



Elwood Union Free School District Electronic Transfers

Report of Examination

Period Covered:

July 1, 2012 — August 31, 2013

2014M-133



Thomas P. DiNapoli

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State of New York Office of the State Comptroller

Division of Local Government and School Accountability

July 2014

Dear School District Officials:

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

Following is a report of our audit of the Elwood Union Free School District, entitled Electronic Transfers. This audit was conducted pursuant to Article V, Section 1 of the State Constitution and the State Comptroller's authority as set forth in Article 3 of the General Municipal Law.

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

Respectfully submitted,

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

Introduction

Background

The Elwood Union Free School District (District) is located in the Town of Huntington, Suffolk County. The District is governed by a Board of Education (Board) comprising five elected members. The Board is responsible for the general management and control of the District's financial and educational affairs.

The Superintendent of Schools (Superintendent) is the District's chief executive officer and is responsible, along with other administrative staff, for the day-to-day management of the District under the Board's direction. The Treasurer is appointed annually by the Board and, as custodian of all District moneys, is responsible for disbursements.

The District operates four schools with approximately 2,625 students and 375 employees. The District's expenditures for the 2012-13 fiscal year were \$53,282,835, which were funded primarily with real property taxes and State aid.

Objective

The objective of our audit was to evaluate the District's controls over electronic transfers. Our audit addressed the following related question:

- Has the District established adequate controls over electronic transfers?

Scope and Methodology

We examined the District's processing of electronic transfers for the period July 1, 2012 through August 31, 2013.

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 findings and recommendations and indicated they are taking corrective action.

The Board has the responsibility to initiate corrective action. Pursuant to Section 35 of the General Municipal Law, Section 2116-a (3)(c) of the Education Law and Section 170.12 of the Regulations of the Commissioner of Education, a written corrective action plan (CAP) that addresses the findings and recommendations in this report

must be prepared and provided to our office within 90 days, with a copy forwarded to the Commissioner of Education. To the extent practicable, implementation of the CAP must begin by the end of the next fiscal year. For more information on preparing and filing your CAP, please refer to our brochure, *Responding to an OSC Audit Report*, which you received with the draft audit report. The Board should make the CAP available for public review in the District Clerk's office.

Electronic Transfers

General Municipal Law (GML) allows local governments and school districts to disburse or transfer funds in their custody by means of electronic or wire transfers, provided that the governing board has entered into a written agreement with the bank prescribing the manner in which electronic transfers will be accomplished. While electronic transfers provide a convenient method of moving money between district accounts and making payments to third parties, because these transactions are usually effective within minutes of being executed, it is essential that they are reviewed, authorized and confirmed in a timely manner.

An effective system of internal controls over electronic transactions includes written policies and procedures that identify authorized online banking activities and electronic funds transactions,¹ and establishes who may initiate, approve, transmit and record transfers. The policies and procedures should segregate duties so that the same person is not able to approve transfers and then execute the transaction. Appropriate controls also include retaining itemized documentation for each electronic transfer.

During our audit period, the District processed 442 electronic transfers totaling over \$188.2 million. We judgmentally selected three months² in the audit period and reviewed all electronic transfers processed to determine who initiated and approved each transfer, if the funds were deposited to either a valid District account or for payment to a vendor for a valid District purpose, and if the District received a confirmation from the bank verifying that the transaction had been processed.

The Board does not have written policies, procedures or Board resolutions to govern electronic transfers. As a result, the Treasurer and a payroll clerk processed electronic transfers without adequate segregation of duties or documentation of transactions. None of the 98 electronic transfers in our sample, totaling \$42.9 million, had evidence that at least two people were involved in transaction processing, and the payroll clerk was allowed to process 10 transfers totaling \$3.9 million without the Treasurer's or any other official's approval. Further, nearly half of the transactions in our sample did not have a written confirmation from the bank as required by law. The District also did not retain any supporting documentation for 44 transfers totaling \$12.0 million.

¹ Which include transfers of funds within District bank accounts, and transfers from District accounts to non-District accounts (wires)

² See Appendix B, Audit Methodology and Standards, for our selection process.

Segregation of Duties

An effective system of internal controls over electronic transfers ensures that at least two people are involved in each electronic transaction, one for authorization and one for transmittal. This includes transfers between accounts in the same bank, transfers (wires) between different banks and payments to vendors.

We reviewed 98 electronic transfers from four banks during the months of October 2012, May 2013 and August 2013, totaling nearly \$42.9 million and found that all of the transfers were either deposited to another District account or transferred for payment for a valid District purpose (primarily for payroll-related payments). However, we found no evidence that two people from the District were involved in any of the electronic transactions:

- Documentation showed that the Treasurer initiated 46 of the 98 transactions, totaling nearly \$23.7 million. However, there was no evidence that another District employee or official was involved in the processing of the electronic transfers.
- District officials told us that the Treasurer processed another 42 transactions totaling nearly \$15.3 million but there was no documentation to that effect.
- District officials also told us the remaining 10 transfers totaling \$3.9 million were processed by a payroll clerk, rather than the Treasurer, for payment of payroll and payments due to the New York State & Local Retirement System. There was no evidence that the Treasurer or another official had approved any of these transfers.

We also found that the District did not retain any supporting documentation for 44 of the transfers, totaling almost \$12.0 million. In response to our inquiries, District officials contacted the bank and obtained reports that documented the date, purpose, amount and, when available, the person processing the transfer for 42 of the 44 transfers totaling \$11.4 million. District officials were not able to provide any supporting documentation for two electronic transfers totaling \$518,966.³ We were told by a bank representative that these transactions were requested by the former Treasurer in person at the bank.

The failure to maintain adequate documentation of electronic transfers and ensure that each transaction is processed by at least two people – one for authorization and another for transmittal – increases the risk of unauthorized or inappropriate transactions.

³ These transactions were transfers to other District bank accounts.

Written Confirmations

GML requires that financial institutions that process electronic transactions provide a written confirmation to the officer of the municipality or school district that has requested the transaction. This confirmation must be provided no later than the business day following the day on which the funds were transmitted. These confirmations allow officials to verify the appropriateness of the transactions and detect errors in the transmission or content of payment orders.

We reviewed supporting documentation for all 98 electronic transfers and found that the District did not have a written confirmation for 47 transfers processed, totaling \$12.8 million from two of the four banks that processed electronic transfers. One bank did not send confirmations for 43 of its electronic transfers totaling \$11.0 million, but informed us that email confirmation is available if the District signs up for it.

When electronic transfers are processed without obtaining written confirmations, there is a risk that an unauthorized person might access a District account and make transfers to unauthorized accounts or payments to unauthorized vendors without timely detection.

Recommendations

1. The Board should:
 - Establish comprehensive written policies and procedures for electronic transfers, which should authorize individuals to perform electronic transfers and require District officials and employees to retain supporting documentation for each transaction.
 - Segregate duties to ensure that no one person can both initiate and approve electronic transfers. If one person initiates the transaction, another authorized person should review and approve it.
2. District officials should ensure that written confirmations are provided by the bank from which District funds are transferred, no later than the next business day.

APPENDIX A

RESPONSE FROM DISTRICT OFFICIALS

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



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July 2, 2014

Mr. Ira McCracken
Chief Examiner
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Dear Mr. McCracken,

The Elwood UFSD Board of Education and Administration appreciate the time and effort spent on your office review of our district policies and procedures. The insights and suggestions your staff provided serve to improve our operations and we are thankful for that. The Board of Education and Administration agree with your findings.

For each recommendation included in the report, the following is our corrective action taken.

Audit Recommendation #1

The Board should:

- Establish comprehensive written policies and procedures for electronic transfers, which should authorize individuals to perform electronic transfer and require District Officials and employees to retain supporting documentation for each transaction.
- Segregate duties to ensure that no one person can both initiate and approve electronic transfers. If one person initiates the transaction, another authorized person should review and approve it.

District Response:

- The Board of Education has adopted an electronic transfer's policy. The business office has developed procedures to process electronic transfers and document the transfers.
- The business office has segregated the duties of the District Treasurer, Deputy Treasurer and Assistant Superintendent for Business. The District Treasurer and Deputy Treasurer can both initiate electronic transfers only; the Assistant Superintendent for Business must approve all transfers prior to disbursement from district accounts.

Audit Recommendation #2

District Officials should ensure that written confirmations are provided by the bank from which District funds are transferred, no later than the next business day.

District Response:

For all transactions initiated and approved via online an automatic confirmation is received from the bank. This confirmation is printed and kept on file with the back-up for the transfers. For all transactions initiated via fax a confirmation email is sent to the District Treasurer for record.

The Elwood Union Free School District would like to thank the audit team for their assistance and review of Board policy and office procedure. We continue to monitor the policy and procedures and continuously look for ways to improve and strengthen controls.

Sincerely,

Joseph Fusaro
Board President

APPENDIX B

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 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. 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 professional misconduct. We then decided on the reported objective and scope by selecting for audit the area most at risk. We selected electronic transactions. To accomplish the objective of this audit and obtain valid audit evidence, our procedures included the following:

- We interviewed District and bank personnel and documented the security procedures for wires and transfers.
- We obtained all District bank statements for the audit period and quantified the number and amount of electronic transactions.
- We judgmentally selected the three months of October 2012, May 2013 and August 2013 as follows: one month near the beginning and one month near the end of the 2012-13 fiscal year, and one of the two months in the 2013-14 fiscal year within our audit period. We reviewed all electronic transactions recorded on the bank statements to determine who initiated and approved the transaction, if the funds were either deposited to another District account or transferred for payment to a vendor for a valid District purpose, and if the District received a confirmation from the bank verifying that the transaction had been processed.

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

APPENDIX C

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