

HEMPSTEAD UNION FREE  
SCHOOL DISTRICT

INTERNAL AUDIT

RISK ASSESSMENT UPDATE  
AND  
ANNUAL TESTWORK

June 22, 2018

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## Board of Education and Audit Committee Hempstead Union Free School District

We have been engaged to assist the Hempstead Union Free School District in performing a risk assessment update and annual test work for the year ended June 30, 2018 as required by Chapter 263 of the Laws of New York State. The purpose of our engagement is to assist the district in determining the level of risk and adequacy of controls in the various functional processes within the School District. A complete description of the methodology used in performing the risk assessment is included in the subsequent pages of this report. We have also performed test work in areas agreed to by the audit committee as required. The results of that test work have been included in this report.

The risk assessment and testwork was performed in accordance with professional and ethical standards contained in Government Auditing Standards issued by the Comptroller General of the United States and the general standards of the AICPA's Code of Professional Conduct. These standards are required by the Regulations of the Commissioner of Education.

The engagement to perform the initial risk assessment and test work is part of an ongoing internal audit function. The results of the risk assessment and test work performed have been discussed with management of the Hempstead Union Free School District and are the overall responsibility of the School District.

This report is intended solely for the informational purposes in order to develop a plan to identify and manage the School District's risks. This report and all information used to compile the report is the property of Hempstead Union Free School District.

We appreciate the opportunity to serve you as internal auditors and thank the individuals in your School District for their cooperation.

*D'Arcangelo + Co., LLP*

June 22, 2018

Rome, New York

## **METHODOLOGY**

The internal audit process for Hempstead Union Free School District has been established in accordance with Chapter 263 of the Laws of New York State to provide an independent, objective assurance and consulting activity designed to add value and improve the organization's operations. It helps the District accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes.

### ***Defining Audit Universe***

The first step leading to the development of the School District's Risk Register is to define the audit universe. The School District's audit universe encompasses both financial and non-financial functions and have been categorized into the following business units:

- Governance
- Information Technology
- Budget
- Financial Reporting
- Payroll/Human Resources
- Accounts Payable
- State Aid
- Attendance
- Capital Projects
- Special Aid Programs
- School Lunch
- Fixed Assets
- Transportation
- Cash Receipts/Billing
- Extraclassroom

### ***Weighting of Business Units***

The risk that each of the above business unit's pose on the School District is unique. The weighting of business units attempts to account for the relative measure of importance between business units and the impact on the overall risk level. A weighting factor was derived by evaluating each business unit based on the following categories:

- *Size of Unit* - Based on total revenue/expenditures processed by business unit band/or volume of transactions.
- *Complexity of Transactions* - Based on the nature of transactions processed.
- *Public Exposure* - Based on the potential of business unit to harm the School District's reputation within the community.
- *Time Since Last Audit* - Based on the last date that internal audit procedures have been performed.

## METHODOLOGY

- *Compliance with laws and Regulations* - Based on laws and regulations that direct the business unit's activities.

### ***Defining Business Unit Processes***

Business units have been broken out into key processes that will be the basis of the risk register. The objective is to identify and prioritize processes that pose the greatest potential risk and liability to the School District.

### ***Categories of Risk***

Risk will be assessed for each business unit process in two categories:

*Inherent Risk* - Inherent risk measures the potential for objectives not being attained at the desired level before applying the assessment of the internal control process.

*Control Risk* - Control risk measures the adequacy of internal controls designed to reduce the inherent risk within the process. Each process will be assessed for control risk utilizing the concepts of the COSO model. This model was developed in 1992 by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) and has been adopted as the generally accepted framework for internal control and is widely recognized as the definitive standard against which organizations measure the effectiveness of their systems of internal control. The COSO model focuses on the following components:

- *Control Environment* - The Control Environment sets the tone of an organization, influencing the control consciousness of its employees. It is the foundation for all other components of internal control, providing discipline and structure.
- *Risk Assessment* - Risk Assessment is the identification and analysis of relevant risks to the achievement of the School District's objectives, forming a basis for determining how the risks should be managed.
- *Control Activities* - Control Activities are the policies and procedures that help ensure management directives are carried out. Control activities include a range of activities such as approvals, authorizations, verifications, reconciliations, security of assets, and segregations of duties.
- *Information and Communication* - Information must be identified, documented, and communicated in a form that enables employees to carry out their responsibilities.
- *Monitoring* - Monitoring is a process that assesses the quality of an internal control system's performance over time.

## METHODOLOGY

### ***Assessing a Risk Level***

The assessment of risk will be based on four levels of severity:

<i>Low</i>	Low likelihood of significant impact on School District objectives.
<i>Moderate</i>	Moderate likelihood of significant impact on School District objectives.
<i>High</i>	High likelihood of significant impact on School District objectives.
<i>Severe</i>	Extreme likelihood of a catastrophic impact on School District objectives.

### ***Risk Appetite***

Risk Appetite broadly sets the level of risk that the Board of Education deems acceptable. The Board of Education has set a *moderate* level of risk appetite for the purpose of this initial risk assessment. Those processes that have been assessed a level of control risk greater than the risk appetite are to be included in the School District's long range internal audit plan over a four year period. The level of risk appetite is designated with a blue line on the School District's Risk Register on Pages 5 through 8.

### ***Managing the Risk***

The options of the School District in managing its risks can be summarized as follows:

- *Treat* - Implement accounting and operational controls.
- *Terminate* - End the activity.
- *Transfer* - Outsource activity or obtain insurance.
- *Tolerate* - Accept risk and monitor.

### ***Audit Plan***

An audit plan must be implemented by the Audit Committee based upon the identified risks, risk appetite, and how the risk is to be managed. Risks that are identified that are above the acceptable risk appetite of the Board of Education should be a priority in the audit plan.

**RISK REGISTER AS OF June 22, 2018**

		Risk Assessment														
Business Unit	Process	Inherent Risk				Control Risk				Testwork Performed						
		As of June 22, 2018														
		Severe	High	Mod	Low	Severe	High	Mod	Low	2016	2017	2018	2019	Reference		
Governance	General Policy and Procedures	✓					✓									
	Monitoring	✓					✓									
	Organizational Structure	✓					✓									
	Risk Management	✓					✓									
Information Technology (IT)	Network Security		✓				✓									
	Financial Application Security		✓				✓									
	Miscellaneous Application Security		✓				✓									
	Disaster Recovery		✓				✓									
Budget	Development	✓					✓									
	Presentation/Compliance	✓						✓								
	Monitoring	✓					✓									
	Amendments				✓		✓									
Financial Reporting	Monthly Reporting	✓								✓						
	General Accounting		✓							✓						
	Annual Reporting		✓							✓						
	Financial Oversight		✓				✓									
	Fund Balance Management		✓				✓									

## RISK REGISTER AS OF June 22, 2018

		Risk Assessment															
Business Unit	Process	Inherent Risk				Control Risk							Testwork Performed				
		As of June 22, 2018															
		Severe	High	Mod	Low	Severe	High	Mod	Low	2016	2017	2018	2019	Reference			
Payroll/HR	Payments to Employees	✓					✓						✓				
	Allocation of Expenditures	✓					✓										
	General Employee Administration		✓				✓										
	Employee Benefit Administration	✓					✓										
	Employee Attendance	✓					✓										
	Hiring/Termination of Employees		✓				✓										
Purchasing/AP	P.O. System		✓				✓					✓					
	Payments Outside P.O. System	✓					✓				✓						
	Procurement Process	✓					✓				✓						
	Private Purpose Trust Expenditures			✓						✓							
	Reporting Requirements		✓							✓							
	Allocation of Expenditures	✓								✓							
	Payment Processing	✓					✓			✓							
	Petty Cash Administration			✓													
State Aid	General Processing/Monitoring		✓				✓										
	Basic Aid		✓				✓										
	Transportation Aid			✓						✓							
	Building Aid/Capital		✓				✓										
	Excess Cost Aid			✓						✓							
	BOCES			✓						✓							



## RISK REGISTER AS OF June 22, 2018

		Risk Assessment														
Business Unit	Process	Inherent Risk				Control Risk				Testwork Performed						
		As of June 22, 2018														
		Severe	High	Mod	Low	Severe	High	Mod	Low	2016	2017	2018	2019	Reference		
Attendance	Tracking Student Attendance	✓								✓						
	Student Performance Data			✓						✓						
Capital Projects	Planning	✓					✓									
	Monitoring	✓					✓									
	Completion	✓					✓									
Special Aid	Grant Application	✓					✓									
	Allowable Costs	✓					✓									
	Cash Management	✓					✓									
	Reporting and Monitoring	✓					✓									
	Compliance	✓					✓									
School Lunch	Federal & State Reimbursement	✓					✓									
	Sales Cycle and System	✓					✓									
	Inventory and Purchases	✓					✓									
	Eligibility Verification			✓						✓						
Fixed Assets	Acquisition and Disposal	✓					✓									
	Compliance			✓						✓						
	Inventory	✓					✓									

# RISK REGISTER AS OF June 22, 2018

		Risk Assessment															
Business Unit	Process	Inherent Risk				Control Risk						Testwork Performed					
		As of June 22, 2018															
		Severe	High	Mod	Low	Severe	High	Mod	Low	2016	2017	2018	2019	Reference			
Transportation	Fleet Maintenance			✓							✓						
	Risk Management		✓				✓										
	Personnel Compliance			✓							✓						
	Facilities Maintenance and Security		✓				✓										
Cash Receipts/ Billing	Real Property Tax	✓									✓						
	Medicaid		✓				✓										
	Out of District Tuition			✓							✓						
	Use of Facilities			✓			✓										
	Admissions and Concessions		✓				✓										
	Donations			✓							✓						
	Collection/Posting of Receipts		✓				✓										
Extraclassroom	General		✓				✓										
	Cash and Cash Receipts		✓				✓										
	Expenditures and Purchasing			✓							✓						
	Inventories			✓								✓					

## **STATUS OF PRIOR YEAR'S RISKS AND RECOMMENDATIONS**

### ***Accounting Procedures Manual***

#### 2016 Observation

Although the District has documented in limited circumstances certain procedures within the business office, the District does not have a formalized accounting procedures manual or an inventory of its internal controls.

#### Risk

Without documented accounting procedures or an inventory of internal controls, employees have no formal guidance as to their specific role in the accounting process as well as their specific role in the internal control process for the District. An effective internal control system relies heavily on a formal communication system that sets the expectations of its employees and establishes their role in the process. This lack of formal communication increases the risk of internal controls not being followed as intended and employees not knowing what is expected of them. It prohibits the ability to effectively train new employees, evaluate performance, and improve on existing procedures or internal control.

#### Recommendation

We recommend that the District develop a comprehensive accounting procedures manual that is separate from Board Policy. Such a procedures manual would ensure that procedures are consistently applied throughout the District. It would effectively notify all accounting personnel of their duties and improve lines of communication. In developing the accounting procedures manual, the District should consider the following elements:

- Written job descriptions for each accounting position. These descriptions should be provided to each employee and serve as a guideline for hiring and evaluating personnel. The District already has many of these job descriptions documented.
- Appropriate descriptions of all financial policies, accounting procedures, internal controls over payroll, cash disbursements, and cash receipt cycles.
- A segregation of duties matrix for each of the main transaction cycles that provides an overview of the role of each position in the internal control process.

<b>STATUS OF PRIOR YEAR'S RISKS AND RECOMMENDATIONS</b>
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- A list of standard forms and system generated reports used in the School with a detailed explanation of their purpose and preparation.

The accounting procedures manual should be updated annually and should be distributed to all accounting personnel and other appropriate personnel. It should evolve to meet the needs of the District and should provide an accurate reflection of the current system of accounting.

**Current Year Status:**

**The District is in agreement with this recommendation. The District as of March 31, 2018 has prepared an accounting procedures manual. The District should continue the process of documenting additional areas of internal control and further define the processes in relation to risk in each area.**

***Conflict of Interest Statements***

**2016 Observation**

Currently neither the Board of Education nor management is required to sign an annual conflict of interest statement. Although not required by law, a conflict of interest statement is considered a best practice for purposes of transparency. The conflict of interest statement would disclose any relationship, contract, or transaction that could have an appearance of conflict with board members or key employee's decision.

**Risk**

The District, unknowingly, could have a contractual relationship that could be deemed a conflict of interest for either a board member or key employee.

**Recommendation**

We recommend the District require an annual conflict of interest statement be documented from its board members and key employees to disclose any potential appearance of a conflict of interest.

**Current Year Status:**

**The District is in agreement with this recommendation. Currently the Board of Education signs conflict of interest statements. The process should be expanded to include key employees of the District.**

<b>STATUS OF PRIOR YEAR'S RISKS AND RECOMMENDATIONS</b>
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***Section 4980H- Measurement Period***

2016 Observation

Section 4980H of the Internal Revenue Code ("IRC") requires employers with at least 50 full-time employees and/or full-time equivalent employees ("FTEs") to either pay a penalty or offer affordable health care coverage that provides minimum essential coverage and minimum value. Federal regulations allow employers to use an optional safe harbor method known as the "Look-Back Measurement Method" to determine whether an employee with variable hours is to be treated as a full-time employee for purposes of determining liability under Section 4980H of the Internal Revenue Code. In order to apply the "Look-Back Measurement Method" as a safe harbor option, the employer must designate the standard measurement periods and corresponding stability periods that will be used.

Risk

Without adopting a board policy regarding the "Look-Back Measurement Period" there is risk that the use of the allowed safe harbor could be challenged.

Recommendation

The District should adopt a policy regarding the "Look-Back Measurement Period" that is in the best interest of the District.

**Current Year Status:**

**The District has adopted an appropriate Look Back Measurement Period.**

<b>STATUS OF PRIOR YEAR'S RISKS AND RECOMMENDATIONS</b>
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***Budget Preparation/Monitoring***

2016 Observation

Based on the budget performance in the General Fund for the year ending June 30, 2015 the District's net change in fund balance was a deficit of \$15,152,362, resulting in a total fund balance deficit of \$203,182. The voter approved budget for the year ending June 30, 2015 including the encumbrance roll over was over expended by \$8,640,674. There appears to be a lack of internal controls over the monitoring of the budget that would forecast budgetary problems in time for the District to make appropriate adjustments during the year. The preparation of the budget for fiscal year June 30, 2016 includes the use of available fund balance to fund the budgeted expenditures in the amount of \$2,000,000. Since the District ended the June 30, 2015 fiscal year with a deficit, the District is beginning the June 30, 2016 budget year with a total deficit of \$2,203,182 based on budgeted actual revenues. During our fieldwork in February 2016 there were no budget projections available for our review. There was no revenue budget entered into the financial software to be able to monitor the budget to actual performance in a timely manner. A new business consultant was hired by the District in March 2016. The business consultant has prepared a projection for the fiscal year June 30, 2016 which anticipates an additional deficit to the District's fund balance.

Risk

Continued lack of responsible budget preparation and timely monitoring could severely impact the District's ability to operate effectively.

Recommendation

We recommend the District implement proper budgetary development procedures and monitoring that includes timely and accurate fund balance projections as well as timely budget performance reporting.

**Current Year Status**

**The District has made improvement in this area however should formalize the process in the subsequent year.**



## **STATUS OF PRIOR YEAR'S RISKS AND RECOMMENDATIONS**

### ***Budget Monitoring***

#### 2016 Observation

To fulfill their budgetary monitoring responsibilities, District officials and the Board of Education should periodically review budget-to-actual revenue and expenditure reports and monitor year-end fund balance projections. Effective financial management requires District officials and the Board to control their budgets. This involves ensuring that spending stays within budgeted appropriations and that necessary actions are taken to meet budgeted plans. To determine if the District has sufficient budgetary monitoring controls we reviewed the information historically provided to the Board of Education on a monthly basis. Currently, the Board of Education does not receive Budget to Actual information as part of the Board Packet issued monthly. In addition we inquired about fund balance projection procedures and were informed that no such projection were completed or presented to the Board until the new Business Official was hired in late March 2016. We also were informed that inaccurate information regarding available fund balance for was being communicated to the Board in regards to the 2015-2016 fiscal year.

#### Risk

In order to make sound financial decisions, the Board must receive timely, accurate financial information. One of the basic objectives of accounting and financial reporting is to provide managers and governance with financial information useful for determining and forecasting financial condition. Accurate financial information is necessary for the Board to develop proper budgets and multiyear financial plans and to make sound financial decisions. Without this information significant budget deficits could and have occurred in the District.

#### Recommendation

We recommend that the District develop budgetary monitoring procedures that include monthly budget to actual reporting to the Board of Education as well as timely fund balance projections beginning as early as possible.

#### Current Year Status

**The District has made improvement in this area however should formalize the process in the subsequent year.**

<b>STATUS OF PRIOR YEAR'S RISKS AND RECOMMENDATIONS</b>
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***Finance Manager (nVision) Permissions***

2016 Observation

The District has no formal procedures for determining access rights within the Finance Manager software. The former Business Administrator had full administrative rights within the financial software and was the person responsible for assigning user rights. The financial system administrator should be independent of the business office and should not be involved in the District's financial operations.

Risk

Effective controls over access rights to the financial software application is imperative to prevent users from being involved in multiple aspects of a financial transaction.

Recommendation

The District should develop appropriate policy and procedures to ensure that user access rights are appropriate for their job description and level of responsibility. The financial system administrator should be delegated to an individual with no financial transaction responsibilities.

Current Year Status

**The District has made improvement in this area and has evaluated all permissions from January through September 2018.**



<b>STATUS OF PRIOR YEAR'S RISKS AND RECOMMENDATIONS</b>
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***Contingency Plan***

2016 Observation

The District has not conducted a Business Impact Analysis (BIA) to determine the timeframes in which they can operate without having access to key instructional and district business applications and overall IT Infrastructure services (e.g., Internet Access, Access to email). In addition, the Business Impact Analysis would determine the amount of data that the District's departments and instructional areas are willing to lose in the event of an IT system failure. These results from the Business Impact Analysis would determine whether data backup strategies are designed to meet the District requirements and the extent in which an alternate location is needed to operate the District's IT systems in the event the primary server room was inoperable.

Currently, there is not an alternate location that has been identified to operate the District's IT systems in the event the primary server room was inoperable. In the event that internet access was lost, District staff would relocate to BOCES to process payroll and financials.

Risk

Without a formal contingency plan that has been tested, there is risk that upon the loss or interruption of the IT function, data could be irretrievable and the School District's processing capability diminished.

Recommendation

The District should develop a contingency plan and a timeline for testing to ensure the District has sufficient capability in case of IT system failure.

Current Year Status

**There has been no corrective action related to this observation. The District plans on implementing a plan with the assistance of Nassau BOCES.**

<b>STATUS OF PRIOR YEAR'S RISKS AND RECOMMENDATIONS</b>
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***Affordable Care Act (ACA) Reporting Compliance***

2016 Observation

The District currently utilizes Finance Manager financial software. The financial software has not yet been updated to provide the information necessary to comply with Section 6055 and 6056 reporting. As of April 10, 2016 the District was not in compliance with ACA reporting provisions for the 2015 year.

Risk

The District will not be able to comply with the ACA reporting requirements for the 2016 reporting year.

Recommendation

The District should develop procedures to timely comply with the ACA reporting provisions.

**Current Year Status**

**The District is in compliance with ACA reporting.**

<b>STATUS OF PRIOR YEAR'S RISKS AND RECOMMENDATIONS</b>
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***Payroll/Human Resources-Segregation of Duties***

2016 Observation:

It was noted that the payroll department enters employee's salary and rates of pay. Segregation of duties could be strengthened by having the human resource department enter the employee's salary into the Finance Manager system. In addition new salaries and pay rates are not properly reviewed and recalculated prior to the new fiscal year.

Risk

Rates of pay entered into the financial system could be incorrect.

Recommendation:

Currently, the human resource department is meeting with the district's new employees and going over required documentation. In order to properly segregate payroll controls, human resource department should enter the new employee's salary into the financial software. Payroll should simply be entering the employee's payroll related deductions.

We also recommend that before the start of each fiscal year that the human resource department review all upcoming increases in pay rates and salaries. These rates would be recalculated and traced to supporting documentation such as contracts or agreements with employees'. The payroll department should then review and recalculate the pay rates and salaries entered by the human resource department as a second check. This would also ensure that individuals whom have attained a longevity status would have the proper longevity paid. The human resource department would be best for this step as they have control over the personnel files and all pertinent information for each employee. We also recommend that after the recalculation of new salaries and rates that performance of this control be documented by initialing or signing a report showing the rates.

**Current Year Status**

**The District has been working closely with the Human Resources Department since April 2018 to make improvements in all areas noted.**

## STATUS OF PRIOR YEAR'S RISKS AND RECOMMENDATIONS

### **Payroll/HR-General Employee Administration**

**Inherent Risk - Severe**

**Control Risk - High**

**Risk Appetite – Moderate**

#### ***Exit Interview Checklist***

##### **2016 Observation:**

We noted that the district does not have a proper exit conference with employee's leaving the service of the district.

##### **Recommendation:**

When employees leave the district due to retirement, resignation, or termination; the district does not hold a proper exit conference, nor have they implemented a checklist of all needed documentation items. We recommend that the district develop an exit conference checklist for the human resource department to complete when an employee leaves the district. This checklist should contain information regarding any retirement planning, health insurance including COBRA coverage, and payment for retirement or insurance. In addition this checklist will ensure that any employee leaving the district is properly informed of any benefits that are legally appropriated to them. It will also serve as notice that employees are no longer employed with the district thus eliminating the possibility of non-employees receiving district employee benefits.

##### **Current Year Status**

**There has been no corrective action to this observation. The District will evaluate the use of these checklists.**

### ***Communication and Overpayments to Employees***

##### **2016 Observation:**

We noted that when an employee leaves the district the Human Resource department will prepare an action sheet for the change. The action sheet will state the applicable departure date for the employee. It was noted that the timeliness of this sheet reaching the payroll office is not functioning properly. Employees need to be deactivated on both the Human Resource side of the financial software as well as on the payroll side. This non-timely manner of reporting has lead payroll to overpay individuals.

## **STATUS OF PRIOR YEAR'S RISKS AND RECOMMENDATIONS**

### Recommendation:

We recommend that the district create a process or procedure whereby payroll is notified immediately of an employee's departure from the district. The procedure should also include a range of dates that paperwork must be submitted to payroll. For example the procedure should state that a week prior to payroll being run that all timesheets and changes be submitted to payroll. This would ensure that any changes that need to be made are made in a timely manner. The district should also implement a last and final payout for employees that is created by payroll and reviewed by management for accuracy. This last and final payout should be initialed as reviewed and approved prior to being paid out.

### Current Year Status

**The District has made improvement in this area however should formalize the process in the subsequent year.**

## ***Paycheck and Direct Deposit Advices***

### 2016 Observation:

It was noted that all employees are required to show ID and sign for their paycheck or direct deposit advice. If this does not occur on the day that checks are released, they are brought back to the payroll department. With the limited amount of staff, these unclaimed items are placed in a box to await an individual to claim them and no follow up is initiated.

### Recommendation:

We recommend that the district implement a procedure or process where an individual outside of payroll attempts communication with the individual whom did not take ownership of their paycheck or direct deposit advice. This will ensure that all unclaimed items are in fact legitimate employees. Unclaimed paychecks and/or direct deposit advices should be kept in a secure locked area with access restricted.

### Current Year Status

**There has been no corrective action to this observation. As part of the current internal audit, procedures were performed on the June 22, 2018 payroll for the Highschool and Middle School. Results of those procedures are included in this report.**

<b>STATUS OF PRIOR YEAR'S RISKS AND RECOMMENDATIONS</b>
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***Time Sheets and Payroll Certification***

2016 Observation:

We noted that all submitted timesheets to the payroll department are entered into the Finance Manager system by the payroll office staff. Each member enters a designated group of timesheets into the system. Once they are entered there is no second check of the time input into the system by anyone other than the individual entering the time.

In addition we noted that the payroll certification process could be strengthened. At present a payroll change report is not being produced or reviewed by the individual certifying payroll. Random checks of individual rate of pay and additional payroll items are not being tested.

Recommendation:

We recommend that once all time has been entered into the system that an individual besides the one entering the time review the work of the other employee. This will ensure that time entered is accurate and complete and that any errors would be detected and corrected.

We recommend that the individual processing payroll to run a payroll comparison or change report. This report will note any changes in an employees pay from the prior payroll to the current payroll. This report will allow the individual certifying the payroll to note any new hires, changes in pay rates, or abnormal pay amounts. In addition to reviewing this report, the individual certifying payroll should randomly select a group of individuals and trace their rate of pay back to an employment agreement or contract to ensure the amount of pay is accurate and complete. These individuals should be documented as tested and approved.

**Current Year Status**

**There has been no corrective action to this observation. The District is evaluating this recommendation.**

<b>STATUS OF PRIOR YEAR'S RISKS AND RECOMMENDATIONS</b>
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**Payroll/HR-General Employee Administration**

***Employee/Independent Contractor Classification***

**2016 Observation:**

During our review of cash disbursements to individuals it was noted the Director of Facilities is currently classified as an independent contractor. Based on our review of this individual's role within the District it appears that the individual should be classified as an employee instead of as an independent contractor. The individual should receive an IRS Form W-2 and should have appropriate taxes withheld as well as contributed by the District.

**Recommendation:**

We recommend the District classify this individual as an employee in the future. The District should review any classification of an independent contractor to ensure that they are in compliance with IRS regulations.

**Current Year Status:**

The prior Director of Facilities no longer works for the District. However during the current year review of cash disbursements it was noted that individuals that received a recruitment incentive through the Teachers for Tomorrow grant were paid through accounts payable instead of payroll. Recruitment incentive is taxable compensation that should be paid through payroll with appropriate taxes withheld. It was also noted that a car allowance paid to a District employee was also paid through accounts payable instead of payroll.

<b>STATUS OF PRIOR YEAR'S RISKS AND RECOMMENDATIONS</b>
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***Special Aid Grant Management***

2016 Observation:

Based on our review of the cost allocation of the special education grant (IDEA 611) it was noted that the allocation of special education expenditures was not fully utilized resulting in a significant loss of federal aid reimbursement of approximately \$1,000,000. This appears to be due to the allocation of these expenditures through the General operating fund instead of through the Special Aid Fund. Monitoring of grant expenditures is imperative to ensure that the full allocation of grant funding is utilized.

Recommendation:

We recommend the District implement proper procedures to monitor the applicable grant expenditures to ensure the full allocation of grant funding is utilized. The District should inquire with the grantor regarding the recovery of the funding allocation that was not utilized.

**Current Year Status**

**Internal controls over grant management is still in need of improvement. The allocation of grant expenditures is not properly accounted for as a direct allocation to the grants. The District is preparing journal entries to reclassify expenditures to the grants at the end of the year which not proper grant accounting. In doing this the District risk of disallowed costs and potential loss of grant funding. The District plans on hiring a full time grant administrator to implement necessary improvements in this area.**



<b>STATUS OF PRIOR YEAR'S RISKS AND RECOMMENDATIONS</b>
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***Receiving of Goods***

2016 Observation:

During our inquiry of the procurement process we noted that goods are received by the individual buildings and distributed to the individual that requisitioned the goods. The receiving documentation needed by the accounts payable clerk is being delayed by the fact that the documentation is not being timely remitted to the accounts payable department even though the goods have been received. This results in late payments to the vendor as well as additional time tracking down the documentation by the account payable clerk.

Recommendation:

We recommend that each building designate a person responsible for the receiving of goods into the building. Once received into the building the receiving documentation should be signed and remitted to the accounts payable clerk. The goods can then be distributed to the individual that requisitioned the goods.

**Current Year Status**

**There has been no corrective action to this observation. Based on our interview with the accounts payable clerk and testing of purchase orders it was noted that the receiving copy of the purchase order is not consistently be delivered to the buildings.**

***IRS Form 1099***

2016 Observation:

During our review of disbursements to individuals it was noted that there were payments issued to the recipient of a litigation settlement that was not reported on IRS Form 1099 to the recipient.

<b>STATUS OF PRIOR YEAR'S RISKS AND RECOMMENDATIONS</b>
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Recommendation:

We recommend the District review its procedures related to the compliance of IRS Form 1099 reporting requirements to ensure that all IRS Form 1099's are issued appropriately.

Current Year Status

**Based on additional testwork performed in this area it appears that reporting requirements for IRS Form 1099 are still not being met. Payments of a recruiting incentives to approximately 20 teachers that were paid out of accounts payable were not issued IRS Form 1099 for the 2017 tax year. Additional litigation settlements to former employees that were also not issued Form 1099.**

*Vendor Contracts*

2016 Observation:

During our testing of disbursements it was noted that there is significant confusion related to the contractual rates used by service providers of the District. This issue was cited by the District's external auditor for the year ending June 30, 2015 as well as the District's claims auditor in the current year. The legal standing of the District should be reviewed relative to the rates used by the vendor based on the contract in place. It was also noted that payments to a service provider appeared to be in excess of the documented board authorization. Although it appears that the services were provided to support the invoice there was no authorization of the amounts paid that could be located.

Recommendation:

We recommend the District review its contracts to ensure the contractual language is clear and concise. The contracts should be reviewed with the vendor to ensure that the rates charged and documentation required for payment is clear and understood by both parties.

Current Year Status

**The District is still in the process of revising contractual language. Significant improvements have been made in this area.**

## **CURRENT YEAR RISKS AND RECOMMENDATIONS**

### **Financial Reporting-Fund Balance Management**

**Inherent Risk-** *High*

**Control Risk-** *High*

**Risk Appetite-** *Moderate*

#### ***Fund Balance Reserve Plan***

##### **Observation**

There has been increased scrutiny by the Office of the New York State Comptroller regarding school district reserves. The emphasis on transparency of funding methodologies has been a common citing. Although not required by law it is considered “best practice” for Districts to adopt policies that address the purposes of its reserve funds, optimum funding levels and methodology for each reserve. The Board should periodically analyze the reasonableness of the balances in its reserves.

##### **Risk**

The District could be cited for lack of proper oversight over reserve activity.

##### **Recommendation**

The District should adopt policies for reserve funds that address the purpose of each reserve, optimal funding levels and methodology, and conditions under which the reserves will be used.

### **Purchasing/AP-Payment Processing**

**Inherent Risk -** *Severe*

**Control Risk -** *High*

**Risk Appetite –** *Moderate*

#### ***Credit Cards***

##### **Observation:**

During the review of credit card purchases instances were noted that documentation for purchases made with the Bank of America credit are not being received to support the purchase. This has also been discovered by the District’s internal claims auditor in their review of the same claims.

<b>CURRENT YEAR RISKS AND RECOMMENDATIONS</b>
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**Risk**

Improper use of District funds.

**Recommendation**

The District should be more diligent in collecting the supporting invoices for credit card purchases.

***Cash Advances***

**Observation:**

During the review of cash advances made to various board members it was noted that supporting invoices were not received in accordance with District policy.

**Risk**

Improper use of District funds.

**Recommendation**

The District should be more diligent in collecting the supporting invoices for cash advances.

***Taxable Benefits-Car Allowance***

**Observation**

During our review of cash disbursements to key employees it was noted that the District paid a monthly car allowance to an employee that is based on an “unaccountable plan”. These payments were allowable under the contract but are considered a taxable benefit per IRS regulations. Upon our review the District reporting on IRS Form W-2 and IRS Form 1099 there was no reporting of the car allowance for this employee.

**Risk**

The District may not be properly reporting taxable income for contractual benefits of employees

**Recommendation**

We recommend the District review this benefit and its procedures to ensure that the benefit is properly reported on either Form W-2 or Form 1099. Wording in the employment contract

## **CURRENT YEAR RISKS AND RECOMMENDATIONS**

should address the potential taxability of the benefit under IRS regulations, and provide wording that it is the employee's responsibility to ensure that it is properly reported on their Form 1040 based on the appropriate Internal Revenue Code.

### **Special Aid-Compliance**

**Inherent Risk-** *Severe*

**Control Risk-** *High*

**Risk Appetite-** *Moderate*

### ***Uniform Guidance Procurement Policies***

#### **Observation:**

On December 26, 2014 the Office of Management and Budget's Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards, more commonly referred to as the "Uniform Guidance," became effective for all Federal awards, whether the funds are provided directly from a Federal agency or passed-through another state or local agency.

The District currently has effective procedural controls in place over the management of Federal awards as concluded through the testing of grant expenditures. However, key changes under the Uniform Guidance expanded the rules regarding the documentation of internal controls over Federal Awards to require that they be documented in writing in the District's policies and that management should evaluate and document the results of ongoing monitoring to identify internal control issues. The written internal controls should specifically address each of the twelve (12) compliance requirements of the Federal Award Programs.

The Uniform Guidance has allowed a two (2) fiscal year implementation period from the date Uniform Guidance came into effect. This deferment requires the implementation of Uniform Guidance Procurement policies as of July 1, 2018.

#### **Risk:**

The District may not be in compliance with Federal Grant regulations related to procurement guidelines

#### **Recommendation:**

The District should document policies and procedures in accordance with the new Uniform Guidance. This should include monitoring procedures to ensure that internal controls over compliance are working effectively. The new procurement policies and procedures should be in place for the June 30, 2019 fiscal year grants.

<b>CURRENT YEAR RISKS AND RECOMMENDATIONS</b>
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***School Lunch Claims***

**Observation:**

During our review of school lunch claims it was not that claims forms have not been submitted since February, 2018.

**Risk**

Federal and State funding will not be received timely

**Recommendation:**

The District should ensure that federal and state claim reimbursements are done timely to improve District cash flow.

## **RESULTS OF ANNUAL TESTWORK**

## **EXECUTIVE SUMMARY OF ANNUAL TESTWORK**

*D'Arcangelo & Co., LLP* was requested by the *Hempstead Union Free School District* Board of Education and the Audit Committee to perform analysis and validation tests of the District's payroll by way of a Payroll Payout Audit, with an emphasis on potential irregularities.

Our analysis within each area consisted of the following:

- **Payroll Payout Observation (June 22, 2018)**
- **Additional Confirmation Procedures on payees that were not validated through observation**

### **Analysis of Payroll Payout**

On June 22, 2018 we conducted a complete Payroll Payout Audit for *Hempstead Union Free School District*. This internal audit procedure consisted of the following phases: Planning, Field Work and Follow-up, and Analysis/Results.

#### ***Planning***

During the planning phase, we obtained payroll sign in-sheets from the Payroll Department for each building location, prepared confirmation letters and self-addressed envelopes and assigned *D'Arcangelo & Co.* audit team members to the following locations:

- Hempstead High School
- ABG Schultz Middle School

#### ***Field Work and Follow-Up***

On the morning of June 22, 2018, we obtained the current pay period pay checks from the Business Office for the locations noted above. During the distribution process, we carried out the following procedures at each District location:

- Obtained an employee photo identification and signature
- Compared the signature obtained to that on the photo identification
- Distributed paycheck upon validation
- Sent confirmation letters to employees who did not pick up a pay check
- Analyzed confirmations returned to the office of *D'Arcangelo and Co., LLP*.



<b>EXECUTIVE SUMMARY OF ANNUAL TESTWORK</b>
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**Analysis/Results**

The following is a summary and analysis of the results of the Payroll Payout Audit.

- On June 22, 2018 we secured 540 paychecks (Including Lumps Sum Payouts) 410 employees
- On June 22, 2018 we validated and distributed 463 paychecks (Including Lumps Sum Payouts) 354 employees (86%)
- D'Arcangelo retained 77 paychecks (56 employees) for confirmation procedures(Including Lumps Sum Payouts)
- On July 10, 2018 confirmation letters were sent to 56 employees for validation
- As of July 26, 2018, 29 (52%) of confirmations were received
- On July 26, 2018, second request confirmation letters were sent to 29 employees
- As of August 22, 2018, 20 (36%) confirmations remain outstanding. Unvalidated employees based on the total population of 410 employees represents 4.9%.
- For the remaining 20 unvalidated employees the District has made inquiries with the building principals. As of October 25, 2018, the building principals have validated 19 of the 20 employees. The District will continue its efforts to validate the remaining 1 employee.

<b>Paycheck or Deposit Stub</b>	<b># of Pay Checks/ Deposit Stubs</b>	<b>Percentage</b>
Claimed by Employee	463	86%
Confirmation for Validation	77	14%
<b>Total</b>	<b>540</b>	<b>100%</b>

<b>Building</b>	<b># of Employees</b>	<b>Validation</b>		
		<b>In Person</b>	<b>Confirmation</b>	<b>No Responses</b>
Hempstead Highschool	225	204	15	6
ASBG Middle School	185	150	21	14
<b>Total</b>	<b>410</b>	<b>354</b>	<b>36</b>	<b>20</b>
	100.0%	86.3%	8.8%	4.9%

<b>ADDITIONAL TESTWORK PERFORMED</b>
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**Payroll/HR-General Employee Administration**

***Targeted Employee Payroll Analysis***

**Objective**

The objective of this analysis was to determine that key administrative employees with the most risk of management override were paid according to their contracted salary.

**Procedures Performed and Outcome**

We targeted eight (8) high risk employees with access to the financial software or could have access to the financial software. We recalculated all payroll payments made to the employee for the period July 1, 2016 through June 15, 2018. We observed no instances where salary paid represented a gross deviation from the contracts set forth by the District contracts.

**Recommendation**

No recommendation necessary based on the outcome of procedures performed.

**Payroll/HR-General Employee Administration**

***Targeted Employee Same as Vendor***

**Objective**

The objective of this test was to look at any payments made to targeted employees outside of payroll, and ensure they appear reasonable. After any matches are found we investigate all payments made and look into anything that appears to be suspicious.

**Procedures Performed and Outcome**

We targeted seven (7) high risk employees with access to the financial software or could have access to the financial software. We then scanned the entire disbursements journal for payments made to these individuals. All occurrences of payments made to these individuals were reviewed. The payments were made up of contractual payments as well as mileage reimbursements. All payments appeared reasonable.

**Recommendations**

No recommendation deemed necessary based on the outcome of procedures performed.

## ADDITIONAL TESTWORK PERFORMED

### Benford's Law Analysis

#### Objective

The objective of this analysis was to apply statistical reasoning to possibly identify potential issues contained in the disbursement journal.

#### Background

Benford's Law is a statistical anomaly that was first discovered by Simon Newcomb and then further analyzed by Frank Benford. This law states that the odds of a number appearing at any point within a number are predictable. For example, below is a chart containing the statistical odds of any given number being the first digit of a larger number.

Digit	1	2	3	4	5	6	7	8	9
Odds of Obtaining as 1st Digit (%)	30.1	17.6	12.5	9.7	7.9	6.7	5.8	5.1	4.6

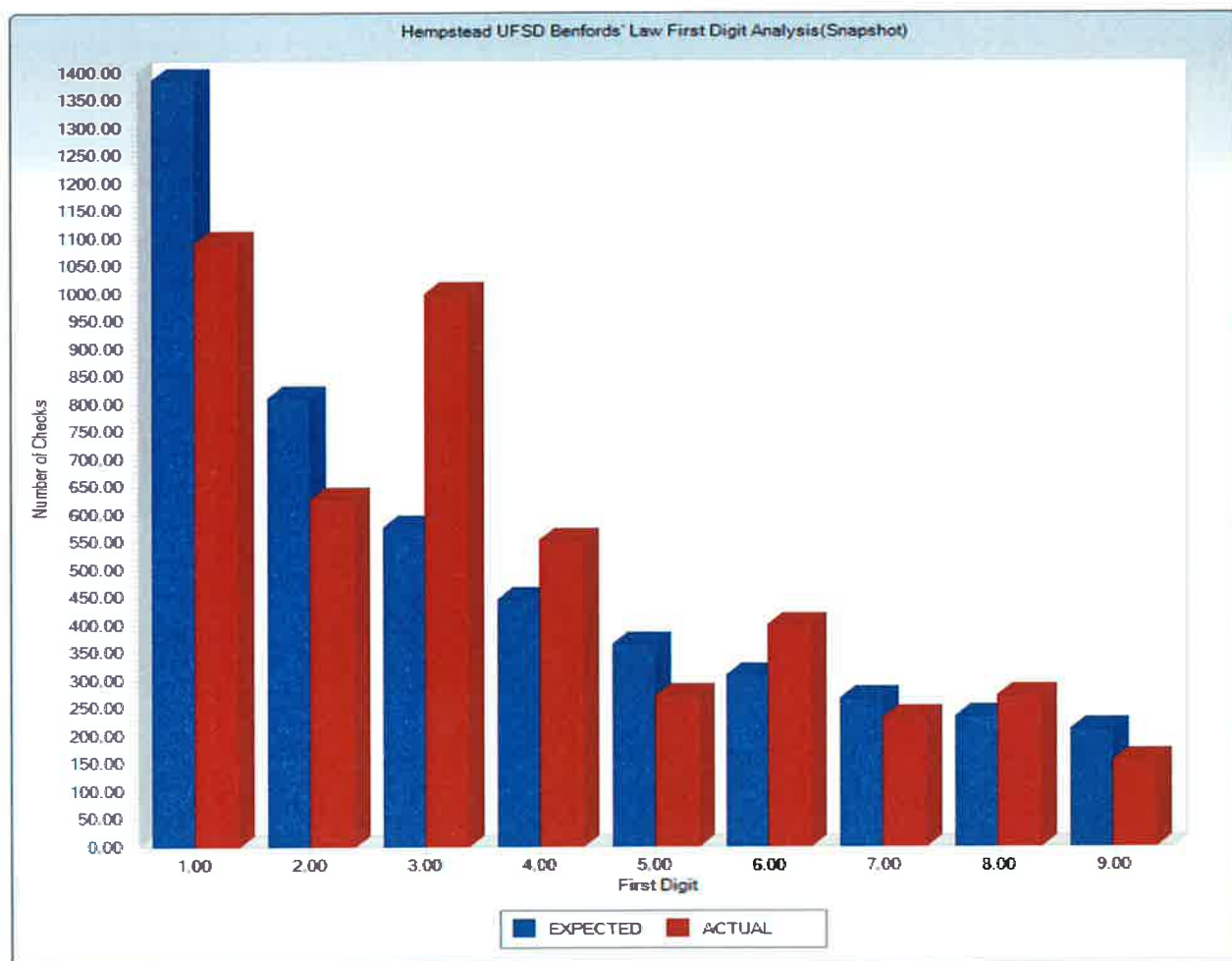
(<http://intuitior.com/statistics/Benford's%20Law.html>)

The odds of the number one being in the first position is 30.1%. By comparing a set of data to these criteria we could identify areas to look into further.

#### Procedures Performed and Outcome

By applying Benford's Law to the Districts disbursement journal data for the period of July 1, 2017 through June 15, 2018, the following results were calculated for both the first digit and second digit.

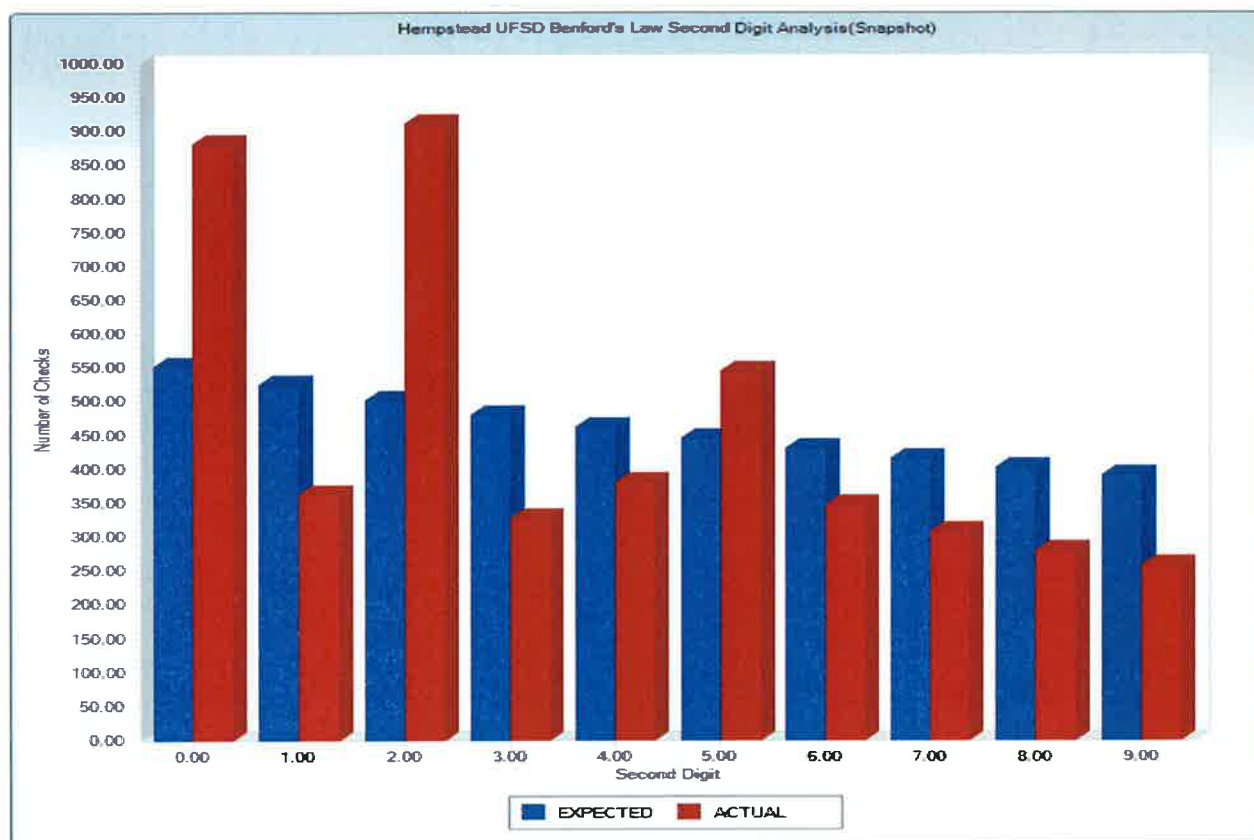
## ADDITIONAL TESTWORK PERFORMED



### Results for 1<sup>st</sup> Digit Test

The first digit Benford's Law Analysis showed variances against the expected counts for the first digits of 3, 4, 6, and 8. The overwhelming reason for each of these number spikes was due to the payment of Medicare reimbursement to individuals for either single or married coverage and differing plans. The first digit of 4 also had spikes in addition for reimbursements to employees for contractual items. In addition, the first digit of 3 spiked because of employee deductions and garnishments paid.

## ADDITIONAL TESTWORK PERFORMED



### Results for 2nd Digit Test

In performing the second digit Benford's law Analysis we saw a higher than expected number of check amounts with the second digit of "0, 2, and 5". The second digit 0 can be explained by a large number of even dollar checks for contractual payments. For example, 100, 200, 500, 1,000. The number 2 was mainly associated with payments to employees for Medicare reimbursements. The number 5 was mainly associated with employee contract reimbursements for items such as clothing, boots, etc; as well as Medicare reimbursements.