



Peru Central School District Internal Controls Over Selected Financial Activities

Report of Examination

Period Covered:

July 1, 2006 — January 31, 2008

2008M-122



Thomas P. DiNapoli

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State of New York Office of the State Comptroller

Division of Local Government and School Accountability

October 2008

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 Peru Central School District, entitled Internal Controls Over Selected Financial Activities. 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*



State of New York Office of the State Comptroller

EXECUTIVE SUMMARY

The Peru Central School District (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 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.

The District reported approximately \$34.1 million in general fund expenditures during the 2006-07 fiscal year. The District's gross payroll and employee benefits totaled approximately \$16.5 million and \$8.2 million, respectively. During the same year, the extra-classroom activity fund recorded more than \$552,500 in receipts and disbursements. The District has approximately 650 individual computers that are networked together. District employees use computers in day-to-day operations for instructional purposes and to process financial transactions.

Scope and Objective

The objective of our audit was to determine if the District had established effective internal controls over selected financial activities for the period July 1, 2006 to January 31, 2008. Our audit addressed the following related questions:

- Are internal controls over the payroll process appropriately designed and operating effectively to adequately safeguard District assets?
- Are internal controls over cash receipts and disbursements appropriately designed and operating effectively to adequately safeguard District assets?
- Are internal controls over extra-classroom activity funds adequate?
- Are internal controls over the District's information technology system appropriately designed to protect electronic data?

Audit Results

We found instances where the District had not established critical internal controls, or the controls that had been established were not implemented and operating effectively. Additionally, District officials did not completely implement corrective action to address several of the deficiencies that were noted in both the District's independent audit report and internal audit report for the 2006-07 fiscal year. As a

result, the District is vulnerable to the possibility of errors and/or irregularities occurring and not being detected in a timely manner.

Internal controls over the payroll process were not appropriately designed and operating effectively to adequately safeguard District assets. The Board had not adopted comprehensive written policies and procedures to provide guidance and internal controls for payroll processing and leave time accruals. Specifically, District officials did not adequately segregate duties over payroll and provided minimal oversight. As a result, the District failed to update the Business Administrator's employment contract, inaccurately calculated longevity pay for an employee, and did not give prior approval for overtime payments made to the payroll clerk and account clerk totaling \$10,545. Additionally, we found that certain employees' leave accruals did not conform to the benefits authorized in their employee contracts or collective bargaining agreements.

Internal controls over cash receipts and disbursements were not appropriately designed or operating effectively to adequately safeguard District assets. There were weaknesses in controls over cash receipts and disbursements because the District failed to develop written policies and procedures, did not adequately segregate duties, and provided minimal oversight. Account clerks affixed the Treasurer's signature to payroll and accounts payable checks without the Treasurer's oversight or review. The claims auditor did not perform her duties and responsibilities in compliance with the District's internal claims auditor policy. Generally, we noted that cash receipts were not properly accounted for or deposited timely. For example, District officials were unable to account for cash collected at three sporting events and were unable to identify the origin of \$1,410 of cash on hand in District safes. Additionally, we noted \$8,886 of sports-admission receipts that were deposited 12 days or more from the date funds were received.

Internal controls over extra-classroom activity funds (activity fund) were inadequate. The District did not maintain the activity fund in accordance with the guidelines established by the Board. None of the 10 activity fund accounts reviewed maintained a student ledger during the 2006-07 school year. Although the District appointed a faculty auditor to monitor the activity fund, there was no indication that the faculty auditor did this. We found 20 disbursements totaling \$10,431 that lacked adequate documentation to allow us to determine if they were for appropriate student activities. We also noted 17 cash receipts totaling \$9,070 that were deposited 12 days or more from the date funds were received.

Internal controls over the District's information technology system were not appropriately designed to protect electronic data. The District had not established adequate written policies and procedures for information technology (IT) and the protection of its electronic data. The policies that were in place did not establish sufficient controls to adequately safeguard the District's IT system and the data that is stored on it.

Comments of District Officials

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.

Introduction

Background

The Peru Central School District (District) is located in Clinton County in the Towns of Ausable, Black Brook, Peru, Plattsburgh, Saranac and Schuyler Falls. 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 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 are four schools in operation within the District, with approximately 2,130 students and 435 employees. The District's budgeted expenditures for the 2007-08 fiscal year are \$40 million, which are funded primarily with State aid, real property taxes, and grants.

The District reported approximately \$34.1 million in general fund expenditures during the 2006-07 fiscal year. The District's gross payroll and employee benefits totaled approximately \$16.5 million and \$8.2 million, respectively. During the same year, the extra-classroom activity fund recorded more than \$552,500 in receipts and disbursements. The District has approximately 650 individual computers that are networked together. District employees use computers in day-to-day operations for instructional purposes and to process financial transactions.

Objective

The objective of our audit was to determine if the District had established effective internal controls over selected financial activities. Our audit addressed the following related questions:

- Are internal controls over the payroll process appropriately designed and operating effectively to adequately safeguard District assets?
- Are internal controls over cash receipts and disbursements appropriately designed and operating effectively to adequately safeguard District assets?
- Are internal controls over extra-classroom activity funds adequate?
- Are internal controls over the District's information technology system appropriately designed to protect electronic data?

**Scope and
Methodology**

We examined the District’s control environment and its internal controls over payroll, cash receipts and disbursements, extra-classroom activity funds and information technology for the period July 1, 2006 to January 31, 2008.

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 GML, 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 forwarded to our office within 90 days. 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

The primary objective for internal controls over payroll processing is to ensure that employees are paid wages and salaries, and provided benefits, to which they are entitled. Internal controls for payroll consist of written policies and procedures for preparing and disbursing payroll, as well as written Board authorization for salaries, wages and fringe benefits. Two important components of any internal control system are the proper segregation of duties to ensure that one person does not control all phases of a transaction, and management oversight.

The Board's failure to adopt comprehensive written policies and procedures for payroll processing and leave time accruals has resulted in a lack of segregation of duties and lack of compensating controls over these functions. As a result, the District failed to update the Business Administrator's employment contract, inaccurately calculated longevity pay for an employee, and did not give prior approval for overtime worked by the payroll clerk and account clerk. Additionally, we found that certain employees' leave accruals did not conform to the benefits authorized in their employee contracts or collective bargaining agreements.

Payroll Processing

Written payroll policies and procedures, combined with job descriptions that assign responsibilities for specific payroll activities, help to ensure that each employee understands the overall objectives and his/her individual role in the payroll process. An important principle of internal control requires that no individual have uncontrolled access to an entire processing cycle. It is incumbent upon the Board to establish a system of checks and balances to ensure that duties are adequately segregated.

The District's payroll clerk and account clerk are responsible for the payroll process, but their duties are not designed to check one another, and they perform their duties with only minimal oversight. The District implemented only one independent review of the payroll process by having the Business Administrator certify the final payrolls. However, we found that the Business Administrator's reviews were not adequate because he did not compare the payroll register to additional payroll source documents or checks. This deficiency still exists, although both the District's independent audit report and internal audit report for the 2006-07 fiscal year cited the District for failing to segregate duties over the payroll process. There was no indication that the audit committee, which consists of the entire Board, completely addressed the findings of either the independent or internal audits.

Based on the lack of internal controls over the payroll process during our scope period, we traced the names of all recipients of payroll payments during the 2006-07 fiscal year to either staff directories, personnel files, or Board Minutes to verify that they were legitimate District employees. We noted no exceptions. In addition, we tested the accuracy of 20 employees' salaries during the 2006-07 fiscal year. We found that two of the 20 employees had discrepancies between their salaries and approved employment contracts. For example, we determined that the Business Administrator received four percent salary increases during both the 2006-07 and 2007-08 school years, although the Board and Business Administrator did not have written documentation that a new agreement was written and signed by both parties, as required by the Business Administrator's contract. Additionally, although the Business Administrator's contract stated that he could receive a buyout of health insurance benefits each year in the amount of 75 percent of the District's actual cost of an individual plan, he was paid a health insurance buyout of 100 percent of the District's actual cost during both the 2006-07 and 2007-08 school years, totaling \$5,466 and \$5,876 respectively. We noted the District subsequently approved the increase from 75 percent to 100 percent retroactively by Board resolution dated February 5, 2008. District officials indicated the Board was aware of the increases to the Business Administrator's salary and health insurance buyout during the 2006-07 and 2007-08 school years and realized that the District had not taken appropriate action in amending the Business Administrator's employment contract.

During our review, we also found that the payroll clerk reviewed and calculated all administrative longevity and retirement payments without oversight by District officials. We found that an employee was overpaid by \$465 during the 2006-07 school year and then underpaid by \$465 during the 2007-08 school year because the payroll clerk made an error in calculating the employee's longevity salary payments. We also reviewed a sample of 10 retirement payments totaling approximately \$158,000 to verify that they were accurately calculated. We noted no exceptions. However, the payroll clerk's ability to process administrative longevity and retirement payments without management oversight is a critical control weakness that could result in overpayments being made without being detected by District officials.

During our review, we also determined that the payroll clerk and account clerk are paid bi-weekly but submit their timesheets on a monthly basis. Therefore, they are paid for hours worked before the Business Administrator reviews and approves their timesheets. We also determined that the payroll clerk and account clerk were not required to receive pre-approvals for the overtime hours that they

reported they had worked. The payroll clerk and account clerk received compensation for 387.25 hours of overtime totaling \$10,545 during our audit period. Since the District did not have adequate procedures to track the use of overtime, the District could not determine whether the overtime was necessary or if it was accurately reported.

Concentrating key payroll duties with one individual weakens internal controls and significantly increases the risk that errors and/or irregularities could occur and remain undetected. The District's lack of proper oversight over the payroll process, as evidenced by the absence of compensating controls, further increases the potential for fraud and abuse.

Leave Time Accruals

A good system of accounting for employee leave time (vacation, sick, etc.) includes periodically verifying that the records for leave time earned and used, and leave allowances to which employees are entitled, are accurate and prepared timely. The District must have adequate policies and procedures in place governing the use of leave time. These policies and procedures must be authorized by the Board, and include provisions for the adequate supervision over the reporting of employee attendance and the maintenance of leave accrual records.

The District's payroll clerk uses the District's fiscal management software to maintain leave accrual records for instructional and administrative employees, and the account clerk maintains manual leave accrual records for non-instructional employees. The payroll clerk and account clerk perform these duties with minimal oversight. Most employees are required to submit supervisor-approved biweekly attendance sheets to the payroll or account clerk so that the clerks can calculate the employees' leave accruals. However, we noted that the Superintendent, Business Administrator, and 10 other District management employees submitted monthly attendance sheets. Therefore, the payroll clerk and account clerk were unable to ensure that these District employees had sufficient leave time available prior to being paid for it. Furthermore, we determined that the District did not update and maintain biweekly leave accrual records for all non-instructional employees. Instead, the District maintained these records periodically throughout the school year. The District prints instructional and administrative employees' leave accrual balances on their biweekly checks or direct deposit stubs, whereas the District provides non-instructional employees with their leave accrual balances at the beginning of the school year. This constitutes the District's only independent review of employees' leave accrual records.

Because of the lack of policies and procedures covering leave time accruals, and the lack of oversight, we reviewed a sample of 15

employees' leave accrual records to ensure that leave was earned in accordance with employee contracts or collective bargaining agreements, and to verify that the days when the employees were absent were properly deducted from their leave accruals. We noted that three of the District's confidential Business Office employees earned and used compensatory leave time, although the employees' contracts did not contain a provision for compensatory leave time. As a result, we reviewed all six of the District's confidential Business Office employees' leave accrual records and determined that four of these employees used a total of 320.50 hours of compensatory leave time during our audit period, valued at approximately \$6,000. A fifth employee also earned and used compensatory leave time. However, the District did not maintain records of this leave time, so we were unable to determine the number of hours of compensatory leave time that she used.

We also noted that the clerks did not always properly deduct used leave time from employees' leave accrual records because an informal protocol allowed employees to use more leave time than they had earned. Instead of docking employees' pay, the clerks deducted the negative leave accrual balances from the employees' leave accrual balances at the start of the next fiscal year. We reviewed all employees' leave accrual records at the end of the 2006-07 school year and determined that 12 employees had negative leave accrual balances at the end of the 2006-07 school year totaling 15.50 days, valued at approximately \$2,900.

The District's account clerk maintains leave accrual records for the accounts payable clerk. During our review, we noted that the accounts payable clerk's leave accrual records were not accurately maintained and up-to-date for the 2006-07 and 2007-08 school years because she had not submitted attendance records to the account clerk for the 2005-06 school year. Without accurate beginning leave accrual balances at the end of the 2005-06 school year, the account clerk was not able to carry forward and maintain accurate leave accrual records for the accounts payable clerk during the ensuing 2006-07 and 2007-08 school years.

It is essential that the District maintain accurate leave records to determine the proper amount of termination payments that are due to employees who retire or resign from their positions and to ensure that District employees are compensated for the correct amounts to which they are contractually entitled.

Recommendations

1. The Board should establish a comprehensive payroll processing and leave accrual policy that incorporates the duties, records

and procedures that are needed to ensure records are accurate, efficient, timely, and appropriate.

2. District officials should segregate payroll duties. Where it is not practicable to segregate duties, District officials should establish appropriate compensating controls, such as increased management review procedures.
3. The Board and District officials should ensure that changes to employment contracts are properly authorized and documented.
4. Someone independent of the payroll process should review the accuracy of administrative longevity and retirement payment calculations before the District makes the payment.
5. District officials should ensure that compensation to employees for time worked is adequately substantiated by approved time records.
6. Someone independent of the maintenance of leave time records should review leave time accrual records and balances for accuracy periodically throughout the year.
7. District officials should ensure that employee leave benefits coincide with the terms of applicable collective bargaining agreements or other employment contracts.
8. District officials should not allow employees to have negative leave accrual balances.

Cash Receipts and Disbursements

The Board is responsible for designing internal controls that help to safeguard the District's resources and ensure that these resources are used economically and efficiently. An adequate system of internal controls includes clear policies and procedures that promote effective operations, the prudent use of resources, and the adherence to applicable laws and regulations. Further, an effective system of internal controls provides for the segregation of duties so that no single individual controls all phases of a transaction. When it is not practical to segregate duties because of limited staff resources, the Board should establish compensating controls. Such compensating controls should provide that the Board or other administrative staff periodically review the work of the staff under their direction and periodically rotate their staff's work duties.

The Board has not adopted comprehensive written policies and procedures to provide guidance and internal controls for cash receipts and disbursements. The Board's lack of guidance has resulted in a lack of segregation of duties and compensating controls over the District's cash receipts and disbursements. As a result, we found that account clerks affixed the Treasurer's signature to payroll and accounts payable checks without the Treasurer's oversight or review. We noted that cash receipts were not properly accounted for or deposited timely. The claims auditor did not perform her duties and responsibilities in compliance with the District's internal claims auditor policy. The District's failure to establish adequate internal controls over its cash receipts and disbursements increases the chance that District monies could be misused and not be detected or corrected in a timely manner.

Segregation of Duties — An effective system of internal controls over cash receipts and disbursements ensures that no one individual performs incompatible duties, and that the work of one employee is independently verified in the course of another employee's regular duties. While it may not always be possible to achieve an optimal segregation of duties, at a minimum, recordkeeping, bank account reconciliation and cash disbursement duties must be separated.

The reconciliation of bank account balances to general ledger cash balances is an essential control activity. This process provides for the timely identification and documentation of differences between District and bank cash balances. Bank reconciliations provide a unique opportunity for an internal verification of cash receipt and

disbursement transactions. Without accurate and complete bank reconciliations that are performed and reviewed by an individual who is independent of the cash-custody function, District officials cannot have a reasonable level of assurance that the accounting records are correct or that monies are accounted for properly.

Bank reconciliations were not performed by an individual independent of the cash custody and record keeping functions. Specifically, the Treasurer was responsible for performing bank reconciliations and, at the same time, also responsible for the collection of cash; making daily deposits; recording of receipts within the fiscal management software; transferring funds from District accounts; signing checks; preparing, approving and reviewing journal entries; and recording accounts payable disbursements in the absence of the accounts payable clerk. The Board and Business Administrator received and reviewed bank reconciliations on a monthly basis. However, the Board and the Business Administrator did not receive bank statements or trial balances and thus could not verify that bank reconciliations were properly performed. We reviewed all of the District's bank account reconciliations for the months of November 2006, March 2007, October 2007 and May 2007 and identified no discrepancies. However, concentrating key cash receipts and disbursement duties with one individual weakens internal controls and significantly increases the District's exposure to the possibility of fraud, abuse, and professional misconduct.

Check Signing — Effective controls over cash disbursements is vital to prevent unauthorized payments and misuse of funds. The Treasurer plays a critical role in the cash disbursement process because she is responsible for signing the District's checks. The Treasurer must ensure that the use of her signature is properly controlled and safeguarded from being used to make payments that have not been properly approved. Education Law requires the Treasurer's actual or facsimile signature to be affixed to District checks by the Treasurer or under the Treasurer's direct supervision.

The Treasurer did not maintain adequate control over her signature in compliance with District policy. District checks are computer-generated with the Treasurer's signature imprinted on them. The account clerk and accounts payable clerk affix the Treasurer's signature to payroll and accounts payable checks without the Treasurer's oversight or review. In addition, although signed checks are stored in a walk-in vault within the Business Office until they are disbursed, seven employees have the combination to open the vault. Signed checks are also readily accessible to other individuals, because the vault is open throughout the school day. As a result of this control weakness, we scanned more than 2,500 cancelled payroll checks and more than 900

accounts payable checks to verify that they were issued in sequence and could be accounted for. We did not identify any exceptions based on our testing. However, the lack of controls provides little or no assurance that signed checks are being produced only for legitimate District purposes and are being properly disbursed.

Cash Receipts — A good system of internal controls over cash receipts requires District officials to supervise employees who handle monies and sequentially issue duplicate press-numbered receipts for all cash collections. Additionally, good business practice requires cash and checks to be deposited as quickly as possible to prevent the loss or misuse of cash. Delays in depositing and recording cash receipts make cash more susceptible to theft or loss and can reduce the District's potential interest earnings.

The District recorded \$16,578 in sports admission revenues during our audit period. We tested sports admission receipt records to determine whether cash receipts were deposited promptly. We examined 20 cash receipts totaling \$8,886, and found that all of the cash receipts were deposited between 12 and 88 days after they were received. On average, the District deposited cash receipts 40 days after they were received. For example, two cash receipts totaling \$811 were collected on September 1, 2007 and were not deposited at the bank until 88 days later on November 28, 2007. Additionally, we examined a detailed transaction report for sports admission revenues and the sports schedules for football, wrestling, and girls and boys basketball during our audit period to verify that the Treasurer deposited the money collected for each sporting event that was held at the District. We determined that deposits were not made for three girls' basketball games. The athletic director was not able to provide us with any documentation of collections for these games, but did confirm that the games took place and that sports admissions had been collected. Because the District recorded average revenue of \$200 per girls basketball game, we determined that approximately \$600 of sports admission revenues were unaccounted for. Our review of sports admission cash receipts also included performing a cash count of the money on hand in the athletic director's safe. The safe contained \$156, which the athletic director stated was her own personal money that she used as a start-up fund at sporting events for sports admission collections. When District employees commingle personal funds for use during District operations, it increases the District's exposure to liability and makes it more difficult to establish accountability.

On March 6, 2008, we performed a cash count of all of the cash receipts that the District maintained in its four school building safes to determine whether the District properly accounted for the money. We found approximately \$5,000 in the safes, \$1,410 of which was

unidentified receipts that District officials were unable to identify the source.

District personnel's failure to properly account for cash receipts results in District monies being more susceptible to loss and misuse. Management's lack of oversight over cash receipts increases the risk that such monies could be used for purposes other than as intended.

Claims Auditing — Conducting a proper audit of claims before the District pays them is an integral part of any internal control system. Education Law authorizes the Board to adopt a resolution to appoint a claims auditor to perform this critical District function. The claims auditor assumes the Board's powers and duties for approving and disapproving claims against the District. The claims auditor must report directly to the Board. With limited exceptions, the District's Treasurer cannot make payment for claims without first being approved by the claims auditor.

We determined that the District is not in compliance with its claims auditor policy because the claims auditor does not report concerns directly to the Board prior to payment of claims. Additionally, she does not ensure that the purchases do not exceed the available appropriations, ensure that purchases are in agreement with contracts that the District has entered into, or ensure that vouchers do not include charges for taxes. The claims auditor stated that she met with the Board for the first time in the month of February 2008, although she has been the District's claims auditor for almost 20 years. Additionally, we found that the District prints and signs accounts payable checks prior to the claims auditor's review. Although the claims auditor receives these checks to review before the District disburses them, she does not review the actual checks, but instead reviews the check copy that is attached to the claims. Because the claims auditor does not review the actual check, she cannot determine if payments have been made by the District prior to her audit. The Treasurer informed us that on occasion, the District makes certain payments¹ prior to audit.

The lack of effective internal controls over the claims auditing process increases the risk that improper claims may be paid against the District and go undetected and uncorrected.

Recommendations

9. The Board should establish a comprehensive cash receipts and disbursements policy to ensure that the District collects monies, issues receipts, deposits monies received, and disburses monies properly.

¹ According to Education Law, the Board can pass a resolution to pay certain items prior to audit. The payments indicated by the Treasurer are not applicable to this law.

10. District officials should segregate cash receipts and disbursements duties. Where it is not practicable to segregate duties, the District should use appropriate compensating controls.
11. District officials should ensure that someone who is independent of the cash custody duties performs complete and accurate monthly bank reconciliations to ensure that any discrepancies are promptly identified and resolved. District officials should also require that someone who is independent of the cash-custody duties reviews and approves the monthly bank reconciliations.
12. The Treasurer should maintain control of her facsimile signature, or supervise the signature process for all District disbursements.
13. District officials should ensure that signed checks are only accessible to individuals who are authorized to disburse checks.
14. District officials should ensure that cash and checks collected are deposited timely.
15. District officials should ensure that all cash receipts collected are supported with appropriate documentation and are properly accounted for.
16. The Treasurer should provide the athletic director with a petty cash fund for the purpose of making change at sporting events.
17. The Board should ensure that the claims auditor performs her duties in compliance with the District's internal claims auditor policy.

Extra-Classroom Activity Funds

The Regulations of the Commissioner of Education (Regulations) require each school district's Board of Education (Board) to establish rules and regulations for the safeguarding, accounting, and auditing of all monies received and derived from extra-classroom activities. The Regulations require the Board to appoint a central treasurer to maintain extra-classroom activities fund receipts and disbursements and a faculty auditor to oversee the management of the extra-classroom activities funds.

Generally, extra-classroom activity funds are raised through charges for, by, or in the name of, organizations whose activities are conducted by students. Students raise and spend these funds to promote the general welfare, education, and morale of all students, and to finance the normal and appropriate extracurricular activities of the student body. The District's 26 accounts in the extra-classroom activity fund (activity fund) recorded more than \$776,000 in receipts and disbursements during the period July 1, 2006 to January 31, 2008 and had a combined cash balance of approximately \$104,500 as of January 31, 2008.

The Board and District officials are responsible for protection and oversight of the District's cash assets, including activity fund monies. These responsibilities include adopting policies and procedures that describe the records that District personnel and students must maintain, and the duties and control procedures that they must follow to adequately safeguard activity fund monies. Having a good system of internal controls over these funds helps minimize the risk that errors or irregularities may occur and go undetected. We found that, while the Board established a policy governing the operations of the activity fund and approved a resolution for establishing accounting procedures that conform to the Regulations, activity fund monies were not maintained in accordance with the policy and Regulations because the Board did not effectively oversee District officials' performance of activity fund-related duties. As a result, neither the Board nor District officials have assurance that activity fund monies are properly accounted for in compliance with Regulations.

The Board appointed the middle school principal to the position of faculty auditor during the 2006-07 fiscal year and the assistant middle school principal during the 2007-08 fiscal year, but there was no indication that either faculty auditor performed a review of activity fund records. Additionally, although the Board did receive monthly activity fund reports, such reports were not accompanied by completed

bank reconciliations. We also determined that no one independent of the individual performing bank reconciliations reviewed them to verify that they were properly performed. Furthermore, we determined that certain activity funds were being operated for students below Grade 6, which is not in compliance with Regulations. We also found that the District did not implement corrective action to several of the extra-classroom activity fund deficiencies that were noted in the District's internal audit report for the 2006-07 fiscal year. We reviewed activity fund cash disbursements, cash receipts, and student ledgers to determine the extent of these weaknesses.

Cash Disbursements — A good system of internal controls over activity fund cash disbursements provides that the District only pays for purchases that are supported by sufficient documentation and for appropriate student activities. Additionally, good business practice requires the District to make blank check stock accessible only to individuals who are authorized to sign activity fund checks.

We reviewed 20 disbursements totaling \$10,431 that were remitted from 12 of the 26 activity fund accounts to determine if they had sufficient supporting documentation and found that all 20 cash disbursements lacked adequate documentation to show that they were made for appropriate student activities. Fifteen disbursements were made without any supporting documentation, such as an itemized receipt or invoice; three disbursements were based on a non-itemized purchase card statement; and two disbursements were based on receipts that were created by the individual who made the purchase. When payments are made without sufficient supporting documentation, District officials cannot ensure that the purchases were made for appropriate purposes.

Additionally, we reviewed 20 disbursements totaling \$10,465 that were remitted from seven of the 26 activity fund accounts to determine if they were made for appropriate student activities. We found that eight of the 20 cash disbursements totaling \$2,779 were not made for appropriate student activities, but instead were purchases that should have been made through the use of District operating funds. The eight disbursements consisted of a payment of \$1,625 for a laminator, \$417 for curtains and decorations for the high school office, and six payments totaling \$737 for Kleenex.

During our review, we also noted that although blank check stock is stored in a locked filing cabinet within the high school office, the central treasurer, high school principal, and two high school secretaries have access to the filing cabinet. As a result, we scanned a sample of more than 700 cancelled activity fund checks to verify that they were issued in sequence and could be accounted for. Although we noted no

exceptions based on our testing, District officials have no assurance that all blank check stock is properly accounted for when individuals who are not authorized have access to activity fund checks.

Cash Receipts — A good system of internal controls over activity fund cash receipts ensures that the District supervises employees who handle monies and issues duplicate press-numbered receipts in sequence for all cash collections. Additionally, good business practice requires cash and checks to be deposited daily or as quickly as possible to prevent the loss or misuse of cash. Furthermore, it is critical that cash receipts are deposited intact² to reduce the risk of fraud and concealment.

We examined 20 cash receipts totaling \$32,454 for 10 activity fund accounts to verify that the monies were deposited timely in accordance with good business practices. We found that it took 12 days or more from the date the funds were received to deposit 17 cash receipts totaling \$9,070. For example, a receipt totaling \$194 was collected on December 20, 2006 and was not deposited at the bank until 259 days later on September 5, 2007. Additionally, receipts totaling \$1,407 (including \$1,299 in cash) were collected on December 14, 2006 and were not deposited at the bank until 34 days later on January 17, 2007. When cash is not deposited promptly, it is subject to increased risk of loss or misuse.

Additionally, we analyzed the composition of all cash receipts to verify that deposits were made intact. We determined that all receipts were deposited in total, but that in nine instances cash was replaced with personal checks totaling \$304.50. For example, the central treasurer replaced cash with personal checks in three separate instances totaling \$59.50. Additionally, we determined that a high school typist replaced a cash receipt with a personal check totaling \$120. This cash receipt was collected on June 22, 2006, but the replacement check was not deposited at the bank until September 11, 2006.

We also noted that the central treasurer issued manually numbered receipts instead of pre-numbered receipts; thus, we could not verify that all receipts were issued in sequence and could be accounted for. As a result, we examined the central treasurer's ledger and supporting documentation to determine if any receipts were issued in duplicate. We noted no exceptions. However, when receipts are not pre-numbered, there is an increased risk that fraud or concealment could occur and remain undetected or that errors could be made and not be corrected.

² In the same amount and form (cash or check) in which they were received

Student Ledgers — The student treasurer of each activity fund shall maintain a ledger that shows all receipts and disbursements and indicates a daily running balance. This ledger should be on a form prescribed by District officials. The faculty advisor should guide the student treasurer in posting his/her account ledger and should periodically check the student treasurer's account balances. The student treasurer's ledger should periodically be compared to the central treasurer's ledger for accuracy, and any discrepancies should be investigated.

We examined 10 student ledgers for the 2006-07 and the 2007-08 school years to determine if the student treasurers of the activity funds maintained ledgers showing all receipts and disbursements and indicated a running balance that agreed with the central treasurer's ledger. We found that none of the 10 activity funds maintained a student ledger during the 2006-07 school year. Additionally, we determined that only six of the 10 activity funds maintained a student ledger during the 2007-08 school year. However, of the six activity funds, only one activity fund's student ledger contained all receipts and disbursements and a running balance that agreed with the central treasurer's ledger. When student ledgers are not maintained or do not agree with the central treasurer's ledger, there is an increased risk that fraud and concealment could occur and remain undetected.

The Board and District officials should take appropriate steps to better account for activity fund monies. Unless the Board increases its oversight and District officials perform fund management duties in accordance with Regulations and good business practices, there is a greater likelihood that errors and irregularities could occur and remain undetected and that activity fund monies could be lost or misused.

Recommendations

18. The Board and District officials should ensure that activity funds are maintained in accordance with District policy and the Regulations of the Commissioner.
19. The faculty auditor should oversee the management of extra-classroom activities fund monies in accordance with requirements in the Regulations.
20. District officials should provide the Board with quarterly extra-classroom activities fund reports that are accompanied by complete bank reconciliations.
21. District officials should require that someone who is independent of the extra-classroom activities fund cash custody and recording functions reviews and approves monthly extra-classroom activity fund bank reconciliations.

22. The Board should discontinue the operations of activity funds that are not in compliance with Regulations.
23. District officials should ensure that all extra-classroom activity fund disbursements are supported by sufficient documentation.
24. District officials should ensure that purchases made out of the extra-classroom activities fund are for appropriate student activities.
25. District officials should ensure that activity fund blank check stock is only accessible to individuals who are authorized to sign activity fund checks.
26. District officials should ensure that cash and checks collected for extra-classroom activities are deposited on a timely basis.
27. District officials should prohibit employees from replacing District cash receipts with personal checks, including those received from extra-classroom activity funds.
28. The central treasurer should use pre-numbered receipts for all extra-classroom activity fund receipts.
29. Faculty advisors should ensure that student treasurers maintain a student ledger showing all receipts and disbursements, and a running balance.

Information Technology

The District relies on an information technology (IT) system for computer education, access to the internet, e-mail communication, storing student data, maintaining financial records and reporting to various State and Federal agencies. Therefore, the IT system and the data it holds are a valuable District resource. If the IT system fails, the results could range from inconvenient to catastrophic. Even small disruptions in electronic data systems can require extensive employee and consultant hours to evaluate and repair.

The Board and District officials should control and monitor both user access and physical access to IT systems to reduce the risk of misuse and/or alteration of data that could result in a potential financial loss to the District. The Board should also develop a formal disaster plan to provide guidance on the prevention of the loss of computer information as well as the recovery of data in the event of disaster. We found that internal controls over the District's fiscal management system and network were inadequate: computer equipment was not protected from unauthorized access; audit logs were not generated and reviewed by someone independent of the Business Office operations; backups of non-financial data were not adequately stored; and the District did not have a formal IT disaster recovery plan. Because the Board did not develop policies and procedures to address these issues, the District's IT systems and electronic data have been subject to an increased risk of loss or misuse.

Computer System Access

It is important that the District have access controls in place to provide reasonable assurance that its computer resources are protected from unauthorized modifications. To control electronic access, a computer system or application needs a process in place to identify and differentiate among users. User accounts identify users and establish relationships between a user and a network, computer, or application. The technology coordinator creates these accounts, and they contain information about the users, such as passwords and access rights to files, applications, directories and other computer resources. Access controls include establishing adequate passwords, limiting administrator accounts, and restricting users to only the applications that are necessary for their day-to-day operations.

Passwords — Passwords are associated with user accounts and are used to identify, authenticate, and limit the access of individuals who are attempting to access a computerized system or application. The more complex a password, the more difficult it is for an unauthorized user to obtain access to the District's system. As passwords can be

guessed, copied, or overheard, passwords must be held to complexity requirements and changed periodically, and access rights must be revoked upon a set number of failed sign on attempts. Passwords must be stored in an encrypted format to prevent browsing and compromise. Additionally, it is important the District officials remove vendor default accounts when they install computer applications to prevent unauthorized individuals from accessing the system. Using these techniques significantly increases the District's protection and reduces the risk that unauthorized users can gain access to sensitive information.

We found weaknesses in the District's internal controls over passwords. Because of the sensitive nature of these findings, we communicated them directly to District officials.

User Rights Controls — To ensure proper segregation of duties and internal controls, the fiscal management system should only allow users access to the computer functions necessary to fulfill their job responsibilities. Having access controls in place prevents users from being involved in multiple aspects of financial transactions. Generally, a system administrator is designated as the person who has oversight and control of the system, and the ability to add new users as well as change users' passwords and rights. With this ability, administrators are able to control and use all aspects of the software. A good system of controls requires that this position be separate from the Business Office function.

The District's tax collection financial software application does not have access controls. As a result, the application does not have the ability to restrict the access levels of different users, which allows users to have full access to all levels of the application. Currently, the tax collector and Deputy Treasurer have access to the tax collection software application, although only the tax collector's job responsibilities entail maintaining records of tax collection on a day-to-day basis.

The software application that the District uses to process all other financial transactions has access controls. The four access categories allowed are "Add," "Update," "Delete," and "Print." The ability to restrict the access levels of different users is a good control feature in the computerized financial software application. However, several users have been granted access to functions that they do not need to fulfill their day-to-day job responsibilities. For example, the Business Administrator has the ability to create cash disbursements, cash receipts, and journal entries, although he does not need these functions to carry out his day-to-day job responsibilities. Furthermore, we determined that the payroll clerk and account clerk have the ability

to print payroll checks, and the accounts payable clerk has the ability to print accounts payable checks, although they do not need these functions to carry out their day-to-day job responsibilities.

We also found that the District Treasurer and two NERIC³ user accounts had administrative rights to the District's financial software application, which gives them the ability to add new users as well as change users' passwords and rights. With this ability, these individuals are able to control and use all aspects of the financial software application, which creates the opportunity for the manipulation and concealment of transactions.

Based on the weaknesses noted over the District's fiscal management software, we examined payroll payments, leave accruals maintenance, and accounts payable payments to verify that transactions were appropriate. Although our testing did not reveal any material exceptions, the District's failure to establish adequate password requirements and controls of user rights does not provide reasonable assurance that the District's computer resources are protected from unauthorized modifications.

Audit Logs

A computerized fiscal management system should provide a means of determining, on a constant basis, who is accessing the system and what transactions are being processed. Audit logs (commonly known as audit trails) maintain a record of activity by system or application. The audit log must provide information such as the identity of each person who has accessed the system, the time and date of the access, what activity occurred, and the time and date of sign off. Management or management's designee must review this audit log to monitor the activity of users who access the fiscal management software. This tool provides a mechanism for individual accountability, reconstructing events and problem monitoring.

The District's tax collection software does not generate the reports needed to properly monitor financial activity. Conversely, the District's financial application used to process all other financial transactions does have the ability to generate reports needed to properly monitor financial activity. However, the District does not generate any reports from this audit log, and the District has not designated someone independent of the Business Office operations to review audit logs. This is a significant weakness that could allow unauthorized activities to occur and go unnoticed and unresolved.

Physical Security Over Network Servers

Maintaining adequate security over District IT systems helps to ensure that they are protected from loss and used effectively for their intended

³ The Northeastern Regional Information Center (NERIC) supports the District's fiscal management software.

purpose. District officials can establish security over IT systems and equipment by controlling access to servers and by physically securing servers. However, we found that a server located in the middle/high school library was not physically secured because it was located on a shelf in an unlocked room. Therefore, unauthorized individuals could gain access to the server, which could result in services being disrupted, costly equipment being damaged, destroyed or stolen, and personal information being compromised.

Data Backup

Data must be backed up (copy made) on a routine basis, and the backup must be stored at an environmentally and physically secure off-site location. We found that District officials had not established policies or procedures to ensure the backup of District information. Currently, District financial data is backed up daily to an off-site network server. However, non-financial data is backed up daily to tapes that are stored in the same room as the network servers. Additionally, the IT Coordinator indicated that the backup tapes have not been periodically tested to verify the capability of restoring the District's system. The District risks losing most, if not all, of its non-financial data if the system is compromised and a backup is not available to restore it to normal operations.

Disaster Recovery

The District's internal control system should include a formal disaster recovery plan to address the possible loss of computer equipment and data and establish procedures for recovery in the event of such a loss. The plan should detail the precautions to be taken to minimize the effects of any disaster and enable the District to either maintain or quickly resume its mission-critical functions. The plan must include a significant focus on disaster prevention. However, District officials have not established a formal disaster recovery plan and consequently, in the event of a disaster, District personnel have no guidelines or plan to follow to help minimize or prevent the loss of equipment and data or guidance on how to implement data recovery procedures.

Recommendations

30. District officials should adopt policies and procedures to strengthen internal controls relating to the use of complex passwords, enforcement of password changes on a regular basis, and the revocation of access rights after a set number of failed sign-on attempts.
31. District officials should ensure that all financial software applications include strong passwords and other access controls and have the ability to create audit logs and other reports to monitor user activity.
32. District officials should remove vendor default accounts from all applications as they are added to the system.

33. District officials should evaluate employee job descriptions and assign computer system access rights to match the respective job functions.
34. The Board should designate someone independent of the Business Office operations to assign user access rights and review audit logs generated by the computerized fiscal management system.
35. District officials should store backups of District information at an environmentally and physically secure off-site location. In addition, this data should be periodically tested to verify that it is capable of restoring the District's system.
36. The Board should adopt policies and procedures to strengthen internal controls over IT equipment storage, data backup and disaster recovery.

APPENDIX A

RESPONSE FROM DISTRICT OFFICIALS

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

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A. Paul Scott
Superintendent of Schools

Randolph B. Sapp
School Business Administrator

October 17, 2008

Office of the State Comptroller
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Glens Falls, New York 12801

To the Office of the State Comptroller:

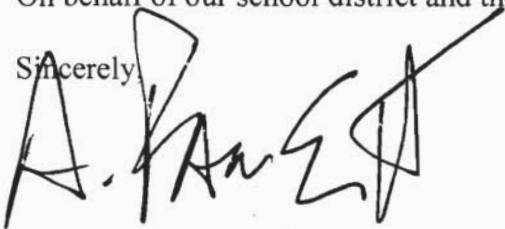
Thank you for the extensive audit of Peru CSD associated with fiscal accountability. Peru CSD has been making use of your annual **School Accountability Initiative** reports to help us update practices and policies at Peru CSD since the first edition of that report released in December 2005. Strengthening and updating of fiscal accountability at Peru CSD has been an area of focus during recent years. Our school district has established or updated policy and/or protocols for cell phones, competitive bidding, conference & workshop reimbursement, inventory control, mandatory training for Board members on fiscal oversight matters, meals and refreshments, Medicaid reimbursement, multi-year finance planning and purchase orders, among other areas of fiscal accountability.

Peru CSD agrees with the four general areas of internal controls highlighted within your audit report. Those four general areas complement various 'next steps' for continuous improvement of fiscal accountability practices identified fall 2007 at Peru CSD by our internal auditor and administration. Your comprehensive audit report on Peru CSD suggests to Peru CSD that previous areas of attention by Peru CSD on areas such as credit cards, cell phones and travel expenses were 'on point' and that current internal auditing areas of focus, including those identified in your audit report, are suitable 'next steps' for continuous improvement.

Especially appreciated are the various detail recommendations associated with the four areas of fiscal accountability updating you identified as in need of improvement. The extensively detailed set of recommendations is already helping us pinpoint areas of focus to continue advancing district policy and fiscal accountability practice at Peru CSD.

On behalf of our school district and the community we serve, I offer you our thanks.

Sincerely,



A. Paul Scott, 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 oversight, cash receipts and disbursements, purchasing, and payroll and personal services.

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. We then decided upon the reported objectives and scope by selecting for audit those areas most at risk. We selected payroll, cash receipts and disbursements, extra-classroom activity funds and information technology for further audit testing.

We focused our attention on whether adequate internal controls were in place over the processing of payroll and maintenance of leave accrual records. We interviewed officials, reviewed policy manuals, observed transactions, and examined payroll records such as timesheets, payroll registers, collective bargaining agreements, employment contracts, leave accrual records, and absence reports, to determine the effectiveness of internal controls pertaining to the payroll processing and leave accruals, and any associated effects of deficiencies in those controls.

We examined the cash receipts and disbursements function to determine if duties were adequately segregated, and if not, if the necessary compensating controls were in place. We interviewed officials, reviewed policy manuals, performed cash counts, observed transactions, and examined financial records such as the general ledger, monthly trial balances, cancelled checks, cash receipt slips, cash receipts book, validated deposit slips, bank statements, bank reconciliations, warrants, and claims, to determine the effectiveness of internal controls pertaining to the cash receipts and disbursements and any associated effects of deficiencies in those controls.

We reviewed all District policies relating to extra-classroom activity funds. We interviewed the central treasurer, observed transactions, and examined extra-classroom activity fund records such as the central treasurer's ledger, student ledgers, payment order forms, cancelled checks, bank statements, validated deposit slips, student activity deposit forms, cash receipts, and cash receipts book, to determine the effectiveness of internal controls over extra-classroom activity fund functions and any associated effects of deficiencies in those controls.

We reviewed all District policies related to computer use and information technology. We interviewed the District's IT Coordinator regarding network passwords, physical access to the system, controls within the fiscal management software, backups of data, and disaster recovery plans. We physically inspected the location of system equipment, viewed Business Office employees' computer screens, and reviewed user access reports.

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

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