

Scarsdale Union Free School District
Internal Audit Report on Detailed Testing
August 28, 2023

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INTERNAL AUDIT REPORT ON DETAILED TESTING

To the Board of Education and Audit Committee
Scarsdale Union Free School District
Scarsdale, New York

We have prepared this report as the result of our detailed testing as further described, which were agreed to by the Scarsdale Union Free School District (District), on payroll activity during the period January 1, 2022 through December 31, 2022.

The District's management is responsible for administering this area.

This engagement for detailed testing was performed in accordance with consulting standards established by the American Institute of Certified Public Accountants. The sufficiency of the procedures is solely the responsibility of the District. Consequently, we make no representation regarding the sufficiency of the procedures either for the purpose for which this report has been requested or for any other purpose.

Our procedures and findings are described in the following pages.

We were not engaged to and did not conduct an examination or review, the objective of which would be the expression of an opinion or conclusion, respectively on payroll and billings. Accordingly, we do not express such an opinion or conclusion. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you.

We would like to express our appreciation for the cooperation and assistance that we received from the District's administration and other employees during our engagement.

This report is intended solely for the information and use of the District and is not intended to be and should not be used by anyone other than the specified parties.

Cullen & Danowski, LLP
August 28, 2023

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Introduction:

This report is organized as follows:

- Background information
- Summary of the engagement
- Procedures performed during our detailed testwork
- Findings as a result of our review
- Recommendations to further strengthen internal controls or improve operational efficiency

Some of the recommendations may require a reassignment of personnel duties within the District and/or a monetary investment. However, any enhancement of controls should be done after a careful cost-benefit analysis.

Corrective Action Plan:

Commissioner of Education Regulation §170.12(e)(4) requires that a corrective action plan (CAP), approved by the Board of Education, must be filed within 90 days of issuance with the New York State Education Department (NYSED).

The District should submit the CAP along with the respective Internal Audit Report via the NYSED Portal.

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Background:

Good business practice requires that the District establish proper segregation of duties and adequate controls over the payroll area. These controls should ensure the completeness and accuracy of payroll related transactions (e.g., salaries, claims forms, stipends, separation payouts, etc.), changes to salaries, user account revisions and the retention of proper documentation supporting the activities.

The expenditures related to payroll are usually the largest part of the annual budget for school districts, the 2022-23 actual costs for the District's salary related expenditures including contractual, hourly, longevity and stipend costs totals \$100,299,786. The Business Office has a full-time Payroll Clerk working in the Payroll Department (Department) to handle the District's payroll processing with assistance from other employees including the Bookkeeper, who is responsible for managing the payroll withholdings and related disbursements to the third parties. The Assistant Superintendent for Business and Facilities oversees the activities of the Department. The District utilizes the SMARTS financial system (SMARTS) to process payroll.

We performed a review of the District's payroll processing that included meetings and test work, as per the engagement letter dated July 1, 2022, to determine the effectiveness of the payroll area. During the fieldwork, we gained an understanding of the past practices, current initiatives and any planned changes related to the payroll area. This included procedures to follow up on recommendations made by other auditors that relate to the payroll function, particularly the review of internal controls related to payroll withholding payments due to the clerical errors during the 2020 and 2021 years resulting in Internal Revenue Service (IRS) assessed penalties.

Summary:

We note that the District has protocols in place related to the processing of payroll transactions that includes a *Payroll Process* document with detailed steps covering various procedures and internal controls designed to mitigate the inherent risk within the payroll process (e.g., Payroll Clerk is unable to set up employees in SMARTS) and the Business Office understands the need to have proper controls in place. We also found that the employees we interviewed demonstrate a positive attitude towards improving procedures and are knowledgeable about the requirements related to their responsibilities.

We found some opportunities to improve operations as a result of our engagement that are described further in the findings and recommendations sections that follows. We suggest implementing these recommendations to further strengthen internal controls and/or improve operational efficiencies related to the District's payroll area. In addition, we have been informed that the District has decided to change the financial system from SMARTS to a new program with a phased approach starting with the budget module during the 2023-24 year and then implementing the other modules, which includes human resources and payroll, beginning with the 2024-25 year.

Procedures:

Our procedures related to payroll, as per the engagement letter dated July 1, 2022, were as follows:

- Review Board policies and District procedures related to payroll.
- Interview Business Office employees regarding policies, procedures and systems in effect related to payroll processes.

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- Review all collective bargaining agreements and a sample of individual employment agreements to understand the terms and conditions.
- Review the current payroll cycle process and identify the strengths, weaknesses and key control attributes for testing.
- Perform a payroll reconciliation from one cycle to the next during this fiscal year and document the process. Review supporting documentation for a sample of activities in one of the payrolls.
- Review payroll related activity during the period under review as follows:
 - For contractual payments – select a sample of 25 payments to ensure amount paid agrees to employee records and contract (if applicable) and compare all amounts withheld for benefits, union dues, etc. to supporting documentation.
 - For non-salary payments (hourly, stipend, overtime, etc.) – select a sample of 50 payments and review for proper approval, amount and account distribution.
 - For new hires – select a sample of 10 payments to ensure that the payment amounts are correct (i.e., salary amount agrees to Board approval or employee’s contract), appointment was Board approved prior to start date and proper documentation is on file (e.g., certifications, etc.).
 - For separation payments - select a sample of 10 payments to ensure final payments are correct (i.e., retirement incentives; accumulated unused time), proper documentation is on file (i.e., retirement or resignation letter from employee; Board resolution) and compliance with specifications in the respective contract.
 - For staff on leave of absence – select a sample of 10 employees to review the cut-off and restoration activity related to the payroll.
 - For disbursements to third parties as a result of withholdings (union dues, taxes, etc.) – select a sample of 2 payments for each type of withholding (or benefit) and compare to payments made to the applicable third party.
 - For changes to the payroll module data – select a payroll change report for 2 months to ensure a sample of edits are appropriate as well as properly approved and supported (i.e., Board approval).
 - For substitute teacher payments – review and document the procedures and select all of these payments from 2 payroll cycles to ensure accuracy and completeness as well as reconcile these payments to the permanent teachers’ absences and ensure the absences are properly recorded.
 - Follow up on recommendations made by other auditors that relate to the payroll function.

Findings:

Review of Board policies and District procedures and interviews with Business Office employees related to payroll found:

- There are Board policies related to payroll that include *Policy # 6800 – Payroll Procedures, Policy #6805 – Tax-sheltered Annuity Plan, Policy #9600 – Administrative Personnel Salaries and Fringe Benefits* and *Policy #9610 – Administrative Personnel Accumulated Unused Vacation Pay*.
- The Personnel staff create the new employee records within SMARTS and activate the new hire in the HR module. After the Personnel staff set up the new employee, the Department enters the salary information and the start date to begin the payroll payments. The new employee only starts receiving

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paychecks after the Department has completed these steps, resulting in appropriate segregation of duties related to payroll processing for new hires.

- The Business Office performs a thorough review of the salary changes related to the annual rollover process. The Department utilizes Excel spreadsheets based on data extracted from the SMARTS system to double check the salary tables and confirming the salary amounts for the various employee "types" within SMARTS.
- The District has standard procedures related to the administration of the payroll area:
 - The Board approves the hiring of new staff prior to adding the employee to the payroll; although the Board recognizes, from time to time, it may be prudent and necessary for the Superintendent to employ a teacher, administrator or other staff member provisionally before the Board has an opportunity to formally act to appoint the proposed employee.
 - The Department is responsible for preparing all payrolls.
 - Each payroll must be duly certified by being examined and approved by the Assistant Superintendent for Business.
- The Payroll Clerk performs the calculations related to changes to employees' salary amounts; however, we found that these calculations are not reviewed by a second person in the Business Office to double check the accuracy of the change in salary amount.
- The Payroll Clerk enters the timesheet information into the SMARTS system and then runs a Projected Amounts Report that details by budget code and by person the hours worked, but there is a lack of procedures to have a second person in the Business Office compare the timesheets to the report to verify that the input is correct.
- The Payroll Clerk calculates changes on the pink sheets (i.e., leaves of absence, salaried new hires, position changes, terminations and additional pays), and enters these amounts into the payroll screen. However, we found that these calculations are not reviewed by second person in the Business Office to ensure accuracy of the changes.

Review of all collective bargaining agreements and a sample of individual employment agreements noted:

- The terms and conditions in these agreements were understandable and this information was needed to complete our testwork related to the selected payroll payments that we reviewed during our fieldwork. Although we noted that the Department must maintain comprehensive records to track and monitor the various memorandums of agreements (MOAs), off-schedule earnings or hiring date stipulations that require additional administrative work to ensure the accuracy of annual salary amounts for numerous employees associated with these MOAs, off-schedule earnings or stipulations.

Review of the current payroll cycle process found:

- The Department performs a complete review during each payroll cycle using an Excel worksheet along with several SMARTS system-generated reports to compare earnings, deductions and withholdings (e.g., federal taxes, state taxes, annuities, etc.) and maintains appropriate supporting documentation.
- Throughout our review of the payroll cycle there were no exceptions or errors noted regarding payroll contractual amounts. There is adequate segregation of duties and all payments tested had been supported by collective bargaining agreements and appropriate authorization and approvals.

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Performing a payroll reconciliation from one cycle to the next during this fiscal year and review of supporting documentation for selected activities in one of the payrolls noted:

- There were no exceptions noted during the review of the November 15, 2022 and November 30, 2022 payroll reconciliation as the activities selected for review appeared appropriate and were properly supported.
- The District maintains the proper records related to the payroll reconciliation that the Department completes for each payroll cycle. This includes utilizing the Excel spreadsheets noted above to compare the SMARTS system information from one payroll cycle to the next payroll cycle to ensure completeness and accuracy of the salary amounts as part of the detailed review process.
- The District was able to provide the requested documentation to support the changes recorded in SMARTS, which included all earnings and deductions variances from one payroll cycle to the next. This included the supporting records for all employees with changes to their contractual payroll code amount, the selected employees with changes to other payroll codes and explanations for variances to certain payroll codes in total. The Department utilizes an Excel spreadsheet to facilitate the recording and tracking of payroll changes from one payroll cycle to the next, since SMARTS does not have a system-generated report that lists these payroll changes resulting in inefficiencies and potential errors.
- The payroll certification process includes the submission of the SMARTS system-generated report to the Assistant Superintendent for Business, for their review to certify each payroll cycle.
- The Department includes the explanations on the Excel spreadsheet that lists the differences related to earnings and deductions from the current payroll cycle to the previous payroll cycle. The inclusion of this Excel spreadsheet along with the explanations as part of the payroll certification process enhances the review and approval process by the District Treasurer.

Review of the selected 25 contractual payments to employees found:

- There were no exceptions related to the selected 25 payments as we noted all of these contractual payments had been accurate based on the employee's salary amount as per their respective employment contract and the all amounts withheld were properly supported.
- As noted above, there are a number of MOAs, off-schedule earnings and stipulations with the bargaining unit contracts resulting in complexities with verifying the salary amounts earned by the employees selected for testing. The Payroll Clerk needed to spend considerable time to provide records and documentation to properly support these earnings due to these complexities.

Review of the selected 50 non-salary payments (hourly, stipend, overtime, etc.) to employees noted:

- There were no exceptions related to the selected 50 non-salary payments, since there were proper approvals, the amounts were accurate and the account distribution was correct.
- There were payments to teachers for tutoring supported by *Quarantine Tutoring Payment Sheets* at a rate of \$100 per hour. We found that the District prepared documents that were approved by the Scarsdale Teachers Association (STA). However, there was a lack of a formal signed agreement, language in the STA bargaining unit contract, MOA or Board approval to support this non-salary related payment.

Review of the selected 10 new hires and the procedures to add these employees to the payroll found:

- The District has appropriate procedures to add the employees to the payroll based on staff changes related to hiring employees.

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- There were no exceptions related to the payroll amounts of the selected employees, the appointment of the new hires were approved by the Board prior to the payroll start date and the proper documentation was on file except for the finding in the next bullet point.
- There were 2 instances where the employee's Human Resources file did not include a New Hire Checklist.

Review of the selected 10 separations and the procedures to remove these employees from the payroll noted:

- There were no exceptions related to the payroll amounts of the selected employees, the separations were Board approved and the proper documentation was on file.
- The separation payments were properly supported with adequate documentation that included a detailed calculation of the payout, employees' attendance calendar, employees' resignation letter and Board minutes approving the employees' separation. In addition, we noted that the payments agreed to the employees' bargaining unit contract information related to the separation payouts.
- The District has appropriate procedures to remove the employees from the payroll based on staff changes related to employee separations.

Review of the selected 10 staff on leaves of absence and the procedures to add and remove these employees to/from the payroll found:

- There were no exceptions noted as the cut-off and restoration activity related to payroll were appropriate. In addition, the absences related to these leaves were properly recorded in SMARTS and the amount of benefit time used agreed with the employees remaining benefit time balance.

Review of the disbursements to third parties as a result of withholdings for the selected 2 payroll cycles noted:

- The Business Office has enhanced procedures related to the review and approval of the third-party payments related to payroll withholdings to ensure they are processed correctly and timely. This was the result of the IRS matters as noted above.

Review of the payroll module data changes for the selected payroll change reports from 2 months found:

- There were no errors related to the selected payroll change amounts, as we found that these revisions had been appropriate, supported and properly approved (i.e., Board resolution). The reasons for these differences are formally documented on the Excel spreadsheet during the review of each payroll cycle as noted above.

Review of the substitute teacher payments from the selected 2 payroll cycles noted:

- There are formal procedures and standard forms that are used by the District related to processing payments to substitute teachers. There were no exceptions noted related to the selected substitute teacher payments as the amounts were accurate, forms were completed appropriately and the permanent teachers' absences were properly recorded.

Follow up on recommendations made by other auditors that relate to the payroll function found:

- The District engaged an accounting firm, Nawrocki Smith, to review the internal controls over payroll withholdings and issued an Agreed-Upon Procedures Report dated September 2022. We found that this report included six (6) recommendations and we noted that the District has addressed all of these items.

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Recommendations:

We recommend that the District consider implementing the following recommendations to further improve internal controls and operational efficiencies related to payroll activities:

1. Develop procedures to require a second person in the Business Office review the calculations on the pink sheets (i.e., leaves of absence, salaried new hires, position changes, terminations and additional pays) prepared by the Payroll Clerk to ensure the accuracy of these amounts.
2. Establish procedures to assign a second person in the Business Office the task of comparing the timesheet information entered into the SMARTS system by the Payroll Clerk to the Projected Amounts Report to verify that the input is correct regarding the budget codes and hours worked by each employee.
3. Investigate the functionality of SMARTS to determine if the system can provide a payroll change report from one payroll cycle to the next payroll cycle that lists these payroll changes resulting in efficiencies by replacing the use of the Excel spreadsheet that takes staff time to prepare and there is a possibility of potential errors with this manual process.
4. Continue with efforts to verify the accuracy of withholdings and payments to third parties including the submission of wire transfers to the IRS for federal taxes. We recommend that the Business Office ensure that the designated second employee performs a review all of the information prepared by the Bookkeeper for accuracy prior to submission and signs-off to memorialize their review.
5. Ensure that all non-salary contractual payments are properly supported by a formal signed agreement, language in the employment contract, MOA or Board approval (e.g., tutoring at a rate of \$100).
6. Establish procedures to ensure that each employee's Human Resources file includes the New Hire Checklist as part of the proper documentation.