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# Final Audit Report

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Herkimer-Fulton-Hamilton-Otsego  
Board of Cooperative Educational Services

For the Period

July 1, 1997 through June 30, 1998

BOC-0599-12

March 12, 2001

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**The University of the State of New York**  
**THE STATE EDUCATION DEPARTMENT**  
**Office of Audit Services**  
**Albany, New York 12234**





THE STATE EDUCATION DEPARTMENT / THE UNIVERSITY OF THE STATE OF NEW YORK / ALBANY, NY  
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March 12, 2001

Mr. Barry Entwistle  
Board President  
Herkimer-Fulton-Hamilton-Otsego BOCES  
352 Gros Boulevard  
Herkimer, New York 13350

Dear Mr. Entwistle:

The following is our final audit report (BOC-0599-12) of the Herkimer-Fulton-Hamilton-Otsego BOCES for the period July 1, 1997 through June 30, 1998. The audit was conducted pursuant to Sections 305 and 1950 of the Education Law in pursuit of Goal #5 of the Board of Regents/State Education Department Strategic Plan: "Resources under our care will be used or maintained in the public interest."

It is the policy of the State Education Department to consider for review matters of significant disagreement which result from the issuance of a final audit report. Appendix C describes the process to be followed in the event of such disagreement.

Ninety days from the issuance of this report, BOCES officials will be asked to submit a report on actions taken as a result of this audit. I appreciate the cooperation and courtesies extended to the staff during the audit.

Sincerely,

Daniel Tworek

Enclosure

cc: Commissioner Mills, R. Cate, J. Kadamus, A. King, B. Porter, T. Sheldon, S. Spear, B. Stambler, J. Stevens, C. Szuberla, C. Foster (DOB), H. Hoffman (OSC), J. Stoothoff, District Superintendent of Schools

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# Executive Summary

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Herkimer-Fulton-Hamilton-Otsego (Herkimer) BOCES ranked 35<sup>th</sup> of the 38 BOCES in the State, in terms of total general fund expenditures, for the 1997-98 school year (\$13.9 million). The pie chart illustrates general fund expenditures by program for the 1997-98 school year.

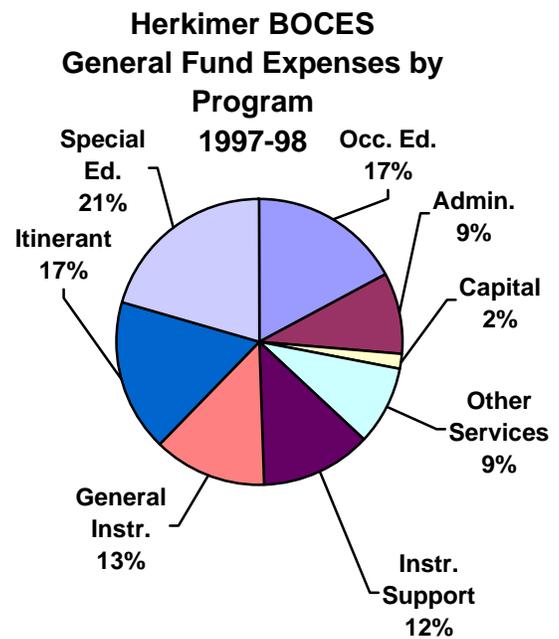
## Background and Scope of the Audit

The audit examined financial management practices, records and documentation related to selected areas of Herkimer BOCES operations for the period July 1, 1997 through June 30, 1998. These areas included Administration, Occupational and Continuing Education, Special Education, Alternative Education, Operations and Maintenance, and other select CO-SERs. This was a financial related audit and the objectives were to: determine if cost allocations and transfers are accurate and reasonable; determine if services comply with Department approved specifications and provide measurable cost savings to school districts; verify that only reasonable and necessary costs are incurred; and verify that the budgetary process provides control over the expenditure of funds.

## Audit Results

Presented below is a summary of the audit findings developed in response to the audit's objectives.

- Administrative expenditures exceeded the approved budget.
- The District Superintendent was paid for expenses outside of the contract.
- Documentation was unavailable to support some expenditure transfers.
- Several opportunities exist to improve management practices.
- EPE contact hours were undocumented resulting in an overpayment of \$5,194.



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# Introduction

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## Background

Boards of cooperative educational services (BOCES) are voluntary, cooperative associations of school districts that have joined to provide educational programs or services more economically than each could offer by itself, and are authorized by Section 1950 of the Education Law.

BOCES may provide such services as special education for students with disabilities, occupational education, academic and alternative programs, summer school, staff development, computer services, educational communications and cooperative purchasing. Today, there are 38 BOCES in New York State and all but 13 of the 705 school districts in the State are members.

Each BOCES submits an annual Cooperative Services Application (CO-SER) to the State Education Department (Department) for approval of each program and service offered to districts. After the BOCES obtains approval and determines budgeted program costs, it notifies the districts of available programs and the applicable rates.

Districts that belong to a BOCES are called component districts and are required to collectively pay the BOCES' administrative costs. Only districts that actually use the programs offered by a BOCES, called participating districts, are required to pay for the programs' costs. Costs charged to the districts for administration and programs are based on budgeted costs and are adjusted at year-end to reflect actual costs. Typically, a refund is issued to the districts to reconcile differences. The State pays aid for school districts based on eligible BOCES expenditures and the school districts' wealth.

Herkimer-Fulton-Hamilton-Otsego BOCES (Herkimer BOCES), headquartered in Herkimer, New York, serves 12 component districts. During the 1997-98 school year, Herkimer BOCES was ranked 35<sup>th</sup> of the 38 BOCES, in terms of general fund expenditures, with over \$13.9 million in general fund expenditures.

Herkimer BOCES' services include occupational and continuing education, special education, alternative education, adult education, instructional support, and other services.

## Objectives, Scope and Methodology

Section 305 of the Education Law requires the Department to perform fiscal audits of BOCES at least once every three years. Pursuant to Sections 305 and 1950 of the Education Law, we audited management practices, records and documentation related to select operations of Herkimer BOCES for the period July 1, 1997 through June 30, 1998. This was a financial related audit and the objectives were to:

- determine if cost allocations and transfers are accurate and reasonable;
- determine if services (CO-SERs) comply with Department approved specifications and provide measurable cost savings to school districts;
- verify that only reasonable and necessary costs are incurred; and
- verify that the budgetary process provides control over the expenditure of funds.

To accomplish our objectives we reviewed applicable laws, regulations, policies and procedures; interviewed Department and Herkimer BOCES management and staff; examined records and supporting documentation; sampled transactions on a non-statistical basis; and reviewed Herkimer BOCES audited financial statements.

There is no State or BOCES process to assess whether CO-SERs result in measurable savings to school districts. As a result, the audit was not able to complete this portion of the objectives.

We conducted the audit in accordance with *Government Auditing Standards* issued by the Comptroller General of the United States. An audit includes examining, on a test basis, evidence supporting transactions recorded in the accounting and operational records and applying other audit procedures considered necessary in the circumstances. An audit also includes assessing the estimates, judgments and decisions made by management. We believe that the audit provides a reasonable basis for our findings, conclusions and recommendations.

## **Comments of Herkimer BOCES Officials**

Herkimer BOCES officials generally agree with the findings and recommendations in this report. Their comments have been included where appropriate and their response is included as Appendix B.

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# Administrative Expenditures

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Education Law, Section 1950(4)(b)(1), states that the administrative budget shall include, but need not be limited to, any and all expenditures associated with the board, office of the District Superintendent, general administration, central support services, planning, and all other administrative activities. Herkimer BOCES' expenditures exceeded the budgeted amount and the District Superintendent received financial remuneration outside of the approved contract.

## **Expenditures Exceeded Administrative Budget**

There is no mechanism for BOCES to increase the administrative budget once the original budget has been approved by vote of the component school districts.

The Uniform System of Accounts for Boards of Cooperative Education Services (System of Accounts), as prepared by the Office of the State Comptroller (OSC), states that "encumbrance accounting will be used." Encumbrance accounting is defined as a system which "requires that each appropriation account show the amount appropriated, the amount encumbered, the amount expended and the unencumbered balance. The purpose of this system is to guard against the creation of liabilities in excess of appropriations approved by the board."

The System of Accounts defines purchasing procedures by stating that "before a purchase order or similar document is released to a supplier or contractor, a notice of encumbrance shall be filed with the treasurer. If an appropriation balance is available, the treasurer will enter the encumbrance against the proper appropriation account and indicate his approval. In the case a proposed commitment exceeds the balance available, the encumbrance cannot be entered and must be returned to the unit without approval."

The administrative budget approved by the component districts was for \$1,282,613. Herkimer BOCES actually expended \$1,300,997. This constitutes overspending the approved budget by \$18,384, or 1.4 percent.

One possible cause for the overspending of the administrative budget is that Herkimer BOCES' processes permit purchase orders to be issued that exceed remaining appropriations.

Herkimer BOCES will later request board approval for budget transfers or amendments. This increases the likelihood that Herkimer BOCES may overspend budgeted appropriations without authority.

## **District Superintendent's Contract**

According to Section 1950 (4)(a)(1) of the Education Law, BOCES are required to file copies of employment contracts and amendments to such contracts with the Commissioner of Education within five days of execution. In addition, the Department has issued guidelines to determine what payments are included in the calculation of compensation subject to the salary cap.

According to the minutes of the Herkimer BOCES Board of Education meeting dated April 15, 1998, the Board decided to amend the contract between Herkimer BOCES and the District Superintendent to include a car allowance of "not less than \$6,000." On June 18, 1998, a payment of \$6,000 was made to the District Superintendent. However, according to Herkimer BOCES, no amendment was made to the District Superintendent's employment contract.

On June 30, 1998, another payment of \$538 was made to the District Superintendent to reimburse him for six months of the employee portion of NYS health insurance. The District Superintendent was enrolled through the NYS Education Department, and Herkimer BOCES reimbursed him for the amount withheld on his State salary for the employee's share of the health benefits. According to Department guidelines, this amount is considered compensation subject to the salary cap. Additionally, the audit noted that the employment agreement between Herkimer BOCES and the District Superintendent does not stipulate that Herkimer BOCES should make this payment.

The audit noted that the total of these payments and salary paid to the District Superintendent does not exceed the salary cap imposed by Education Law.

Herkimer BOCES provided additional benefits to the District Superintendent without amending the employment contract and has not complied with Education Law regarding the filing of these changes. Herkimer BOCES intends to file the contract amendment once one is executed.

## **Recommendations**

1. Institute a review process that will prevent exceeding the administrative budget.
2. Discontinue the practice of allowing the issuance of purchase orders in excess of appropriations.
3. Formally amend the District Superintendent's contract to reflect the additional payments for the car allowance and reimbursement of health insurance premiums, and submit it to the Department for review.

## **Comments of Herkimer BOCES Officials**

Herkimer BOCES officials concur with these recommendations.

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# Cost Allocations and Transfers

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Education Law requires that the net cost of operating a BOCES service be allocated among participating districts. The System of Accounts facilitates such allocations by requiring a separate accounting of revenues and expenditures for each service program. Expenditures should be charged directly to the pertinent service involved and expenditures related to more than one service should be prorated accordingly. Interservice program transfers are used to record charges in other service programs.

Section 1950 (4)(d) of the Education Law states that those component districts that do not participate in a cooperative service are not required to pay any share of the expenditures for such service. In order to ensure that components pay only for services received, cost allocations between funds and among CO-SERs should be accurate and reasonable.

The audit reviewed a limited number of transfers and found that Herkimer BOCES needs to improve documentation to ensure that the net cost of operating BOCES services is accurately allocated among participating programs. There is a need for improved documentation for operations and maintenance costs, telephone charges, and computer technology charges.

## Operations and Maintenance

Five operations and maintenance CO-SERs were reviewed to assess the appropriateness of the allocation of the costs to other CO-SERs. The five CO-SERs were 701 – Operation and Maintenance, 702 – Special Education Supervision, 703 – Itinerant Supervision, 704 – Telephone, and 705 – Computer Technology. Herkimer BOCES officials were able to describe the methodology used to allocate the costs of all five CO-SERs. However, in three of the cases, documentation was unavailable to support the accuracy of the allocation.

Herkimer BOCES is not able to provide adequate documentation to support the allocation of costs for operation and maintenance charges (CO-SER 701), telephone charges (CO-SER 704) and computer technology charges (CO-SER 705).

Herkimer BOCES officials explained that the original allocations were calculated several years ago and have been lost, but believe that the allocations are substantially correct.

## **Recommendations**

4. Annually review the accuracy of the methodology used to allocate costs among CO-SERs.
5. Maintain supporting documentation of the methodology.

## **Comments of Herkimer BOCES Officials**

Herkimer BOCES officials concur with these recommendations.

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# Opportunities to Improve Management Processes

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Management is responsible for establishing effective management processes or controls. Management controls include establishing the goals and objectives of the organization, and the methods and procedures to ensure that the goals are met. These procedures include areas such as planning, organizing, directing and controlling program operations. They include systems for measuring, reporting and monitoring program performance. The audit reviewed several processes that it determined significant to the audit objectives and identified opportunities for improvement. Among the areas are the development of additional policies and procedures, improved accounting for equipment inventory, financing non-employee expenses at a conference, and excessive use of confirming purchase orders.

## **Additional Policies and Procedures**

OSC's *Financial Management Guide* (Guide), Volume 2, Subsection 11.1010, states that effective internal control systems are designed to assure management that all resources entrusted to their care are used in accordance with all laws, regulations, policies and sound business practices, where applicable. In addition, all resources should be safeguarded against waste, loss and misuse.

A component of an effective internal control structure is to establish written policies and procedures that define management's position and guide employees in the performance of their duties. Current, updated policies and procedures allow a comparison of how things are actually done to how they are supposed to be done so that corrections can be made when necessary.

Herkimer BOCES does not have certain suggested policies related to the following areas:

1. Non-employee travel arrangements made or paid for by Herkimer BOCES using public funds.
2. Appropriate use of meal allowances.
3. Required documentation for employee travel expenses.
4. The personal use of Herkimer BOCES' phones.
5. The personal use of Herkimer BOCES' vehicles.
6. Overtime eligibility and approval.

In addition, procedures did not exist in the following areas:

1. Payment processing, including check preparation, review, approval and signature.
2. Credit card use and payment, including required documentation.

## **Improved Internal Controls**

The audit noted the following opportunities for improvements in Herkimer BOCES' internal control structure.

### Accounts Payable System

The internal auditor plays an active role in the payment process by reviewing purchasing documentation prior to payment. The control provided by the function of an internal auditor can be improved by modifying procedures in two ways. The first is to require the internal auditor to periodically review a listing of all checks and the supporting payment documentation (warrant). Currently, the District Superintendent is signing the warrant reports without any review. Herkimer BOCES needs to revise its procedures to send the warrant report to the internal auditor along with the vouchers. This will ensure that checks are not being prepared without a review. The second is to require the internal auditor to mark the invoice or the purchase order after review in order to document the review.

### Cash Receipts System

One person responsible for receiving cash and checks is involved in posting this information onto the financial records. The same person is also responsible for performing bank reconciliations. These functions should be separated among individuals without other financial duties and then reviewed by the business manager. Internal controls would also be strengthened by making daily deposits. Currently, the treasurer batches them and deposits are made "at least weekly."

These weaknesses increase the risk that undetected losses could occur. Herkimer BOCES officials were evaluating internal controls at the time of the audit.

## Equipment Inventory System Needs Improvement

The Guide, Volume 1, Subsection 3.2010, states that it is important to maintain adequate fixed asset records to meet the requirements of Generally Accepted Accounting Principles (GAAP), and as a valuable tool for controlling fixed assets and planning replacements.

The Guide, Volume 2, Subsection 2, 11.1010, also states that effective internal control systems are designed to assure management that all resources entrusted to their care are used in accordance with all laws, regulations, policies and sound business practices, where applicable. In addition, all resources should be safeguarded against waste, loss and misuse.

Education Law, Section 1950 (18), states that "on or before January 1, 1997, each BOCES shall develop and adopt a formal policy on personal property accountability." This shall include procedures for a periodic inventory of personal property. Herkimer BOCES has created such a policy.

Commissioner's Regulations, Section 170.3(I) (1) (iii), states "Procedures for the perpetual inventory of all personal property, including the periodic inventory of valuable personal property having a unit resale value of \$500 or more on at least an annual basis, and the periodic inventory of all other personal property at least once every two years."

The audit sampled 53 assets on the Herkimer BOCES' equipment inventory list in order to determine the accuracy of this list. The audit found that:

- 47 assets were not located;
- 3 assets could not be located but documentation was available indicating that these assets were recently sold at auction; and
- 3 assets were located in the building and room listed on the inventory list.

This represents a serious lack of control of fixed assets. Herkimer BOCES has not invested sufficient resources to perform an annual inventory of these assets and, as a result, they do not comply with Education Law, Regulations or Herkimer BOCES' policy.

Herkimer BOCES officials agree that the inventory system needs improvement and are investigating an approach to strengthening controls.

## **Non-Employee Conference Expenses**

Article 8, Section 1, of the New York State Constitution states that "no county, city, town, village or school district shall give or loan any money...to or in aid of any individual." Furthermore, the Guide states that any additional cost incurred for lodging when an official is accompanied by a spouse is not an actual and necessary expense and the local government may not pay for it. The actual and necessary cost is the usual cost for a single occupancy room.

Herkimer BOCES paid \$525 for meals for three people at a conference in Tucson, Arizona. The documentation does not support that these people were Herkimer BOCES employees. Herkimer BOCES has not provided documentation showing that these amounts were reimbursed to Herkimer BOCES.

Herkimer BOCES appears to have incurred costs to the benefit of private individuals.

## **Confirming Purchases Orders**

The Department's School Business Management Handbook on Purchasing suggests the purchase order system follow specific steps from requisitioning the good or service to approval of the claim for payment. It also suggests that by following the process, certain internal controls are inherent to ensure:

- The best value is obtained;
- Proper authority exists before commitments are made;
- There are sufficient funds for the purchases; and
- Competitive bidding requirements are met.

The Guide, Volume 2, Subsection 8.3050, states that confirming purchase orders are "Verbal orders, subject to subsequent confirmation by a written purchase order, and may be given in cases where necessity for immediate action exists. Naturally, such a deviation from 'the norm' should have a very limited use. The individual placing such an order should justify the need for this action. Lack of proper planning should not be considered a valid reason for this process."

The audit determined that, of 43 invoices sampled, Herkimer BOCES used nine confirming purchase orders. This represented 21 percent of the payments sampled.

The use of confirming purchase orders limits the assurance that every purchase followed appropriate policies or procedures prior to obligating Herkimer BOCES for the liability.

## **Disclosure of Interest**

According to General Municipal Law, Section 803:

“Any municipal officer or employee who has, will have, or later acquires an interest in any actual or proposed contract with the municipality of which they are an officer or employee, shall publicly disclose the nature and extent of such interest in writing to the governing body thereof as soon as they have knowledge of such actual or prospective interest.”

The payroll clerk has an ownership interest in an auto supply company. This company was paid \$895 for auto supplies based on a bid award. Herkimer BOCES has not provided evidence that this interest was disclosed.

Herkimer BOCES does not have a policy requiring such disclosure. This disclosure should be made to the board in order to prevent the appearance of a less-than-arm's-length transaction providing an unfair advantage to a vendor.

## **Recommendations**

6. Review the suggested policies and procedures and consider adoption. Periodically review all Herkimer BOCES policies for adequacy.
7. Require the internal auditor to review and approve all warrants prior to submission to Herkimer BOCES' board. In addition, require the internal auditor to indicate review and approval by signing off on supporting documentation.
8. Consider separating the cash receipt, accounting, and bank reconciliation functions in order to improve internal controls. In addition, consider making daily bank deposits.

9. Conduct a physical inventory of fixed assets and adjust inventory records accordingly. Maintain the inventory on an ongoing basis.
10. Issue guidance to staff regarding the use of confirming purchase orders.
11. Review the circumstances related to a less-than-arm's-length transaction with an auto supply store. Report to the board on the results of the review.

### **Comments of Herkimer BOCES Officials**

Herkimer BOCES officials concur with these recommendations.

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# Employment Preparation Education Program

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School districts and BOCES generate (Employment Preparation Education (EPE) aid by reporting contact hours and student enrollment on Form SA-160.1, EPE State Aid Claim Form. Under Section 168.2 of the Regulations, a contact hour for EPE means 60 minutes of instruction given by a teacher in approved program component areas. The Department requires the number of reported contact hours to be clearly documented to ensure that EPE revenues paid to the districts or BOCES are appropriate. Any undocumented or overstated contact hours will be questioned upon audit and revenues will be reduced accordingly. The districts or BOCES must maintain classroom attendance rosters of all students who attend EPE programs.

Herkimer BOCES received a total of \$215,020 in EPE aid for the period July 1, 1997 through June 30, 1998, based on reported contact hours. The audit found that Herkimer BOCES could not support all of the EPE contact hours claimed and, as a result, were inaccurately reported.

Giving Rural Adults a Study Program (GRASP) is an education program where the student completes teacher prepared homework packets and returns them to the teacher. The calculation of GRASP contact hours is based on the number of homework packets returned by the student, subject to limits based on the number of hours the teacher works and the number of active students in the program.

The audit examined a sample of claimed contact hours to verify that adequate supporting documentation is available and requested documentation to support 5,759 of these contact hours. Herkimer BOCES provided documentation that supported only 4,332, or 1,427 fewer than the amount claimed. Herkimer BOCES provided a report that indicated that they underreported contact hours by 356 hours. The effect of the errors was that Herkimer BOCES overstated EPE hours by 1,071. As a result, the audit reduced the EPE claim by \$5,194 ( $\$4.85 \times (1,427 - 356)$ ).

## **Recommendation**

12. Review Department guidelines for counting contact hours, and review the internal procedures that are followed in calculating and reporting such hours.

## **Comments of Herkimer BOCES Officials**

Herkimer BOCES officials concur with this recommendation.

Contributors to the Report  
Herkimer-Fulton-Hamilton-Otsego  
Board of Cooperative Educational Services

- James A. Conway, Audit Manager
- Ronald Talarico, Senior Auditor

**NEW YORK STATE EDUCATION DEPARTMENT  
OFFICE OF AUDIT SERVICES  
AUDIT REVIEW PROCEEDINGS**

**Requests for Audit Review**

It is the policy of the State Education Department to consider for review matters of significant disagreement which result from a final audit report issued by the Office of Audit Services.

An organization requesting an audit review must make a written application to the Associate Commissioner for Planning and Policy Development, New York State Education Department, Room 128 EB, Albany, New York 12234 within 30 days of receiving the final audit report. An organization may request a review of an audit whenever the final audit report directs the recovery of funds from the organization and one or more of the following conditions is met:

- Recovery of funds would cause immediate and severe financial hardship to the organization, thereby affecting the well-being of program participants;
- The organization's violation was caused by erroneous written guidance from the State Education Department;
- The State Education Department failed to provide timely guidance on the matter or condition when the organization had previously requested such guidance in writing; and/or
- The report contains errors of fact or misinterpretation of laws, statutes, policies or guidelines.

Organizations requesting an audit review must submit a written application describing how one or more of the above conditions have been met. This application must include all evidence and information the organization believes are pertinent to support its position.

An audit report which recommends improvements in internal controls of administrative or financial systems, but has no material financial impact on the organization, will not be considered for an audit review proceeding.