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Compendium of School District Audits

Richard L. Fair

State Auditor

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Enclosed is our Compendium of School District Audits for fiscal year 2000. If you would like a personal briefing, please call me at (609) 292-3700.

A handwritten signature in black ink, appearing to read "Richard L. Fair".

Richard L. Fair
State Auditor

October 17, 2000

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Compendium of School District Audits

Scope

N.J.S.A. 18A:7F-6d authorized the State Auditor to conduct audits of those boards of education where the school district receives 80 percent or more of their financing from state resources. As of April 18, 2000 we have completed 17 audits. This report summarizes problem areas frequently encountered during those audits.

Objectives

The objective of this report is to present those conditions which represent possible statewide systemic problems and to recommend corrective measures. This report is issued pursuant to the State Auditor's responsibilities as set forth in Article VII, Section 1, Paragraph 6 of the State Constitution and Title 52 of the New Jersey Statutes.

Methodology

We reviewed the audit reports and related workpapers for the 17 districts whose reports were published by April 18, 2000. These audits were conducted in accordance with *Government Auditing Standards*, issued by the Comptroller General of the United States. We summarized conditions that occurred in multiple districts. We interviewed staff members responsible for these audits. We also interviewed officials from the Department of Education regarding the department's auditing and monitoring functions as they relate to the various school districts.

Conclusions

We noted certain common concerns dealing with administrative practices, internal controls, and compliance with laws and regulations meriting the attention of both the Department of Education and the respective boards of education. Procedures concerning the recording and disbursing of employee base salaries were, for the most part, reasonable and handled in a proper manner. These disbursements account for the majority of expenditures. Problems occurred when expenditures were made covering

situations such as lump sum payments, awards, overtime, or payments for special programs. Problems were also found concerning the payments for health insurance benefits. The districts continued to pay premiums for employees who were no longer eligible for participation in the programs. Additional problems included unallowable or unreasonable expenditures, improper use of state contracts, and failure to follow bidding procedures required by state statutes.

Implementation of the recommendations included in this report could improve the financial efficiency of school districts, strengthen the internal controls, and help ensure compliance with statutory requirements. This could result in tax savings for the residents of New Jersey or reallocation of resources to other educational areas. Implementation could also reduce the chance that incidents of fraud, waste, or abuse occur and go unnoticed. Several of our findings have been referred to the Attorney General for further investigation.

Recommendations

Increased monitoring by and guidance from the New Jersey Department of Education [DOE] can help districts reduce the problems discovered during our various audits and reduce future occurrences.

School districts in New Jersey have traditionally operated under the home rule principle with the districts having substantial authority over their respective financial operations. While the districts can address many of the problems discussed in this report through adherence to required statutes and strengthening of internal controls, the DOE can help. The department could increase its monitoring of the districts' financial activities, provide more guidance to districts, and provide early warnings of potential trouble areas. Departmental efforts could be increased through a combination of existing mechanisms and additional resources.

Currently, financial monitoring consists primarily of the Office of Fiscal Review and Improvement, the Office of Single Audit, and the County Superintendents' Office. The department is significantly expanding their Office of Fiscal Review and Improvement. This office, whose primary

responsibilities include the Abbott Districts, helps in the preparation of budgets and reviews of expenditures. DOE is also attempting to increase the monitoring of the school districts through the creation of a new audit office. Duties of this office are to include compliance audits, audits of the activities of state run school districts, and investigative audits at school districts when deemed necessary. Also, they are to perform reviews of the annual financial statement audits and accompanying workpapers. Additional professional staff may be necessary to meet these demands.

County Superintendents have oversight responsibilities, but not necessarily of a financial nature. Although they receive copies of the financial statement audits for each district within their respective counties, they do not perform comprehensive reviews of these audit reports and are not staffed to do so. County Superintendents also have direct contact with the school districts on a recurring basis and therefore should have an understanding of individual district operations and demographics. Each superintendent is required to render an annual report to the commissioner of such matters as the commissioner may require. Their annual reports to the commissioner could be used to identify issues needing further review by the Office of Fiscal Review and Office of Single Audit.

DOE should establish procedures to coordinate the activities of these groups to provide adequate monitoring and guidance to the districts. Such activities should include, but not be limited to, the mechanisms listed below.

The Department of Education's *Comparative Spending Guide* could be used to identify areas for further investigation.

The DOE prepares an annual *Comparative Spending Guide* from financial statements issued by the school districts. This guide allows school officials and the public the opportunity to review and compare various components of a school district's expenditures with other similar districts in the state through a series of

indicators presenting costs on a per pupil basis. Information provided indicates, by category, which districts' spending levels deviate from the norm. The DOE has developed a uniform account code intended to assure consistency of data between districts. We found that the districts were not consistent in categorizing financial transactions on the financial statements. This lessens the usefulness of the *Comparative Spending Guide* as an effective analytical tool in the comparison of school expenditure patterns.

Although the department has not been using this guide to analyze deviations, they are moving to expand their work in this area. For example, they will undertake target reviews of Abbott districts with high spending levels. They have also identified districts with low categorical spending levels with the purpose of finding and rewarding best practices. To enhance the value of the guide, however, the DOE should provide additional training to business administrators in the use of account codes.

An annual financial statement audit is prepared for each school district. These audits are performed by independent accountants hired by the local school boards. Besides giving independent assurance that the financial statements are presented fairly, the reports contain sections dealing with internal control and compliance issues. A copy of each audit is forwarded to the DOE for review. These audit reports could be used as an additional resource in determining which districts require assistance or further monitoring. Although the reports receive a desk review for completeness, the issues presented in them are not used by the DOE as a risk indicator.

DOE could develop guidelines of potential business risks dealing with compliance and performance issues and have each district undertake a periodic self assessment of controls and operations. The frequency of these assessments could be determined

Districts' audit reports could be used as a risk indicator.

Districts could undertake periodic self-assessments.

based on the risks identified at the district by DOE. Each district could report upon the policies or procedures in effect to prevent exposure to a given risk or provide a time table with corrective action(s) when a risk exists. The guidelines could also include best practices against which the districts could measure themselves.

The state could aid
in salary
negotiations.

Many of the personnel issues discussed in this report were the result of contracts negotiated between the individual districts and the various bargaining units representing employees of the district. These bargaining units often have access to professional negotiators provided by national and state organizations. DOE could assist the districts by providing input concerning salaries and benefits during negotiations and employing professional negotiators for districts requesting such aid. Department officials should also consider conducting negotiations for the districts.

Business
Administrators
could have greater
independence.

Currently, business administrators and the board secretaries are employees hired by the districts. At most districts, one individual holds both titles under contracts typically running for a term of one year. Independence is crucial to the effective operation of a business office. To achieve independence, business administrators could be appointed and dismissed by the districts, subject to advice and consent of the DOE or, in the extreme, could be made state employees. Such a change could also provide consistency in training, provide a more consistent philosophical approach, and provide DOE with a direct link to the daily operations of the districts. As an alternative, DOE auditors could be placed on site at some districts, performing pre-audits of transactions.

Besides using the information gathered to identify risks for further audit or investigation, the issues could be communicated to the districts through

Best practices could be communicated better.

periodic bulletins and internet sites. The districts could then have access to issues such as problems and best practices encountered at other districts and recommended action to prevent or correct those problems or improve operations.



Payroll Expenditures

Extraordinary payroll pay-outs increase local budgets.

Established procedures sometimes provided excessive retirement benefits, unreasonable reimbursement for unused vacation/sick leave, large raises, and liberal overtime payments. These payments are the result of contractual agreements, ineffective procedures, or lax internal controls. These practices increase personnel costs without providing benefit to the district.

Pension Related Increases

Three districts, either through contractual or board action, provided extraordinary salary adjustments to employees which served to increase their pensions. These adjustments, which are contrary to common practice and appear to be in conflict with state pension regulations, add minimal cost to the district's operations. Pension benefits are paid from state funds and thus, these actions increase the state's long term liabilities beyond the normal commitment.

Lump Sum Payments

Our audits disclosed a wide disparity among school districts in the amount of unused sick leave reimbursement granted on retirement. At least one district audited had very strict limits. Conversely, one district audited has policies that allow retired employees full reimbursement for unused sick leave at the current pay rate. Additionally, one district not only pays terminated employees for current unused vacation leave, but allows the employee to collect for up to 90 days of prior years' vacation allocations at the current rate of pay.

We found three school districts that calculated payments to terminated employees (12 month employees) for unused vacation pay using a work year below the normally accepted 261 days. Two districts used a 240 day base and one used a 219 day base. This procedure increases the daily pay rate above that earned while employed.

One board prepared an extraordinary retirement package for one employee. The package included an extra month's pay, a retroactive raise awarded after the retirement was announced, payment for two weeks vacation instead of the two days unused leave earned, an increased rate of payment for unused sick leave, and the payment of health benefits for an additional year.

Overtime Practices

Problems concerning excessive overtime payments were found at three of the districts audited. These problems unnecessarily increased the personnel cost of district operations. Among the problems noted were lack of supervisory monitoring, use of overtime for regularly scheduled events or regularly occurring situations, non-compliance with terms of negotiated contracts, payment at an incorrect rate, and calculation errors.

One of these districts paid overtime at a rate triple the normal salary instead of the contractually required double time. This same district paid some employees at a time-and-a-half rate even when their work week did not exceed 40 hours.

A custodian at this district requested and was paid for 600 hours work during one month, an average of 19 hours each day. At another district, three employees received two hours of overtime on a daily basis for an extended period of time. At a third district, two employees worked 2.5 hours overtime daily without prior authorization nor documentation explaining the work objectives.

One district paid extra compensation for work performed during the normal workday. Three employees at the same district were compensated for two separate and distinct functions which occurred at the same time.

Salary Increases

Two school districts awarded, either through contract negotiation or executive decision, above average salary increases. One district has a salary schedule which calls for an increase of over 25 percent when a teacher advances from step 14 to step 15, the highest salary step. Another district has a supermax provision in the employment contract which automatically advances employees to the maximum salary upon a required number of years of service.



Expenditures

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monitoring could
reduce the instances of
expenditures that are
either not allowable for
the program charged
or excessive in nature.

Our review of non payroll expenditures found that districts are making expenditures that are either not allowable expenses of the program charged or are excessive in nature. These expenditures increase the cost of operations without providing the district with additional benefits. Additionally, in the case of non-allowable expenditures, the district may be required to reimburse the entity providing the program funding. The DOE could request copies of the minutes of board meetings and peruse the minutes to identify issues needing further audit or investigation. Some of the issues identified here point out the need for an on-site auditor or a business administrator who is independent of board influence. Specifically we noted:

- Six districts had expenditures from special funding sources which seemed unrelated to the corresponding programs' goals and objectives. In one of these cases, \$90,000 was contributed to the city's recreational summer day camp. In another, \$100,000 was paid to the city in the form of property taxes.

- Three districts did not monitor board member travel expenses to ensure they were reasonable, necessary, and/or allowable under established policy.
- Because of a district's inability or reluctance to obtain the needed financing for additional space, they incurred leasing costs equivalent to implied interest rates in excess of 12 percent of the estimated purchase price of these properties.
- One district's legal expenses during fiscal years 1998 and 1999 were \$841,000 and \$632,000, respectively. Included in fiscal year 1999 expenses is the cost of a contract between the district and a law firm in the amount of \$375,000 (\$450,000 for fiscal year 2000). The cost of legal contracts at other local districts audited by our office averaged \$100,000.
- One district purchased 80 Sony Playstations and education software to be used for home bound instruction. These items, which cost \$79,000, were delivered to the district's warehouse in December 1998. They remained in the warehouse at October 1999.
- One district purchased 40 computers valued at \$60,000 and they had not been installed one year after their purchase.
- A district provided mileage reimbursement to employees in the amount of \$52,000 in fiscal year 1998. We tested 46 payments and 50 percent had either no mileage log attached or the mileage reported was overstated or questionable. In three cases, mileage was reported for weekends or days when the employee was out sick. At least six administrators who received a mileage allowance also availed themselves of free gasoline at the maintenance pumps.



Health Benefit Programs

Notification by DOE of health benefit overpayments and the cost of various plans would be beneficial to the districts in controlling expenses.

Current practices employed by the districts have resulted in excess costs being incurred for health benefit programs. Ten of the districts were paying health benefit premiums for employees who had terminated their employment. The period during which these payments were made ranged from a few months to more than 10 years. These practices have resulted in benefit payments being made for and participation by employees no longer eligible for coverage. In one district, the overpayments could total \$2 million per year. Additionally, four districts provide health benefit programs whose premiums exceed those of the State Health Benefits Program which provides similar benefits. Health benefits, in some cases, were provided in circumstances not allowed under current statutes and/or administrative code provisions.



District Staffing

Department of Education analysis of reports on school districts and the *Comparative Spending Guide* could identify risks.

Our review at two districts found that staffing levels exceeded those necessary to operate the district in an efficient and effective manner. The first district had between nine and ten administrative personnel above the average for a comparable district, costing an additional \$1 million. The second district employs 227 custodians. Using the standards set by the *American Schools and University Magazine* for the New Jersey/New York Region, which is based on square feet per custodian, the board should only need 143 custodians, 84 less than currently employed. Using the average cost per square foot, custodian costs should be \$4.6 million per year while the actual annual custodial payroll cost is \$6.1 million. The Department of the Treasury, Local Government Budget Review, when conducting a review for potential savings areas, identified overstaffing as one of the largest. Titles mentioned that should be

examined for possible reduction included instructional assistants, bus aides, lunch aides [part time], clerks, clerical aides, mechanics and helpers, custodians, and community school coordinators. Although the district has primary responsibility for cost control, DOE could assist them in this regard by making reports and studies available to all of the districts. The DOE could also use these analyses and reports to identify issues needing further audit investigation by the DOE.



Internal Control

A strong system of internal control is necessary to ensure that district resources are used in an efficient and effective manner. Strong internal control also reduces the chance that these assets will be lost or used in an unauthorized manner. Internal controls in most of the 17 districts audited need improvement. For example:

- Adequate segregation of duties and supervision of employees are important components of any system of internal control. They provide a system of checks and balances by assuring that no one employee can accidentally or intentionally process an incorrect transaction without it being detected. Procedures at 13 districts were deficient in one or both of these areas.
- Adequate documentation to support transactions, another component of a strong internal control environment, was not maintained at ten of the districts.
- Eleven districts did not have formal written procedures. These are necessary to ensure that employees understand the policies and to assure continuity when administrations change.
- Four districts did not maintain accurate and complete fixed asset records.

Department of
Education
monitoring and
guidance on internal
controls at the districts
helps provide
assurances that
resources are expended
efficiently, effectively
and properly.

- Formal contracts and/or proper approvals should provide the basis for the expenditure of funds. Contracts, in the case of certain expenditures, are required by law. Five districts made expenditures without obtaining one or both of these elements.
- State statutes establish the thresholds for seeking bids when a district wishes to obtain goods or services from a vendor. The districts are allowed to use existing state contracts whether or not the amount of the purchase exceeds the threshold. These rules are established to help the districts obtain goods and services at the lowest prices available. We found cases where the districts either failed to obtain the required bids or erroneously used established state contracts. For example, four districts audited made purchases from non-contract vendors without the necessary bids. These practices can result in a district overpaying for goods or services.

The DOE could develop a self assessment checklist to be completed by the districts. The checklist could be used by the districts and the DOE to identify and correct internal control weaknesses.

