New Jersey State Legislature
Office of Legislative Services
Office of the State Auditor

Town of Phillipsburg School District

July 1, 2007 to June 30, 2009

Stephen M. Eells
State Auditor
The Honorable Chris Christie  
Governor of New Jersey

The Honorable Stephen M. Sweeney  
President of the Senate

The Honorable Sheila Y. Oliver  
Speaker of the General Assembly

Mr. Albert Porroni  
Executive Director  
Office of Legislative Services

Enclosed is our report on the audit of the Town of Phillipsburg School District for the period of July 1, 2007 to June 30, 2009. If you would like a personal briefing, please call me at (609) 292-3700.

[Signature]
Stephen M. Eells  
State Auditor  
April 14, 2010
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Town of Phillipsburg School District

Scope

We have completed an audit of the Town of Phillipsburg School District for the period July 1, 2007 to June 30, 2009. Our audit included financial activities accounted for in the district’s general fund. Total fiscal year 2008 and 2009 expenditures were $60.5 million and $55.8 million, respectively.

The prime responsibility of the district is to provide a quality education to approximately 3500 students by maintaining safe, healthy, competitive, and rewarding school environments. The district serves students from the Town of Phillipsburg and five sending communities at the secondary level: Alpha, Bloomsbury, Greenwich, Lopatcong, and Pohatcong Townships.

Objectives

One objective of our audit was to determine the primary factors that contributed to the district’s fiscal year 2008 year-end general fund deficit of $113,000. Additional objectives were to determine whether financial transactions were related to the school district’s programs, were reasonable, and were recorded properly in the accounting systems.

This audit was conducted pursuant to the State Auditor’s responsibilities as set forth in the “School District Fiscal Accountability Act”, Title 18A:7A-57 of the New Jersey Statutes. It was also conducted pursuant to the State Auditor’s responsibilities as set forth in Article VII, Section I, Paragraph 6 of the State Constitution and Title 52 of the New Jersey Statutes.

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, and policies of the school district. Provisions that we considered significant were documented and compliance with those requirements was verified by interview,
observation, and through our samples of financial transactions. We also read the school district budgets and board minutes, reviewed financial trends, and interviewed school district personnel to obtain an understanding of the programs and the internal controls. In addition, we reviewed annual audit reports issued by independent auditors contracted by the district and a performance audit for the period July 1, 2004 through June 30, 2006 issued by a public accounting firm.

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

Conclusions

We found that the underbudgeted health benefits account and the payment of prior year’s State Unemployment Insurance liability were the main causes for the fiscal year 2008 $113,000 general fund deficit. The district’s June 30, 2007 general fund balance was $3,083,388. The district anticipated using $2.2 million to balance the fiscal year 2008 budget and anticipated having a year-end general fund balance of $883,388. The fiscal year 2008 general fund surplus decreased by $2,974,114. The budget deficit was primarily due to a $639,259 increase in health insurance claims incurred but not reported, and the disputed payment of prior year’s State Unemployment Insurance (SUI) liability of $252,150.

We also found that financial transactions included in our testing were related to the district’s programs, were reasonable, and were recorded properly in the accounting systems. In making this determination, we noted certain internal control weaknesses meriting management’s attention.
Health Benefits Cost

The district needs to evaluate the cost of its health benefits plan.

The district is covered by minimum premium insurance plans for health benefits and prescription drugs. Fiscal year 2008 and 2009 costs amounted to $7.6 and $7.9 million, respectively per the provider’s financial statements. These costs included $400,000 in broker fees. The State offers medical and prescription drug coverage to qualified school employees and retirees, and their eligible dependents under the School Employees' Health Benefits Program (SEHBP). Local employers must adopt a resolution to participate in the SEHBP. We performed a comparison of Phillipsburg School District’s fiscal year 2008 and 2009 health benefits costs to the SEHBP’s costs utilizing state rates effective April 1, 2008 to December 31, 2008 and January 1, 2009 to December 31, 2009. We estimate that the district could have saved $1.7 million in fiscal year 2008 and $2.2 million in fiscal year 2009 if it had participated in the SEHBP. The SEHBP rates increased nearly 25 percent for calendar year 2010. Even if the 2010 SEHBP rates were applied to the district’s fiscal year 2009 health benefits costs, there would be a savings of $850,000.

We recommend the district evaluate its health benefit costs, consider the state health benefits program or seek quotes for other plans or quotes from other insurance carriers that may result in cost savings to the district.

Recommendation

Internal Controls

Management is responsible for establishing and enforcing internal controls that safeguard assets from loss or unauthorized use. Proper segregation of duties and maintenance of accurate and complete documentation are necessary to ensure
The district should strengthen financial system computer controls. Incompatible duties should be segregated.

the proper use of resources as authorized by the school board. While the district has taken steps to strengthen internal controls, our review has identified deficiencies in segregating incompatible duties and controls over purchasing.

Segregation of Duties

Access controls are necessary to prevent unauthorized use of computer resources. System users should only be provided with the access necessary to perform assigned job responsibilities. The district used the E-map accounting system to process payroll and expenditure transactions. Our review of the E-map system access levels showed four individuals, the Business Administrator, the Assistant Business Administrator, and their Secretary, and the Secretary of the Superintendent, had privileges allowing full procurement and payroll access. Also, all full-time accounts payable employees had privileges allowing full procurement access and two of the three payroll employees had full payroll access. In addition to full procurement access, the accounts payable employees could establish vendors on the system, increase purchase order amounts, print and run checks through a check signing machine, and were responsible for the check distribution. The payroll supervisor, who has the ability to add/remove an employee on the payroll system and process their pay, also receives the paychecks for distribution.

Fiscal year 2009 middle and high school student activity fund expenditures were $62,000 and $346,000, respectively. We found a lack of segregation of duties for both funds. In each school the same person receives cash, makes deposits, and prepares reconciliations. In addition, there is no audit trail for revenues collected, which would exist if receipt books were used. Therefore, we were unable to test for propriety. Our test of 19 middle school activity fund expenditure transactions showed a lack of supporting documentation for five transactions.
In addition, we noted two documents included copied approvals. Our test of 62 high school activity fund expenditure transactions showed the comptroller's rubber stamp was used 60 times for the approval. We also noted that on three occasions items purchased were shipped to requestors' homes, and on two occasions cash advances were inappropriately made. Both the comptroller's rubber stamp and the checkbook are kept in the comptroller's unlocked desk.

General fund checks for payments to sport officials are made out to the athletic director. He deposits the checks to the separate athletic bank account and pays the officials as needed. At the end of the school year, a check is issued to the Phillipsburg Board of Education for any unused funds. We tested 24 payments to sport officials and noted five payment vouchers were missing and eight contained incomplete details such as a missing check number, amount, or the paid official's social security number or signature. The district's Business Office does not request or review any documentation supporting the athletic bank account activity.

**Recommendation**

The district is in the process of implementing the new computerized accounting and payroll system. We recommend the district restrict employee access to only what is required to perform job responsibilities when establishing privileges on the new system. Also, the district should assign conflicting duties within the payroll function to other employees. Payroll checks should be received and distributed by someone other than the payroll office employees.

We recommend the district develop procedures to strengthen internal controls governing student activity funds. Such procedures should provide for adequate segregation of authorization, custody, accounting, cash disbursement, and reconciliation duties. They should also provide for adequate documentation in support of cash and expenditure transactions and proper supervisory review.
Also, we recommend the district improve record keeping for payments to sport officials and that the Business Office review documentation supporting the athletic bank account activity periodically.

**Purchasing**

Our review of purchasing controls disclosed the following weaknesses:

- Our review of the E-map master vendor file showed duplicate entries for approximately 300 vendors. Also, 5,912 of the 7,594 vendors have not been used since July 1, 2007.

- Manual checks are signed with signature stamps. The stamps and a key to the check printing machine are kept in the same location that is often unlocked and accessible by Business Office employees including accounts payable clerks.

- Our testing disclosed a lack of Business Administrator approval for 28 of 88 purchase orders and a lack of proper supporting documentation and/or description for 19 purchase orders. We also noted a lack of evidence of proper bids or quotes for 10 of 23 purchase orders tested. In addition, there were 26 purchase orders created after the services had been completed or invoiced.

- The district does not have a centralized receiving unit. Deliveries are made directly to the requisitioning school or department. A gold copy of the purchase order is being utilized as a receiving report. It should be signed after delivery is taken, goods verified, or services completed. The document should then be forwarded to the Business Office before payment is made to a vendor. We tested 47 receiving reports and noted 25 were signed by the Business
Office accounts payable clerks using the receiver’s name and then initialed by the clerks. In addition, two reports had no signatures of the receiver.

- According to the fiscal year 2010 agreement for legal services, the district should compensate the law firm $12,000 for ordinary preparation for and attendance at all regularly scheduled board committee, and special/emergency meetings and day-to-day communications. Additional services rendered are to be billed at the hourly rate of $150 for all legal work performed by attorneys and $75 for work performed by paraprofessionals. We were not provided with a copy of the fiscal year 2008 and 2009 agreements; however, per the board minutes the fiscal year 2009 rates were $150 for attorneys and $90 for paraprofessionals. The review of fiscal year 2008 and 2009 invoices from the vendor showed some work performed by attorneys was billed at $295 per hour and work performed by paraprofessionals was billed at $95 per hour. The possible overpayments amounted to $1,046.

- The district leases 20,000 square feet of office space to house its Business Office and Special Services unit. The district pays a fixed rent based on a per square footage rate and a percentage of operating expenses as defined in the lease agreement. The district paid $335,000 in fixed rent during lease year 2008, which included part of the building operating expenses. Total operating expenses for the building were $442,000. The district was responsible for 39 percent of the total operating costs, which resulted in the district being required to make an additional payment of $43,000 to the landlord. The district does not request an end-of-year breakdown with supporting documentation of operating expenses from
the landlord to verify their accuracy.

The facility is occupied by another tenant, an outpatient health and wellness care provider. There are no separate gas and electric meters installed which would identify actual utility usage for each tenant. The landlord reported $152,000 in electric and gas expenses for the 2008 lease year. The health care facility is open seven days a week and its operating hours run from 5:15 am to 9:00 pm Monday through Friday and 7:30 am to 1:00 pm on Saturday and Sunday. It is probable that the wellness center utilizes more energy than what it is charged based on its square footage of occupancy. A more equitable allocation of these costs should be negotiated or actual costs based on the installation of separate meters should be provided.

- The district provides health, prescription, and dental coverage to its eligible employees and their dependents through two private health insurance companies. The district is required to notify the plan administrators of any changes in coverage due to hiring, terminations, or changes in coverage status. We compared the May 2009 billing lists of covered employees to the May payroll data and found that six former employees were not removed from medical and prescription coverage for a period of 8 to 17 months after termination. We also found that dental premiums were paid for 27 former employees for a period of three months to seven years after termination. We communicated the findings to the district and were assured terminated employees would be removed from the coverage rolls. We performed a follow-up test and found that 4 of the 27 employees were still listed on a November 2009 dental bill. We were informed that these individuals were not visible as being active on the provider website when the
district attempted to delete them. The district failed to review monthly itemized lists supporting subsequent dental bills which would have identified the four individuals. We also contacted the insurance companies about claims filed by the former employees and found that six individuals have used the dental coverage and two individuals used medical coverage after they terminated employment with the district. The errors noted amounted to $19,000 in overpayments for dental premiums calculated using 2009 rates and $70,000 in overpayments for medical and prescription premiums paid.

The district relies on a broker for the health coverage. It does not have a contract nor does it receive details of itemized claims by employee.

**Recommendation**

We recommend the district strengthen internal controls governing the procurement function to adequately safeguard district assets. Specifically, the district should:

- Eliminate duplicate entries from the vendor master file and consider using federal identification numbers as a vendor number to eliminate duplicate entries in the future.

- Keep signature stamps in a secured and locked location.

- Ensure transactions are approved and properly supported and delivered goods verified with receiving reports authorized by employees other than requisitioners and accounts payable clerks.

- Recover the overpayments made to the vendor for legal services.

- Request an end-of-lease-year breakdown of operating costs and verify the accuracy of
of all additional payments. The property leased for the Business Office will change ownership in July 2010 and the district is in a process of negotiating a new four or five year lease agreement. The district should request the landlord to install separate utility meters to monitor the amount of energy and gas being consumed by each occupant.

- Ensure procedures are in place for the timely removal of terminated employees from the districts benefit plans. The procedures should require monthly billings to be reviewed for enrollment eligibility.

- The district should also request periodic reports of claims paid by health benefits insurers to assure claims are only paid on behalf of qualified plan participants.
April 7, 2010

Mr. Stephen M. Eells
State Auditor
Office of the State Auditor
PO Box 067
Trenton, NJ 08625-0067

Dear Mr. Eells:

Attached please find the response/comments to the audit report for the Phillipsburg School District. Please present this information as part of the final copy of your audit.

Thank you.

Sincerely,

William A. Bauer
School Business Administrator

Cc: Mr. Bret Schundler, Commissioner, Department of Education
    Mr. Mark Miller, Superintendent, Phillipsburg School District
    Mr. Paul Rummerfield, President, Phillipsburg Board of Education
Response to Audit Findings
Office of Legislative Services-Office of State Auditor

The following is the Phillipsburg School District response to the attached audit findings just completed by the Office of the State Auditor. During the course of the seven (7) month audit of our District most of the recommendations set forth in the report were addressed and acted upon by the Business Office.

HEALTH BENEFITS:
1 – We evaluated the major concerns including costs and claims, and determined what we could do to increase the cost controls. We called for an internal audit of the district account with Horizon and as a result revamped the payment schedules and reduced the commissions paid by 50%. We are also continuing to negotiate a further reduction in administrative costs and fees being charged with an anticipation of saving the District more money. During the course of the audit the District was subpoenaed by the State Attorney General to discuss possible insurance abnormalities in our coverage. We were considered victims because of past problems caused by billing and claims procedures. These concerns have now been corrected.

INTERNAL CONTROLS:
1 – The Business Office has replaced the old financial software package with a new accounting, payroll and personnel system in order to improve the control factors that needed revamping. These changes went into affect 7/1/2009 for the accounting and personnel systems and 1/1/2010 for payroll. Also for payroll we have outsourced the function to a payroll company.
2 – The activities and athletics funds have been streamlined with increased controls in paperwork and documentation for needed back up information.

PURCHASING:
1 - With the newly installed accounting program (7/1/2009) all vendors are up to date with tighter controls of purchase orders and payments.
2 – In regard to a centralized receiving unit – we discussed the idea with the auditors and based on what was recommended the District would need to spend an additional $500,000 - $750,000 more to create this purchasing unit (staff, space, equipment). This District doesn’t have the ability to spend this additional money; therefore this is not a feasible alternative for the Phillipsburg School District.
3 – We have structured a new retainer contract with our attorneys that will result in an annual savings of $20,000.
4 – The Warren County Community College is our new landlord and a new lease agreement is forth coming. The District saves approximately $125,000 in tax cost immediately. In addition, we are taking additional space for a new Middle School Alternative Program. The County College is leveling off our rent for the next four-five years and even with the additional space the District saves approximately $40,000 per year.