A REPORT BY THE NEW YORK STATE OFFICE OF THE STATE COMPTROLLER

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COMPTROLLER

NEW YORK STATE DIVISION OF HUMAN RIGHTS

INTERNAL CONTROLS OVER FINANCIAL OPERATIONS

2003-S-55

DIVISION OF STATE SERVICES

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Report 2003-S-55

Ms. Michelle Donaldson
Commissioner
NYS Division of Human Rights
One Fordham Plaza
Bronx, New York 10458

Dear Ms. Donaldson:

The following is our report on the Division of Human Rights' system of internal controls over financial operations.

This audit was performed according to the State Comptroller's authority as set forth in Article V, Section 1 of the State Constitution, and Article II, Section 8 of the State Finance Law. Major contributors to this report are listed in Appendix A.

Office of the State Comptroller
Division of State Services

January 4, 2005

EXECUTIVE SUMMARY

NEW YORK STATE DIVISION OF HUMAN RIGHTS INTERNAL CONTROLS OVER FINANCIAL OPERATIONS

SCOPE OF AUDIT

The New York State Division of Human Rights (Division) was created in 1968 under the State Human Rights Law. The Division is charged with enforcing this law to ensure that all New Yorkers have equal opportunity in employment, housing, public accommodation, education and credit. It also serves as an alternative to the court system for resolving discrimination claims. During the calendar year 2003, the Division expended State funds totaling $15.3 million, of which $10.7 million was for personal service costs and $4.6 million was for other expenses. The Division's main office is located in the Bronx, and there are 11 other regional offices throughout the State. As of December 2003, the Division employed a staff of 208.

Our audit addressed the following question about the Division's oversight of internal controls for calendar year 2003:

- Does the Division have an adequate system of internal controls over its basic financial operations?

AUDIT OBSERVATIONS AND CONCLUSIONS

We found that the Division does not have an adequate system of internal controls over its basic financial operations. We found major weaknesses with controls over payroll, equipment, accounting and information systems, cash disbursements and purchasing practices.

We examined each of the following five basic components of internal control as they relate to the Division's fiscal operations: the control environment, the communication system, procedures for assessing and managing risk, control activities, and monitoring systems. As detailed in our report, we found the Division needs to take immediate action to strengthen all of these components to ensure its control systems are effective. (See pp. 9-15)

The majority of the Division's budget is spent on payroll. We determined that management needs to perform a thorough review of payroll-related practices and develop adequate controls to ensure that its payroll costs are appropriate. We identified many instances where the Division may not be paying employees correctly, either because control activities are not adequate, work is not verified or controls are not being monitored. Specifically, the Division needs to improve its controls over time sheet review, removing employees from the payroll, adding new employees to the payroll and processing overtime. (See pp. 17-21)

The Division owns computer hardware costing in excess of $1 million. We identified many instances where the Division is not complying with required equipment control procedures for these and other equipment items. For example, the Division does not perform periodic physical inventories to account for all equipment. Most of these shortcomings are due to management's lack of knowledge about what is required. Management needs to perform a thorough review of equipment-related controls to ensure that Division equipment is adequately safeguarded against loss. (See pp. 22-23)

The Division has a local area network to run its day-to-day operations consisting of about 250 terminals and other computer equipment. We found that the Division needs to improve certain controls over the network, such as requiring employees to periodically change their computer passwords. (See pp. 24-25)

During 2003, the Division spent about $4.6 million on purchases of goods and services. We found that the Division needs to enhance controls over such expenditures. For example, we identified three paid vouchers totaling $2,937 for which the Division did not maintain sufficient proof that the goods or services were received. In addition, we selected a judgmental sample of 15 payments totaling approximately $50,000 to determine if the corresponding goods and services were purchased in accordance with the Division's policies. We found multiple problems with 12 out of the 15 purchases. For example, the Director of Finance did not approve 10 of the 15 purchases before the items were ordered. (See pp. 25-29)

COMMENTS OF DIVISION OFFICIALS

A draft copy of this report was provided to Division officials for their review and comment. Their comments have been considered in preparing this report and are included as Appendix B. Officials generally agreed with our findings and reported actions underway to implement our recommendations.

CONTENTS

INTRODUCTION

Background

The New York State Division of Human Rights (Division) was created in 1968 under the State Human Rights Law. The Division is charged with enforcing this law to ensure that all New Yorkers have equal opportunity in employment, housing, public accommodation, education and credit. It also serves as an alternative to the court system for resolving discrimination claims. During the calendar year 2003, the Division expended State funds totaling $15.3 million, of which $10.7 million was for personal service costs and $4.6 million was for other expenses. The Division's main office is located in the Bronx, and there are 11 other regional offices throughout the State. As of December 2003, the Division employed a staff of 208.

Audit Scope, Objective and Methodology

We examined the Division's system of internal controls over fiscal operations for the period January 1, 2003 through December 31, 2003. The objective of our performance audit was to determine whether the Division has established an adequate system of internal controls over its basic fiscal operations including payroll, equipment, accounting and information systems, cash disbursements, purchasing, and budgeting.

To accomplish our objective, we interviewed Division officials, as well as reviewed and analyzed Division records and reports pertaining to the Division's major financial management functions. Specifically, we tested internal controls over payroll, equipment, accounting and information systems, cash disbursements, purchasing, and budgeting. We also reviewed and analyzed pertinent laws, policies, bulletins and procedures.

We conducted our audit in accordance with Generally Accepted Government Auditing Standards. Such standards require that we plan and do our audit to adequately assess those procedures and operations included within the audit scope. Further, these standards require that we understand the Division's internal control structure and compliance with those

laws, rules and regulations that are relevant to the Division's procedures and operations that are included in our audit scope. An audit includes examining, on a test basis, evidence supporting transactions recorded in the accounting and operating records and applying such other auditing procedures as we consider necessary in the circumstances. An audit also includes assessing the estimates, judgments and decisions made by management. We believe our audit provides a reasonable basis for our findings, conclusions and recommendations.

In addition to being the State Auditor, the Comptroller performs certain other constitutionally and statutorily mandated duties as the chief fiscal officer of New York State, several of which are performed by the Division of State Services. These include operating the State's accounting system; preparing the State's financial statements; and approving State contracts, refunds, and other payments. In addition, the Comptroller appoints members to certain boards, commissions and public authorities, some of whom have minority voting rights. These duties may be considered management functions for purposes of evaluating organizational independence under Generally Accepted Government Auditing Standards. In our opinion, these management functions do not affect our ability to conduct independent audits of program performance.

Response of Division Officials to Audit

We provided a draft copy of this report to Division officials for their review and comment. Division officials generally agreed with our findings, and their comments have been considered in preparing this report and are included as Appendix B.

Within 90 days after the final release of this report, as required by Section 170 of the Executive Law, the Commissioner of the Division of Human Rights shall report to the Governor, the State Comptroller, and the leaders of the Legislature and fiscal committees, advising what steps were taken to implement the recommendations contained herein, and where recommendations were not implemented, the reasons therefor.

EVALUATION OF INTERNAL CONTROL STRUCTURE

We examined each of the following five basic components of internal control as they relate to the Division's fiscal operations: the control environment, the communication system, procedures for assessing and managing risk, control activities, and monitoring systems. We found the Division needs to take immediate action to strengthen all of these components to ensure its control systems are effective.

Control Environment

The control environment is the attitude toward internal control and control consciousness established and maintained by the management and the employees of an organization. It is a product of management's philosophy, style and supportive attitude, as well as the competence, ethical values, integrity, and morale of the organization's people. The organizational structure and accountability relationships that management establishes are also key factors in the control environment. The control environment has a pervasive influence on all the decisions and activities of an organization. A positive control environment is the foundation for each of the other components of internal control, providing discipline and structure for the entire system. Management and employees must therefore establish and maintain an environment throughout the organization that sets a positive and supportive attitude toward internal control. We noted several conditions that limit the effectiveness of the Division's control environment.

One of the major purposes of internal control is to promote compliance with laws, rules, regulations and management directives. Management therefore needs to demonstrate knowledge and understanding of appropriate requirements that are relevant and significant to their operations if they are to foster compliance within the organization. Many of these relevant requirements exist in the form of user procedure manuals, directives and periodic bulletins issued by oversight agencies such as the Department of Civil Service (DCS), the

Office of the State Comptroller (OSC) and the Division of the Budget (DOB). In several instances where we found the Division was not complying with established State policies, we determined that the situation occurred primarily because management was not aware of certain requirements affecting their operations. For example:

- When we examined compliance issues in the payroll area, we noted that some Division employees do not keep daily time records of actual hours worked even though such records are required both by DCS regulations and by collective bargaining agreements with employee unions. The Division also does not maintain centralized leave accrual records, but has staff track their own leave balances on their time sheets. These time sheets incorrectly state that employees' accumulated sick leave accruals cannot exceed 1,237.5 hours, when the correct number should be 1,500 hours, as defined in the union contracts. We also noted that management does not annually inform employees of their leave accrual balances as required. When we discussed each of these situations with the Division's Human Resource Director, we found this official was unaware of the appropriate requirements.

- When we examined controls in the equipment and asset management area, we found the Division does not maintain a comprehensive listing of its fixed assets and does not conduct periodic physical inventories. The New York State Accounting System User Procedure Manual and the Statewide Fixed Asset Accounting System require both of these activities. Further, OSC issues a bulletin each year instructing agencies how to report the taxable value of personal use for vehicles assigned to agency officials and staff, yet the Division's Finance Director was unaware of these requirements. As a result, W-2 forms for at least two Division employees who are given exclusive use of vehicles, likely understate their taxable earnings.

When we brought the above situations to management's attention, officials were receptive to establishing procedures to ensure future compliance. These situations highlight the need for management to stay up-to-date on the authoritative pronouncements that affect Division operations.

In addition, the Division has not established a code of conduct, nor does it have an employee manual detailing generally applicable procedures and expectations for employees. Instead, officials indicate they give all staff a copy of a State employee orientation handbook that they download from the Governor's Office of Employee Relations' website. While it may be appropriate to use these materials as one source of information, it is equally important for management to develop policies, procedures and reference materials that pertain directly to the Division's financial-related functions and convey management's specific expectations. Division officials indicate that they will begin to establish policies in their financial functions.

Communication

Communication is the exchange of useful information between and among people and organizations to support decisions and coordinate activities. Within an organization, information should be communicated to management and other employees who need it in a form and within a time frame that helps them to carry out their responsibilities. Communication can also take place with outside parties, such as customers, suppliers and regulators.

As we examined the internal controls related to each of the fiscal functions, it was apparent that some of the problems we encountered were caused, at least in part, by a lack of effective communication within the Division. For example, most of the staff-level employees that we encountered during our audit had not been provided with any written procedures or manuals that would explain their job responsibilities or direct them in fulfilling their duties. As a result, we found that Division employees were not complying with generally accepted control procedures over financial-related functions, as discussed in detail in the Financial Functions section of this report.

Assessing and Managing Risk

Risks are events that threaten the accomplishment of objectives and can ultimately impact an organization's ability to accomplish its mission. Risk assessment is the process of identifying, evaluating and determining how to manage these events. At every level within an organization there are both internal and external risks that could hamper the accomplishment of established objectives. To have reasonable assurance that the organization will achieve its objectives, management needs to ensure each risk is assessed and handled properly. Ideally, management should seek to prevent these risks from occurring, but many times prevention is either not possible or not cost effective. In such cases, management needs to decide whether to accept the risk, take some action to reduce the risk to more acceptable levels, or avoid the risk entirely.

We found Division management needs to improve the way it assesses and manages risk. Officials indicate that formal risk assessments relating to many fiscal functions, including accounting and information systems, budgeting, disbursements, equipment, payroll and purchasing, have not been performed for several years. The results of our compliance testing also indicate that any informal risk assessment process that may be occurring has not been sufficient. Further, the fact that we consistently identified instances where policies and procedures were not followed indicates that management is not sufficiently monitoring the systems that are in place and therefore has little basis for determining whether risks are adequately controlled.

Control Activities

Control activities are tools, both manual and automated, that help prevent or reduce the risks that can impede the accomplishment of the organization's objectives and mission. Management should establish control activities to effectively and efficiently accomplish the organization's objectives and mission.

Management should also closely monitor and evaluate control activities to ensure they are functioning properly and that their effectiveness is not being compromised by such things as managerial overrides, collusion or careless judgments. When designing and implementing control activities, management

should obtain the maximum benefit from the control activities it establishes at the lowest possible cost.

One commonly used control activity is the requirement that documentation be maintained to substantiate decisions, events and transactions. Another good control is approval and/or authorization for certain employee decisions, events or transactions. There should also be verifications to ensure the completeness, accuracy, authenticity or validity of transactions, events or information. Further, assets should be safeguarded and access to resources and information should be restricted to reduce the risk of unauthorized use or loss.

The Division needs to improve its control activities to ensure that its fiscal-related objectives can be achieved. For example:

- A Division employee is responsible for reviewing the accuracy of employee time sheet entries. However, there was no documentation of either her review or that of her supervisor.

- There was no requisition form to document that user departments had requested various items the Division ultimately purchased. We also found that the purchase of, as well as the payment for, some goods and services were not properly approved. Division officials state that a clerk was designated as an authorized signatory. The approval of purchases and payments should be management's responsibility. However, the Division could authorize a calculation clerk to perform this function for purchases with a low specified dollar limit.

Monitoring

Monitoring is the review of an organization's activities and transactions to assess the quality of performance over time and to determine whether controls are effective. Management should focus monitoring efforts on internal control and achievement of organizational objectives. For monitoring to be most effective, all employees need to understand the organization's mission, objectives, responsibilities and risk tolerance levels.

To monitor the continued effectiveness of an internal control system, management should undertake both ongoing

monitoring activities and separate evaluations. Ongoing monitoring occurs during normal operations and includes regular management and supervisory activities, comparisons, reconciliations and other actions people take in performing their duties. It includes ensuring that managers and supervisors know their responsibilities for internal control and the need to make control and control monitoring a part of their regular operating processes.

The Division needs to significantly improve the monitoring of practices in the Finance Unit. We found little evidence that management is evaluating whether the Finance Unit's internal control structure is effective in achieving the Unit's goals.

In addition, we identified many problems in the payroll, equipment, accounting and information systems, cash disbursements, and purchasing areas that demonstrate that management is not adequately monitoring internal controls. For example:

- We found incomplete time sheets, as well as time sheets where accrual balances were carried forward incorrectly, did not add up correctly, and/or were used before they were earned.

- Most Division equipment items have no identifying tags indicating Division ownership. Physical inventory counts of Division property have not been performed. The Division's property listing does not include all Division equipment.

- Computer passwords do not have expiration dates and terminals do not lock up after a period of inactivity.

Recommendations

1. Take actions to ensure that Division management has the knowledge and understanding of financial-related requirements that are relevant to Division operations.

   (Division officials responded that management of the Division's Bureau of Administration will continue to meet regularly upon receipt of new budget bulletins and other directives to identify implementation issues. Meetings will then be held with appropriate staff to ensure compliance.)

Recommendations (Cont'd)

2. Establish a code of conduct.

   (Division officials responded that the Personnel Department is presently writing a code of conduct that will be ready for staff distribution by the end of the fiscal year.)

3. Commit to writing the policies and procedures for the Division's financial-related functions and communicate them to all staff involved with these functions.

   (Division officials responded that the Division's Administration unit has begun writing procedures for all financial-related functions. Completion is scheduled for the end of this fiscal year, with staff training to follow shortly after that.)

4. Perform periodic assessments of the Division's financial-related operations.

   (Division officials responded that beginning with the first quarter of fiscal year 2005-06, the Director of Finance will initiate quarterly testing of financially-related operations. Implementation of the resulting corrective action plans will be monitored.)

5. Take actions to ensure there are adequate control activities that call for decisions, events and transactions to be documented, approved, authorized and verified.

   (Division officials responded that the preparation of the procedures referred to in response to Recommendation 3 will include a control assessment.)

6. Develop a program to monitor financial-related functions.

   (Division officials responded that in addition to periodic assessments by the Director of Finance, the Division's Internal Control Officer will prioritize financial-related activities in the implementation of the Division's Internal Control Program.)

FINANCIAL FUNCTIONS

We found that internal controls over financial-related functions need to be significantly enhanced. Management needs to take a more active role in developing adequate internal controls and monitoring the system established. We found major weaknesses with controls over payroll, equipment, accounting and information systems, cash disbursements, and purchasing practices. The budget process had minor weaknesses.

Payroll

The majority of the Division's annual budget is spent on employee salaries. We determined that management needs to perform a thorough review of payroll-related practices and develop adequate controls to ensure that its payroll costs are appropriate. We identified many instances where the Division may not be paying employees correctly, either because employees do not know what is required, control activities are not adequate, work is not verified or controls are not being monitored. Specifically, the Division needs to improve its controls over time sheet review, removing employees from the payroll, adding new employees to the payroll and processing overtime payments.

Time Sheet Review

The New York State Department of Civil Service Attendance and Leave Manual (Attendance and Leave Manual) states that an adequate and accurate record of attendance must be maintained for each employee. Employees represented by the Public Employee Federation (PEF) and Civil Service Employee Association (CSEA) should indicate time of arrival and departure as well as meal breaks. The New York State Accounting System User Procedure Manual states that agencies must maintain complete and accurate records of leave accruals.

At the end of every four-week period, Division employees submit time sheets to the Human Resources Unit. During 2003,

221 employees worked, at some time, for the Division. We randomly selected a sample of five employees from this population and examined their 13 time sheets covering the period December 19, 2002 through December 17, 2003. We found that two sample employees who were required to enter arrival and departure times did not do so on many of these time sheets - one employee recorded no times on any time sheets and another recorded times on only 3 of 13 time sheets.

On their time sheets, Division employees record their leave accrual earnings and usage for the four-week period. These time sheets are the Division's only record of leave accrual information. We found that these records are not adequately secured as these files are left in plain sight overnight. Employees can alter approved timesheets to increase accrual balances as this is the only record of an employee's accrual balance. Furthermore, we found that the accrual entries on these records are not always accurate. For example:

- A secretary's time sheet for the four-week period ended January 15, 2003 shows a beginning sick leave accrual balance of 38 hours, using 18.75 hours and earning 7.5 hours. The ending balance for that period should have been 26.75 hours. However, the ending sick leave balance on her time sheet was 36.75 hours, an overstatement of 10 hours.

- For the period beginning July 3, 2003, an employee shows a starting accrued overtime balance of six hours. The ending balance on the prior period time sheet is 22 hours.

- On December 8, 2003 and December 17, 2003, an employee used a total of 16 hours of sick leave. However, the accrual balance on her time sheet indicated only eight sick leave hours charged against the beginning balance.

The Division did not identify these errors, even though a clerk in the Human Resources Unit is responsible for reviewing employee time sheet entries and the Director of Human Resources is responsible for verifying her work. One control weakness that may have permitted these errors not to be detected is the fact that the clerk does not document her review on the time sheets and the Director of Human Resources does

not document his review of the clerk's work. In addition, the clerk has no written direction detailing how to perform her review. We question whether any time sheet review is going on at all, based on these and other time sheet errors identified during our audit. Management is not adequately monitoring the time sheet processing function.

In addition, State employees earn sick leave credits each pay period to be used for employee and family illnesses. Sick leave is only to be used for appropriate purposes. When employees use excessive sick leave there should be follow-up action. This action includes but is not limited to doctor's notes, explanation by the employee and investigation by the Division. We found no evidence of such action in the records at the Division for two sampled employees, a secretary and an attorney, who had a high number of sick leave occasions (23 and 16 respectively) in 2003. In addition, the secretary used leave credits before they were earned. Division officials could not document that these situations were investigated or that the two employees had ever been counseled about their use of sick leave. Division officials indicate that they have an unwritten sick leave policy, and for one of the two employees cited, the use of sick leave was justified. However, there was no documentation in the file for either employee. Division officials should establish a written sick leave policy, as well as obtain and retain written documentation of whether the use of excessive sick leave is warranted.

Employees Removed from the Payroll

During 2003, 11 employees terminated their service with the Division. We reviewed the personnel files for the five employees with the highest salaries to determine whether the Division removed the employees from the State payroll timely. For 3 of the 5 employees, we found no problems with the Division's timeliness and accuracy in removing the employees from the State payroll. However, the Division did not handle transactions appropriately for the other two employees.

For example, a Division employee retired on June 27, 2003. We found no time sheets for this employee for almost one year before she retired, from July 4, 2002 through June 27, 2003. Division officials stated this employee stopped working and went on sick leave with half pay as of June 6, 2002 and they did not know that they needed to maintain time records for her.

However, according to the employee's last available time sheet, her last day of work was June 26, 2002. Officials were unable to explain why the employee was put on sick leave with half pay three weeks before the employee stopped working.

Employees Added to the Payroll

The Division hired seven employees during 2003. We reviewed the personnel files for the last five employees hired to determine if they were added to the State payroll correctly. For three of the five employees hired, we found no problem with the manner in which they were added to the State payroll. The Division did not handle transactions for the other two employees appropriately. According to the employees' time sheets both began work at the Division on July 14, 2003. However, Division officials could not provide evidence that these two employees were paid for their first three days of work.

Overtime

Full-time Division employees generally work a 37.5 hour workweek. Employees can earn compensatory and non-compensatory overtime. When an employee works more than 40 hours in a week, the hours earned above the 40-hour threshold are considered compensatory overtime and the employee is paid for these hours. The hours between 37.5 and 40 are considered non-compensatory overtime. The employee is not paid for these hours and instead accrues the hours for future use. During 2003, 52 employees earned paid overtime. For each of the five employees with the most earned overtime, we selected the bi-weekly payroll period with the highest overtime cost to verify if the amount earned was supported by time sheet entries. We found problems with the overtime payments for each of the five employees. For example:

- A Human Rights Specialist (HRS) was paid $1,682 for 41 hours of compensatory overtime earned for the period October 23, 2003 through November 5, 2003. However, the employee earned only 16 overtime hours for which he was eligible to be paid. Therefore, the employee was overpaid by 25 hours or $1,026. Further, while the employee's time sheets indicate the total number of overtime hours worked each day, it does not indicate when the hours were worked. This practice is not consistent with the Attendance and Leave Manual

requirement that hours worked be indicated on the time sheet.

- On December 3, 2003, an HRS was paid $937 for 23.5 hours of overtime earned purportedly for the period November 6, 2003 through November 19, 2003. We found that the employee's time sheet showed no overtime earned for that two-week period. The Director of Human Resources told us and we verified that this payment was actually for overtime worked during the period August 28, 2003 through September 10, 2003. The Division should have reported the correct payroll period when processing this payment. In addition, the Division took nearly three months to pay the employee for the time worked. Similar to the previous employee, the time card did not indicate the specific overtime hours worked for each overtime day.

Additionally, we noted that another employee time sheet incorrectly recorded his accrued non-compensatory overtime in the "overtime compensatory" column and accrued holiday leave for Election Day in the "overtime non-compensatory" column. Since the amount of time an employee is allowed to retain for overtime and holiday leave balances differs, these balances should be accounted for separately. Furthermore, we question why the time sheet accrual balance includes compensatory overtime entries since these hours should be paid to the employee and not carried forward from pay period to pay period.

Each of these situations demonstrates that management needs to take a more active role in monitoring the maintenance of time and attendance records. Division officials indicate that they are working with another New York State agency to implement an electronic time sheet that will improve the time keeping process.

Other Payroll-Related Issue

The contracts between the State of New York and CSEA and PEF require that employees be advised of their leave accrual balances at least once a year. The Human Resources Unit did not provide this information to employees since they did not know this was required.

Equipment

The Division owns computer hardware costing in excess of $1 million. We identified many instances where the Division is not complying with required equipment control procedures. Most of these shortcomings are due to management's lack of knowledge about what is required. Management needs to perform a thorough review of equipment-related controls to ensure that computer equipment and other Division fixed assets are adequately safeguarded against loss.

Compliance with State Requirements

The New York State Accounting System User Procedure Manual states that agencies should implement certain control procedures to ensure the proper safeguarding of State property. These requirements include the use of identification numbers for all equipment, equipment control records be maintained, periodic physical inventory counts be conducted, and equipment utilization records be maintained. Also, a dollar value should be given to each item of equipment. This information is useful for identifying a particular item or group of items and for establishing financial accountability.

We found that the Division does not have sufficient controls in place to safeguard its equipment, as follows:

- There is no indication of Division ownership on much of the Division's equipment, and there are no identification numbers listed for many items on the Division's equipment register.

- There are no written procedures relating to the recording, transferring and disposing of equipment items.

- The Division does not perform periodic physical inventories to account for all equipment.

- Division management does not know the total value of its equipment inventory.

- Utilization records are not maintained.

Accuracy of Division Equipment Register

The Division does maintain an equipment register. However, we found that it is not accurate. We selected a sample of 10 equipment items from the Division's list of 262 equipment items at its Central Office. The purpose of this sample was to determine if the Division could account for items on its equipment register. Division officials could not find one computer from the sample. Furthermore, none of the items that we found had any identifying number indicating Division ownership.

We also selected a judgmental sample of five equipment items located in the Division's Central Office and attempted to trace those items back to the Division's equipment list. We found that one of these items, a facsimile machine, was not on the Division's equipment register. In addition, none of these five items had identification indicating Division ownership. Our review also found a purchase totaling $3,470 for 14 flatbed scanners, received in March 2003, that were not recorded on the Division's equipment register.

Division Vehicles

The Division owns three vehicles, one for use by the Commissioner, a second for use by the Executive Deputy Commissioner, and a third for general work-related use by staff. The value of the personal use by the Commissioner and Executive Deputy Commissioner of their State vehicles is subject to Income and Social Security/Medicare taxes and must be reported on each employee's W-2 form every year. As such, personal use should have been reported to the Office of the State Comptroller to be included on the 2003 W-2 forms. Although a payroll bulletin is distributed to agencies each year detailing these requirements, Division officials told us that they did not know they had to report this information. We are concerned that this lack of understanding indicates management is not monitoring official pronouncements that directly affect the Division's fiscal operations.

As previously reported, Division officials also did not maintain records of equipment utilization. As a result, we found that there are no usage records for the Executive Deputy Commissioner's vehicle. Division officials stated a utilization log will be maintained for this vehicle.

The Division has a local area network to run its day-to-day operations consisting of about 250 terminals and other computer equipment. We found that the Division needs to improve certain controls over the network.

General Controls

General controls are the structure, policies and procedures that apply to an entity's overall computer operations including access controls, service continuity, and security program planning. Without effective general controls, application controls (which are the controls over input, processing and output of data associated with individual applications) may be rendered ineffective by circumvention or modification.

We found that the Division's access controls need to be improved. While Division personnel are required to use a password to sign onto the system, password controls need to be enhanced. For example, the New York State Office of Cyber Security and Critical Infrastructure Coordination recommends that passwords be changed at regular intervals and that the maximum password life be 90 days. We found that Division employees were not required to periodically change their computer passwords.

In addition, to prevent unauthorized access to information, automated controls should be established that require authentication or re-authentication after a predetermined period of inactivity for computer workstations. We found that Division terminals did not lock up or shut down after a period of inactivity. Division officials contend that at the time of the audit, they were in the process of configuring local workstations to lock up after 15 minutes of inactivity. Division officials state that computer stations are initially configured to lock up after 10 to 15 minutes of non-use, but that users can change this. There is no monitoring system in place to ensure employees leave the computers as configured. In addition, as of August 9, 2004, we found that employees are still not required to periodically change their computer passwords.

Other Computer-Related Issues

In today's environment, State entities must implement controls to detect and prevent the introduction of malicious software in their computer systems. The introduction of malicious software, such as a computer virus, can cause serious damage to networks, workstations and business data. Division computers should be equipped with up-to-date anti-virus software. We selected a judgmental sample of five computer workstations from the 191 terminals at the Division's Central Office. The purpose of this sample was to determine if these computers were loaded with up-to-date anti-virus software. We found that one of the five computers did not have any anti-virus software. Additionally, one of the four with the software had not had its virus definitions updated for six months. Division officials state that as of July 21, 2004 they have configured all workstations to automatically run a weekly virus check. We visited the Division on August 9, 2004 to confirm this and found that Division officials have made changes to ensure that virus definitions are updated automatically. Division officials should continue this in the future.

State agencies should regularly review system logs of external network connections for system abuses. We initially found that the Division did not adequately monitor which Internet sites employees visit nor block inappropriate Internet sites. By not adequately monitoring employee Internet usage, the Division risks not only cyber attacks and overloaded network traffic from spam, but also the possibility that illegal materials may be downloaded into the organization's systems, etc. As part of our visit on August 9, 2004, we found that the Division is now blocking inappropriate sites.

Cash Disbursements

During 2003, the Division spent about $4.6 million on purchases of goods and services. We found that the Division needs to enhance controls over such disbursements.

To process a payment, agencies generally must request that the Office of the State Comptroller (OSC) disburse the funds. Agencies must first ensure they have evidence that goods or services have been received and that vendor invoices are correct. The New York State Accounting System User Procedure Manual states that agencies should set forth the

authority and responsibility for all expenditures in a general policy manual. It further states that payment should be made only after the original voucher and corresponding pertinent papers have been processed and approved.

During the period January 1, 2003 through November 24, 2003, the Division processed 1,843 vouchers totaling $3.3 million. We selected a judgmental sample of 15 payments totaling approximately $50,000 to determine if these transactions were processed accurately. To obtain a cross-section of the different types of expenditures, we selected expenses for travel and computer equipment, and payments to employees and vendors with multiple transactions. We found problems with 11 of the 15 payments that we reviewed (four of these payments had multiple problems). For example:

- We identified three paid vouchers totaling $2,937 for which the Division did not maintain sufficient proof that the goods or services were provided. For example, an organization was paid $1,570 on April 16, 2003 for subpoena services. However, Division officials could not document that Division Attorneys who had reportedly used these services had verified that the services were provided or that the vendor's statement of services provided was accurate. Division officials indicate that they will keep proof on file with the payment that services were provided.

- There was insufficient documentation supporting payments for three vouchers totaling $2,603. One was to reimburse an employee for purchases totaling $806 from a flower store. Division officials could not provide an invoice detailing what was purchased, where the commodities were delivered, or explaining why the purchases were work-related.

- State agencies are also responsible for entering object codes when processing vouchers. The accuracy of the object codes is essential for the proper functioning of the accounting system, as they identify the accounts to which expenses are to be posted and serve as the basis for exercising budgetary and other controls. We identified three disbursements where the object codes provided by the Division were incorrect. In one case, the Division bought a Ford Explorer for $21,158 and charged the

expenditure to code 54900 - "Subway Tokens, Bus Fares, Taxi Fares." The purchase should have been charged to code 57100 "Vehicles." In another case, the Division purchased 14 scanners for $3,470 and charged the expense to "Contractual Services - Other," rather than to "Information Technology - Equipment," as would have been appropriate.

- Division policy requires the Director of Finance or his designee to approve all vouchers in writing before they are paid. We identified five vouchers totaling $11,393 with no such written approval. In responding to our preliminary findings on this matter, Division officials indicated a calculation clerk II was designated as an authorized signatory. Voucher approval should be a management function, rather than a clerical one. However, the Division could let a calculation clerk perform this function for low-dollar items.

As with other areas, a major cause of these problems appears to be management's insufficient oversight and monitoring of the disbursement process. For example, OSC's Bureau of State Expenditures (BSE) found that the Division's Card Program Administrator made personal charges, totaling at least $4,686, on the Division's State-issued purchase/travel card. BSE also cites that this same person was in charge of approving program expenditures, and management did not monitor the employee's activities.

During 2003, the Division made approximately 60 petty cash disbursements totaling about $3,900. We selected a random sample of five disbursements totaling $909 to determine if there was adequate supporting documentation for each disbursement and if they were work-related. We found problems with four out of the five payments:

- There was no invoice or bill to support two of the disbursements totaling $100.

- For a third disbursement amounting to $50, we found a bill but there was no documentation indicating that it was for a work-related purpose.

- On July 15, 2003, the Division used petty cash funds to give an employee a $659 payroll advance. Normally, the

advance should have been deducted from the employee's next payroll check but, because of a personal emergency, the Division turned the advance into an interest-free loan and did not require the employee to completely repay the amount until March 2004. It is inappropriate for the Division to use the petty cash account for employee loans.

Agencies should reconcile the bank and book balances of all accounts monthly to determine the reasons for any differences and to correct any errors in the accounts. We found the Division is not taking adequate steps to reconcile the petty cash account. The Division provided us with its bank reconciliations for October and December 2003, which had unexplained reconciling differences of $79.82 and $140.81, respectively. Since there were only about 60 petty cash transactions totaling $3,900 for the year, there is no reason why these two differences should be left unexplained.

Purchasing

Generally, State agencies must purchase goods and services using a competitive process. The Division's practices call for department heads in need of goods or services to submit requisition forms to the Division's purchasing agent. After selecting the most economical vendor, which is generally off a State contract, the purchasing agent should prepare a purchase order that is used to encumber the expense in the State Accounting System. The purchase must be approved by the Director of Finance, who should ensure that there is money available. Purchase orders are sent to vendors to notify them of the goods and services needed. We found that the Division needs to ensure that employees comply with this process.

During the period January 1, 2003 through November 24, 2003, the Division processed 1,843 vouchers totaling $3.3 million. We selected a judgmental sample of 15 payments totaling approximately $50,000 to determine if the corresponding goods and services were purchased in accordance with the Division's policies. This is the same sample as the one used for our cash disbursement review. We found multiple problems with 12 out of the 15 purchases. For example:

- The practice of preparing a purchase order and forwarding it to the Director of Finance allows him to

determine whether there are funds available for the purchase before the goods or services are provided. We identified two purchases where the services were provided before the purchase order was created. For example, on March 4, 2003, the Division created a purchase order to obtain transcript services for a prior period - February 18, 2003 to February 21, 2003. Therefore, the vendor provided services before Division management approved the purchase.

- We identified 12 instances where there was no written requisition order on file. In six of the cases, the purchase order indicated that the purchasing agent had requisitioned the goods or services, rather than the department that needed the commodity. The purchasing agent is not an authorized requisitioner, and she should not be determining the needs of the Division's various departments. In addition, to ensure proper internal controls, the responsibilities between requisitioning and ordering should be segregated.

- We also identified four instances where the purchase orders did not contain the approval of the Director of Finance. In addition, there were six other cases where we found no purchase order at all. As a result, it appears that the Director of Finance did not approve 10 of the 15 purchases we selected before the items were ordered.

Once again, these problems occurred primarily because management does not monitor controls to ensure they are working properly.

Budget

We identified minor problems with internal controls related to the Division's budget processes. The most serious is that the Finance Unit does not provide Division managers with reports detailing variances between budget and actual cost-center expenditures. As a result, managers are unable to monitor the financial activities within their span of control to identify problems, errors or irregularities that may arise.

Recommendations

7. Take action to ensure that:
   - all employees submit time sheets;
   - employees record arrival and departure times on their time sheets;
   - time sheets are adequately secured;
   - accrual balances are accurate and employees are informed of their balances at least once each year;
   - time sheet entries are adequately reviewed and that such reviews are documented;
   - the payroll processing function is monitored;
   - employees are paid for all hours worked;
   - overtime is supported by time sheet entries, paid timely and the correct pay period is recorded on the State Accounting System when processing overtime pay;
   - employees do not use leave that has not been earned; and
   - overpayments to employees are recouped.

   (Division officials responded that they plan to obtain an electronic time and attendance system in the new fiscal year. In the interim, policies and procedures, including operational standards, have been written for all payroll issues identified above. They will be distributed to and discussed with the payroll staff.)

8. Division officials should establish a written sick leave policy, as well as obtain and retain written documentation of whether the use of excessive sick leave is warranted.

   (Division officials responded that modifications to the Division's sick leave policy are presently being prepared, with subsequent training for unit heads and managers to ensure consistent implementation.)

Recommendations (Cont'd)

9. Implement equipment control procedures, including recording all terms on the register, tagging of equipment to indicate ownership, performing annual physical counts of Division equipment, determining the value of Division equipment, and maintaining utilization records for equipment.

   (Division officials responded that the expansion of the Division's asset inventories has begun, and an annual physical count of equipment will commence in fiscal year 2005-06. Division officials add that the tagging of assets is presently scheduled for the first few months of 2005.)

10. Annually report the personal use of Division vehicles to the Office of the State Comptroller.

    (Division officials responded that logs are presently being kept to document Division vehicle usage.)

11. Take efforts to ensure that employees change their computer systems passwords at regular intervals; computer workstations lock up or shut down after a period of inactivity; and Internet use is monitored and inappropriate sites are blocked.

    (Division officials responded that all user accounts have been configured to lock out work stations after 15 minute periods of inactivity, and password authentication is required to regain access. All user accounts have been modified to require a password change every 60 days.)

12. Verify that goods have been received or that services have been provided before paying vendors, and review vendor invoices to ensure that they are accurate.

    (Division officials responded that policy and procedures have been strengthened to require verification of goods before payments are processed.)

Recommendations (Cont'd)

13. Maintain sufficient documentation to support the reason for expenditures.

    (Division officials responded that documentation for expenditures is now routinely obtained.)

14. Enter correct object codes into the State Accounting System.

    (Division officials responded that a modified listing of Division codes with clearer examples has been distributed and a staff meeting was held to discuss practical application.)

15. Take action to ensure that vouchers are approved by the Director of Finance or his designee before they are paid.

    (Division officials responded that policies and procedures have been changed and in-service training has taken place in the Vouchering Unit to assure this is taking place.)

16. Use the petty cash account for appropriate and supported Division expenses.

    (Division officials responded that policies and procedures have been clarified and documented, and more uniform use of the petty cash disbursement request form has been introduced.)

17. Reconcile the Division petty cash account and clearly identify the reasons for any differences.

    (Division officials responded that the Office of the State Comptroller's Bureau of Cash Management has reviewed and accepted the Division's petty cash reconciliations through September 2004. The Director of Finance will continue to reconcile the petty cash account on a monthly basis.)

Recommendations (Cont'd)

18. Take actions to ensure that purchase orders are prepared by the purchasing agent based upon department requisitions and they are approved by the Director of Finance before the goods and services are received.

    (Division officials responded that written procedures are in place to require a purchase request from any department seeking acquisition of goods or services. These are approved by the Director of Finance before goods or services are requisitioned.)

19. Provide managers with reports detailing variances between budget and actual cost-center expenditures.

    (Division officials responded that monthly disbursement reports are now prepared and distributed to senior staff for review.)

MAJOR CONTRIBUTORS TO THIS REPORT

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GEORGE E. PATAKI
GOVERNOR

MICHELLE CHENEY DONALDSON
COMMISSIONER

3 December 2004

Re: Audit Report #2003-S-55

Frank J. Houston
Office of the State Comptroller
110 State Street
Albany, NY 12236

Dear Mr. Houston:

Enclosed please find the response of the NYS Division of Human Rights to the final draft of the aforementioned audit, which took place from December 4, 2003 to March 26, 2004.

The preliminary audit findings were mailed to the Division on 21 April 2004, and covered the results of the review of payroll, equipment, accounting & information, disbursements, purchasing and budget operations. A second preliminary audit findings document was mailed to the Division on 21 June 2004, and covered the five components of internal control as defined by the Office of the State Comptroller: the control environment, communication, assessing & managing risk, control activities and monitoring.

After submitting an initial response on 21 July, 2004, Division officials met with the audit team to discuss the initial drafts. Subsequently, OSC faxed the final draft report to the Division on 11 November 2004.

If you have any questions, please do not hesitate to contact Martha Furlong, Deputy Commissioner for Administration, at 718-741-8358, or by e-mail at mfurlong@dhr.state.ny.us.

Sincerely,

Michelle Cheney Donaldson
Commissioner

MCD:lnw

Encl.

The following is the response of the NYS Division of Human Rights to the final draft of audit 2003-S-55, which took place from December 4, 2003 to March 26, 2004.

The preliminary audit findings were mailed to the Division on 21 April 2004, and covered the results of the review of payroll, equipment, accounting & information, disbursements, purchasing and budget operations. A second preliminary audit findings document was mailed to the Division on 21 June 2004, and covered the five components of internal control as defined by the Office of the State Comptroller: the control environment, communication, assessing & managing risk, control activities and monitoring.

After submitting an initial response on 21 July, 2004, Division officials met with the audit team to discuss the initial drafts. Subsequently, OSC faxed the final draft report to the Division on 11 November 2004.

The following are agency responses to the specific recommendations offered in the final draft document:

1. *Take actions to ensure that Division management has the knowledge and understanding of financial-related requirements that are relevant to Division operations.*

   To promote awareness of financial-related requirements, management of the Division's Bureau of Administration will continue to meet regularly upon the receipt of new budget bulletins and other directives to identify implementation issues. Meetings will then be held with appropriate Administration staff to ensure compliance. Issues deemed to affect greater numbers of Division staff will be addressed at Commissioner level staff meetings.

2. *Establish a code of conduct.*

   The Personnel Department is presently writing a code of conduct that will be ready for distribution by the end of this fiscal year. It will be distributed to all current staff, and will be distributed to new staff as a part of the orientation package they receive. The Personnel Department will periodically update this document, and a current copy will be accessible in electronic format.

3. *Commit to writing the policies and procedures for the Division's financial-related functions and communicate them to all staff involved with these functions.*

   Under an agency-wide initiative, the Division's Administration unit has begun writing procedures for all financial-related functions: purchasing, vouchering, equipment maintenance and inventory control, reimbursements and reconciliations, and petty cash. Completion is scheduled for the end of this fiscal year, with staff training to follow shortly after that.

4. *Perform periodic assessments of the Division's financial-related operations.*

   Beginning with the first quarter of FY05-06, the Director of Finance will begin quarterly testing of financially-related operations based on the sampling done in the preparation of this report. Results of these internal control tests will be kept by the Director of Finance and the agency's Internal Control Officer. Implementation of resulting corrective action plans will be monitored by these two staff members.

5. *Take actions to ensure there are adequate control activities that call for decisions, events and transactions to be documented, approved, authorized and verified.*

   The preparation of the aforementioned procedure documentation (see #3) will include a control assessment, and if weaknesses are found, controls put into place.

6. *Develop a program to monitor financial-related functions.*

   In addition to periodic assessments by the Director of Finance (see #4), the Division's Internal Control Officer will prioritize financial-related activities in the implementation of the Division's Internal Control Program.

7. *Take action to ensure that:*
   - *all employees submit time sheets;*
   - *employees record arrival and departure times on their time sheets;*
   - *time sheets are adequately secured;*
   - *accrual balances are accurate and employees are informed of their balances at least once each year;*
   - *time sheet entries are adequately reviewed and that such reviews are documented;*
   - *the payroll processing function is monitored;*
   - *employees are paid for all hours worked;*
   - *overtime is supported by timesheet entries, paid timely and the correct pay period is recorded on the State Accounting System when processing overtime pay;*
   - *employees do not use leave that has not been earned; and*
   - *overpayments to employees are recouped.*

   The Division has initiated discussions with the Office of Temporary and Disability Assistance to obtain an electronic time and attendance system. That agency is presently updating their system, and initial estimates indicate it will be available to the Division in the new fiscal year. In the interim, policies and procedures, including operational standards, have been written for all payroll issues identified in the audit. These guidelines will be distributed to all payroll staff followed by meetings to discuss their implementation. This will take place during the third quarter of FY04-05.

8. *Division officials should establish a written sick leave policy, as well as obtain and retain written documentation of whether the use of excessive sick leave is warranted.*

   Modifications to the Division's sick leave policy are presently being prepared, with subsequent training for unit heads and managers to ensure consistent implementation.

9. *Implement equipment control procedures, including recording all items on the register, tagging of equipment to indicate ownership, performing annual physical counts of Division equipment, determining the value of Division equipment, and maintaining utilization records for equipment.*

   The expansion of agency asset inventories has begun, and an annual physical count of equipment will commence in FY05-06. The tagging of agency assets is presently scheduled for the first few months of 2005.

10. *Annually report the personal use of Division vehicles to the Office of the State Comptroller.*

    Logs are presently being kept to document agency vehicle usage, and will be submitted accordingly.

11. *Take efforts to ensure that employees change their computer systems passwords at regular intervals; computer workstations lock up or shut down after a period of inactivity; and Internet use is monitored and inappropriate sites are blocked.*

    All user accounts have been configured to lock out work stations after a 15 minute period of inactivity, and password authentication is required to regain access. All accounts have also been modified to require a password change every 60 days. Users are not permitted to use the same password chosen within the previous twelve cycles. Blocking of inappropriate sites and updating virus signatures have been complied with as stated on page 23 of the report.

12. *Verify that goods have been received or that services have been provided before paying vendors, and review vendor invoices to ensure that they are accurate.*

    Policy and procedures have been strengthened to require verification of receipt of goods by packing slips or by department signature before every payment is processed.

13. *Maintain sufficient documentation to support the reason for expenditures.*

    The majority of cases that led to this recommendation had to do with lack of documentation for expenditures related to process servers. To acknowledge receipt of service, the agency's General Counsel had been sending signed invoices to the Finance Office for payment. The General Counsel will now supplement this documentation with copies of the affidavit of service. Documentation for other expenditures is now routinely obtained.

14. *Enter correct object codes into the State Accounting System.*

    A modified listing of DHR object codes with clearer examples has been distributed and a staff meeting was held to discuss practical application.

15. *Take action to ensure that vouchers are approved by the Director of Finance or his designee before they are paid.*

    Policies and procedures have been changed and an in-service has taken place in the Vouchering Unit to assure this is taking place.

16. *Use the petty cash account for appropriate and supported Division expenses.*

    Policies and procedures have been clarified and documented, and more uniform use of the petty cash disbursement request form has been introduced. Beginning with the first quarter of FY05-06, the Director of Finance will begin quarterly testing of petty cash. Results of these internal control tests will be kept by the Director of Finance and the agency's Internal Control Officer.

17. *Reconcile the Division petty cash account and clearly identify the reasons for any differences.*

    The OSC Bureau of Cash Management has reviewed and accepted the Division's petty cash bank reconciliations through September 2004. The Director of Finance will continue to reconcile the petty cash account on a monthly basis.

18. *Take actions to ensure that purchase orders are prepared by the purchasing agent based upon department requisitions and that they are approved by the Director of Finance before the goods and services are received.*

    Written procedures are in place to require a purchase request from any department seeking acquisition of goods or services. These are approved by the Director of Finance before goods or services are requisitioned.

19. *Provide managers with reports detailing variances between budget and actual cost-center expenditures.*

    Presently, monthly basis disbursement reports are now prepared and distributed to senior staff for review. The Division is in negotiations with the Department of Parks & Recreation to obtain at no cost their Financial Management System. The system has highly advanced reporting capabilities, and will allow the agency to create much more detailed fiscal reports. The Division is scheduled to have this system in place by the new fiscal year.

LNW:dim 11/30/04