



Discovery Charter School Internal Controls Over Cash Disbursements

Report of Examination

Period Covered:

July 1, 2013 — October 31, 2014

2015M-14



Thomas P. DiNapoli

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State of New York Office of the State Comptroller

Division of Local Government and School Accountability

May 2015

Dear School Officials:

A top priority of the Office of the State Comptroller is to help charter school officials manage school financial operations efficiently and effectively and, by so doing, provide accountability for moneys spent to support school operations. The Comptroller audits the financial operations of charter schools outside of New York City to promote compliance with relevant statutes and observance of good business practices. This oversight identifies opportunities for improving school financial operations and Board governance. Audits also can identify strategies to reduce costs and to strengthen controls intended to safeguard school assets.

Following is a report of our audit of the financial operations of the Discovery Charter School, entitled Internal Controls Over Cash Disbursements. This audit was conducted pursuant to Article V, Section 1 of the State Constitution and the State Comptroller's Authority as set forth in Section 2854 of the New York State Education Law, as amended by Chapter 56 of the Laws of 2014.

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

Respectfully submitted,

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

Introduction

Background

A charter school is a public school, financed by local, State and federal resources, that is not under the control of the local school board and is governed under Education Law Article 56. Charter schools have fewer legal operational requirements than traditional public schools. Most of the regulations for charter schools are contained in the School's bylaws, charter agreement and fiscal/financial plans. Charter schools are required to set both financial and academic goals, and a school's renewal of its charter is dependent on meeting these goals.

The Discovery Charter School (School) is located in the Town of Greece in Monroe County. The School's charter was approved by the New York State Board of Regents in 2010, with operations beginning in August 2011. The School is governed by the Board of Trustees (Board), which comprises nine members. The Board is responsible for the general management and control of the School's financial and educational affairs. The Board appoints the School Director (Director) who is responsible, along with other administrative staff, for the day-to-day management of the School under the direction of the Board. The Business Manager is the chief accounting officer and is responsible for maintaining custody of the School's funds and financial records and preparing the monthly and annual financial reports.

During the 2013-14 school year, the School provided elementary education for 214 students in kindergarten through 4th grade. The School's operating expenses totaled approximately \$3.1 million. These expenses are funded primarily with revenues derived from billing area school districts¹ for resident pupils and from certain State and federal aid attributable to these pupils.

Objective

The objective of our audit was to review internal controls over cash disbursements. Our audit addressed the following related question:

- Did the Board establish effective internal controls over cash disbursements?

Scope and Methodology

We examined internal controls over cash disbursements for the period July 1, 2013 through October 31, 2014.

We conducted our audit in accordance with generally accepted government auditing standards (GAGAS). More information on such

¹ The billed schools districts include Greece, East and West Irondequoit, Gates-Chili and the Rochester City School District.

standards and the methodology used in performing this audit are included in Appendix B of this report.

**Comments of
School Officials and
Corrective Action**

The results of our audit and recommendations have been discussed with School officials and their comments, which appear in Appendix A, have been considered in preparing this report. School officials generally agreed with our recommendations and indicated they plan to implement corrective action.

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

Cash Disbursements

The Board and School management are responsible for establishing and implementing effective cash disbursement policies and procedures to ensure that cash is disbursed only upon proper authorization. Duties must be segregated so that no single individual controls most or all phases of a disbursement transaction. In a small operation, where complete segregation of duties is not possible, active supervision and oversight become even more important components of an effective internal control system. When internal controls are not designed appropriately or operating effectively, there is an increased risk that errors and irregularities may occur and not be detected and corrected, and unauthorized payments could be made for non-School purposes.

The School's Business Manager and Office Manager are responsible for most of the financial transactions. However, procedures have been structured so that the Office Manager and the Business Manager serve as a check on each other's work. In addition, the Director, Administrative Assistant and Board members provide additional oversight. These independent checks serve to mitigate the risk of errors or irregularities in most aspects of the School's cash disbursement processes. However, we found that the School could strengthen controls over payroll transfers and journal entries.

The School contracts with a third-party vendor (vendor) for payroll services. This vendor has access to the School's bank account. When the vendor finalizes the payroll, it directly withdraws the money from the School's bank account for disbursement to employees, the respective taxing authorities and its own fees. The checks are drawn against the vendor's account and the Office Manager records a payroll journal entry in the School's system based on the payroll report provided by the vendor and approved by the Business Manager. Allowing the vendor to directly debit the School's operating account creates additional risk for inappropriate transactions to occur. Direct vendor access removes the ability of the School to prevent irregularities from occurring. It also provides a mechanism for the vendor to hide its fee. The School should pay the payroll processing fees to the vendor through its regular bill-paying process. Due to these control weaknesses and the resultant increased risk, we tested 34 employees' salaries to ensure that they were paid at Board-approved pay rates. We verified that employee leave time was properly granted and its use was approved. We also verified that the payroll payments debited by the vendor were supported by the payroll register.

In addition, while the Office Manager makes most journal entries² and the Business Manager enters most adjusting journal entries, no one regularly reviews them. Journal entries can be used to cover up inappropriate transactions in the accounting records. Therefore, we reviewed all journal entries from July 2013 through August 2014 for reasonableness and appropriateness. We also reviewed two months of bank statement activity³ and examined canceled checks for payments that cleared during these months to ensure that payments were properly recorded in the accounting system and all electronic transactions were appropriate.

Except for the deficiencies noted previously and minor issues discussed with School officials, internal controls over cash disbursements were determined to be adequate. We commend School officials for establishing and implementing a good system of financial controls and anticipate that addressing these findings will further improve financial oversight.

Recommendations

The Board and School Management should:

1. Work with the vendor to arrange for payroll checks to clear against the School's bank account and should pay the payroll service fee to the vendor by check using their regular bill-paying process.
2. Periodically review the journal entries completed by the Business Manager.

² Which are reviewed by the Business Manager

³ The months of August and November 2013 were selected randomly.

APPENDIX A

RESPONSE FROM SCHOOL OFFICIALS

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

May 21, 2015

Edward V. Grant, Jr., Chief Examiner
Office of the State Comptroller
The Powers Building
16 W. Main Street, Suite 522
Rochester, NY 14614

Re: Response and Corrective Action Plan for Discovery Charter School Report of Examination 2015M-014

Dear Mr. Grant:

We would like to commend the auditors for the thoroughness and professionalism they displayed for the duration of the audit. The Discovery Charter School Board and management take seriously their fiduciary and financial oversight responsibilities and are appreciative of the feedback and guidance that has been received from your office during the audit process.

Please find below management's response and corrective action plan relating to your overall findings and recommendations:

Cash Disbursements

1. OSC recommended the board and management should work with the vendor to arrange for payroll checks to clear against the School's bank account and should pay the payroll service fee to the vendor by check using their regular bill-paying process.

Response and Corrective Action Plan – It is rare for the school to have a live payroll check as currently 100% of our employees are on direct deposit, however we will work with our vendor to determine the most appropriate course of action for the school for both payroll checks and recurring vendor invoices. Any changes will be implemented by July 1, 2015.

2. OSC recommended the board and management should periodically review the journal entries completed by the Business Manager.

Response and Corrective Action Plan – Effective immediately, the Board Chairman will review and sign off on all journal entries on a monthly basis.

We appreciate the courtesy of the audit staff throughout the entire process. The Board has taken great strides to ensure efficiency and strength with regard to the School's financial record

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keeping and reporting. Thank you for working with us to continue improving upon our internal controls.

Sincerely,

David Vigen
Board Chairman

APPENDIX B

AUDIT METHODOLOGY AND STANDARDS

Our overall goal was to assess the adequacy of the internal controls over cash disbursements put in place by School officials. To accomplish the objective of the audit and obtain valid audit evidence for the period July 1, 2013 through October 31, 2014:

- We interviewed appropriate School officials and employees and reviewed Board policies and procedures in order to obtain an understanding of the procedures for processing expenditures of School funds.
- We randomly selected two months from our audit period (July 2013 through September 2014, October 2014 was not available) using Excel. For August 2013 and November 2013, we determined if disbursements from the bank statements agreed with the Check Detail Report reviewed by the Board. We also verified that the canceled check images matched the bank statement and Check Detail Report. We also determined if payroll disbursements made during our test months agreed with the payroll reports provided by the vendor.
- We tested a random sample of 35 claims from the cash disbursement data. We then compared the information in the data to the supporting documentation and check stub. We reviewed the claim for the correct amount and appropriateness.
- We randomly selected two months of bank statements to review, August and November 2013, using random sampling in Excel. In our review, we accounted for all payments by verifying they appear on the Check Detail Report and have been approved by the Board, verified information appearing on non-payroll canceled checks agrees with the Check Detail Report, reviewed canceled checks for unusual endorsements, traced total amount of the check detail report to the total amount recorded in the general ledger cash control account verifying the amount was recorded correctly and verified that bank reconciliations were completed timely.
- We reviewed all electronic transfers out of the School's bank accounts to ensure they were appropriate.
- We used the same months of August and November 2013 for payroll testing because our bank statement review included tests of payroll-related bank transactions. Using the School's website, which has the most up-to-date list of teachers and staff, we randomly selected 10 employees for each payroll tested. In selecting our sample, if an employee was not employed during our test periods, we replaced the employee with another random selection. We then compared the Board-approved salaries from the 2014-15 budget to the payroll register. We were unable to locate salary information for three individuals in the budget and used salary information provided on the offer letter in their personnel records, which was also Board approved. For the employees randomly selected that were not yet employed in the 2013-14 school year, we reviewed the most recent payroll records (check date October 3, 2014) and used the 2014-2015 budget to obtain the salary for these employees.

- We reviewed journal entries for the audit period for reasonableness and any unusual credits to cash.

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.

APPENDIX C

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