Canton
Central School District
Internal Controls Over Payroll

Report of Examination
Period Covered:
July 1, 2007 — March 31, 2009
2009M-164
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Division of Local Government and School Accountability

October 2009

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 Canton 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 Canton Central School District (District) is located in the Town of Canton in St. Lawrence County. The District is governed by the Board of Education (Board) which comprises nine elected members. The Board is responsible for the general management and control of the District’s financial and educational affairs. The Superintendent of Schools (Superintendent) is the chief executive officer of the District and is responsible, along with other administrative staff, for the day-to-day management of the District under the direction of the Board.

There is one school in operation within the District, with approximately 1,400 students and 270 employees. The District’s general fund expenditures for the 2007-08 fiscal year were approximately $21.6 million, funded primarily with State aid, real property taxes, and grants.

The District employs a full-time Business Administrator to oversee its business operations. The District Treasurer performs payroll duties and processes payroll for all employees on a bi-weekly basis. The District’s payroll expenditures totaled $11.5 million for the 2007-08 fiscal year.

Objective

The objective of our audit was to examine the District’s internal controls over payroll. Our audit addressed the following related question:

• Are internal controls over payroll processing appropriately designed and operating effectively to adequately safeguard District assets?

Scope and Methodology

Our overall goal was to assess the adequacy of the internal controls put in place by officials to safeguard District assets. To accomplish this, we performed an initial assessment of the internal controls so that we could design our audit to focus on those areas most at risk. Our initial assessment included evaluations of the following areas: financial oversight, cash receipts and disbursements, purchasing, payroll and personal services and information technology. Based on that evaluation, we determined that controls appeared to be adequate and limited risk existed in most of the financial areas we reviewed. However, we determined that risk existed in the payroll area and, therefore, we examined internal controls over payroll for the period July 1, 2007 to March 31, 2009.
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.

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 indicated that they planned to take or had already taken 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.
The primary objective of internal controls over payroll processing is to ensure that employees are paid wages and salaries, and provided benefits, to which they are duly entitled. An important component of any internal control system is proper segregation of duties, ensuring that no one person controls all phases of a transaction. Specifically, strong internal controls over payroll require that one person does not have the ability to authorize, execute, and record a transaction or control an entire payroll processing cycle. Another important component of any system is management oversight. Concentrating key duties (i.e., authorization, recordkeeping, and custody) with one individual with little or no oversight weakens internal controls and significantly increases the risk that errors and/or irregularities might occur and go undetected and/or uncorrected in a timely manner.

When it is not practical to segregate duties because of limited staff resources, District officials should establish compensating controls. Such compensating controls could include periodic review of payroll transactions by personnel independent of the payroll process (e.g., payroll change reports).

Internal controls over the District’s payroll processing are not appropriately designed because the Treasurer performs virtually every phase of the payroll process. Specifically, the Treasurer has user access rights in the District’s computerized payroll module which allow her to enter new employees, activate and inactivate existing employees, and make changes in employees’ hourly and annual salary rates – including her own. She is also responsible for setting up employee payroll deductions and direct deposits, preparing and signing payroll checks, and maintaining payroll records. The Treasurer processes the District’s payroll without any oversight or involvement of any other District official or employee independent of the payroll process. Further, District personnel were unaware that payroll change reports could be generated and therefore did not generate or review them. Without proper segregation of authorization, recordkeeping and custody duties or oversight, there is an increased risk the Treasurer could create fictitious employees, process improper payroll payments to her or to other employees, and adjust the records to prevent detection.

Although the District has certain mitigating controls in place, these controls are not operating effectively. The Superintendent signs a payroll certification sheet without reviewing payroll information for accuracy, employee existence, and/or completeness. In order for the payroll certification process to be effective and provide assurance that
the payroll is accurate and complete, the Superintendent must review the payroll documents before certifying the payroll. In addition, the District claims auditor reviewed three to four selected payrolls per fiscal year during our scope period. However, in 2007-08 when the duty was assigned to her, she announced to the Treasurer and the Board in advance the payroll dates she would review. The dates were announced as a means to inform the Board of the implementation of the control measure. Randomly selecting payroll dates for review without prior notification to anyone in the District will enhance the effectiveness of this mitigating control.

The weaknesses identified increase the risk that unauthorized changes or errors may occur without being detected and corrected in a timely manner. As a result, we reviewed employee contracts, salary letters, board minutes, appointment documents, and other associated documentation to determine if the following payments were accurate, properly authorized, and supported:

- Gross payments to 10 key officials totaling $422,132 during 2007-08, and the associated gross bi-weekly salary payments in 2008-09
- Twenty-five selected employees’ gross amounts paid during 2007-08 totaling $1.3 million
- Gross bi-weekly payroll payments of 10 selected employees totaling $15,762 for two selected payroll periods during our scope period
- The gross payrolls of 15 employees who received 27 or more paychecks in 2007-08 totaling $767,405
- Balloon payments made to 10 employees totaling $76,287 in 2007-08.

We also performed the following three tests to further verify the accuracy of the payroll:

- Examined the personnel documentation of 20 employees to verify that they were bona-fide employees.
- Reviewed Federal withholding amounts for all employees totaling $469,359 for four pay periods during our scope period, to determine if the amounts paid agreed to payroll withholding records.
• Selected the gross bi-weekly payroll payments of 12 employees who did not have any Federal amounts withheld, totaling $4,700 for four pay periods during our scope period, to verify that the lack of Federal withholdings was legitimate and justified.

Our testing of payroll did not reveal any exceptions.

District officials provided us with documentation to indicate that as of May 11, 2009, the Superintendent now performs a sufficient review of each payroll prior to certification, and as of June 19, 2009, the Business Administrator now retains copies of a payroll change report that she generates and reviews each pay period. Lastly, the claims auditor indicated to us that she would review selected payrolls without announcing in advance the dates to be examined.

**Recommendations**

1. District officials should continue to ensure that payroll information is reviewed before certification and that changes to payroll information are reviewed each pay period.

2. The claims auditor should review selected payrolls throughout the fiscal year without informing District officials or employees of her selection in advance.
APPENDIX A

RESPONSE FROM DISTRICT OFFICIALS

The District officials’ response to this audit can be found on the following page.
October 9, 2009

Statewide & Regional Projects Unit  
Division of Local Government & School Accountability  
Office of the New York State Comptroller  
295 Main Street, Room 1050  
Buffalo, New York 14203-2510

Re: Canton Central School District Audit

Dear [Redacted]:

This correspondence is provided in response to the preliminary draft findings contained in Canton Central School District’s Report of Examination on Internal Controls Over Payroll covering the period July 1, 2007-March 31, 2009. Our actions with regard to the two recommendations contained in the report are detailed below.

Recommendation 1: District officials should continue to ensure that payroll information if reviewed before certification and that changes to payroll information are reviewed each pay period. District Action: As indicated in the Report, the superintendent instituted and continues the practice of reviewing a detailed listing of payees and associated transactions prior to certifying each payroll. Similarly, our business manager routinely requests, reviews, and retains copies of payroll change reports for each pay period.

Recommendation 2: The claims auditor should review selected payrolls throughout the fiscal year without informing District officials or employees of her selection in advance. District Action: Also indicated in the Report, our claims auditor now selects the payrolls that are to be examined without announcing the dates of those payrolls in advance.

On behalf of the District, I wish to thank the examining team for their professionalism in conducting the audit and for their assistance in helping us improve our fiscal controls. Please contact me at (315) 386-8561, extension 202, if additional information is needed.

Sincerely,

[Signature]
William A. Gregory  
Superintendent of Schools

cc: Mrs. Barbara B. Beekman, President, Board of Education
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 oversight, cash receipts and disbursements, purchasing, payroll and personal services, and information technology.

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

After reviewing the information gathered during our initial assessment, we determined where weaknesses existed, and evaluated those weaknesses for the risk of potential fraud, theft and/or professional misconduct. 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.

We gained an understanding of the internal controls over payroll at the District and then tested various payroll items such as: verifying employees’ existence, payments to key officials, verification of selected employees’ annual salaries, tracing withholdings to transfers into the trust and agency fund, verifying that payrolls were extended correctly, verifying the correct number of checks were issued to selected employees, and reviewing balloon payments. The sources of evidence we reviewed included but was not limited to the following: employee time records, personnel files, appointment letters, Board minutes, payroll reports, bank statements, claim forms, Board adopted employee contracts and agreements and journal entries.

We conducted our 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.
APPENDIX C

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Steven J. Hancox, Deputy Comptroller
John C. Traylor, Assistant Comptroller

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