



Cortland Enlarged City School District Oversight of Financial Operations

Report of Examination

Period Covered:

June 1, 2011 — July 9, 2012

2012M-230



Thomas P. DiNapoli

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State of New York Office of the State Comptroller

Division of Local Government and School Accountability

February 2013

Dear District Officials:

A top priority of the Office of the State Comptroller is to help school district officials manage their districts efficiently and effectively and, by so doing, provide accountability for tax dollars spent to support District operations. The Comptroller oversees the fiscal affairs of districts statewide, as well as districts' compliance with relevant statutes and observance of good business practices. This fiscal oversight is accomplished, in part, through our audits, which identify opportunities for improving district operations and Board 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 Cortland Enlarged City School District, entitled Oversight of Financial Operations. This audit was conducted pursuant to Article V, Section 1 of the State Constitution and the State Comptroller's authority as set forth in Article 3 of the General Municipal Law.

This audit's results and recommendations are resources for district officials to use in effectively managing operations and in meeting the expectations of taxpayers. 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*

Introduction

Background

The Cortland Enlarged City School District (District) is located in the City of Cortland and five towns in Cortland County. The District is governed by the Board of Education (Board), which comprises seven 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 District's chief executive officer 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 six schools in operation within the District, with approximately 2,800 students and 447 employees. The District's budgeted expenditures for the 2012-13 fiscal year were \$45.1 million, which were funded primarily by State aid, real property taxes and grants.

The Director of Business Services is responsible for managing the District's financial operations and overseeing the work of Business Office staff. These responsibilities include appropriately assigning users within the financial software. The District Treasurer (Treasurer), an Onondaga-Cortland-Madison Counties Board of Cooperative Educational Services employee, is the District's chief accounting officer and is responsible for properly accounting for all District moneys, including billing for reimbursements due to the District. The District also employs a payroll clerk, an accounts payable clerk, and a personnel clerk. The District contracts with the Central New York Regional Information Center to provide support for its financial software.

The District's Business Office experienced significant turnover in administration during the 2010-11 and 2011-12 fiscal years. The Treasurer retired in April 2011, followed by the payroll clerk in May 2011, and the Director of Business Services in December 2011. The Superintendent who served the District for approximately six years subsequently left in May 2012 and was replaced with an interim Superintendent, who only served the District for approximately two months. The current Superintendent was hired in August 2012. The District has since replaced three Directors of Business Services, two Treasurers, and a payroll clerk.

Objective

The objective of our audit was to determine whether the Superintendent and the Director of Business Services provided adequate fiscal oversight over District financial operations. Our audit addressed the following related question:

- Did the Superintendent and the Director of Business Services provide proper oversight of the District’s financial operations?

**Scope and
Methodology**

We examined the District’s internal controls over Business Office functions and the assignment of users’ access within the financial software for the period June 1, 2011 to July 9, 2012. We expanded our scope to include the District’s billing for reimbursements due for the period September 1, 2009 to July 9, 2012.

We conducted our audit in accordance with generally accepted government auditing standards (GAGAS). More information on such standards and the methodology used in performing this audit is included in Appendix B 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. District officials agreed with our recommendations and indicated they planned to initiate corrective action.

The Board has the responsibility to initiate corrective action. A written corrective action plan (CAP) that addresses the findings and recommendations in this report should be prepared and forwarded to our office within 90 days, pursuant to Section 35 of the General Municipal Law. For more information on preparing and filing your CAP, please refer to our brochure, *Responding to an OSC Audit Report*, which you received with the draft audit report. We encourage the Board to make this plan available for public review in the District Clerk’s office.

Fiscal Oversight

The Board is responsible for the overall fiscal management of the District and has established various policies to meet this responsibility. The Board's Financial Management Policy delegates much of the specific responsibilities to the Superintendent to manage and control all financial transactions. Further, the policy designates the Director of Business Services to be primarily responsible for the coordination and management of the District's business affairs while reporting to the Superintendent. The Treasurer is responsible for providing the Board periodic reports that monitor the District's financial activity, including available cash balances. Further, a financial management system should include controls that provide for proper segregation of duties by preventing users from being involved in multiple aspects of a financial transaction and by allowing users to access only those computer functions that are necessary to fulfill their job responsibilities.

The former Superintendent and Director of Business Services did not provide sufficient oversight over the District's financial operations. They both failed to properly assign users within the financial software, and Business Office staff performed incompatible duties without management's sufficient oversight or control. As a result, the risk increases that errors or improper payments could occur and remain undetected and uncorrected. Further, District officials failed to ensure that Business Office staff were billing for various reimbursements due to the District. As a result, the District lost out on at least \$52,000 in reimbursement revenues due.

Segregation of Duties

District officials are responsible for providing for a proper segregation of duties for the payroll and cash disbursements processes so that no one individual controls all phases of a transaction. In general, the functions of transaction approval, recordkeeping, asset custody and reconciliation must be separated. The primary purpose for segregating duties is to prevent or detect errors and fraudulent activity in a timely manner. If it is not practicable to adequately segregate these duties, mitigating controls should be implemented, such as providing management oversight and review of the associated transactions.

The payroll clerk's and accounts payable clerk's duties are not sufficiently segregated to ensure that disbursements are adequately safeguarded. The payroll clerk routinely adds and updates employee records, enters time sheet information, sets up direct deposit, processes payroll, and directs the checks to be printed at the Central New York Regional Information Center (CNYRIC) with the Treasurer's

signature applied electronically. She also makes payroll journal entries for any necessary adjustments. Neither the former Superintendent nor the interim Superintendent certified any of the payrolls to verify the accuracy and necessity of those payments.

Similarly, the accounts payable clerk routinely processes vendor disbursements and directs the checks to be printed at the CNYRIC with the Treasurer's signature applied electronically. The CNYRIC returns those checks to the accounts payable clerk for mailing. She also uploads a file listing all the disbursements to the District's bank for payment and is solely responsible for authorizing any adjustments requested by the bank for disbursements not included in the uploaded file. While the Treasurer does regularly reconcile the recorded cash balances with the adjusted bank balances, such reconciliation would likely only detect a disbursement that was not recorded or was recorded in error. No one compares the actual disbursements uploaded to the bank to the disbursements that were audited and approved to be paid. As such, the risk still exists that an unauthorized payment could be made without detection or correction.

District staff also have access to software components that enable them to perform functions they are not assigned. Specifically, the Treasurer has access to process payroll, as well as print both payroll and vendor checks. In addition, all 20 Onondaga-Cortland-Madison Counties Board of Cooperative Educational Services staff in the CNYRIC¹ have unlimited access to the District's modules within the financial software. Granting these rights in the financial software increases the risk that District funds could be misappropriated without detection or correction.

Prior administration assigned these duties and rights, and former staff access rights were simply replicated to the current staff. No one was able to justify the assignment of these duties and rights to the staff discussed. We reviewed payments to key District officials totaling \$382,626, direct deposits totaling \$449,917 and salary rate changes for 10 employees, as well as changes to vendor information for 20 vendors within the financial software during the audit period.² While our review did not disclose any material discrepancies or unusual transactions, because of these weaknesses, a significant risk exists that errors and irregularities can occur without detection.

¹ The District's financial data is stored on a server located at the CNYRIC. All CNYRIC staff with "Super User" rights have access to the District's financial data.

² See Appendix B, Audit Methodology and Standards, for details on our sample selections.

Billing for Reimbursements

Education Law provides that the financial responsibility for educating non-resident students in foster care lies with the school district in which those students resided at the time of the social services placement. To properly facilitate this reimbursement, it is the responsibility of the educating district to identify all non-resident students receiving services, determine which district to bill, accurately calculate costs, and prepare and submit the necessary documentation in a timely manner. The Medicare Catastrophic Act of 1988 made it possible for school districts to obtain partial Medicaid reimbursement for many special education services³ that they provide to Medicaid-eligible students. Claims must be supported by documentation of the services provided to students and submitted to Medicaid within two years of the date that services were provided.

District staff failed to file claims with Medicaid and bill home districts for students residing in foster care settings within the District. The District has a non-resident tuition policy which requires staff to bill home districts for tuition for foster care students. While the former Treasurer did prepare tuition bills, she retired in April 2011, and no one has billed for this tuition for the 2010-11 school year since her retirement. In a similar manner, no one has submitted any claims to Medicaid for services provided to Medicaid-eligible students during the 2010-11 and 2011-12 school years, since such billing had become allowable beginning in April 2011.⁴

These lapses in billing occurred at a time when the District's administration and business operations were experiencing significant staff turnover. As key staff left District service, there was no effective transition of their duties to the subsequent staff. For example, the Treasurers appointed after the former Treasurer's retirement did not realize that the recently-retired Treasurer prepared billings for reimbursements; thus, no one prepared these billings.

We estimated the lost revenue for non-resident tuition to be \$52,000. Because Medicaid reporting requirements changed in 2011, and the District may not have had the necessary information to submit claims that it could have been eligible to be reimbursed for, we did not attempt to estimate the amount of this lost revenue. However, the annual revenues for the last four years (2006–2009) for Medicaid reimbursement averaged approximately \$346,000. Going forward, if

³ Reimbursable services include physical and occupational therapy, speech pathology, psychological counseling, skilled nursing services, basic and comprehensive psychological evaluations, medical evaluations, medical specialist evaluations, audiological evaluations, and transportation.

⁴ Due to changes in reporting and billing, schools in New York State could not bill for services starting in September 2009. This billing hold was lifted in April 2011, and schools could retroactively bill for services provided from September 2009 forward.

District officials do not properly submit for reimbursements due, the District could continue to lose these important revenues.

Recommendations

1. The Superintendent should ensure that the Director of Business Services and Treasurer assign financial duties so that one person does not have custody, recordkeeping responsibilities, and authority to approve and execute transactions.
2. The Superintendent should ensure that the Treasurer establishes procedures to bill home districts for foster care children who are enrolled in the District.
3. The Superintendent should ensure that the Treasurer establishes procedures for filing claims with Medicaid for support services provided to Medicaid-eligible students.

APPENDIX A

RESPONSE FROM DISTRICT OFFICIALS

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



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January 23, 2012

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RE: Oversight of Financial Operations, Cortland Enlarged City School District
(June 1, 2011 – July 9, 2012)

Dear Chief Examiner:

Please accept this letter in response to the examination of the financial operations of the Cortland Enlarged City School District. The scope of this audit was to determine if there was adequate fiscal oversight over District financial operations. While we are pleased that the District operations in the areas under your review did not find evidence of fraud, theft or professional misconduct, we do acknowledge the report identifies risks inherent in some of the practices and operations of the financial operations of the District and welcome the opportunity to address them.

In reviewing your report and our response, it is important to note that the Cortland Enlarged City School District is a small city school district. The majority of the District's resources are directed to the delivery of instruction and the classroom. The business office staff consists of a Director of Business Services, treasurer, a payroll clerk, and an accounts payable clerk. In addition, the District has experienced a significant turnover in the business office and senior administration both prior to and during the audit. The Board of Education and administration recognize a key component to the successful development and implementation of strategically sound business practices is to create a stable business office. Our corrective action plan will be developed to ensure we minimize risk and provide for stability in the business office. We will review each audit finding and develop and implement a comprehensive plan to remediate the identified risks.

Segregation of Duties:

A role based security system will be defined and implemented for the District's financial system. This system will utilize standardized roles, administrative approval and periodic review of permissions. While limited staff reduces the opportunity to create optimal segregation of duties and coverage for employees, the role based system will allow for management to identify areas of risk and provide oversight.

Billing for Reimbursements:

A key component to a stable business office is well developed policies, documentation of processes and procedures and cross training of staff. The current billing practices of the District will be reviewed, updated and documented to ensure future continuity. Training and cross training of staff is a priority for the business office. We have begun training and cross training in key business office processes such as Medicaid billing and will continue to develop training plans for staff.

Please note we appreciate the thorough nature of the review and the professionalism of the audit team. On behalf of the Board of Education and District administration, we would like to thank you for the time, effort and constructive feedback provided by your team. We remain committed to implementing processes that will ensure the continuing financial integrity of our District.

Respectfully Submitted,



Michael J. Hoose
Superintendent of Schools



Afane Van Donsel
President, Board of Education

MJH/mjb

APPENDIX B

AUDIT METHODOLOGY AND STANDARDS

Our overall goal was to assess the adequacy of the internal controls put in place by the Board, the District Superintendent and the Director of Business Services 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.

During the initial assessment, we interviewed appropriate District officials, performed limited tests of transactions and reviewed pertinent documents such as Board policies and procedures, Board minutes and financial records and reports. In addition, we obtained information directly from the computerized financial systems 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.

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 the fiscal oversight provided by the District Superintendent and the Director of Business Services over the District's financial operations for further review and audit testing. We performed the following procedures:

- We interviewed District officials, District employees and Business Office staff regarding the existing internal control systems over the payroll process, foster care tuition billing, Medicaid claim reimbursements, and the financial management system.
- We reviewed access rights to the financial software to determine whether user access rights were appropriately restricted based on the user's official day to day job duties.
- We obtained a list of all individuals enrolled in direct deposit from the financial software. We compared this list to the June 8, 2012 payroll to determine whether there were inactive employees being reported, and whether employee names, direct deposit amounts and banking information were not being duplicated. We also reviewed and followed up on any changes between the direct deposit listing for June 8, 2012 and September 6, 2012 to verify that the direct deposit listings contained actual District employees.
- We judgmentally reviewed payments made to eight key District officials totaling \$382,627 during the 2011-12 fiscal year to determine whether these payments were supported and in accordance with their employment contracts.
- Using the payroll change report from the financial software for the period July 1, 2011 through July 9, 2012, we chose a non-biased judgmental sample by selecting every 25th name from the report for a total of 10 names. We compared the rate changes to the employment contract, personnel file and Board minutes, and determined whether the rate change was supported and properly approved.

- We reviewed the audit log for the period July 1, 2011 through June 30, 2012 for any changes made by the Treasurer and the accounts payable clerk. We judgmentally selected a total of 20 vendors that had a change made to their information. We reviewed one payment made to each vendor during that period. We interviewed the Treasurer and accounts payable clerk to determine whether the change made to vendor information was proper and whether the payments represented legitimate District expenses.
- We judgmentally reviewed 10 payments totaling \$29,812 to vendors whose names appeared to be for goods and services not generally provided by a school district. We reviewed the supporting documentation for each payment to ensure it was a proper District expense.
- We reviewed the District’s checking account activity for checks that were exceptions to the “Positive-Pay”⁵ control. We interviewed District officials as to the process for approving any checks noted as exceptions.
- We reviewed bank transfers and electronic payments totaling \$35.1 million made during the months of February and June 2012. We traced these amounts to District bank statements and supporting documentation to determine whether the disbursements were adequately supported and deposited into a legitimate District bank account, or represented a payment to a District vendor.
- We obtained the names of all individuals who are assigned online banking access. We reviewed this listing to determine if the individuals should have online banking access and what access rights they had.
- We reviewed the approvals provided for all bank transfers during the month of June 2012 to determine whether each transfer was initiated and approved according to District procedures.
- We inquired to all school districts that had foster care students placed in the District as to whether these districts paid foster care tuition for the 2010-11 and/or the 2011-12 school years.
- We interviewed District staff with oversight roles for Medicaid billing to determine the process for claiming reimbursements.

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 objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

⁵ “Positive Pay” allows the District to monitor and control the checks presented against its accounts so that only authorized items are paid.

APPENDIX C

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