The Honorable Christine Todd Whitman  
Governor of New Jersey

The Honorable Donald T. DiFrancesco  
President of the Senate

The Honorable Jack Collins  
Speaker of the General Assembly

Mr. Albert Porroni  
Executive Director  
Office of Legislative Services

Enclosed is our report on the audit of the City of Passaic Board of Education for the period July 1, 1997 to September 30, 1999.

If you would like a personal briefing, please call me at (609) 292-3700.
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City of Passaic Board of Education

Scope

We have completed an audit of the City of Passaic Board of Education for the period July 1, 1997 to September 30, 1999. Our audit was limited to expenditures made by the board during our audit period. The prime responsibility of the City of Passaic Board of Education is to provide a quality education to approximately 10,000 pre-kindergarten to twelfth grade students. Expenditures approximated $100 million per year.

Objectives

The objectives of our audit were to determine whether expenditures were related to the school district’s programs and were reasonable. This audit was conducted pursuant to the State Auditor's responsibilities as set forth in N.J.S.A. 18A:7F-6d.

Methodology

Our audit was conducted in accordance with Government Auditing Standards, issued by the Comptroller General of the United States. In preparation for our testing, we studied legislation, administrative code, policies of the board and the Department of Education Comparative Spending Guide. Provisions that we considered significant were documented and compliance with those requirements was verified by interview and observation and through our samples of financial transactions. We also read audit reports issued by the board’s certified public accounting firm and the budget, reviewed financial trends, and interviewed district personnel to obtain an understanding of the district’s programs and the internal controls.

A nonstatistical sampling approach was used. Our samples of expenditures were designed to provide conclusions about the validity of transactions as well as internal control and compliance attributes. Transactions were both randomly and judgmentally selected.
Conclusions

We found that the financial transactions included in our testing were related to the school district's programs and were reasonable. In making this determination, we noted certain matters meriting management’s attention.
Teachers’ Salaries

The district should review the large differential in their top salary range.

According to the New Jersey Department of Education’s comparative cost reports, the Passaic School District ranks in the upper quartile for per pupil cost. The chief contributor to this high ranking is their classroom salary and benefits cost, which also ranks in this upper quartile.

Our analysis of the teacher’s collective bargaining agreements and salary schedules found that the Passaic teachers’ salary schedule does not differ dramatically from that of other North Jersey districts audited by our office. However, the salary schedule calls for an increase of over 25 percent when a teacher advances from step 14 to 15, the highest salary step. Also, Passaic’s contract provides longevity salary adjustments of up to 11.5 percent of the salary guide amount. As a result of these two items, a teacher with a BA degree and 14 years experience teaching in the district earning $52,300 in 1998, received an increase to $67,700 (29 percent) in 1999 due to advancing to step 15. Longevity and higher educational qualifications also impact on a teacher’s salary, so that the average salary of a teacher at step 15 is above this amount.

In recent contract negotiations, management made obvious efforts to control salary costs by reducing the salaries of the lower steps in 1997 and awarding only modest cost of living increases in the other years. These negotiations have also eliminated the ten year level of the longevity awards for newly hired employees. Step 15 salary levels, however, were not included in the 1997 reductions, resulting in these large increases at step 15.

Recommendation

The district should address the top pay and longevity issues in future bargaining negotiations.
Segregation of Duties

Incompatible duties in both payroll and cash disbursements should be segregated.

During our review, wages totaled $75 million annually. Management is responsible for establishing and enforcing internal controls that safeguard assets from loss or unauthorized use. Adequate internal controls include subjecting the work of each employee to the review of another employee. Our review of the payroll and accounts payable/cash disbursement functions showed incompatible functions being performed by the same individual. The authorization, custody and accounting functions should be segregated to strengthen internal controls. The following conditions were noted during the review.

The individual who processes pay time on the payroll system has the ability to make unauthorized changes to the payroll records. This employee also receives and distributes the paychecks. Although our review noted no discrepancies, these functions are incompatible and there is no independent review.

A signature plate is utilized to sign checks paid to vendors. The individual who operates the check signing machine also processes purchase orders and vendor payments on the financial system. This individual then reconciles the checks with the vendor invoices. These functions are incompatible.

Recommendation

Management should assign the conflicting duties noted above to other employees and establish independent monitoring of key functions. Specifically, we recommend that the Office of Human Resources review the payroll edit report and verify that only authorized hires, terminations and changes in direct deposit information are made by the payroll office. Payroll checks should be received and distributed by someone other than the original processor. Additionally, the duties of signing and mailing vendor checks should be given to someone outside of the accounts payable unit.
Property Tax Payments on Leased Buildings

In order to help meet its instructional facility needs, the district has been leasing four buildings from non-profit churches. The terms of the leases require the district to pay all operating costs of the buildings including all property taxes. Annually, the district pays over $100,000 to the City of Passaic for property taxes on these four buildings. These buildings were former parochial schools that were never on the city’s property tax rolls until they were leased to the district. The explanation given by the city tax assessor is that when a tax exempt entity, such as a church, starts profiting from leasing its buildings they become liable for property taxes. The opinion of our Legislative Counsel differs. In accordance with N.J.S.A. 54:4-3.6 the following property shall be exempt from taxation: “all buildings actually used for colleges, schools, academies or seminaries, provided that if any portion of such buildings are leased to profit-making organizations or otherwise used for purposes which are not themselves exempt from taxation, said portion shall be subject to taxation and the remaining portion only shall be exempt...”. According to Legislative Counsel, “a local board of education is not a “profit-making organization” and so the continued use of the building for public education purposes continues the real property tax exemption enjoyed by the religious institution that previously operated the school.”

Recommendation

The district should seek relief from real property taxes on these leased buildings.