



Argyle Central School District

Internal Controls Over Payroll

Report of Examination

Period Covered:

July 1, 2012 — October 31, 2013

2014M-51



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 Argyle Central School District, entitled Internal Controls Over Payroll. 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 Argyle Central School District (District) is located in the Towns of Argyle, Fort Edward, Greenwich, Hartford and Hebron in Washington County. The District is governed by the Board of Education (Board) which comprises five elected members. The Board is responsible for the general management and control of the District's financial and educational affairs. The Superintendent of Schools (Superintendent) is the 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.

The District has one school in operation with approximately 600 students and 110 employees. The District's budgeted appropriations for the 2013-14 fiscal year were \$11.3 million, which were funded primarily with State aid and real property taxes.

The District reported approximately \$11 million in general fund expenditures during the 2012-13 fiscal year. During the same year, the District's gross payroll totaled approximately \$5.6 million. The District's bookkeeper works under the direction of the Business Manager and is responsible for processing payrolls and maintaining leave accrual records for all District employees.

Objective

The objective of our audit was to determine if the District had established effective internal controls over payroll and leave accruals. Our audit addressed the following related question:

- Are internal controls over payroll and the maintenance of leave accruals appropriately designed and operating effectively to adequately safeguard District assets?

Scope and Methodology

We examined the District's internal controls over payroll for the period July 1, 2012 through October 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 are 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 generally agreed with our recommendations and have initiated, or indicated they planned to initiate, 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.

Payroll

One of the Board's and District officials' responsibilities is to establish a system of internal controls over payroll to ensure that employees are paid wages and salaries, and provided benefits, to which they are entitled. Good internal controls for payroll consist of establishing written policies and procedures for preparing and disbursing payroll and maintaining leave accrual records. It also is important that the Board provide written authorization for salaries, wages and fringe benefits. Two important components of any internal control system are properly segregating financial duties to ensure that one person does not control all phases of a transaction and providing management oversight. When duties cannot reasonably be segregated among staff members, District officials should implement compensating controls to reduce the risks associated with incompatible duties.

The Board's lack of comprehensive written policies and procedures for payroll processing and maintaining leave time accrual balances has resulted in the bookkeeper performing incompatible duties related to payroll processing and maintaining all leave accrual balances, without the mitigating control of District officials sufficiently monitoring or reviewing her work to ensure accuracy. Although our testing did not reveal any material discrepancies, the District's failure to establish adequate internal controls over payroll processing and leave accrual balances could lead to errors occurring and remaining undetected. Also, the District has an increased risk that it could make inappropriate payments to employees based on errors within their leave accrual records.

Payroll Processing

Written payroll policies and procedures, combined with job descriptions affixing responsibilities for specific payroll activities, help to ensure that employees understand their role in the payroll process. An important principle of internal controls dictates that one individual should not have uncontrolled access to the entire payroll processing cycle. If the District's limited staff precludes establishing adequate segregation of duties, at a minimum, the Board should consider implementing certain mitigating controls such as having someone independent of the payroll preparation process certify the payrolls. This certification should compare payroll source documents to payrolls to ensure they are based on actual hours or days worked and Board-authorized hourly rates or annual salaries.

The Board had not adopted comprehensive written policies and procedures for processing payroll. The bookkeeper's payroll duties were not adequately segregated because she was responsible for

creating manual and computerized employee records; entering and making changes to employees' pay rates, withholdings and deductions; collecting time records from employees; entering employees hours worked and salaries paid; printing payroll checks; and having access to paychecks until she disbursed them to District employees. All of these incompatible duties were performed by the bookkeeper without sufficient oversight by someone not involved with processing payroll.

The Business Manager is responsible for executing direct deposits of paychecks for participating employees and reviewing interaccount transfers from the operating fund bank accounts to the trust and agency fund bank account. In addition, the Treasurer signs the paychecks to be distributed to employees with a signature stamp. However, the Business Manager's and Treasurer's limited roles related to processing payroll did not provide sufficient oversight or monitoring of the bookkeeper's work to mitigate the risks incurred due to her incompatible duties.

The Superintendent also provided an independent review of the payroll process by reviewing and certifying the final payrolls. However, the Superintendent's reviews were not extensive enough because she did not compare payroll journals to payroll source documents (i.e., time records) or the paychecks. Additionally, the Superintendent did not always sign payrolls to indicate that she had reviewed them and did not always date the payrolls to indicate that her certification took place before the paychecks were disbursed. We reviewed a random sample of five payroll journals¹ for payrolls that occurred during our audit period and found that one was not signed by the Superintendent and the other four did not have a date recorded with the Superintendent's signature to indicate the date of the certification. Therefore, we could not determine if these four payroll journals were certified prior to the payroll date.

We traced the names of a random sample of 20 individuals² who received payroll payments during the 2012-13 fiscal year to personnel files to verify they were legitimate District employees. In addition, we reviewed payroll payments totaling \$924,717 made to a sample of 10 employees³ during the 2012-13 fiscal year to verify that the bookkeeper's entries to the payroll records agreed with input documents such as time records, pay rates agreed with employment contracts or collective bargaining agreements and gross pay was calculated correctly. We did not identify any discrepancies.

¹ Refer to Appendix B for further information.

² Ibid.

³ Ibid.

Furthermore, we reviewed all nine separation payments totaling \$113,824 that the District made to employees who left District employment during our audit period to verify that the payments were properly calculated and in compliance with the provisions outlined in the employees' employment contract or collective bargaining agreement. Except for one minor exception that we discussed with District officials, we did not find any material discrepancies.

Although we did not find any material discrepancies, when the District allows one individual to have incompatible duties within the payroll processing without providing proper oversight and monitoring of his or her work, it increases the District's risk that errors or irregularities could occur and remain undetected.

Leave Time Accruals

A good system of accounting for employee leave time (i.e., vacation and sick time) requires District officials to periodically verify the accuracy of employee records with regard to leave time earned and used. The District should have comprehensive policies and procedures to provide periodic independent reviews of leave time accrual records and balances. District officials should ensure that employees earn leave time in accordance with employment contracts and collective bargaining agreements and that District personnel properly deduct leave time used from employee leave accruals.

The Board did not adopt comprehensive written policies and procedures to provide proper guidance and internal controls over leave time accruals. The bookkeeper was responsible for maintaining leave accrual records for District employees with limited oversight. When employees use their leave time, the bookkeeper uses the information provided on leave request forms, time sheets and an online registry containing instructional staff absences to determine the amount of leave time to deduct from employees' leave accrual balances.

On an annual basis, the bookkeeper provides employees with their leave accrual balances for their review. However, District officials do not periodically review these leave accrual balances to ensure the bookkeeper is accurately maintaining the records.

We reviewed the leave time records of 10 employees⁴ to verify whether the bookkeeper properly deducted days recorded as absences on the employees' time records from their leave accrual balances during the 2012-13 fiscal year. We also verified whether leave time credited and carried over for these employees during the 2012-13 and 2013-14 fiscal years agreed with their employment contracts or collective bargaining agreements.

⁴ Ibid.

Although we did not find any material discrepancies, when District officials do not periodically review the accuracy of leave accrual records maintained by the bookkeeper, it increases the risk that errors could occur within employees' leave accrual balances and remain undetected. Also, it increases the possibility that the District could make inappropriate payments to employees upon their separation from District employment based on errors within their leave accrual records.

Recommendations

1. The Board and District officials should establish comprehensive payroll processing and leave time accrual policies and procedures that incorporate the duties to be completed and records to be maintained for processing payrolls and maintaining leave records.
2. District officials should segregate the bookkeeper's payroll duties so that this individual does not control all aspects of payroll transactions. If it is not feasible to adequately segregate the bookkeeper's duties, District officials should establish compensating controls to routinely monitor and review the bookkeeper's work.
3. The Superintendent should compare payroll journals to payroll source documents when certifying payrolls and should sign and date the certifications to indicate that they have been approved before the District makes the corresponding payroll payments.
4. District officials should periodically review leave time accrual records and balances to ensure accuracy.

APPENDIX A

RESPONSE FROM DISTRICT OFFICIALS

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



ARGYLE
CENTRAL SCHOOL

July 16, 2014



Office of the State Comptroller
Division of Local Government and
School Accountability
One Broad Street Plaza
Glens Falls, NY 12801

Dear 

We are in receipt of the report of your audit of the Argyle Central School District for the period covering July 1, 2012 – October 31, 2013. The District appreciates the work performed and the recommendations made as a result of this audit. Please accept this as our Corrective Action Plan.

1. The Board and District officials should establish comprehensive payroll processing and leave time accrual policies and procedures that incorporate the duties to be completed and records to be maintained for processing payrolls and maintaining leave records.

RESPONSE: The Board and District officials are in the process of reviewing and updating all District policies. During the course of that review, the Board and District officials will establish comprehensive payroll processing and leave time accrual policies and procedures that incorporate the duties to be completed and records to be maintained.

2. District officials should segregate the bookkeeper's payroll duties so that this individual does not control all aspects of payroll transactions. If it is not feasible to adequately segregate the bookkeeper's duties, District officials should establish compensating controls to routinely monitor and review the bookkeeper's work.

RESPONSE: Due to staffing restrictions, District officials have established various compensating controls to monitor and review the bookkeeper's work. These include reviewing and approving time sheets, random reviews of substitute time records, and limiting access to paychecks before they are disbursed to District employees.

3. The Superintendent should compare payroll journals to payroll source documents when certifying payrolls and should sign and date the certifications to indicate that they have been approved before the District makes the corresponding payroll payments.

RESPONSE: The Superintendent is comparing payroll journals to payroll source documents when certifying payrolls. The Superintendent does sign and date certifications prior to payroll payments being made.

4. District officials should periodically review leave time accrual records and balances to ensure accuracy.

RESPONSE: The Business Manager will review random leave time accrual records each year to ensure accuracy. Leave time accrual information has also been added to employee pay stubs so that any discrepancies or concerns may be raised by the employee in a timely manner.

We would like to thank you for these recommendations as we are always looking to effectively manage the District's operations. We appreciate that although no material discrepancies were found, better controls can be implemented to help safeguard against future issues. Please contact me with any questions or concerns.

Sincerely,

Jan Jehring
Superintendent of Schools

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 performed an initial assessment of the internal controls so that we could design our audit to focus on those areas most at risk. Our initial assessment included evaluations of the following areas: financial condition and oversight, control environment, cash receipts and disbursements, purchasing, payroll and personnel services and information technology.

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

After reviewing the information gathered during our initial assessment, we determined where weaknesses existed, and evaluated those weaknesses for the risk of potential fraud, theft or professional misconduct. Based on that evaluation we determined that controls appeared to be adequate and limited risk existed in most of the financial areas we reviewed. We then decided on the reported objective and scope by selecting for audit those areas most at risk. We selected payroll for further audit testing.

To accomplish the objective of this audit and obtain valid audit evidence, our procedures included the following:

- We interviewed District officials and employees and reviewed the District's policy manual, employment contracts, collective bargaining agreements and various financial records and reports to gain an understanding of the internal controls over the processing of payroll and maintenance of leave accruals and any associated effects of deficiencies in those controls.
- We used a computerized random number generator to select five payroll journals from all of the payroll journals during our audit period. We reviewed these payrolls to determine if they were certified by the Superintendent and if they were certified prior to the payroll date.
- We used a computerized random number generator to select 20 individuals in the payroll system who received a payroll payment during the 2012-13 fiscal year. We traced the names of these individuals to personnel files to verify they were legitimate employees.
- We reviewed payroll payments that were made to a judgmental sample of 20 employees during the 2012-13 fiscal year to verify that the bookkeeper's entries to the payroll records agreed with supporting documentation, pay rates agreed with employment contracts or collective bargaining agreements, and that gross pay was calculated correctly. Our sample was selected by first selecting five employees who were involved in the processing of payroll. We then used

a computerized random number generator to select 15 other employees who received a payroll payment during the 2012-13 fiscal year.

- We reviewed all nine separation payments that were made to employees who left District employment during our audit period to verify that the payments were in compliance with the provisions outlined in the employees' employment contract or collective bargaining agreement and were properly calculated.
- We reviewed a judgmental sample of 10 employees' leave time records to verify whether the bookkeeper properly deducted days recorded as absences on the employees' time records from their leave accruals during the 2012-13 fiscal year. We also verified whether leave time credited and carried over for these employees during the 2012-13 and 2013-14 fiscal years agreed with their employment contracts or collective bargaining agreements. Our sample was selected by first selecting five employees who were involved in the approval, reporting and maintenance of leave accrual records. We then used a computerized random number generator to select five other employees from five different departments who had earned leave time during the 2012-13 fiscal year.

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

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