



Naples Central School District Internal Controls Over Selected Financial Activities

Report of Examination

Period Covered:

July 1, 2005 — March 30, 2007

2007M-208



Thomas P. DiNapoli

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State of New York Office of the State Comptroller

Division of Local Government and School Accountability

December 2007

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 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 Naples Central School District, entitled Internal Controls Over Selected Financial Activities. This audit was conducted pursuant to the State Comptroller's authority as set forth in Article V, Section 1 of the State Constitution, and 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 Naples Central School District (District) is governed by the Board of Education (Board) which comprises nine elected members. The Board is responsible for the general management and control of the District's financial and educational affairs. The Superintendent of Schools (Superintendent) is the chief executive officer of the District and is responsible, along with other administrative staff, for the day-to-day management of the District under the direction of the Board.

The Board is responsible for establishing internal controls to provide reasonable assurance that assets are properly safeguarded from unauthorized use or disposition and are properly accounted for. Internal controls should assure that there is a separation of duties so that no single individual controls all phases of a transaction, professional services are procured in an efficient manner, and that claims contain enough documentation to determine compliance with statutory requirements, policies, and agreements. Internal controls should also assure that fuel inventories are protected from loss and used effectively, as intended, and that computerized data and assets are properly safeguarded, and should provide for the timely identification of errors or irregularities so that corrective action can be taken. Once established, the Board has the responsibility to monitor internal controls to ensure that they are operating properly.

Scope and Objective

The objective of our audit was to determine if controls over selected financial operations are appropriately designed and operating effectively for the period July 1, 2005 through March 30, 2007. Our audit addressed the following related questions:

- Are internal controls in the Treasurer's office appropriately designed and operating effectively to adequately safeguard District assets?
- Has the Board established policies and procedures to ensure that professional services are acquired as economically as possible?
- Are internal controls over diesel and gasoline fuel inventories appropriately designed and operating effectively?
- Has the Board established policies and procedures to ensure that computer data is stored in a secure area and access to financial data is restricted?

Audit Results

District officials did not effectively assign responsibilities to the Treasurer/payroll clerk¹ to ensure there was a proper segregation of duties and did not establish sufficient compensating controls. The Treasurer/payroll clerk maintained the books of original entry (general journal, and cash receipt and disbursement journals) and general and subsidiary ledgers. She also invested cash, made inter-fund and inter-bank transfers, signed checks, reconciled bank statements, entered employee payroll changes, collected time sheets, entered hours worked and salaries paid, posted expenditures to the subsidiary ledgers, prepared and disbursed paychecks and helped maintain personnel files. Further, she was the system administrator, which enabled her to create new users, update access rights and perform other administrative functions including management overrides. This is an incompatible duty because the Treasurer/payroll clerk uses the system on a daily basis to perform her job duties.

We also found that professional services were not always procured in conformance with General Municipal Law, which requires the District to obtain qualified and necessary professional services as economically as possible, and to document the basis for the selection of service providers. The District did not solicit competitive proposals for accounting and legal services and paid related invoices that were not consistent with written agreements. Payments for accounting services exceeded contracted amounts by \$20,275 and payments for legal services exceeded agreed upon amounts by a minimum of \$3,680.

Internal controls to protect fuel inventories against fraud, abuse or misuse are not adequate. District personnel are not accurately reconciling measurements of deliveries, usage and inventories on hand to calculate losses or gains of fuel. Instead of using actual pump readings, District personnel simply plug in the "total gallons pumped" figure based on the difference between daily physical measurements. Further, because the District has two underground tanks, these deficiencies could allow fuel leaks to go undetected and lead to substantial costs, such as groundwater and soil remediation and DEC fines.

Finally, the Board has not established policies and procedures to sufficiently address the safeguarding of computerized data and assets. The network has six servers and approximately 400 computers. We found computer equipment is not physically secure and access to financial data was not restricted.

Comments of District Officials

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

¹ The same individual serves as Treasurer and payroll clerk.

Introduction

Background

The Naples Central School District (District) is located in the Towns of Bristol, Canadice, Canandaigua, Naples, Richmond, and South Bristol, Ontario County, the towns of Cohocton and Prattsburgh, Steuben County, the towns of Italy and Middlesex, Yates County, and the town of Springwater, Livingston County. The District is governed by the Board of Education (Board) which comprises nine elected members. The Board is responsible for the general management and control of the District's financial and educational affairs. The Superintendent of Schools (Superintendent) is the chief executive officer of the District and is responsible, along with other administrative staff, for the day-to-day management of the District under the direction of the Board.

There are two schools in operation within the District, with approximately 900 students and 200 employees. The District's general fund expenditures for the 2005-06 fiscal year were \$13.4 million, which were funded primarily with State aid, real property taxes, and grants.

The Treasurer/payroll clerk, Assistant Superintendent for Business and Operations (School Business Administrator), and two account clerks maintain the financial records using an accounting software package. The Treasurer/payroll clerk is responsible for cash custody, cash reconciliation, maintaining the books of original entry, processing payroll, and is also the administrator of the accounting software with administrative rights.² Although, the District did not solicit competitive proposals for accounting and legal services, it signed written agreements for these services. During the 2005-06 fiscal year, the District procured professional services for legal and accounting services in the amounts of \$95,534 and \$47,175, respectively.

The District maintains an inventory of gasoline and diesel fuels in an 8,000 gallon underground diesel tank and a 1,000 gallon underground gasoline tank. The fuel inventories are primarily used by the Transportation Department; however the Buildings and Grounds Department also uses the fuel inventories. During the 2005-06 fiscal year, the District purchased 3,000 gallons of gasoline and 36,000 gallons of diesel fuel at a cost of \$5,500 and \$74,000, respectively.

² Administrative rights allow the user to manage the access rights of other users and carry out other high-level computer management tasks.

The information technology (IT) network is used to process and store financial and non-financial data.³ The network consists of six servers and approximately 400 computers. The IT department has a Director of Technology, a technology developer, two technicians and two aides. The District contracts for additional IT services as needed.

Objective

The objective of our audit was to determine if controls over selected financial operations are appropriately designed and operating effectively for the period July 1, 2005 - March 30, 2007. Our audit addressed the following related questions:

- Are internal controls in the Treasurer's office appropriately designed and operating effectively to adequately safeguard District assets?
- Has the Board established policies and procedures to ensure that professional services are acquired as economically as possible?
- Are internal controls over diesel and gasoline fuel inventories appropriately designed and operating effectively?
- Has the Board established policies and procedures to ensure that computer data is stored in a secure area and access to financial data is restricted?

Scope and Methodology

We examined internal controls over selected financial activities of the Naples Central School District for the period July 1, 2005 through March 30, 2007.

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 are included in Appendix C of this report.

Comments of District Officials and Corrective Action

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

³ The financial data is stored on a dedicated server. Non-financial data includes student attendance records, data generated by students and staff, and student grades.

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, the Board must approve a corrective action plan that addresses the findings in this report, forward the plan to our office within 90 days, forward a copy of the plan to the Commissioner of Education, and make the plan available for public review in the District Clerk's office. For guidance in preparing the plan of action, the Board should refer to applicable sections in the publication issued by the Office of the State Comptroller entitled *Local Government Management Guide*.

Treasurer's Office Operations

The Board is responsible for establishing a system of internal controls to ensure that District personnel properly authorize, record, and report accounting transactions, and comply with laws and regulations; and to ensure that District officials monitor and review the work of staff to safeguard District assets and ensure operations are efficient and effective.

Segregation of Duties – An effective system of internal controls provides for the separation of duties so that no single individual controls all phases of a transaction. When key duties and responsibilities are segregated, the District establishes checks and balances over its financial operations that reduce the risk that errors and/or irregularities will go undetected. When it is not practical to segregate duties because of limited staff resources, it is important for the Board to establish compensating controls. Such compensating controls could include the requirement that the Board, or some other administrative staff, periodically review the work in question or that duties be rotated among appropriate staff members. In addition, it is important for the District's accounting software to produce reports for proper monitoring of financial activity, and for District officials to independently review those reports.

Although the Treasurer's Office had sufficient staff to adequately segregate duties, the Treasurer was primarily responsible for all financial operations except accounts payable. The Treasurer/payroll clerk had custody of cash assets, maintained the accounting records and processed payroll. She performed all of these duties without adequate oversight from the School Business Administrator, as required by the Board.

We found that internal controls over cash receipts and disbursements, purchasing, and payroll were weakened by a lack of segregation of duties. Furthermore, District officials did not establish sufficient compensating controls in the Treasurer's office.

- The Treasurer/payroll clerk maintained the books of original entry (general journal and cash receipt and cash disbursement journals), the general and subsidiary ledgers, and prepared journal entries. Although the Business Administrator signed off on manual journal entries prepared by the Treasurer, he did not review the journal entries entered in the computer system. Therefore, this compensating control was ineffective.

- The Treasurer invested cash, made inter-fund and inter-bank transfers, signed checks and reconciled bank statements. There was no indication that anyone reviewed the bank statements and/or cancelled checks before the Treasurer received them. Although we were informed that the Business Manager reviewed the Treasurer's bank reconciliations and that they were made available to the Board for review, there was no indication, such as a signature, that a review actually took place or documentation as to the procedures used. As a result, we could not determine if this compensating control was effective.
- The Treasurer was also the payroll clerk, responsible for recording payroll transactions, entering employee payroll changes, collecting time sheets, entering hours worked and salaries paid, posting expenditures to subsidiary ledgers, preparing and disbursing paychecks and assisting in the maintenance of employees' personnel files. Although the Superintendent did certify payrolls, this was not done until after the release dates for the direct deposits.⁴

Due to the lack of segregation of duties and inadequate mitigating controls, we reviewed a sample of cash receipts to ensure that they were properly received, recorded and deposited timely and intact and tested certain bank reconciliations to ensure they were prepared monthly and agreed with accounting records. We also reviewed a sample of disbursements to ensure they were supported and represented proper charges against the District. In addition, we tested certain journal entries, and bank and wire transfers to ensure they were appropriate. Finally, we performed a pay out on the May 25, 2007 pay day.

While our testing did not reveal any material discrepancies, the concentration of key duties with one individual with little or no oversight significantly increases the risk that errors or irregularities could occur and go undetected.

Recommendation

1. The Board should review the duties within the Treasurer's Office and institute controls to properly segregate duties. If this is not possible, the Board should ensure that the School Business Administrator and the internal auditor provide oversight and monitoring.

⁴ The date by which the District must notify their bank of the amounts to be transferred to individual employee bank accounts so the funds reach the employees' accounts on pay day.

Professional Service Contracts

An effective system of internal controls over professional services consists of written policies and procedures governing claims processing and procurement. A good system of internal control consists of policies, practices, and procedures that provide reasonable assurance that the District is using its resources effectively (i.e., prudently and economically) and that it is complying with applicable laws and regulations. A major component of a good system of internal controls is management's attitude and support for internal controls, and its regular monitoring of controls to make sure they are working effectively. The Board is responsible for designing internal controls that help safeguard the District's assets and ensure the prudent and economical use of District moneys when procuring goods and service, and to protect against favoritism, extravagance, fraud and corruption. The objectives of a procurement process are to obtain services, materials, supplies or equipment of the desired quality, specified quantity, and at the lowest price, in compliance with applicable Board and legal requirements. This helps ensure that taxpayer dollars are expended in the most efficient manner. Furthermore, the objectives of the claims processing function are to ensure that every claim contains enough supporting documentation to determine whether it complies with District policies, and that the amounts claimed represent actual and necessary District expenses.

Procurement Policy

General Municipal Law requires school districts to adopt written policies and procedures for the procurement of goods and services that are not subject to competitive bidding requirements. These policies and procedures should contain provisions requiring personnel to purchase these goods and services based on a written request for proposals (RFP), written quotations or verbal quotations. The policies and procedures should also describe each method of procurement and the procedures for determining which method will be used. For example, the procurement policy could require District personnel to solicit a specified number of proposals, or obtain a specified number of oral or written quotes for purchases that fall between certain dollar thresholds. The procurement policy should also describe the type of documentation District personnel must provide and maintain for each of the actions taken.

The Board adopted a procurement policy that states that all goods and services not subject to competitive bidding will be secured by use of written requests for proposals, written quotations, verbal quotations, or any other method that assures that goods will be purchased at the lowest price and that favoritism will be avoided. However, the

solicitation of alternative proposals or quotations for professional service contracts is subject to the sole discretion of the Board. As a result, District personnel have not received detailed guidance on when they are required to obtain RFPs/quotes, the number they must obtain, and the documentation they should retain to show the actions taken.

Request for Proposals

An RFP is a highly structured document that specifies minimally acceptable functional, technical, and contractual requirements, as well as the evaluation criteria that will govern the contract award. Potential vendors are supplied with copies of the RFP and are requested to submit proposals by a specified date. While the District is not required to issue RFPs for professional services, it is required to establish a process that ensures the District obtains qualified, necessary professional services as economically as possible, and to document the basis for the selection of service providers.

An RFP is among the best methods for enhancing negotiating leverage with vendors. An RFP's advantages include:

- Informs vendors that an official contract is pending and encourages them to make their best effort. More rapid and responsive vendor replies result.
- Requires the District to specify the proposed purchase.
- Alerts vendors that the selection process is competitive.
- Forces vendors to respond factually. Vendors know that if selected, they are contractually bound by their previous representations.
- Provides reasonable assurance that the District is not overpaying for services.

District officials generally did not solicit RFPs when obtaining professional services because the purchasing policy did not require them to do so, or document their basis for selection. For example, the District contracted with an organization to provide legal services totaling \$95,534, and paid another organization \$47,175 for accounting services without the benefits of an RFP. By not using RFPs for significant expenditures, the District runs the risk of not obtaining professional services of acceptable quality and the most reasonable price.

Accounting and Legal Services

Internal controls over claims processing⁵ are intended to ensure that every claim contains enough supporting documentation to determine if it complies with District policies, and that the amounts claimed represent actual and necessary District expenses.

RFPs, written agreements, purchase orders and effective audits of claims are all controls that help assure that the required scope of professional services are obtained at the agreed upon rate of compensation. RFPs and written agreements should clearly define the expectations and responsibilities, including expected compensation, for both parties. Use of a purchase order system will assist in assuring that the transaction is in compliance with agreements prior to the services being rendered. Increases to purchase orders can provide red flags that initiate further review of professional service payments.

Payments for accounting services were not consistent with contracted amounts. The contract for accounting services⁶ specifically detailed the services to be provided and the cost of those services. The contract also stated, "If significant additional time is necessary, we will discuss it with you and arrive at a new fee estimate before we incur the additional costs." Although the contract prices for the fiscal years ending June 30, 2005 and June 30, 2006 were \$13,200 and \$13,700, respectively, we found the District made five progress payments for audit, accounting and consulting services totaling \$22,500 for the fiscal year ended June 30, 2005, and \$24,675 for accounting work for the fiscal year ended June 2006. There was no evidence that an agreement had been reached, either oral or written, to justify the additional charges of \$20,275.

Payments for legal services were not consistent with hourly rates stated in the letter of understanding with District counsel and were not properly itemized. We reviewed 31 invoices, totaling \$95,500, and found only 11 invoices (35 percent) totaling \$33,700, were sufficiently itemized to allow us to re-calculate the dollars/hour rate charged. From those, we concluded the District overpaid a minimum of \$3,680 in legal costs because a higher than contract rate was charged. The other 20 invoices totaling \$61,800 were not sufficiently itemized to allow us to re-calculate the dollars/hour billed, or to determine if the District had previously been billed for the services.

⁵ The Board has delegated its responsibility for auditing and approving claims to a claims auditor.

⁶ Written agreement to provide audit services, which includes general assistance with technical issues, information system issues, and compliance matters for the fiscal years ending June 30, 2005, 2006 and 2007.

Although the Board entered into written agreements for their accounting and legal services, blanket purchase orders were not issued. In addition, the claims auditor did not review the written agreements or require adequate supporting documentation before approving payment and the School Business Administrator⁷ did not provide adequate oversight of the purchasing process. As a result, the District was not aware of the overcharges, and management's ability to exercise timely and effective budgetary control, and prevent unauthorized purchases was diminished.

Recommendations

2. The Board should amend its purchasing policy or develop additional written procedures to provide detailed guidance for personnel as to when they are required to obtain RFPs/quotes, the number they must obtain, and the detailed procedures for documenting compliance with the Board's purchasing policies and procedures.
3. The Board should require the use of blanket purchase orders when acquiring professional services to ensure that billings are within the contracted amounts.
4. The Board should review the payments for professional services and seek to recoup any payments that exceeded contractually agreed upon amounts.
5. The claims auditor should ensure that all agreements are reviewed as part of the audit process, that all payments are made in accordance with the terms of the agreements and that claims for payment are sufficiently itemized and documented to provide reasonable assurance that only services rendered are being paid for.

⁷ School Business Administrator is the purchasing agent.

Internal Controls Over Fuel Inventories

Effective control procedures and accurate records are important elements of an internal control system over gasoline and diesel fuel inventories. It is essential that District officials ensure that such a consumable inventory is protected from loss and that it is used effectively for its intended purpose. District officials can fulfill this responsibility by designing and adopting internal controls over their fuel inventories and by monitoring adherence to these controls. A good system of internal controls consists of policies and procedures adopted by the Board that help ensure that fuel inventories are protected from loss or theft. It is important for staff to maintain detailed inventory records, perform periodic physical inventories, and reconcile the records with delivery, usage, and leak test records, and with the physical inventories. These internal controls help to ensure the accuracy and effectiveness of the system to safeguard and account for those inventories items.

The New York State Department of Environmental Conservation (DEC) requires the operator of any facility with a combined underground storage capacity of more than 1,100 gallons to maintain daily inventory records for the purpose of detecting leaks. Records must be kept for each tank and must include measurements of deliveries, usage, inventory on hand, and losses or gains. Records must be kept current, account for all variables which could affect an apparent gain or loss, and must be in accordance with generally accepted policies. The DEC requires that records be maintained and made available for inspection for a period of not less than five years. Failure to maintain and reconcile such records constitutes cause for DEC-ordered tests and inspections of the facility at the operator's expense.

We found that District officials had not developed comprehensive internal control policies that described the duties that District personnel must follow, the records that personnel must maintain, and the procedures that personnel must perform to achieve adequate safeguards for the District's fuel inventories. Although the District maintains records for its two underground storage tanks,⁸ District personnel are not accurately reconciling the records to ensure that measurements of deliveries, usage, inventory on hand, and losses or gains of fuel are accurate. District personnel simply plug in the "total gallons pumped" figure based on the difference between daily

⁸ The District has an 8,000 underground diesel fuel tank and a 1,000 underground gasoline fuel tank.

physical measurements instead of actual pump readings. Although District personnel physically measure⁹ the level of fuel in the tanks daily to check the amount of fuel in the tanks, they do not physically measure the level of fuel in the tanks after fuel deliveries to verify the amounts delivered and ensure the amount billed was actually received. The District's pumps are older-style pumps with non-digital readouts. District personnel do not track the amount of fuel pumped, which vehicle/department the fuel is being pumped for, or the odometer reading of the vehicle being fueled. There are also no controls in place to prevent someone from pumping fuel into an unauthorized vehicle or container. Because the District does not track vehicle odometer readings or fuel pumped per vehicle, the District is not able to analyze fuel usage per vehicle to determine if the miles-per-gallon is reasonable and appropriate per vehicle, which could lead to the identification of theft or required vehicle maintenance. As a result of the District's inadequate fuel inventory and usage records, we were unable to perform a reconciliation of fuel inventories.

It is necessary for the District to keep accurate records to properly account for its fuel inventories and to fulfill DEC requirements. To help ensure the accuracy of the fuel inventory records, the District must have an effective system of internal controls in place to confirm that all fuel deliveries and usage are accurately recorded and supported, and that consumable inventory records are reconciled on a periodic basis.

Without Board-adopted policies, there is no common standard for employees to follow which can result in misunderstandings by staff and operations not being performed according to management's expectations. The failure to reconcile inventory records results in a lack of accountability over fuel inventories. Inaccurate and incomplete usage records also increase the risk that errors and irregularities might occur and go undetected. Furthermore, because the District uses underground tanks and because District personnel do not accurately reconcile fuel inventory records, which would allow them to identify whether the tanks are leaking, fuel leaks may go undetected and could result in environmental damage and substantial costs, such as groundwater and soil remediation and DEC fines.

Recommendations

6. The Board should adopt written, comprehensive internal control policies and procedures for its fuel inventories that address the acquisition and use of fuel and the maintenance of accurate and timely inventory records.

⁹ District personnel place a long measuring stick into the tanks to measure the amount of fuel in the tanks.

7. District officials should periodically reconcile inventory records to physical inventories and follow up on any material differences.
8. The District's Business Administrator, or internal auditor under the guidance of the Board's audit committee, should perform periodic reviews of fuel inventory records.

Information Technology

An effective system of internal controls to safeguard computerized data includes policies and procedures adopted by the Board to minimize the loss or corruption of essential data. Computer data is a valuable District resource. District officials rely on computer data for making financial decisions and for reporting to State and Federal agencies. If the computer or server on which this data is stored were to fail or the data is lost, stolen, or altered either intentionally or unintentionally, the results could range from inconvenient to catastrophic. Even small disruptions in electronic data systems can require extensive employee and consultant hours to evaluate and repair. For this reason, computer data should be physically secure and access to computer data systems should be controlled and monitored to reduce the risk of misuse and/or alteration of data resulting in potential financial loss to the District. We found that District officials have not established internal control policies and procedures to effectively address the safeguarding of computer data.

The District uses one networked computer system, supported by six servers, to process and store financial and non-financial data.¹⁰ The financial data is located on one of the servers, which is solely dedicated to financial data. Non-financial data resides on the five remaining servers. The computer system is managed by an IT administrator who is an employee of the District. In addition, the District contracts for additional IT services as needed for the network system.

The use of a computerized financial management system affects the manner in which the District initiates processes, records and reports transactions. The extent to which the District uses computer processing in significant accounting applications, as well as the complexity of that processing, determines the specific risks that the computerized financial management system poses to the District's internal control. The District's use of a computerized financial management system presents a number of internal control risks that must be addressed. District officials have not established internal controls to help ensure the safeguarding of computer data. Specifically, the Board has not adopted formal policies relating to the physical security of computer equipment and data and access rights.

¹⁰ Non-financial data includes such items as student attendance records, data generated by students and staff, and student grades.

Physical Security

Policies and procedures should ensure that technology assets are protected by limiting access to those assets, securing those assets from fire damage and ensuring those assets are in a climate-controlled environment. Physically securing computer hardware, servers, and wiring closets should be the District's first step in protecting its IT assets.

The Board has not established adequate policies and procedures for the physical security of IT assets, resulting in IT assets being at risk of damage and misuse. The District has six servers, of which two are in the IT director's office and four are in a server closet in a computer lab. During our initial walk-through of the IT department and on several other occasions, we observed the doors to the server room and the IT director's office were left open, and therefore accessible to un-authorized personnel, students and visitors with access to the computer lab. In addition, the servers and wiring closets were in areas that were not secure from fire damage and not climate-controlled.

Without adequate physical security, all other security measures may be meaningless. Physical threats, whether internal or external, malicious or inadvertent, could lead to stolen hardware and the release of personal or confidential information. Security breaches can cost thousands of dollars and countless hours to correct and possibly lead to costly litigation for the District.

Access Rights

To ensure proper segregation of duties and internal controls, it is important that the computer system allow users to access only the computer functions that are necessary to fulfill their job responsibilities. Access controls prevent users from being involved in multiple aspects of financial transactions. Generally, a system administrator has oversight and control of the system and has the ability to add new users, and change passwords and user rights. Because system administrators control and use all aspects of the software, a good system of controls requires the system administrator to be independent from the Treasurer Office function.

We found that the Treasurer/payroll clerk is also the system administrator. As a result, she can create new users, update access rights, and perform other administrative functions including management overrides. These duties are incompatible with the Treasurer duties she performs on a daily basis.

Recommendations

9. District officials should develop a comprehensive internal control structure to safeguard computer hardware and computerized data.
10. The Board should designate an individual outside of the Treasurer's Office to be the system administrator.

APPENDIX A

RESPONSE FROM DISTRICT OFFICIALS

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

**NAPLES CENTRAL SCHOOL
NAPLES, NEW YORK 14512**



November 19, 2007

To Whom It May Concern:

Enclosed you will find the District's response for Appendix A,
Response from District Officials.

Sincerely,

Pamela J. Claes
District Clerk

District Response

This is to confirm that the District has had an opportunity to review the draft of the New York State Comptroller's Audit Report. This included a review of the document with the Board of Education's Audit Committee and representatives from the Comptroller's office.

The District was encouraged to note that the audit and testing of payroll, and the associated supporting documentation found no material discrepancies. The District does recognize, however, the appropriateness of the comments related to the distribution of duties in order to maximize opportunities for increased checks and balances in the area of financial management.

The results and recommendations of this audit will be used by district officials as a resource in effectively managing operations and to improve District operations.

The District has reviewed its practices and is in the process of instituting an action plan based upon the draft audit recommendations. It is as follows:

Treasurer's Office Operations – Recommendation No. 1

As noted in our discussions, the District is currently researching new integrated financial accounting packages which, when implemented, will create the ability to segregate to multiple users for payroll, human resource functions, and other duties at the appropriate, recommended level of risk assessment. The goal is to have the new software in place by July 1, 2008, the beginning of the new fiscal year.

Currently employee salary information and changes which have occurred based on contracts and Board action are conveyed to the payroll clerk by the district clerk. In order to mitigate processes during the transition to the new improved software, all employee information will be transferred in written form with both parties signing to verify the actions. Certification of payrolls by the Superintendent now occurs prior to the printing of checks and release of direct deposit data to the bank.

As was discussed, while the Treasurer maintains the books of original entry for cash receipts, she does not receive monies but rather records entries from source documents created by others, for example: ACH deposits for state aid are received electronically directly into the District's bank account and then receipted by the business official who then provides the receipts to the Treasurer for input into the cash receipts journal; the tax collector receives all tax monies and deposits those monies into the bank account and then the collector provides copies of the deposit slips to the Treasurer who then records the receipt of tax monies into the cash receipts journal using source documents supplied by the tax collector.

Further discussions noted that the Treasurer invested cash and made inter-fund and inter-bank transfers only at the direction and/or authorization of the school business official. Documentation will be implemented to provide written verification of the initial directions

and authorizations by the business official; additionally, the internal claims auditor will conduct a periodic review of these transactions.

Bank statements and cancelled checks are now received by the business official or Superintendent, reviewed and verified by a third party, and then verified again by the business official or Superintendent in writing prior to the treasurer receiving the documentation to be entered into the accounting records.

Even though testing for the audit did not reveal any material discrepancies, the district acknowledges the concern regarding the concentration of key duties with one individual. The compensating controls and implementation of the new accounting software will provide the appropriate segregation of duties as recommended.

Professional Service Contracts – Recommendation Nos. 2 - 5

There is no specific agreement for professional legal services. Hourly rates have been provided for legal work; because of the District's diverse needs and the legal expertise required, blended rates have sometimes been used by the legal firm to appropriately invoice the District. These hourly rates are established by the firm based on the legal expert conducting the professional service for the District. Beginning July 2007, all legal invoices will be submitted to the District to include hourly time expended and applicable hourly rates per contact or event. Cross-contracted services via BOCES will also be explored in planning for the 2008-2009 budget and RFP's.

See
Note 1
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The base professional accounting agreement between the District and the accounting firm allows for additional services to be provided by mutual agreement. Additional work was verbally requested by the District throughout the fiscal year. In the future, all requests for additional assistance will be in writing. Summary invoices (the final year-end billings) are available which identify the specifics of the additional services which were provided to the District and invoiced by the firm as well as the basic agreement billings which were established by the terms of the engagement letter.

See
Note 2
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Based on recommendations of the audit, the District will review all paid invoices for the audit period from the legal and accounting firms and, where appropriate, request detailed, itemized backup documentation to clarify and validate billings.

As per recommendations, Requests for Proposal documents will be developed and utilized for professional services. Additionally, blanket purchase orders will be utilized for all professional services. Board policies will be reviewed regarding all recommendations and corrective actions. Administrative regulations will be developed to ensure clarity of processes and procedures which are to be adhered to per Board of Education policies.

Internal Controls Over Fuel Inventories – Recommendation No. 6 - 8

Internal controls to protect fuel inventories will be improved as recommended. Diesel pump readings and use of fuel for district vehicles is recorded on vehicle trip sheets. To mitigate and monitor overall usage of fuel, drivers will use the procedure recommended by auditors by listing on a primary control record the number of gallons pumped which will be reconciled weekly with actual physical daily measurements of inventory. The Head Bus Driver/Mechanic will be responsible for the oversight and verification of the fuel usage process, and the Head Mechanic/Bus Driver will provide the daily review of usage and the physical monitoring of the fuel inventory. The business official will review and verify records for fuel purchases and usages on a regular basis, but no less than monthly to ensure that there are no material differences. Board policies will be reviewed regarding all recommendations and corrective actions for fuel inventories. Administrative regulations will be developed to ensure clarity of processes and procedures which are to be adhered to per Board of Education policies.

Information Technology – Recommendation Nos. 9 – 10

In June of 2007 a main server closet was equipped with an APC Air Conditioner as well as an environmental monitor and an alarm system which will send an email alert to the Director of Technology. This allows the servers to be maintained at the appropriate, recommended temperatures and permits doors to the server closet to remain closed and locked. Backups for District's servers are built each night and tapes are stored in a fire-safe in the District Office.

The District maintains all financial data on a separate server, accessible only to District Office personnel due to firewalls. When the new financial software is in place, access controls will be implemented as recommended. The recommendation that system administrator rights for financial software be removed from the Business Office is understandable; however, at this point in time with the present software that would be difficult. In order to mitigate segregation of duties as recommended, the system administrator rights will be assumed by the Director of Technology at the written direction of the Superintendent. Audit logs will be printed and reviewed on a regular basis to determine that the financial software is being utilized appropriately and during approved hours of work. Additionally, the Board of Education will continue to update policies and procedures relating to the physical security of computer equipment and data and access rights.

The District would like to express its appreciation for the way that the audit was conducted. The staff from the Comptroller's office conducted themselves in a most professional manner and the suggestions related to the improvement of operational procedures will strengthen the financial management of the District.

The Board of Education, members of the Administration, and Business Office personnel have benefited from the NYS Comptroller's review of the business operations of the Naples Central School District. Thank you for the opportunity to collaborate with your representatives and for the opportunity to respond to this report.

APPENDIX B

OSC COMMENTS ON THE DISTRICT'S RESPONSE

Note 1

Although the District does not have a signed contract for legal services, hourly rates were established in the letter of understanding from the District's counsel.

Note 2

Summary invoices for accounting services were not provided to us until after the completion of our fieldwork. Our audit found that billings and payments were not consistent with the contract provisions. More importantly, the summary invoices were not provided to the District's claims auditor for review at the time of her audit.

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, payroll and personal services, and information technology.

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 upon the reported objective and scope by selecting for audit those areas most at risk. We selected Treasurer's Office operations, professional service contracts, internal controls over fuel inventories and information technology for further audit testing. We performed the following audit procedures:

- We interviewed key District officials and personnel to gain an understanding of the Treasurer Office operations, transportation department operations, and the IT environment.
- We traced ten randomly selected check/cash receipts totaling \$365,760 to deposit slips and bank statements.
- We selected random sequences of receipts from the Treasurers receipt books and traced them to the cash/checks received log books.
- We reviewed all budget transfers.
- We reviewed the March 2007 bank reconciliations for all funds.
- We performed a payroll payout¹¹ for the May 25, 2007 payroll.
- We judgmentally selected a sampling of ten employees and reviewed whether their salaries had been properly authorized and documented.

¹¹ A payroll payout requires employees to pick up their check in person and to produce identification to verify their identity. This procedure helps confirm the accuracy of the payroll records by ensuring individuals receiving paychecks are legitimate employees.

- We randomly selected six employees and reviewed their personnel files for required documentation (e.g., W-4, fingerprint clearance, retirement system documentation, and teaching certifications).
- We randomly selected six employees and reviewed their salary calculations.
- We reviewed all billings and contracts for legal and accounting services. We reviewed payments totaling \$47,175 for ten invoices for accounting services and payments totaling \$95,534 for 31 invoices for legal services.
- We toured the bus garage and surrounding grounds to gain an understanding of internal controls over fuel inventories in the Transportation Department.
- We toured the District to gain a better understanding of the IT infrastructure.
- We reviewed all user access rights for the District's financial accounting system.

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.

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