



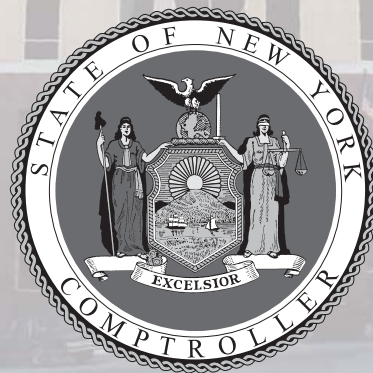
Baldwin Union Free School District Internal Controls Over Selected Financial Activities

Report of Examination

Period Covered:

July 1, 2008 — May 31, 2010

2011M-124



Thomas P. DiNapoli

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State of New York Office of the State Comptroller

Division of Local Government and School Accountability

November 2011

Dear School District Officials:

A top priority of the Office of the State Comptroller is to help school district officials manage their districts efficiently and effectively and, by so doing, provide accountability for tax dollars spent to support district operations. The Comptroller oversees the fiscal affairs of districts statewide, as well as districts' compliance with relevant statutes and observance of good business practices. This fiscal oversight is accomplished, in part, through our audits, which identify opportunities for improving district operations and Board of Education governance. Audits also can identify strategies to reduce district costs and to strengthen controls intended to safeguard district assets.

Following is a report of our audit of the Baldwin Union Free School District, entitled Internal Controls Over Selected Financial Activities. This audit was conducted pursuant to Article V, Section 1 of the State Constitution and the State Comptroller's authority as set forth in Article 3 of the General Municipal Law.

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

Respectfully submitted,

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



State of New York Office of the State Comptroller

EXECUTIVE SUMMARY

The Baldwin Union Free School District (District) is governed by the Board of Education (Board) which comprises five elected members. The Board is responsible for the general management and control of the District's financial and educational affairs. The Superintendent of Schools (Superintendent) is the chief executive officer of the District and is responsible, along with other administrative staff, for the day-to-day management of the District under the direction of the Board.

There are nine schools in operation within the District, with approximately 5,200 students and 1,270 employees. The District's operating expenditures were \$106,429,438¹ and \$108,752,368 in the 2008-09 and 2009-10 fiscal years, respectively.

Scope and Objective

The objective of our audit was to determine if the District had adequate internal controls over selected financial activities for the period July 1, 2008 through May 31, 2010. In addition, we extended our scope from July 1, 2006 to June 30, 2010 to determine if the District over-funded its employee benefit accrued liability reserve (EBALR) and determine whether the unreserved, unappropriated fund balances were within the legal limits. Our audit addressed the following related questions:

- Did the Board adopt realistic budgets, retain only the amount of unreserved fund balance allowed by law, and properly establish and use its employee benefit accrued liability reserve (EBALR)?
- Does the District solicit competition when procuring goods and services that are not subject to competitive bidding?
- Are controls over the Treasurer's electronic signature disk appropriately designed and operating effectively?
- Has the District established adequate internal controls over its information technology (IT) system, and are these controls appropriately designed to protect electronic data?

¹ 2008-09 expenditures were adjusted to show the effect of prior period adjustments

Audit Results

We found that the Board has not established critical controls over its budget process. We estimate that between accumulating fund balance in excess of the statutory limit and significantly over-funding a reserve, the District has accumulated more than \$12.1 million in taxpayer funds inappropriately.

The Board routinely adopted budgets that included appropriations in excess of what was necessary. From the 2006-07 through 2009-10 fiscal years, the District overestimated expenditures by a cumulative total of \$17.2 million, resulting in the District accumulating unreserved, unappropriated fund balance in excess of the statutory limits. We found that the District's unreserved, unappropriated fund balance exceeded the statutory limit by about \$4 million as of June 30, 2010.

In addition, the District maintained an EBALR that was over-funded. As of June 30, 2010, the District had reserved \$8.2 million more in its EBALR than its total liability for compensated absences. Further, the District did not use EBALR funds to pay for compensated absence costs and, instead, levied taxes to pay for these costs. For example, the District paid \$280,450 for these costs in 2009-10 from the General Fund. In accordance with new legislation, the District was allowed to withdraw up to \$3,814,807 from the EBALR to fund appropriations in the 2011-12 budget only. If the District actually used this amount from its EBALR to fund 2011-12 appropriations, the EBALR will still be over-funded by approximately \$4.4 million.

We found several weaknesses with the District's policies and procedures. For example, the procurement policy did not require District officials to solicit competition when awarding contracts for professional services and certain procurement procedures were not consistent with Board-adopted policies. In addition, District officials did not always enter into written contracts with professional service providers. As a result, District officials may have paid more than necessary for goods and services.

The Board did not establish formal policies and District officials did not establish procedures for the protection and use of facsimile signatures disks. Signature disks were kept in a locked drawer in the Business Office that account clerks in the Business Office had access to. These account clerks' job duties included processing payroll and accounts payable. Additionally, the Deputy Treasurer did not always supervise and control the use of her signature disk. Although we did not find any improper transactions, because of these weaknesses, the risk is increased that these signature disks could be used to misappropriate District funds without detection or correction.

Finally, the District needs to strengthen internal controls over certain areas of information technology. The function of System Administrator has not been segregated from individuals with Business Office responsibilities, and the financial software's audit logs are not reviewed to identify unauthorized transactions. As a result, errors and irregularities could occur and not be detected or corrected in a timely manner. Further, the District does not have a Security Breach policy in place to safeguard personal information and to notify District residents if the District's system has had a breach in security.

Comments of District Officials

The results of our audit and recommendations have been discussed with District officials and their comments, which appear in Appendix A, have been considered in preparing this report. Except as indicated in Appendix A, District officials generally agreed with our findings and indicated they planned to initiate corrective action. Appendix B includes our comments on issues raised in the District officials' response letter.

Introduction

Background

The Baldwin Union Free School District (District) is located in the Town of Hempstead, Nassau County. The District is governed by the Board of Education (Board) which comprises five elected members. The Board is responsible for the general management and control of the District's financial and educational affairs. The Superintendent of Schools (Superintendent) is the chief executive officer of the District and is responsible, along with other administrative staff, for the day-to-day management of the District under the direction of the Board.

There are nine schools in operation within the District, with approximately 5,200 students and 1,270 employees. The District's operating expenditures were \$106,429,438² and \$108,752,368 for the 2008-09 and 2009-10 fiscal years, respectively.

Objective

The objective of our audit was to determine if the District had adequate internal controls over selected financial activities for the period July 1, 2008 through May 31, 2010. Our audit addressed the following related questions:

- Did the Board adopt realistic budgets, retain only the amount of unreserved fund balance allowed by law, and properly establish and use its employee benefit accrued liability reserve (EBALR)?
- Does the District solicit competition when procuring goods and services that are not subject to competitive bidding?
- Are controls over the Treasurer's electronic signature disk appropriately designed and operating effectively?
- Has the District established adequate internal controls over its information technology (IT) system, and are these controls appropriately designed to protect electronic data?

Scope and Methodology

During our audit, we examined the District's internal controls over selected financial operations for the period July 1, 2008 to May 31, 2010. In addition, we extended our scope to July 1, 2006 to determine if the District over-funded its Employee Benefit Accrued Liability Reserve and determine whether the unreserved, unappropriated fund balances were within the legal limits.

² 2008-09 expenditures were adjusted to show the effect of prior period adjustments

We conducted our audit in accordance with generally accepted government auditing standards (GAGAS). More information on such standards and the methodology used in performing this audit is included in Appendix C of this report.

**Comments of District
Officials and Corrective
Action**

The results of our audit and recommendations have been discussed with District officials and their comments, which appear in Appendix A, have been considered in preparing this report. Except as indicated in Appendix A, District officials generally agreed with our findings and indicated they planned to initiate corrective action. Appendix B includes our comments on issues raised in the District officials' response letter.

The Board has the responsibility to initiate corrective action. Pursuant to Section 35 of the General Municipal Law, Section 2116-a (3)(c) of the Education Law and Section 170.12 of the Regulations of the Commissioner of Education, a written corrective action plan (CAP) that addresses the findings and recommendations in this report must be prepared and provided to our office within 90 days, with a copy forwarded to the Commissioner of Education. To the extent practicable, implementation of the CAP must begin by the end of the next fiscal year. For more information on preparing and filing your CAP, please refer to our brochure, *Responding to an OSC Audit Report*, which you received with the draft audit report. The Board should make the CAP available for public review in the District Clerk's office.

Budgeting Practices and Fund Balance

A school district's financial condition is an indication of its ability to fund public educational services for students within the district. The responsibility for accurate and effective financial planning rests with the Board and the Superintendent. One of the most important tools for managing a district's financial condition is the budget process. District officials must ensure that budgets are prepared, adopted, and modified in a prudent manner. Budgets should accurately depict the District's financial activity while also using available resources to responsibly lower the tax burden of District residents.

The Board routinely adopted budgets that included appropriations in excess of what was necessary. From the 2006-07 through 2009-10 fiscal years, the District overestimated expenditures by a cumulative total of \$17.2 million, resulting in the District accumulating unreserved, unappropriated fund balance in excess of the statutory limits. In addition, the District maintained an Employee Benefit Accrued Liability Reserve (EBALR) that was over-funded. As of June 30, 2010, the District had reserved \$8.2 million more in its EBALR than its total liability for compensated absences. Further, the District did not use EBALR funds and, instead, levied taxes to pay for compensated absence costs. In accordance with new legislation, the District was allowed to withdraw up to \$3,814,807 from the EBALR to fund appropriations in the 2011-12 budget only. If the District actually used this amount from EBALR to fund 2011-12 appropriations, the EBALR will still be over-funded by approximately \$4.4 million.

Budgeting Practices and Unreserved Fund Balance

The Board is responsible for presenting the District's budget, or spending plan, to the public for vote. In preparing the budget, the Board also is responsible for estimating what the District will receive in revenues (e.g., State aid) and how much fund balance will be available at fiscal year end (some or all of which may be used to fund the ensuing year's appropriations), and, to balance the budget, determining what the expected tax levy will be. Underestimating revenues and/or overestimating expenditures could result in the collection of more real property taxes than necessary. During the several month period from when the spending plan is approved by the voters and when the tax levy is finally established (August), certain information such as refined State aid estimates, the finalized assessment roll of the town in which the District is located, and a more accurate fund balance amount, becomes available as the District's accounting records are closed for the fiscal year ending June 30.

There are two types of fund balance, reserved and unreserved. The reserved portion of fund balance represents moneys that the District

may set aside for specific purposes established by statute and must be used in compliance with statutory directives. The portion of the unreserved fund balance that is used to help finance the next fiscal year's budget is referred to as appropriated fund balance. The portion of the unreserved fund balance that the District retains, which can be used for cash flow purposes and unanticipated expenditures, is referred to as unreserved, unappropriated fund balance. Real Property Tax Law limits the amount of unreserved fund balance the District can retain to no more than 4 percent of the ensuing year's budgetary appropriations.³ Any unreserved fund balance over this percentage must be used to fund a portion of the next year's appropriations, thereby reducing the tax levy, or used to fund legally-established reserves.

Even with all of the available information to prepare its budget, the Board consistently appropriated more for expenses than was necessary, as reflected in Table 1. The District overestimated expenditures by a cumulative total of \$17.2 million from the 2006-07 through 2009-10 fiscal years. Specifically, the District cumulatively overestimated instructional expenditures and employee benefits by \$7.4 and \$4.8 million, respectively, for fiscal years 2006-07 through 2009-10.

Table 1: Budget vs. Actual Expenditures

Fiscal Year	Revised Budget	Actual Expenditures	Variance
2006-07	\$100,968,821	\$98,749,226	\$2,219,595
2007-08	\$106,606,697	\$102,634,023	\$3,972,674
2008-09	\$111,659,374	\$106,429,438 ^a	\$5,229,936
2009-10	\$114,581,310	\$108,752,368	\$5,828,942
Total	\$433,816,202	\$416,565,055	\$17,251,147

^a 2008-09 expenditures were adjusted to show the effect of prior period adjustments

The conservative budget estimates contributed to revenues exceeding expenditures by a total of approximately \$10.7 million from the 2006-07 through 2009-10 fiscal years. Furthermore, the District's adopted budget made it appear that the District would appropriate a portion of its accumulated fund balance each year to close projected budget gaps. In reality, the District's budget resulted in an operating surplus in each of the four fiscal years reviewed (as shown in Table 2), and no fund balance was ever used as a source of financing in those years.

³ Previously, unreserved, unappropriated fund balance could not exceed 2 percent of the current year's appropriations. At June 30, 2007, the limit was 3 percent of 2007-08 appropriations; it increased to 4 percent at June 30, 2008, and continues at 4 percent for years thereafter.

Table 2: Operating Results and Fund Balance					
	2006-07	2007-08	2008-09	2009-10	Total
Beginning Fund Balance ^a	\$18,505,858	\$19,056,866	\$23,173,747	\$26,743,017	
Actual Revenues	\$99,300,234	\$106,750,904	\$109,998,708	\$111,236,086	\$427,285,932
Actual Expenditures ^b	\$98,749,226	\$102,634,023	\$106,429,438	\$108,752,368	\$416,565,055
Operating Surplus	\$551,008	\$4,116,881	\$3,569,270	\$2,483,718	\$10,720,877
Year-End Fund Balance	\$19,056,866	\$23,173,747	\$26,743,017	\$29,226,735	
Less: Reserved Fund Balance	\$14,368,046	\$14,955,464	\$16,918,383	\$17,955,940	
Less: Appropriated Fund Balance	\$2,275,000	\$2,250,000	\$2,250,000	\$2,650,000	
Unreserved, Unappropriated Fund Balance	\$2,413,820	\$5,968,283	\$7,574,634	\$8,620,795	

^a Beginning fund balance includes prior-period adjustments
^b 2008-09 expenditures were adjusted to show the effect of prior period adjustments

While the District's \$2.4 million unreserved, unappropriated fund balance in the General Fund on June 30, 2007 was within the statutory limit, the unreserved, unappropriated fund balances on June 30, 2008, 2009 and 2010 were not. As indicated in Table 3, the unreserved fund balances for those three fiscal years ranged from almost \$6 million to \$8.6 million, which represented 5.4, 6.7, and 7.4 percent of the respective ensuing fiscal years' budgeted appropriations.

Table 3: Unreserved Fund Balance vs. Statutory Limit						
Fiscal Year	Unreserved, Unappropriated Fund Balance	Subsequent Year's Budget	Percent of Subsequent Year's Budget	Statutory Limit	Allowed Unreserved, Unappropriated Fund Balance	Amount Over Statutory Limit
2006-07	\$2,413,820	\$105,764,678	2.3%	3%	\$3,172,940	N/A
2007-08	\$5,968,284	\$110,810,515	5.4%	4%	\$4,432,421	\$1,535,863
2008-09	\$7,574,634	\$114,009,350	6.7%	4%	\$4,560,374	\$3,014,260
2009-10	\$8,620,795	\$116,521,230	7.4%	4%	\$4,660,849	\$3,959,946

The District's budgetary practices have resulted in operating surpluses that caused a significant accumulation of resources that could have been used for the benefit of District taxpayers.

Employee Benefit Accrued Liability Reserve

General Municipal Law (GML) allows the Board to formally establish an EBALR. Moneys from this reserve may only be used to make cash payments to employees for accrued or accumulated unused sick leave, holiday leave, vacation leave and any other forms of payment

for accrued leave time and benefits due upon separation from service. While GML does not restrict the amounts school districts can maintain in an EBALR, prudent fiscal management requires that District officials maintain EBALR balances that are reasonable. To do otherwise, that is, to fund reserves at greater than reasonable levels, results in real property tax levies that are higher than necessary. A recent amendment to GML allowed school districts to withdraw from EBALR's to help fund appropriations in the 2011-12 budget only.

The Board established the EBALR in 2002 for the payment of accrued leave time and benefits due to an employee upon separation from the District and for the payment of future costs for retiree health insurance or other negotiated benefits. However, there is no legal authority to use EBALR funds for purposes other than the payment of accrued leave benefits upon separation from the District. The reserve was initially funded with \$6.2 million in the 2002-03 fiscal year. We analyzed the EBALR balance from the 2006-07 through the 2009-10 fiscal years and compared the annual balances to the District's long-term liability for compensated absences.⁴ In each year, the District reported between 360 percent and 615 percent more money than was necessary to fund liabilities for long-term compensated absences, as shown in the table below.

Fiscal Year	EBALR Reserve Balance	Long-Term Compensated Absences Liability	Excess Reserve ^a	Excess Reserve as Percentage of Liability
2006-07	\$9,972,093	\$1,908,647	\$8,063,446	422%
2007-08	\$10,335,077	\$1,445,941	\$8,889,136	615%
2008-09	\$10,419,825	\$1,979,830	\$8,439,995	426%
2009-10	\$10,445,874	\$2,269,167	\$8,176,707	360%
^a EBALR net of long-term liabilities for compensated absences				

Further, the District did not use EBALR funds to pay for compensated absences costs and, instead, levied taxes to pay for these costs. The District made payments of \$285,512 and \$280,450 in the 2008-09 and 2009-10 fiscal years, respectively, for these costs from the General Fund.⁵ As shown in Table 5, if the District's unreserved fund balance was recalculated to include the excessive EBALR funding, the District's fund balance would have exceeded the statutory limitation by amounts ranging from \$7.3 million to \$12.1 million.

⁴ Long-term liabilities for compensated absences as reported in the District's audited financial statements.

⁵ The District paid compensated absences from the EBALR fund during the 2010-11 fiscal year.

Fiscal Year	Unreserved Unappropriated Fund Balance	Add Excess EBALR	Recalculated Unreserved Unappropriated Fund Balance	Percent of Subsequent Year's Budget	Less Statutory Limit	Recalculated Amounts Over Limit
2006-07	\$2,413,820	\$8,063,446	\$10,477,266	9.9%	\$3,172,940	\$7,304,326
2007-08	\$5,968,284	\$8,889,136	\$14,857,420	13.4%	\$4,432,421	\$10,424,999
2008-09	\$7,574,634	\$8,439,995	\$16,014,629	14.1%	\$4,560,374	\$11,454,255
2009-10	\$8,620,795	\$8,176,707	\$16,797,502	14.4%	\$4,660,849	\$12,136,653

After the recalculation, the percentage of unreserved, unappropriated fund balance retained ranged from 9.9 percent at June 30, 2007 to 14.4 percent at June 30, 2010 of the related subsequent year's budgeted appropriations.

The 2011-12 State budget amended GML to allow school districts, during the 2011-12 school year only, to withdraw from their EBALR an amount not to exceed the lesser of: (a) the dollar value of excess funding in the reserve as certified by the State Comptroller, or (b) the amount of the school district's Gap Elimination Adjustment⁶ as calculated by the NYS Commissioner of Education (Commissioner). The State Comptroller certified an excess EBALR liability of \$8,176,707, and the Commissioner's calculated Gap Elimination Adjustment was \$3,814,807. Therefore, District officials were authorized to withdraw up to \$3.8 million from the EBALR to fund appropriations in the 2011-12 budget. If the District actually uses this amount from its EBALR to fund 2011-12 appropriations, the EBALR will still be over-funded by approximately \$4.4 million.

Recommendations

1. The Board and District officials should develop and adopt budgets that include more accurate estimates for revenues and expenditures.
2. District officials should take steps to ensure that unreserved, unappropriated fund balance does not exceed statutory limits.
3. The Board should ensure that the EBALR contains only the necessary funds to support the District's liability for compensated absences.
4. District officials should ensure that payments for compensated absences are made from the EBALR to the extent that funds are available.

⁶The Executive Budget's School Aid amount includes a \$2.8 billion Gap Elimination Adjustment for the 2011-12 school year that would help achieve a balanced budget through reductions in school aid on a progressive basis, accounting for each school district's wealth, student need, administrative efficiency and residential property tax burden.

Procurement

The Board is responsible for adopting policies to provide reasonable assurance that goods and services will be procured at the best available prices, that taxpayer funds will be expended in a prudent manner, and that procurements comply with statutory requirements. District officials are responsible for establishing procedures that are consistent with Board policies, implementing them, and monitoring their effectiveness. While written contracts between the District and service providers delineate the scope of the services and the method of compensation, they also allow the claims auditor the means to audit vendor claims properly and to determine whether those claims are accurate and valid charges against the District.

We found several weaknesses with the District's policies and procedures covering the procurement of goods and services that are not subject to competitive bidding requirements. For example, the procurement policy did not require District officials to solicit competition when awarding contracts for professional services, and certain procurement procedures were not consistent with Board-adopted policies. District officials did not solicit competition for services procured from seven professionals who received payments totaling \$524,172 during our audit period.

We also found that District officials did not obtain the required number of quotations for three purchases totaling \$13,650, as required by the District's procurement policy. As a result, District officials may have paid more than necessary for such procurements. Further, District officials did not always enter into written contracts outlining the scope of services and the basis for compensation with professional service providers. The lack of written contracts does not provide a clear understanding of the scope of services the professionals are obligated to provide or the compensation to which they are entitled to receive.

Professional Services

Contracts for professional services are not required by law to be competitively bid. However, GML requires school districts to adopt written policies and procedures for the procurement of goods and services that are not subject to competitive bidding requirements. Although not required by law, prudent business practices provide that professional services be awarded after soliciting competition. One way to accomplish this is through the request for proposals (RFP) process, which is meant to ensure that the District receives the desired service on the most favorable terms and conditions, or at the best value. Furthermore, it is important for the Board to enter into written agreements with professional service providers. The

written agreement should indicate the contract period, the services to be provided, and the basis for compensation for those services. The terms of the agreements are used by District officials and the claims auditor to verify that all claims for professional services are proper and in accordance with the agreement or other Board-approved rate of compensation.

The District's procurement policy does not require using competition, such as soliciting proposals, when procuring professional services. In addition, the policy does not outline the procedures that should be followed when procuring professional services. The District paid 58 professional service providers over \$3.7 million during the audit period. We judgmentally selected a test sample of 10 professionals⁷ from those that were paid in excess of \$15,000 during the 2009-10 fiscal year to determine whether contracts were awarded after soliciting competition, whether the Board authorized the contracts, and whether the professionals were compensated in accordance with agreed-upon rates. The District paid the 10 professionals \$690,779 for their services during the audit period. District officials did not solicit competition for the services procured from seven of the 10 professionals, totaling \$524,172 during our audit period. For example, District officials did not seek competition when procuring legal services costing \$268,931, for school physician services costing \$63,580, and for special education services costing \$61,300.

We also found that the District paid three of the 10 professionals \$93,587 during the audit period without written agreements setting forth the scope of services to be provided and the rate of compensation. Although the Board adopted resolutions appointing the three professionals (law firm, school physician, claims auditor), the resolutions did not state the compensation to be paid or the scope of services to be provided. Without such an agreement, District officials could not have assurance that the rates charged and services provided were proper and necessary. Furthermore, the District paid the special education services provider at a rate of pay which differed from the agreed-upon rate stipulated in the contract. The District paid this consultant \$9,400 for services rendered during the audit period, at a rate of \$100 per hour. However, the agreement stated that, depending on the service provided, the consultant was to be paid \$325, \$150, or \$50 per evaluation. As a result, District officials could have paid this provider more than necessary for these services.

Additionally, there was no Board resolution to approve the \$83,120 in compensation paid to the internal auditor during the 2008-09 and

⁷ We judgmentally selected this sample to include a representative sample of the variety of professional service providers used by the District. Our sample included a special education consultant, an external auditor, two physicians, a claims auditor, two lawyers, an internal auditor, a residency investigator, and a psychologist.

the 2009-10 fiscal years. Instead, District officials provided us with a letter, signed by the internal auditor only, in which he proposed the fee for services he would provide in the 2008-09 and 2009-10 fiscal years.

Without soliciting competition, District officials have little assurance that the professional services procured were the most favorable proposals or provided the best value to the District. In addition, the lack of Board authorization and written contracts setting forth the scope of services and the basis for compensation does not provide a clear understanding of the scope of services the professionals are obligated to provide or the compensation to which they are entitled to receive.

Competitive Quotations

The District does not provide clear and consistent guidance to employees when procuring goods and services. While the District has a Board-adopted policy in place, it is supplemented by written procedures that conflict with the policy's requirements. For example, the District's policy requires three verbal quotes for purchases between \$3,001 and \$4,999, but its procedures require verbal quotes for purchases between \$1,001 and \$4,999. The policy requires three verbal quotes for public work contracts between \$5,001 and \$9,999 and three written quotes for public work contracts between \$10,000 and \$19,999. However, the procedures do not distinguish between purchase and public work contracts. These procedures also require purchasing officials, when purchasing items costing \$1,000 or more from a sole source provider, to certify that the vendor is a sole source for that product and document how they determined the sole provider status.

We identified 845 payments that the District made to 445 vendors for various purchase and public work contracts totaling approximately \$2.5 million during the audit period that required verbal or written quotations. We judgmentally selected 10 of these payments totaling \$37,796⁸ to determine if District officials obtained quotations as required by the Board-adopted policy and whether they also followed the supplemental procurement procedures. We found that District officials did not obtain the number of quotations for three purchases totaling \$13,650 as required by the policy. For example, District officials did not request three written quotes for an alarm monitoring service contract totaling \$5,988.⁹

⁸ We judgmentally selected this sample to include a wide variety of purchases the District made throughout the audit period. Our sample included four contractors, an alarm monitoring service, two suppliers, an auto repair company, and a sound system technician.

⁹ The District paid this vendor \$7,933 during the 2008-09 fiscal year.

Although the remaining seven purchases, totaling \$24,146, did not require the solicitation of quotations under the Board-adopted policy, the supplemental procedures required verbal or written quotations for five of the seven payments totaling \$13,215. District officials did not obtain these quotes in accordance with the procedures. In addition, District officials did not document how they determined the sole provider status for camera licenses and software totaling \$2,891, as required by the supplemental procedures.

The failure of District officials to provide clear and consistent guidance on the policies and procedures to be followed when procuring goods and services resulted in District employees not obtaining appropriate competition. Therefore, the District may have paid more than necessary for goods and services at the taxpayers' expense.

Recommendations

5. The Board should consider revising the District's procurement policy to require purchasing officials to solicit competition when awarding contracts for professional services.
6. The Board should enter into written agreements with all professional service providers to document the services to be provided and the basis for payment.
7. The claims auditor should ensure that all claims approved for payment are in accordance with contract or Board-approved rates.
8. The Board should review its procurement policy and supplemental purchasing procedures to ensure that they are clear, consistent, and always followed when procuring goods and services not subject to competitive bidding.
9. District officials should enforce compliance with the District's procurement policy to ensure that written or verbal quotes are obtained, as required. In addition, District officials should document how the sole provider status was determined for those vendors that provide goods and services considered unique.

Treasurer's Signature Disk

The Treasurer is the official custodian of all District funds and is responsible for signing all District checks. Education Law authorizes the Deputy Treasurer to sign District checks only in the Treasurer's absence. If the Board allows a facsimile signature to be used to sign District checks, the signature must be affixed by the signer or under the signer's direct supervision.

At the reorganization meeting for the 2008-09 and 2009-10 fiscal years, the Board appointed a Treasurer and a Deputy Treasurer, and authorized them to sign checks. District checks are signed by the use of a computer disk containing a facsimile signature. Although the primary responsibility for signing checks rests with the Treasurer, the Treasurer does not have a signature disk. Instead, the Deputy Treasurer signed all District checks. The Board also adopted a policy authorizing the Treasurer, the Deputy Treasurer, or the District Clerk to sign checks, with only one signature required. However, there is no provision in Education Law to authorize an individual other than the Treasurer or the Deputy Treasurer, in the Treasurer's absence, to sign checks. Although the District Clerk had her own signature disk, she indicated that she never used it to sign checks, and we did not find her signature on any of the checks reviewed.

We also found that the Board did not establish formal policies and District officials did not establish procedures for the protection and use of facsimile signature disks. As a result, the Deputy Treasurer and District Clerk did not secure their signature disks. Although they kept their signature disks in a locked drawer in the Business Office, the signature disks were accessible by account clerks in the Business Office, whose job duties included processing payroll and accounts payable. Additionally, the Deputy Treasurer did not always supervise and control the use of her signature disk. Because of these weaknesses, the risk is increased that unauthorized individuals could use these signature disks to misappropriate District funds without detection or correction.

We observed the printing of 116 payroll checks totaling \$80,995 in July 2010. The Deputy Treasurer was not present to affix her signature to the checks. Instead, an account clerk affixed the Deputy Treasurer's signature to checks using the Deputy Treasurer's computerized signature disk. Additionally, we examined 20 expenditure transactions totaling \$482,565¹⁰ that were made using the Deputy Treasurer's

¹⁰ We judgmentally based this sample on the type of services provided, some of which appeared to be of an unusual nature. For example, we reviewed payments made to vendors that appeared to provide production services, motivational services, and other undetermined services, which turned out to be for educational materials, athletic apparel, computer software, and special education services.

signature disk, to determine whether payments were for valid District transactions, and found no irregularities. However, the absence of comprehensive policies and procedures for the control and use of the signature disks, and the District Treasurer's lack of control over the custody and use of her signature disk, increases the risk that her signature could be used to generate checks that are not for legitimate District purposes.

Recommendations

10. The District Treasurer should sign all District checks. A properly appointed Deputy Treasurer may only sign checks in the Treasurer's absence.
11. Individuals other than the Treasurer and Deputy Treasurer should not be authorized to sign checks or be provided with a facsimile signature disk.
12. The Treasurer's and Deputy Treasurer's signature disks should be under their personal control and custody, and used only in their presence.

Information Technology

The use of information technology (IT) affects the fundamental manner in which the District initiates, processes, records, and reports transactions. The District's widespread use of IT presents a number of internal control risks that must be addressed, including unauthorized access to data. An effective system of internal controls to safeguard computerized data also includes policies and procedures adopted by the Board to notify District residents in case of a breach of security to the District's system.

District officials have not developed comprehensive IT policies and procedures that provide guidance to District employees on all aspects and appropriate use of IT systems and data. District officials have assigned system administrator rights to Business Office employees and do not review audit logs, which would help them to detect unauthorized transactions. As a result, the risk is increased that District funds could be misappropriated without detection or correction. Additionally, the District does not have an information breach notification policy. Without an information breach notification policy, in the event that private information is compromised, District officials and employees may not be prepared to notify affected individuals.

User Access Rights

A good system of controls would segregate the duties of administering access to the computerized financial system and the Business Office's functions to reduce the risk that District financial information or resources could be misused. The administrator of the financial software should be someone who is not involved in the day-to-day activities of the Business Office, such as the Director of Information Technology.

The Assistant Business Manager/Deputy Treasurer, who signs all checks, and the Senior Account Clerk/Purchasing Agent are assigned system administrator rights in the District's financial software. As system administrators, they have the ability to add and delete users, and assign user rights. Additionally, the Assistant Business Manager/Deputy Treasurer has the ability to maintain vendor accounts, which conflicts with her responsibility to sign District checks. With these conflicting duties, she could misappropriate District funds by creating fictitious vendors, processing financial transactions, and signing District checks.

Further, although the financial software is capable of generating audit logs, District officials do not generate or review the logs to identify unauthorized transactions. As a result, user accounts could be created

for, and access could be granted to, non-existent employees. The system managers also could enter transactions without any other District official being aware of the changes.

We reviewed audit logs of changes to user rights processed by both system administrators for the 2009-10 fiscal year. The audit logs documented 14 modifications to user access rights processed for five employees and provided an explanation for each modification of user rights. Although we did not find unusual transactions, when audit logs of user rights modifications are not reviewed, there is an increased risk that inappropriate modifications may occur and be undetected.

Security Breach

An individual's private and/or financial information, along with confidential business information, could be severely impacted if security is breached or personal data is improperly disclosed. New York State (NYS) Technology Law requires cities, counties, towns, villages, and other local agencies to establish an information breach notification policy. We believe that school districts should adopt such a policy to ensure that affected residents are notified regarding information breaches. Such a policy should detail how the District would notify NYS residents whose private information was, or is reasonably believed to have been, acquired by a person without a valid authorization.

The District does not have an information breach notification policy. Without an information breach notification policy, in the event that private information is compromised, District officials and employees may not be prepared to notify affected individuals.

Recommendations

13. District officials should segregate the functions of system administration and the recording and execution of business transactions.
14. The Board should adopt written policies and District officials should develop procedures requiring an individual outside of the business process to routinely review the financial system's generated exception and change reports. The individual should report the results of the review to management so that unusual or inappropriate transactions can be detected and corrected in a timely manner.
15. The Board should adopt a Breach Notification policy detailing how the District would notify its residents or employees, in a timely manner, in the event of a breach.

APPENDIX A

RESPONSE FROM DISTRICT OFFICIALS

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



Baldwin Union Free School District

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November 1, 2011

Mr. Ira McCracken, Chief Examiner
Division of Local Government and School Accountability
NYS Office Building
Room 3A10
Veterans Memorial Highway
Hauppauge, New York 11788-5533

Dear Mr. McCracken:

Executive Summary

The audit commenced in June 2010 and was completed in September 2010. The draft audit report was received in October 2011. The original audit period covered 23 months. It was expanded another 25 months covering a total audit period of 48 months.

The district generally disagrees with the finding regarding budgeting practices. The district generally agrees with the EBALR finding. The EBALR has been reduced by 38%. It is anticipated that by June 30, 2013, the EBALR will be funded in accordance with the compensated absence liability. The district generally agrees that policies and procedures can always be strengthened and is undergoing a complete policy review with the assistance of New York State School Boards. Effective 2010-11, the district implemented written purchasing guidelines and conducted documented workshops for all personnel involved in the procurement process. This includes professional services procurement.

Budgeting Practices and Fund Balance

The district generally disagrees with the finding regarding critical controls over the budget process. Budgets were prepared, adopted by the board of education and approved by the community in response to the needs of the educational program. As of June 30, 2011, the closing unassigned fund balance is \$1,457,484 or 1.2% of the 2011-12 approved budget. This is in accordance with the statutory requirement of no more than 4%. As previously mentioned, by June 30, 2013, it is anticipated that the EBALR will be funded in accordance with the compensated absence liability. This assumes approval from the Office of the State Comptroller to utilize additional EBALR for 2012-13 revenues. Effective 2010-11, compensated absences are paid out of EBALR. Please note that as part of the 2011-12 revenues, the district utilized \$6 million in reserves plus \$3.65 million in appropriated fund balance. This \$9.65 million was utilized to reduce taxpayer burden.

See
Note 1
Page 23

See
Note 2
Page 23

Procurement

The district generally agrees with the findings in this area. Effective 2010-11, the district implemented written purchasing guidelines and conducted documented workshops for all personnel involved in procurement activities. This includes professional services procurement.

Treasurer's Signature Disk

The district generally agrees with the findings in this area. Please note that signature disks were kept in a locked drawer in the business office safe. Effective 2010-11, the treasurer signs all checks. Should the treasurer be unavailable to sign checks, the treasurer will provide written direction to the deputy treasurer to do such.

Information Technology

The district generally disagrees with the findings in this area. Although policies and procedures can always be improved, the district feels it has adequate IT policies and procedures in place. Effective 2010-11, audit/permission logs are reviewed. With respect to the financial systems administrator, the assistant business manager performs this function. This person is supervised by the assistant superintendent for business. The assistant business manager does not maintain the vendor database and cannot issue a check. The vendor database is maintained by other business office personnel. In addition, systems managers cannot modify their own permissions.

See
Note 3
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Closing

The draft audit contains much information. As the district is not privy to the work papers of the Office of the State Comptroller, the district cannot form an opinion as to the overall accuracy of the draft audit report. A corrective action plan will be forwarded at a future date under separate cover. The district wishes to thank the Office of the State Comptroller for their time and recommendations.

See
Note 4
Page 23

Sincerely,



Dr. James D. Mapes
Superintendent of Schools
Baldwin Union Free School District

Cc: Edward Cullen, Assistant Superintendent of Business
Mary Jo O'Hagan, President of the Board of Education
Carol Smith, Assistant Business Manager
Mary Hobbs, District Clerk

APPENDIX B

OSC COMMENTS ON THE DISTRICT'S RESPONSE

Note 1

Our audit reviewed the District's budgeting practices for the 2006-07 through 2009-10 fiscal years. During this time, the District overestimated expenditures by a cumulative total of \$17.2 million, resulting in the District accumulating unreserved, unappropriated fund balance in excess of the statutory limits. In addition, the District over-funded its EBALR. These budgeting practices were not in the best interest of District taxpayers. We encourage the District to adopt budgets that reflect the District's actual needs, so that taxpayers will pay only the necessary amounts to fund District operations.

Note 2

Although the State Legislature amended GML to allow school districts, during the 2011-12 school year only, to withdraw from their EBALRs a certain amount of money to help finance their budgets, there is no certainty that the State Legislature will once again amend GML to allow school districts to use EBALR money to fund their 2012-13 budgets.

Note 3

The District implemented these procedures subsequent to our audit fieldwork.

Note 4

Our policy is to share all the relevant audit evidence that supports our findings with local officials, upon request. At the exit conference, we indicated that we could provide District officials the supporting documentation to any of the findings they wanted to question or verify. However, District officials did not request any of the audit evidence we used to support our findings.

APPENDIX C

AUDIT METHODOLOGY AND STANDARDS

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

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

After reviewing the information gathered during our initial assessment, we determined where weaknesses existed, and evaluated those weaknesses for the risk of potential fraud, theft and/or professional misconduct. We then decided on the reported objectives and scope by selecting for audit those areas most at risk. We selected the establishment and use of the employee benefit accrued liability reserve (EBALR) fund, the unreserved unappropriated fund balance, Treasurer's duties, procurement, and information technology for further audit testing.

To determine whether the EBALR was appropriately established and maintained and whether the balance retained in the unreserved, unappropriated fund balance was within legal limits:

- We reviewed Board resolutions for the establishment and funding of the EBALR.
- We reviewed applicable laws governing the EBALR.
- We analyzed the reasonableness of the EBALR balance and reviewed supporting documentation used by District officials to justify the funding levels of the reserve.
- We reviewed the District's financial statements for fiscal years ended June 30, 2006 through June 30, 2010, analyzed changes in fund balance, and recalculated the legal limits for the retention of unreserved, unappropriated fund balance for each fiscal year.
- We reviewed revenue and expenditure reports to determine how compensated absences were funded and paid.

To determine the adequacy of controls over the procurement of goods and services not subject to competitive bidding requirements, including professional services:

- We conducted interviews and reviewed the District's purchasing policy and procedures, contracts, Board resolutions, purchase orders, and invoices.

- We tested payments for the purchase of goods and services not subject to competitive bidding to determine if District officials used competition when procuring such goods and services.
- We examined vendor quotations and RFPs to determine if District officials procured goods and services from responsible vendors that provided the most economical proposals that met the District's needs.

To determine whether controls over the Treasurer's signature disk were adequate:

- We observed the check signing process and interviewed the Treasurer, Deputy Treasurer, and office staff to determine the Deputy Treasurer's role in the printing of the checks.
- We observed the usage of and assessed the security of the Treasurer's signature disk.
- We reviewed certain payroll transactions and sampled 20 claims to assess the propriety of the charges against the District.

To determine if controls over the District's Information Technology were designed appropriately:

- We reviewed the District's computer access and security protocols and procedures.
- We reviewed user permissions reports and selected employees' job descriptions to determine whether access rights were assigned based on the employees' respective job functions.
- We interviewed District officials to determine if they had adopted a Breach Notification policy.

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

APPENDIX D

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