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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 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 adequately designed and operating effectively to provide adequate safeguarding of assets in areas such as cash receipts and disbursements, purchasing, claims approval, payroll, capital assets and consumable inventories.

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

In 2005, OSC 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) to produce the "Five-Point School Financial Accountability Plan." The Plan promotes stronger internal controls, improves school district audits and strengthens the roles of boards of education in conducting appropriate oversight.

The main components of the Five-Point Plan are:

- **Strengthen the internal claims auditor function:** Many boards of education delegate the duties of reviewing and authorizing payment for district expenses to an internal claims auditor. Nonetheless, these boards are still ultimately responsible for approving all payments. The 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 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 from 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 it follows the RFP process.

# SCHOOL FINANCIAL ACCOUNTABILITY OVERVIEW

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- **New internal audit requirements:** The law requires all but the smallest school districts<sup>1</sup> 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, nonexempt districts can use existing district staff, shared services agreements or contract for the service.
- **Required audit committees:** The law requires all but the smallest districts<sup>2</sup> 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 completely of nonboard members. In fact, so long as they have requisite experience, committee members do not need to be residents of the district. The guiding principle 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 reform.

## Increased Audit Presence

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To enable OSC to institute an effective audit presence in schools, we requested additional resources in 2005-06 to allow us to hire and train 89 staff members. The State's 2005-06 enacted budget provided initial funding for this program and the 2006-07 enacted budget provided fully annualized funding.

In 2005, Comptroller Hevesi had reassigned more than \$2.1 million in staff resources to increase our audit presence in school districts before adoption of the new legislation. The Division of Local Government Services used these resources to conduct various school audits that year, resulting in 52 individual audit reports issued as of December 31, 2005. The Division accomplished those efforts by reallocating existing resources and without the benefit of any real impact of the new staff resources provided by the school accountability legislation.

The Division's school audit effort increased considerably in 2006, commensurate with the number of new staff we were able to hire and train. However, as explained in Section 3 of this report, delays in obtaining the necessary hiring freeze waivers from the Division of the Budget directly affected our

**Although we have hired 82 employees for the school initiative, only 42 new full-time equivalent auditors were actually available to work on school audits during 2006. Nevertheless, the Division issued 113 audit reports in 2006, and it has another 177 audits currently underway.**

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

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# SCHOOL FINANCIAL ACCOUNTABILITY OVERVIEW

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ability to devote full resources to the school initiative. Although we have hired 82 employees for the school initiative, only 42 new full-time equivalent auditors were actually available to work on school audits during 2006. Nevertheless, the Division issued 113 audit reports in 2006, and it has another 177 audits underway.

## Improvements in Operations and Oversight

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The Five-Point Plan’s legislative requirements and our increased audit presence are beginning to make a considerable difference in how boards of education and administrators oversee school district financial operations. Many boards of education did not wait until the legislative requirements mandated change, but instead proactively acquired training for their members and made positive changes to their policies and oversight mechanisms.

Most school district audits issued in 2006 found that board members had complied with the financial oversight training requirements. In addition, most boards had established audit committees and had begun implementing more rigorous procurement standards for their external CPA audits. The positive changes not only mean that board members are better informed, but also show they have taken actions to establish improved oversight mechanisms in their school districts. Responding to one of the many audits where OSC validated the actions taken by a board to improve its financial oversight, Superintendent Patrick Dougherty of the Tioga Central School District wrote, “We found the external process very helpful. We were pleased to see that overall the district is financially responsible and has effective internal controls. The Board of Education and Administration are committed to ensuring that your recommendations are implemented so that efficient operations and fiscal practices are maintained over time.”

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As originally intended the changes brought about by the Five-Point Plan are driving better internal and external reviews of school district financial operations. Boards of Education, audit committees, administrators and internal auditors are asking better questions, and making improvements to existing practices. By sharing their learning with each other through the school associations and by making audit reports available publicly, the quality of the questions asked and information considered will likely continue to improve. In

# SCHOOL FINANCIAL ACCOUNTABILITY OVERVIEW

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their joint response to our audit of the Yonkers City School District, President Bernadette Dunne and Superintendent Bernard Pierorazio wrote, “As we indicated earlier, the Comptroller’s report highlights areas needing improvement now and demonstrates the need for our attention on an ongoing basis. The Comptroller’s Office and the Legislature have helped us, and all other school districts, by requiring new procedures such as the internal audit process and the increased frequency of audits performed by the Comptroller’s office itself. The Board of Education and the administration take the existence of these deficiencies seriously and are actively involved in making changes for the betterment of our students and taxpayers of the City of Yonkers.”

**“The Comptroller’s Office and the Legislature have helped us, and all other school districts, by requiring new procedures such as the internal audit process and the increased frequency of audits performed by the Comptroller’s office itself.”**

OSC audits serve as a vital complement to the Five-Point Plan. The audit reports not only discuss any internal control weaknesses identified at a school district, but also provide tailored recommendations to help school district officials implement improvements. Since school officials frequently review OSC audit reports completed in other school districts to identify common internal control weaknesses, the reports serve as an informal means of training officials and identifying emerging trends in school financial practices. Combined with the structural improvements brought about by the Five-Point Plan, OSC audit reports are having a powerful effect on raising the quality of the questions asked and discussions held by boards of education and administrators about everyday financial practices. Responding to an OSC audit, Superintendent Gerald Macaluso, President James Clark, Business Manager Robert Boulware and Audit Committee Chair Michael Hryzak wrote, “The Seneca Falls

**Superintendent Gerald Macaluso, President James Clark, Business Manager Robert Boulware and Audit Committee Chair Michael Hryzak wrote, “The Seneca Falls Central School District Board of Education and Administration have reviewed the findings of the Comptroller’s Audit, and appreciate the time and effort that was expended in the review of our operations. The recommendations and guidance provided were extremely useful in our own self-evaluation.”**

Central School District Board of Education and Administration have reviewed the findings of the Comptroller’s Audit, and appreciate the time and effort that was expended in the review of our operations. The recommendations and guidance provided were extremely useful in our own self-evaluation.” Similarly, Superintendent Joseph DeCerbo of the Bolivar-Richburg Central School District wrote, “I would also like to let you know that the auditor from your office who audited the Bolivar-Richburg Central School was a very professional person to work with and he did not make any of our staff feel negative toward the audit process. I feel he was very thorough in the areas he was auditing and that the suggestions offered in the draft report are very useful to our district.”

# SCHOOL FINANCIAL ACCOUNTABILITY OVERVIEW

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In addition to the legislation and increased audit presence, OSC, SED and the school associations have worked together to provide guidance and training to school district officials on how to implement the legislation. The more formal guidance and classroom training efforts help make school officials aware of important issues requiring their attention, and provide reference materials for their later review. These efforts are a critical way of completing the learning process that is changing the financial management practices in schools.

Since the adoption of the five-point fiscal oversight plan in summer 2005 and attendant audits of school districts, school board members, superintendents and business officials have responded with a number of changes in their attitudes and policies toward fiscal accountability. School boards, in particular, have focused more intensively on their stewardship role. Although most boards already understood that they had significant fiscal oversight obligations, awareness of those responsibilities and actions to meet those responsibilities are more overt. Administrators report that boards are more likely to put finances as the “centerpiece” of agendas, posing more questions about program funding, fund balances, transfers and reserves, and sometimes expressing a new appreciation for the complexity of district finances. Some also report a growing inclination for more open discussion about district finances, with “full disclosure and complete transparency” as common practice. The public, too, is now more likely to perceive the school board as responsible for fiscal oversight, and to expect more information about district finances.

There is room still for more education: the NYS Council of School Superintendents (NYSCOSS) reports that members have been requesting training on financial accountability, and the NYS School Boards Association (NYSSBA) says members seek clear, consistent, official guidance so that policies are not based on rumor, word of mouth and atypical situations. Smaller districts, in particular, are still struggling to balance cost pressures against full adherence to both the letter and spirit of the law. OSC audits have been very useful to school administrators in this arena, as they have also used both their own audits and the results of others’ audits to focus their efforts, although districts are concerned about the news media’s propensity to focus on “bad news.”

Trends in our audit report findings further illustrate the positive momentum created by the legislation, OSC audit presence and formal training efforts. Categorizing our audit reports as to whether we found districts well managed, controls needing improvements or serious deficiencies, we noticed a marked improvement in the internal controls reviewed during our 2006 audits. In 37 of 83 (45 percent) internal control audit reports issued in 2006, we concluded that school financial operations were well managed compared to only five of 19 internal control audits (26 percent) in 2005. In addition, despite issuing more than three times the number of internal control audit reports, OSC identified the same limited number of frauds (three) in 2006 as it did in 2005. Moreover, OSC issued seven positive

**Moreover, OSC issued seven positive school audit reports in 2006 where our review of financial policies and internal controls disclosed that officials managed operations so well that risks to assets, if any, were minimal.**

# SCHOOL FINANCIAL ACCOUNTABILITY OVERVIEW

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school audit reports in 2006 where our review of financial policies and internal controls disclosed that officials managed operations so well that risks to assets, if any, were minimal. The Division issued positive audit reports for the following school districts:

- **Broadalbin-Perth Central School District**
- **Cincinnatus Central School District**
- **Deposit Central School District**
- **East Irondequoit Central School District**
- **Franklin Central School District**
- **Frontier Central School District – IDA Pilot Audit**
- **Tioga Central School District**

We anticipate continued improvements to school district financial management and oversight in coming years due to the powerful combination of the Five-Point Plan legislation, OSC audits, and formal guidance and training.

## **Additional Opportunities for Improving Financial Controls**

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Although the audited school districts made considerable improvements in their financial policies and procedures, OSC identified some additional opportunities for officials to improve safeguards over school assets and strengthen operations. These opportunities are discussed in more detail in Section 2 of this report. Working with other organizations such as NYSSBA, NYSSCPA, NYSCOSS, NYSASBO and SED, we will identify ways to provide additional guidance, training and/or audit recommendations that address the most critical, challenging and timely aspects of school district financial management and oversight.

## SECTION 2: ACTIVITY AND RESULTS IN 2006

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### Summary of Reports Issued in 2006 (through December 31)

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<b>Internal Control Audits</b>	<b>83</b>
<b>Budget Review Audits</b>	<b>7</b>
<b>Audits of School Districts' External Audits</b>	<b>3</b>
<b>Special Subject Matter Audits</b>	<b>20</b>
<b>Total</b>	<b>113</b>

The Division spent more than 15,000 staff days using existing and new resources to conduct various school audits in 2006. These audits included audits of financial operations and school district budgets, as well as performance audits of various aspects of school district operations to identify revenue enhancements and/or cost savings. From these efforts, OSC issued 113 individual school audit reports in 2006.

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### Audits – Related to School Legislation and Other Purposes

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The school legislation calls for audits of the fiscal practices of each school district, including assessing current financial practices and determining whether the school districts have adequate internal controls to prevent fraud, theft or professional misconduct. Since the beginning of the school initiative, the Division has issued 102 audits in 100 different school districts that specifically conform to Chapter 267 of the Laws of 2005. OSC conducted 19 audits in 2005 and 83 audits in 2006 that met the requirements of the legislation.

The Division also performed other school district audits in 2006, including seven audits that focused on school districts' budgets and financial condition. Because external annual audits are a significant part of the internal control process in each district, additional audits were performed focusing on the independent audit services at three districts, while conducting separate audits of the internal controls. Finally, 20 special-purpose audits were conducted that assessed various aspects of school operations for cost savings, revenue enhancements and/or other program issues.

## ACTIVITY AND RESULTS IN 2006

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### 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 focus on high-risk areas identified through a 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 also found a wide range of weaknesses in internal controls.

We audited the internal controls of the following school districts:

Akron Central School District	Madison Central School District
Allegheny-Limestone Central School District	Marathon Central School District
Andes Central School District	McGraw Central School District
Beekmantown Central School District	Mount Vernon City School District
Berlin Central School District	Northeast Central School District
Bolivar-Richburg Central School District	Odessa-Montour Central School District
Brentwood Union Free School District	Oswego City School District
Broadalbin-Perth Central School District	Owego Apalachin Central School District
Cairo-Durham Central School District	Penn Yan Central School District
Canajoharie Central School District	Phoenix Central School District
Candor Central School District	Port Jervis City School District
Cassadaga Valley Central School District	Remsen Central School District
Catskill Central School District	Rhinebeck Central School District
Charlotte Valley Central School District	Romulus Central School District
Chazy Union Free School District	Sachem Central School District
Chenango Forks Central School District	Saranac Lake Central School District
Cincinnatus Central School District	Saugerties Central School District
Clyde-Savannah Central School District	Schuylerville Central School District
Corinth Central School District	Scotia-Glenville Central School District
Cornwall Central School District	Seaford Union Free School District
Coxsackie-Athens Central School District	Seneca Falls Central School District
Dalton-Nunda Central School District	Sidney Central School District
Deposit Central School District	Solvay Union Free School District
Dundee Central School District	South Country Central School District
East Irondequoit Central School District	Spencer-Van Etten Central School District
East Ramapo Central School District	Stockbridge Valley Central School District
Elmira Heights Central School District	Sullivan West Central School District
Evans-Brant Central School District	Taconic Hills Central School District
Franklin Central School District	Tioga Central School District
Galway Central School District	Troy City School District
Geneva City School District	Voorheesville Central School District (two reports)
Greater Johnstown School District	Warsaw Central School District
Groton Central School District	Waterloo Central School District
Gowanda Central School District	Waverly Central School District
Hancock Central School District	Wells Central School District
Hinsdale Central School District	Westmoreland Central School District
Inlet Common School District	Wheatland-Chili Central School District
Kinderhook Central School District	William Floyd Union Free School District
Laurens Central School District	Wyandanch Union Free School District
Le Roy Central School District	Yonkers City School District
Lowville Central School District	

## ACTIVITY AND RESULTS IN 2006

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Following are brief descriptions of the scope and findings of some major internal control audits issued in 2006. The summaries not only illustrate the services, but also demonstrate the many ways that OSC provides an independent voice for taxpayers while, at the same time, educates school officials with its routine audits.

- **William Floyd Union Free School District – Controls Over District Assets (2006M-36)**

We found the District's internal control structure was clearly inadequate to detect and prevent fraud, as evidenced by previously disclosed frauds committed by the former Treasurer and former Assistant Superintendent of Business. Our audit also identified additional problematic spending by the District for various questionable expenses, procurement and payroll costs totaling \$3.2 million. District taxpayer dollars were apparently misappropriated in some instances and wasted in others. This widespread abuse of District funds was attributable to the District's poor control environment, which undermined the control structure, often to the benefit of District officials themselves. We also found the Board of Education abdicated its governance responsibilities for overseeing District officials and accounting to the public for the use of District resources.

Due to the Board's chronically lax oversight, the District incurred \$3.2 million in inappropriate or questionable costs. In these instances, the Superintendent authorized the payroll department to increase his salary and he was reimbursed for significant personal costs; the ownership of life insurance policies, with a total residual value of \$768,047, was transferred from the District to six District officials; and officials were reimbursed for meal and lodging costs that far exceeded the federal per diem limits.

In addition, the Board hired a District retiree as a consultant without verifying he was eligible to do the work. The District paid him \$440,535 over the same 40-month period during which he received \$444,768 in retirement benefits from the New York State Teachers' Retirement System, in violation of State law. In total, the District paid the retiree \$834,920 for consulting services during the 1998-99 through 2003-04 school years, as well as \$24,150 in travel allowances to which he was not entitled. Further, the District paid \$940,451 to seven professional service providers, six of whom did not have written contracts, and paid more than \$324,000 to other vendors without using competitive bidding procedures.

- **Wyandanch Union Free School District – Internal Controls (2006M-7)**

We found many instances where the Board of Education either had not established critical internal controls or had implemented controls that were improperly designed or operating ineffectively. The District has possession of less than 50 percent of computer equipment obtained through a New York State Education Department (SED) surplus computer program. Based on information provided by SED, we were unable to locate 74 of the 181 donated computer-processing units, none of the 24 donated laptops, and 81 of the 120 donated monitors on school property. District personnel made recordkeeping errors when accounting for leave time and unsupervised changes to timecards, which led to the District overpaying 17 employees by approximately \$10,717, and

## ACTIVITY AND RESULTS IN 2006

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underpaying 14 employees by approximately \$18,873. Additionally, we could not find any documentation to show how the District calculated a 1.5 percent bonus for the Operations, Maintenance, Transportation and Food Service Workers Union employees.

We tested 10 significant professional service contracts, totaling more than \$600,000, and found that the District awarded all of these contracts without using a request for proposal (RFP) process. The District entered into two contracts with a former Board member for his services as the District's "certificates of participation" (COPS) consultant, for a total cost of \$130,000 for two years. The District never used COPS financing and we could not determine what duties or services the former Board member performed. We believe that the District received no value from its contract with him. In addition, the District paid a private vendor \$68,205 for printing and publishing services, some of which the vendor never provided. We also noted two instances (for purchases totaling \$41,654) where the District made purchases for the State contract bid price from vendors that were not listed on the State contract. In four other instances, the District procured goods and services totaling \$38,767 without using the competitive bidding process.

- **Mount Vernon City School District – Internal Controls Over Purchasing and Assets (2006M-29)**  
On February 9, 2000, the Board of Education adopted a bond resolution that authorized the issuance of serial bonds aggregating \$100 million to finance the construction and reconstruction of various school buildings throughout the District. The Board should have adopted and submitted for voter approval two separate bond resolutions – one bond resolution authorizing the issuance of bonds to finance the construction of the two new school buildings and a second bond resolution authorizing the issuance of bonds to finance the construction of additions to or the reconstruction of existing school buildings. District staff could not locate change orders for the construction projects, totaling \$827,817. Subsequently, District officials provided us with documentation showing that \$185,372 of these change orders were proposed but never approved or paid.
- **Voorheesville Central School District – Administrative Leave Benefits (2006M-4)**  
We found over \$216,000 in questionable salary-related payments and leave benefits provided to two former District officials above their normal salary payments. Of this amount, over \$167,000 were payments and benefits to which they were not entitled, and \$49,000 was paid without proper notification or documentation, or due to inappropriate clauses in their employment contracts. The two officials authorized virtually all of these payments themselves without the knowledge or approval of the Board of Education.
- **Sullivan West Central School District – Planning for the District Merger and Business Office Internal Controls (2006M-50)**  
District officials failed to adopt a comprehensive strategic plan for the merger of three separate school districts into one, consequently mismanaged the merger, and wasted millions of taxpayer dollars. District officials did not address declining building occupancy levels when they moved pupils out of the Delaware Valley and Narrowsburg schools. Therefore, their decision to renovate

## ACTIVITY AND RESULTS IN 2006

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the Delaware Valley and Narrowsburg school buildings – which they later closed because they did not properly address building occupancy levels and declining pupil enrollment – resulted in the unnecessary expenditure of \$12.5 million in taxpayer funds. Although District officials knew that they would receive only 75 percent of the capital project costs in State building aid, they led taxpayers to think that State funding would cover 95 percent of the costs of the District’s capital projects. When total staffing levels increased after the merger, the District was unable to realize approximately \$2.1 million in savings due to economies of scale that were identified in the merger study. We found internal control weaknesses related to the Treasurer’s duties, the procurement policy and the purchasing agent. In addition, the Board did not enforce the requirements of its adopted capital assets policy. Lastly, in 2002, the Board improperly paid \$8,400 to a former business manager for unused vacation time.

- **Evans-Brant Central School District – Administrative Compensation and Benefits, Claims Processing and Inventories (2006M-54)**

We found the District inappropriately paid the former Superintendent \$60,885 in salary and benefits in excess of his employment contracts. The former assistant superintendent, former business administrator and former crew chief also received compensation in excess of their contracts of approximately \$1,600, \$6,300 and \$12,000, respectively. In addition, the treasurer paid herself a \$2,000 stipend without Board authorization.

- **Enlarged City School District of Troy – Internal Controls Over Information Technology and Payroll (2006M-62)**

Our audit of IT disclosed weaknesses in the password controls used to access the District’s computer network. Further, the audit disclosed weaknesses in assigning user rights for the financial management system. The District has assigned certain users in the business office with administrative rights, and we found certain other users with access to the system have the ability to give themselves administrative rights. These rights allow these users unlimited access throughout the system. This access can allow these users to view, modify, edit and create financial activity transactions in functions in which they should not have access, and create management overrides. These privileges weaken segregation of duties and the internal controls over the financial management system.

Our audit of payroll-related expenditures revealed that the District allowed the former Superintendent to cash in 11 unused vacation days for \$5,450 in January 2005. This payment was not authorized in his Board-approved employment contract. The Board passed a resolution to ratify retroactively the payment for the unused vacation days at the conclusion of our audit fieldwork in April 2006. We also noted deficiencies in the leave records maintained for school officials and the process used for determining the payment of unused leave upon retirement. Based on our analysis of leave activity, we determined that the former Superintendent and former Associate Superintendent were paid \$1,239 and \$5,010, respectively, for vacation days that were in excess of their available leave balances.

## ACTIVITY AND RESULTS IN 2006

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- **Yonkers City School District – Internal Controls Over Selected Financial Activities (2006M-79)**  
We identified 162 employees who were paid \$692,648 in excess of the Board-established overtime caps and without sufficient detail to substantiate the hours worked during the 2004-05 fiscal year. We also identified four employees who were provided higher salaries than they were entitled to by Board policy or negotiated contracts, resulting in overpayments of \$134,840. In addition, the District paid five other employees for sick leave they were not entitled to while they were receiving workers' compensation benefits.

Further, during the period July 1, 2004 to October 31, 2005, the District paid claims totaling about \$154.7 million without an audit by the Board or an internal claims auditor. Our tests determined that the District had not identified \$3.3 million in duplicate checks; had not deposited more than \$927,000 in checks on a timely basis; had not adequately tracked outstanding and voided checks; and had not accounted for the purchase and sale of hundreds of thousands of dollars worth of school bus stickers and passes.

### 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. The State Legislature mandates a budget review audit 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**  
**Schenectady City School District**  
**Beacon City School District**

## ACTIVITY AND RESULTS IN 2006

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Following is a brief description of the scope and findings from a 2006 budget review audit. It illustrates the service provided to school districts.

- **Enlarged City School District of Troy – 2006-07 Review of Tentative Budget**

Based on the results of our audit, except as noted below, we found the significant 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 2006-2007, the District could retain 2 percent of \$81,981,525, or \$1,639,631, as unreserved fund balance at the end of the 2005-2006 fiscal year. However, the District's tentative budget includes an appropriation of unreserved fund balance of \$4,625,000 to finance 2006-2007 appropriations. After considering the appropriation of \$4.6 million in fund balance to finance 2006-2007 appropriations, the unreserved fund balance would be \$5.3 million (\$9.9 million less \$4.6 million), which is approximately \$3.7 million in excess of what should be retained (\$5.3 million less \$1.6 million the District can retain). Additionally, the tentative budget estimates State Aid revenue of \$43,226,059. However, the New York State budget proposed by the State Legislature includes State Aid of \$42,283,889 for the District, or about \$942,000 less than the District's estimate. Included in the District's State Aid revenue amount is an estimate of \$2.4 million for aid entitled "Projected Aid to Small Cities," which is not included in the Legislature's proposal. District officials stated that this estimated aid had been received in this amount annually over the past few years and has similarly not been included in the Legislature's prior years' proposals for State Aid.

### 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 a significant part of a school district's 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 one school district audit clearly did not meet professional standards, while the auditors on the other two audits could have improved their approach and documentation.

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

**Brentwood Union Free School District – Independent Audit Services**  
**Windham-Ashland-Jewett Central School District – Independent Audit Services**  
**Wyandanch Union Free School District – Independent Audit Services**

## ACTIVITY AND RESULTS IN 2006

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Below is a brief description of the scope and findings from an audit of a school district's external audit issued in 2006. It illustrates the service provided to school districts and demonstrates how this information serves as an educational tool to the school officials and external auditors.

- **Wyandanch Union Free School District – Independent Audit Services (2006M-3)**

We found that the CPA's annual audit of the District did not meet several critical professional standards. For example, the CPA firm did not comply with auditing standard requirements relating to the consideration of fraud. The standardized checklists that the CPA firm used did not contain the CPA's conclusions regarding the risk of fraud. This lack of conclusions brings into question the value of these checklists in planning and performing an audit to obtain reasonable assurance about whether the financial statements are free of material misstatements and fraud. We found no indication that the CPA firm formulated an audit response to the risk of District management overriding controls. Auditing standards mandate such a response, which stems from the many recent instances in which an entity's upper management has overridden internal controls to perpetrate and cover up fraudulent activity (such as Enron). In addition, the CPA firm did not comply with the second standard of fieldwork, which states that a sufficient understanding of internal controls is to be obtained to plan the audit and to determine the nature, timing and extent of tests to be performed. The CPA firm failed to obtain an adequate understanding of internal controls relating to the District's use of information technology.

Because of these and other deficiencies noted, we believe that the CPA firm's audit work did not meet the purposes, terms and conditions of the contract of engagement with the District.

### Special Subject Matter Audits

In 2006, the Division conducted four special subject audits that resulted in 18 school districts receiving audit reports. We assessed whether payments in lieu of taxes were billed accurately to project owners in six western New York school districts, and determined whether eight school districts had claimed Medicaid reimbursement for eligible services provided to qualifying special education students. In addition, the Division examined whether the Buffalo Joint School Construction Board (BJSCB) was pursuing and achieving the diversity employment goals for minorities and women in the construction trades work force, and whether the hired Program Provider and BJSCB had appropriately carried out and monitored, respectively, Phase 1 of the 10-year, \$1 billion project. "Further, we audited a series of payments from the Yonkers City School District to the Yonkers Industrial Development Agency to determine whether the payments were appropriate and adequately supported, and examined the information technology controls over financial accounting software maintained by the Eastern Suffolk and Southern Westchester BOCES." The Division also reviewed the corrective actions taken by the Roslyn Union Free School District to address the 27 recommendations made last year in our forensic internal control audit that found District officials had used more than \$11 million for personal expenses.

## ACTIVITY AND RESULTS IN 2006

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We audited special subject matters in the following school districts:

**Amityville Central School District**  
**Buffalo Joint School Construction Board (two reports)**  
**Delhi Central School District**  
**Eastern Suffolk BOCES – Assessment of Regional Information Center Internal Controls**  
**Ellicottville Central School District**  
**Frontier Central School District**  
**Glens Falls City School District**  
**Lancaster Central School District**  
**Niagara Falls City School District**  
**Niagara-Wheatfield Central School District**  
**Oneonta City School District**  
**Roslyn Union Free School District – Anatomy of a Scandal Follow-up**  
**Southern Westchester Boces– Assessment of Regional Information Center Internal Controls**  
**Spencerport Central School District**  
**Syracuse City School District**  
**Yonkers City School District**  
**Yorkshire-Pioneer Central School District (two reports)**  
**Yorktown Central School District**

Following are brief descriptions of the scope and findings from some major special subject matter audits issued in 2006. The summaries illustrate the diverse topics covered by this particular service, and demonstrate ways that OSC provides an independent voice for taxpayers and identifies cost savings and revenue enhancement strategies for school officials.

- **Buffalo City School District – Joint Schools Construction Programs Phase 1 (2006M-22)**  
The Joint Schools Construction Board (JSCB) and the District did not establish and implement appropriate management controls or adequately monitor Phase 1 program activities. The District does not withhold the 5 or 10 percent retainage from the Program Provider. District officials could not produce adequate documentation to support \$2.1 million being held by the Program Provider in a self-insurance risk pool. The District was unable to assess the validity of approximately \$24 million in costs charged to Phase 1 projects by the Program Provider, including several million dollars in questionable categories such as charitable contributions or construction paid from contingency. The District should not have paid \$2.6 million to the Program Provider because the Program Provider did nothing to warrant this payment. This amount represented available program funds that were not spent as originally planned because project costs were instead funded by a Federal telecommunications grant.

## ACTIVITY AND RESULTS IN 2006

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The Program Provider allocated certain costs from six Phase 1 projects that exceeded their construction budgets to other Phase 1 projects whose budgets had not been fully expended. This allocation of costs “where they fit” could disallow more than \$8.7 million in Phase 1 costs that were not charged in compliance with SED’s requirements. If this happens, building aid would be reduced by about \$14.3 million and the District would need to use local funds for debt service costs. Certain professionals, the architects, a cost consultant and the attorney for the JSCB are paid directly by the Program Provider. These relationships suggest a lack of independence, because the professional is expected to protect the interests of the District. Finally, the District was unable to demonstrate that the savings anticipated from an energy performance contract would be greater than the cost of the contract and interest costs on the financing used to fund such contract. The contract and interest costs exceed the savings illustrated in the energy performance contract by approximately \$7.5 million.

- **Statewide School District Medicaid Reimbursement (2006MR-1)**

We issued related individual letter reports to the following school districts: Delhi Central School District, Oneonta City School District, Syracuse City School District, Spencerport Central School District, Amityville Union Free School District, Yorktown Central School District, Glens Falls City School District and the Yorkshire-Pioneer Central School District.

We found that districts do not claim all the Medicaid reimbursements to which they are entitled. Based on our audit, these missed reimbursements could result in districts and New York receiving \$140 million less in Medicaid reimbursements than they are entitled to. Eight districts failed to claim at least \$2.7 million of Medicaid reimbursement for related services, Targeted Case Management reviews and ongoing service coordination provided to special education students. As a result, the districts did not receive at least \$675,000 in Medicaid reimbursement revenues, which was their share (25 percent) of the eligible services that district officials could have claimed. In addition, for the Syracuse City School District, we based our tests on a random sample. If similar amounts went unclaimed for the other students in the District, the District’s share of additional revenue would have been over \$1.8 million during the two-year period. Therefore, the total amount of revenue not received by the eight districts could be as much as \$2.5 million.

For a two-year period, the eight districts reported in their annual financial reports a little over \$8 million in revenue from Medicaid reimbursements. If similar conditions exist statewide, districts in New York State could have collectively received over \$70 million more in revenue over a two-year period. Because the State is due an equal share of the Medicaid reimbursements sent to the districts, if similar conditions exist statewide, the State’s share could also amount to over \$70 million over a two-year period.

## ACTIVITY AND RESULTS IN 2006

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- **Yonkers City School District (2006M-57)**

The circumstances surrounding the series of payments made by the District and City for certain costs outside an original project's cost to the Yonkers IDA (YIDA), and ultimately the loan by YIDA to Yonkers Baseball Development, Inc. (YBD), raise serious concerns about the propriety of these transactions. In October 2001, the City paid the YIDA \$669,455 for certain costs outside the contracted costs of a project. In October 2002, the District also paid the YIDA \$669,455 for the same costs. At the same time, the YIDA paid a nearly identical \$670,000 to Yonkers Baseball Development, Inc. (YBD), a for-profit corporation organized by YIDA for developing a baseball stadium in Yonkers. Misleading and unjustified invoices were created to generate the first payment. There is no evidence that the letters/invoices that Community Development Property, Inc. (CDP), the developer for the original project, submitted to YIDA, and that YIDA submitted to the City requesting payment were for legitimate expenses. In our opinion, the August 2002 YIDA bill to the District represented an intentional attempt to use District funds to provide YIDA with resources to make an inappropriate loan to YBD. Finally, our review found that the YIDA had no authority to establish the YBD, nor did the YIDA have implied authority to do so. In addition, the loan to YBD did not comply with the General Municipal Law. In this instance, the YIDA had no authority to loan or give public funds to YBD. In limited cases where loans are allowed, certain procedures must be followed, which YIDA did not do.

The nature and timing of these various transactions have been the subject of investigations by the Westchester County District Attorney and the City of Yonkers Inspector General.

- **Industrial Development Agency - Payment in Lieu of Taxes - Billing Accuracy (2005MR-12)**

We issued individual letter reports to the following school districts: Niagara Falls City School District, Niagara-Wheatfield Central School District, Ellicottville Central School District, Frontier Central School District, Lancaster Central School District and the Yorkshire-Pioneer Central School District.

Thirty percent of the Payment in Lieu of Taxes (PILOT) bills examined were not prepared according to the terms of the respective PILOT agreements. Preparation errors for a one-year period caused project owners to be underbilled a sum aggregating over \$51,000. Other project owners were collectively overbilled by more than \$38,000. If these errors remain uncorrected for the life of the PILOT agreement, the underbillings could total \$520,000 and overbillings could total \$151,000. Causes for these errors included: unclear terms in the PILOT agreements, poor communications with assessing bodies and a lack of monitoring to ensure PILOT billing accuracy. The material consequence of these errors is clear: either the adjusted tax jurisdictions will not receive the correct amount due them or project owners will pay more than required pursuant to their agreement. Both results diminished the purpose of Industrial Development Agency (IDA) and PILOT agreements, which is to encourage economic development to the mutual benefit of the affected tax jurisdictions, the local economy and the participating developers.

## ACTIVITY AND RESULTS IN 2006

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### Response to Audits

As noted previously, most school districts have responded positively to our audit findings and district officials have taken action to fulfill our recommendations, which were based on either audits of their districts or audits of other districts. Many officials have realized that any

implementation costs needed to establish strong controls would 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 districts are 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 and school budgets.

**Many officials have realized that any implementation costs needed to establish strong controls would be offset by cost-savings and the prevention of fraud.**

**We provide school district officials with opportunities throughout the audit process to communicate with our auditors and discuss the audit results.**

We provide school district officials with opportunities throughout the audit process to communicate with our auditors and discuss audit results. 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.

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. Overall, we hope to find through our audits that most districts are well run. However, when there are problems, the public must know that they are being addressed and not being swept under the carpet.

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## ACTIVITY AND RESULTS IN 2006

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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 fieldwork 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.

### Common Themes in Audits

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Although the school districts audited have improved many internal controls, effective governance extends far beyond adopting policies and procedures. It requires a concerted effort on the part of those charged with district management and oversight to understand the business of the district. That understanding includes knowing how employment, personnel and other contracts are approved and modified; who performs and who supervises key financial-related duties; and when weaknesses exist that might preclude the board or its administrators from reasonably preventing and/or detecting the loss or misappropriation of district assets. Furthermore, it requires a considerable amount of attention to information technology (IT). Computer systems and data represent one of the most critical areas of vulnerability not only to schools, but to other entities.

**Although the school districts audited have improved many internal controls, effective governance extends far beyond adopting policies and procedures. It requires a concerted effort on the part of those charged with district management and oversight to understand the business of the district.**

**These common findings represent potential opportunities for individual school districts to improve their financial operations as well as opportunities for OSC and its partner organizations to provide better guidance and education to school officials.**

The Division identified several recurring themes in its audits in 2006. These common findings represent potential opportunities for individual school districts to improve their financial operations as well as opportunities for OSC and its partner organizations to provide better guidance and education to school officials. It is clear from the patterns identified in our audits that not all administrators and boards of education are familiar with the full breadth of their internal control

responsibilities. In addition, since some of the findings relate to the inappropriate actions of school administrators, it is also evident that not all districts were successful in establishing an environment where the possibility of management override has been fully considered.

## ACTIVITY AND RESULTS IN 2006

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One of the main components of the Five-Point Plan is the requirement that all but the smallest school districts establish an internal audit function. 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. The internal audit process assists the board in ensuring that proper internal controls are in place and working. Accordingly, personnel performing this function report directly to the board.

To be effective, an internal audit must take into account the possibility that management could override internal controls. Management is in a unique position to perpetrate fraud because of its ability to directly or indirectly influence and/or manipulate accounting records, contracts and district personnel, thereby overriding controls that otherwise appear to be operating effectively. The internal auditor and board should address the risk of management override apart from any conclusions regarding the existence of more specifically identifiable risks. Some common themes below demonstrate situations where administrators were able to override existing internal controls.

Equally as important to the internal audit's risk assessment is how officials use IT. Since IT is the gateway to various district resources (financial records, performance data, confidential information about students and staff, and cash accessible through checks, transfers and direct deposit), a thorough review of IT checks and balances must be an integral part of the process. It is poor practice for internal auditors, boards and/or external auditors to have anything less than a good understanding of IT controls, regardless of whether the school performs the IT function in-house or outsources it to another entity.

Additionally, as part of a school district's risk assessment process, the board and internal auditor should consider the common themes identified by our audits and determine whether they have identified controls that mitigate these risks in their own schools.

### IT Weaknesses

Findings about weaknesses in a school district's IT system were included in 12 of 83 internal control reports (14 percent) issued. However, all reported weaknesses came about late in 2006, so this appears to be an emerging issue. Frequently, school districts use commercial software packages to process transactions electronically. Our audits found that officials did not always have proper access controls that limit the functions employees can perform within the accounting software (particularly for payroll clerks and treasurers). This type of weakness creates a situation that is similar to not segregating financial duties properly since one employee could authorize all phases of a transaction without oversight. Other IT findings included not requiring employees to use sign-in passwords, allowing employees to change their access rights without approval and not maintaining audit logs and exception reports that system administrators could use to monitor system activity. Further, we also found instances where the schools did not protect computer equipment and data from environmental factors, and did not properly back up data to prevent loss.

## ACTIVITY AND RESULTS IN 2006

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Similar to other internal controls, a board of education must design and implement IT controls that provide reasonable assurance that assets and resources entrusted to their care are used in accordance with laws and policies, and safeguarded against waste, loss and abuse. IT systems and data are valuable resources since school officials use them to make financial decisions, process transactions and serve as the basis for reporting to taxpayers and the State and Federal governments. Access to computer systems must be controlled and monitored to reduce the risk of misuse and/or alteration of the data. In addition, if the computers containing the data should fail, not having the information properly backed up could prove catastrophic. School districts need a formal disaster recovery plan to provide guidance on the prevention of the loss of computer data, as well the recovery of computer data in the event of disaster.

### **Inappropriate Employee Benefit Payments**

In 2006, 15 of 83 audit reports (18 percent) issued on school district internal controls contained various findings about school officials receiving payments for unused leave and other employee benefits to which they were not entitled, or which the board had not authorized by written contract or resolution. Many of these inappropriate benefit payments were made to superintendents or other high-level school administrators, sometimes authorized solely by them. Even with approved written contracts in place, some school district internal controls did not prevent payments for benefits not authorized by the contracts. This type of weakness is one of the previously mentioned examples where management override of controls can occur.

Written employment contracts should contain clear language specifying which benefits the board of education has authorized for its administrators and employees. Transparency in all board approved benefits is an important consideration, so well-structured documents should address all pertinent aspects of employment and contain all salary and benefits to which the employee(s) is entitled. Legal counsel should review the documents prior to the board adopting them and the district should maintain a signed copy on file. In addition, school districts must establish procedures that ensure that officials receive only those payments authorized by the contracts and the board must monitor those procedures and oversee such payments to administrators.

### **Inadequate Audits of Claims**

In 2006, 32 of 83 reports (39 percent) issued on school district internal controls contained findings about a deficient claims auditing function. Frequently these findings identified incompatible duties and inadequate procedures for the claims audit functions. Some claims auditors did not report directly to the board of education, while others had incompatible business functions where they authorized transactions as well as approved payment for them. When performing the claims audit, sometimes auditors failed to require department reviews and approvals, prior authorization of travel expenses and/or documentation to support the amounts claimed. We also identified school districts that made payments to vendors without the benefit of any claims audit to ensure the accuracy and propriety of the vendors' bills.

## ACTIVITY AND RESULTS IN 2006

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The claims audit is such a critical function that it was one of the main components in the Five-Point Plan legislation. Since a claims auditor assumes the powers and duties of the board with respect to auditing and approving claims for payment, the Five-Point Plan requires the individual report directly to the board and not have an incompatible position or perform business-related duties. Moreover, Education Law specifies that districts should not pay any claims without audit and approval.

An internal audit should conduct a thorough review of the claims audit function as part of its risk assessment. Good claims auditing controls should ensure that every claim contains enough supporting documentation to determine that it complies with school district policies, and that the amounts claimed represent actual and necessary school district expenses. In addition, the boards that appoint claims auditors should consider providing them with written job descriptions so they clearly understand their responsibilities and meet the boards' expectations.

### Not Adequately Segregating Duties

Findings about financial duties being segregated inadequately were reported in 34 of 83 audit reports (41 percent) issued on school district internal controls during 2006. Frequently, school business offices have one individual performing too many functions to provide a system of checks and balances over the financial duties of a treasurer, purchasing agent, claims auditor or payroll clerk. Without separating the basic functions of authorizing transactions, keeping custody of assets and maintaining records among more than one individual, it is much more likely that errors, irregularities and even fraud will occur and go undetected.

One of the managerial duties of a board of education is to establish a good system of internal controls. Such a system provides that no individual controls all phases of a transaction and it gives reasonable assurance that district assets are properly safeguarded. When it is not practical to segregate duties because of limited staff resources, the board should establish compensating controls. Such compensating controls might include the board or administrative staff periodically reviewing the work in question, rotating duties and mandatory vacations. Additionally, a school district's accounting software should contain built-in controls that prevent individuals from performing incompatible duties, and it should produce reports necessary for proper monitoring of financial activity. Further, the internal audit function should review whether a school's financial procedures provide sufficient checks and balances over transactions and report identified risks to the board of education.

### Awarding Contracts without Competition

Findings about boards of education that awarded significant contracts (over \$100,000) for professional services, goods and other services without seeking competition were reported in 13 of 83 internal control reports (16 percent) issued in 2006. Not only did boards sometimes contract with individuals for professional services (e.g., director of security, coordinator of psychological services, legal and accounting services) without seeking requests for proposals, the boards also occasionally paid these

## ACTIVITY AND RESULTS IN 2006

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individuals benefits that were not part of their written contracts. Boards also failed to seek competitive bids for items such as gas and electric service, transportation, athletic uniforms and services, such as security and transportation. Generally, school districts did not seek competition prior to awarding contracts because purchasing agents either were not vigilant about following established policies or were not knowledgeable about procurement statutes.

A good system of internal controls over purchasing consists of well-designed policies, practices and procedures that provide the board of education with reasonable assurances that the school district is using its resources effectively and that it is complying with applicable laws and regulations. The district should use its money prudently and economically when procuring goods and services, and safeguard against possible favoritism, extravagance and fraud in the procurement process.

### **Inadequate Capital Asset Records**

In 2006, 47 of 83 reports (57 percent) issued on school district internal controls contained findings about inadequate capital asset inventory records and/or poor control procedures despite board-adopted capital asset policies. Generally, schools use a third-party contractor to maintain inventory records. Often the records are not up-to-date since the third-party contract might not record purchases, disposals and transfers between departments and buildings until months later. Consequently, the inventory records usually do not serve as an effective control to safeguard a school district's investment in capital assets. Our audit findings ranged from merely finding inaccurate records to not being able to locate more than 50 percent of a school district's computer equipment (i.e., missing were 74 of 181 computer-processing units, 24 laptops and 81 of 120 monitors) donated through SED's CREATE program.

The propensity of these findings demonstrates why good governance requires more than just adopting appropriate policies and procedures. Without oversight, officials and the contractors they hire might not follow the policies and procedures due to inattentiveness or lack of understanding. Complete, current and accurate capital asset records fix responsibility for custody and control of school district property and help safeguard it from loss and misuse. In addition, such records can be useful in determining the adequacy of insurance coverage and preparing claims for insurance recoveries. Additional safeguards for high-risk assets such as laptop computers, cell phones and audio-visual equipment should include identification numbers and markings. Protecting such resources also means that school officials should restrict access to inventory items and reconcile inventory records periodically with the results of physical inventories.

## ACTIVITY AND RESULTS IN 2006

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### Educational and Training Activities

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Through November 2006, the Division provided training to over 1,140 school district officials at 16 different events (bringing the total number of school officials trained to date to over 5,000). OSC has also collaborated with the New York State School Boards Association (NYSSBA) to develop a low-cost, distance learning alternative for school board members to meet their training requirement.

Training highlights in 2006 included:

- A statewide teleconference, on “Strengthening School Financial Accountability: A Progress Report,” to over 270 school district officials.
- A session on “Preparing for and Learning from the State Comptroller Audits,” at the New York State Council of School Superintendents Spring Conference, where over 75 officials attended.
- Sessions on “How to Prepare for the Comptroller’s Audit” for over 225 school business officials at the NYSASBO workshops.
- A session, on “School District Audits,” at the NYS School Boards Association Annual Convention, for over 300 school board members.
- Regional presentations (including accounting schools) throughout the State for local and school district officials.

## SECTION 3:

# HIRING NEW STAFF

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Our audit efforts in schools during 2006 increased considerably, commensurate with the number of new staff we were able to hire and train. The Division spent more than 15,000 days using existing and new resources to conduct various school audits in 2006, up from 8,535 in 2005. However, delays in obtaining the necessary hiring freeze waivers from the Division of the Budget (DOB) directly affected our ability to obtain and devote full resources to the school initiative.

Before receiving the budgetary appropriation and hiring freeze waivers in the early fall of 2005, OSC staff began the process of classifying the new auditor positions and seeking Department of Civil Service approval for them. At the same time, OSC began extensive recruiting efforts to identify potential candidates and initiate the process of having people take the Civil Service exams to become eligible for employment. OSC appointed a team of employees and charged them with

recruiting and interviewing candidates to expedite the work. The team placed several advertisements informing recruits about the positions on job-related Internet sites, in newspapers, in professional publications and at college recruiting offices. The Agency emphasized targeting diversity candidates in its recruiting efforts by seeking out additional web sites, college visits, newspapers and professional associations that serve their needs. OSC also updated and modified its policies and procedures for handling resumes, interviews, job applications and references to expedite the needed work in screening candidates. The team met thousands of potential candidates at job fairs, recruiting events and classroom presentations. They also processed thousands of resumes from interested parties, and interviewed about 400 candidates for the available positions.

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Despite these efforts, the team had trouble filling the positions as quickly as OSC needed for its school audits. The delayed timing of waivers granted by DOB necessary for OSC to fill budgeted positions resulted in having to hire relatively large groups of people in late 2005, and then in May and June 2006 with far fewer hires in between. Further, after June 17, 2006, OSC did not receive any waivers to hire the remaining positions until OSC was released from the waiver process in August 2006.

Despite the recruiting and hiring difficulties encountered by OSC during the last year, the Division has hired 82 new auditors to work on the school initiative. Natural attrition and staff retirements have resulted in us also having some auditors leave during the period. Consequently, the Division still has 28 of the 89 positions left to fill. When the effects of hiring delays and staff attrition are considered, the Division had only 42 new full-time equivalent auditors that actually worked on school audits during 2006. Nevertheless, the Division issued 113 audit reports in 2006, and it has another 177 audits underway.

## SECTION 4: PLANS FOR 2007

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### Emerging Issue – Outsourced IT Services

School districts frequently outsource a variety of business office functions, information technology (IT) infrastructure and financial software functions to “third-party specialists” or “service organizations.” Rather than performing these functions in-house, many school districts find that it is more cost-effective to outsource these responsibilities and tasks to a BOCES or to a commercial provider. A commonly outsourced function is payroll and, in school districts, the concept of a central business office is another form of outsourcing that continues to grow in popularity. Under the central business office model, a BOCES performs many of the accounting functions (accounts payable, accounts receivable and payroll, for example) that a district business office would normally handle. BOCES also frequently provide IT infrastructure, as well as financial management software installation, maintenance and support for school districts.

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Although districts may outsource many business functions, the boards of education retain the responsibility to oversee the design and effectiveness of the applicable internal controls of the service organization. Appropriate controls over transactions processed by a service organization are just as imperative as controls over in-house accounting transactions. Likewise, auditors also have a responsibility to evaluate the design and

effectiveness of internal controls over outsourced transactions material or significant to their audit objectives. Internal controls over outsourced IT functions are also an important consideration for boards and external auditors because these systems often contain sensitive or personal and confidential data that must be adequately protected from unauthorized use.

When planning its audits, OSC will be expanding its consideration of the adequacy of internal controls over outsourced transactions and IT functions. When business office or IT functions are outsourced to either a commercial provider or a BOCES, our auditors will inquire about the existence of a Statement of Auditing Standards (SAS) 70<sup>3</sup> report. A SAS 70 report describes the service organization’s control objectives and procedures and may also discuss the results of an auditor’s testing of the effectiveness of those controls.

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<sup>3</sup> The American Institute of Certified Public Accountants has issued Statement of Auditing Standards (SAS) No. 70 that describes professional standards for auditors reporting on the controls of a service organization.

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OSC will also be issuing an advisory bulletin to all school districts, BOCES and local governments on the subject of SAS 70 reports. The purpose of this bulletin is to heighten awareness with officials regarding outsourced transactions and IT functions and to ensure that appropriate controls are in place at service organizations. This bulletin will also discuss different types of SAS 70 reports; suggested requirements for contracts with service providers; and limitations of SAS 70 reports.

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### Continue Audits

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The School Financial Accountability legislation requires the Comptroller to audit every school district, Board of Cooperative Education Services (BOCES) and charter school (832 in total) in the State by March 21, 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 Constitution, Article V and General Municipal Law, Article 3.

New York State Schools	
<b>School Districts</b>	<b>700</b> <sup>4</sup>
<b>BOCES</b>	<b>37</b> <sup>5</sup>
<b>Charter Schools</b>	<b>95</b> <sup>6</sup>
<b>Total</b>	<b>832</b>

Given that the legislation calls for OSC to perform all audits in five years, we will conduct anywhere from 160-200 audits per year as we become fully staffed to complete the task by the date required.

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<sup>4</sup> Total different from last year due to the recently established Eastport-South Manor Central School District.

<sup>5</sup> The Schuyler-Chemung-Tioga and Steuben-Allegany BOCES merged to form the Schuyler-Steuben-Chemung-Tioga-Allegany BOCES.

<sup>6</sup> Total different from last year due to 15 charter schools opening and four charter schools closing.

### General Audit Approach

During 2005 and 2006, our audit teams focused primarily on auditing school districts. These entities comprise the vast majority of units that are subject to the legislation's audit requirements, and this initial focus allowed OSC to get an effective start toward completing the necessary audits by March 31, 2010. During 2006, we developed an audit approach specifically for BOCES audits during the coming years. In addition, during 2007, we will complete the audit approach for charter schools started in 2006 that will allow us to examine those units' specialized operations. We have been gathering information about the unique operations of charter schools, and then drafting an approach similar to the risk-based audits being conducted in school districts and BOCES.

The order in which OSC selects individual school districts, BOCES and charter schools for audit during the year will be influenced by relevant information that comes to our attention such as newspaper articles, taxpayer complaints and/or certain financial indicators. OSC 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." These standards include 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, 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. Examiners perform these steps using standardized procedures to ensure completeness and uniformity. Despite using an approach with standard documents and procedures, examiners are still expected to exercise professional judgment and modify the standard planning approach to fit an audit's circumstances and risks.

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' 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.

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Analyzing the information in the school districts' computer databases would not be useful if the information were unreliable. Therefore, our examiners assess the internal controls over the school districts' computer systems to help ensure that the information is reliable. Examiners obtain information from the 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 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, back-up and disaster recovery plans, user training, and certain application controls. During audit planning, examiners 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.

Audit reports include findings and recommendations that describe any significant weaknesses noted, a discussion of the causes and effects of those weaknesses, and recommendations to the 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 1988 (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 those governing health, safety, civil rights and student assessment. They are funded on a per student basis by the local public school districts from which their enrollments are drawn.

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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 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.

As of 2006, there are 95 authorized charter schools operating in New York State:

<b>Charter Schools in New York State During 2006</b>	
<b>Location</b>	<b>Number of Charter Schools</b>
<b>New York City</b>	<b>59</b>
<b>Buffalo and Niagara Falls</b>	<b>16</b>
<b>Albany, Schenectady and Troy</b>	<b>10</b>
<b>Rochester</b>	<b>4</b>
<b>Long Island</b>	<b>3</b>
<b>Syracuse</b>	<b>2</b>
<b>Westchester</b>	<b>1</b>
<b>Total</b>	<b>95</b>

As indicated earlier, during 2007 we will finalize an audit approach for charter schools that will allow us to examine those units' specialized operations.

## Continue Policy and Training Activities

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Working with its partner organizations, OSC will continue to identify emerging school district financial issues in coming years. As needed, OSC may forward statutory proposals that address concerns and issues facing school officials. Additionally, the Division will continue to identify and provide additional specific training and guidance to school district officials to help them continue improving their financial operations.

One component of the Five-Point Plan is that all school district and BOCES board members elected or appointed after July 1, 2005 must receive six hours of training from an approved

provider on the basics of financial oversight, accountability and fiduciary responsibilities. The approved curriculum consists of the following modules: School District Finances: Roles and Responsibilities; Revenue Sources and the Budget Process; Building School District Fiscal Fitness; Monitoring School District Fiscal Fitness; and Preventing Fraud, Waste and Abuse of District Resources.

OSC has collaborated with NYSSBA to develop a low-cost, distance learning alternative for school board members to help meet this training requirement. Beginning in January 2007, board members will be able to complete the modules through an online program hosted by Hudson Valley Community College (HVCC). Board members can register through HVCC, complete the online modules (including related examinations) and receive a certificate from NYSSBA upon completion. Each session is expected to be available for a six-week period. Board members may complete all five modules online or use a mix of online and other approved training to meet their certification requirement.

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