

A Performance Audit of Selected Fiscal and Operating Practices of Hopatcong Borough School District

AUDIT DIVISION REPORT

Issued September 30, 2021

For the period July 1, 2017 through June 30, 2020



KEVIN D. WALSH
ACTING STATE COMPTROLLER

Table of Contents

Audit Authority and Background	3
Executive Summary, Audit Objectives, Scope, and Methodology	4
Audit Findings and Recommendations	5
Cash Management and Reporting	5
Internal Control over Payroll	9
Extraordinary Aid	11
District and Co-op Shared Costs	13
Ethics Violations	15
District Use of Charge Cards	17
Comptroller Notification	18
Reporting Requirements	19
Auditee Response	Appendix A

Audit Authority

We performed this audit pursuant to the State Comptroller's authority in *N.J.S.A. 52:15C-1 et seq.* We conducted this performance audit in accordance with Generally Accepted Government Auditing Standards (GAGAS). Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Background

Hopatcong Borough School District (District), located in Sussex County, operates four schools that are attended by approximately 1,500 students. In Fiscal Year (FY) 2020, when the District employed 324 full-time equivalent staff, it reported total revenue of \$42.1 million. It received \$15.7 million, or 37 percent of its total revenue, in State Aid.

The Hopatcong Board of Education (Board), which is comprised of nine elected board members, governs the District. The Board appoints a superintendent of schools responsible for the administration of the District.

The District is the local education agency (LEA) for the Sussex County Regional Transportation Cooperative (Co-op). The Co-op includes 116 Boards of Education. It coordinates and provides transportation services for students of public and private schools along established routes. The Co-op is responsible for managing 707 school bus routes to 294 school destinations. It provides transportation to 13,101 students each day. The FY 2020 revenue for the Co-op was approximately \$36 million. As the LEA, the District Board acts as the Co-op's governing body. The District accounts for the financial activity of the Co-op in a separate enterprise fund. This fund serves to separate financial activity and funding related to the Co-op from that of the District.

Executive Summary

The audit found Hopatcong Borough School District failed to comply with (i) proper procedures for cash management and reporting; (ii) internal control requirements related to payroll processing; (iii) Extraordinary Aid application guidelines; (iv) proper allocation of shared costs between the District and Co-op; (v) ethics requirements related to contracts with employee-owned vendors; (vi) regulations regarding the use of charge cards; and (vii) statutory requirements to submit contracts valued in excess of \$2 million to the Office of the State Comptroller (OSC).¹

We make 11 recommendations to improve the District's operations and its compliance with applicable statutes and regulations.

Audit Objectives

The objectives of our performance audit were to review the District's controls over selected fiscal and operating practices, compliance with State laws and regulations, and to assess its compliance with internal policies and procedures.

Audit Scope

The period July 1, 2017 through June 30, 2020.

Audit Methodology

To accomplish our objectives, we reviewed relevant statutes, regulations, District policies and procedures, Board meeting minutes, employment contracts, collective bargaining agreements, audit reports, and other related financial records and supporting documents. We also interviewed certain District personnel to obtain an understanding of their job responsibilities and the District's internal controls.

GAGAS requires that auditors plan and perform audit procedures to assess internal control when internal control is determined to be significant to the objective. The Government Accountability Office's Standards for Internal Control in the Federal Government (*Green Book*)² establishes the standards for internal control systems for public entities. The *Green Book* establishes five components of an internal control system: control environment, risk assessment, control activities, information and communication, and monitoring. *Green Book*, p. 7-8. The five components include 17 principles that support the effective design, implementation, and operation of an internal control system. *Green Book*, p. 8-9.

As part of our review, we selected a judgmental sample of records. Our samples were designed to provide conclusions about the validity of the sampled transactions and the adequacy of internal controls and compliance with applicable statutes, regulations, policies, and procedures with regard to the same. Because we used a non-statistical sampling approach, the results of our testing cannot be projected over the entire population of like transactions or contracts.

1. Effective July 1, 2020 the Comptroller's contract review thresholds were increased. 52 N.J.R. 1443(b)(July 20, 2020).

2. See <https://www.gao.gov/assets/gao-14-704g.pdf>

Audit Findings and Recommendations

Cash Management and Reporting

Objectives

- *Assess the District's internal controls over cash management and reporting.*
- *Determine if monthly bank account reconciliations are performed in accordance with the requirements of N.J.S.A. 18A:17-9.*
- *Determine whether payroll agency fund liabilities are accurately maintained.*
- *Determine if the District accurately accounts for variances identified during the bank account reconciliation process.*

Findings

- Cash balances on monthly financial reports and cash reconciliations did not agree as required by N.J.S.A. 18A:17-9 and District Standard Operating Procedures and Internal Controls (Standard Operating Procedures).
- The District failed to correct significant reconciling items identified by the monthly bank account reconciliation process in a timely manner.
- The District's accounting record of liabilities in the payroll agency fund as of June 30, 2020 was not accurate.
- The District's Standard Operating Procedures are outdated, have not been updated since 2014, and do not reflect current processes.

Criteria

N.J.S.A. 18A:17-9 requires the chief school administrator or board designee other than the secretary to prepare the monthly reconciliation of bank account statements and in conjunction with the secretary to take any steps necessary to bring the cash record balance and reconciled bank balance into agreement prior to the completion of the secretary's monthly report. N.J.S.A. 18A:17-9(a) requires the board secretary to report the reconciled bank account balances to the board in the manner and form prescribed by the commissioner at each meeting (the Board Secretary's Report).

For those school districts that appoint a "treasurer of school moneys" (Treasurer), in accordance with N.J.S.A. 18A:17-31, the Treasurer is the board designee required to prepare the monthly reconciliation (the Treasurer's Report). N.J.S.A. 18A:17-36.

The District's monthly general ledger procedures according to its Standard Operating Procedures require the Assistant to the Business Administrator to compare the Board Secretary's Report and the Treasurer's Report to evaluate whether they are in agreement.

Methodology

To meet these objectives, we did the following:

- Interviewed District personnel responsible for reviewing bank account reconciliations and maintaining financial records;
- Documented and assessed internal controls over cash management and reporting;
- Compared FY 2020 bank account reconciliation cash balances in the various funds to the cash balances on monthly financial reports for those funds;
- Reviewed District meeting minutes to determine whether the Board approved the monthly reports;
- Analyzed general fund reconciling items for potential fraudulent transactions; and
- Substantiated payroll agency fund liability balances as of June 30, 2020.

Audit Results

Our audit found that the District did not update its Standard Operating Procedures for operational changes; failed to remediate prior audit findings; did not comply with *N.J.S.A. 18A:17-9*; did not accurately maintain the liabilities in the payroll agency fund; and did not resolve identified differences between bank account activity and District accounting records in a timely manner.

Internal Control Assessment

We assessed the District's system of internal controls over cash management and reporting. This assessment required us to obtain an understanding of the District's internal controls, determine which controls were key to our audit objective, and assess whether the key controls were properly designed and implemented and operating effectively.

We discovered that the District's Standard Operating Procedures were outdated. An entity's management is required to identify, analyze, and respond to significant changes that could impact the internal control system. *Green Book, p. 9*. The District's Standard Operating Procedures have not been updated since February 2014 and contain references to an accounting system no longer in use.

We also found that the District has not taken effective corrective action to remediate prior audit findings. Prior audits have indicated that weaknesses exist in the operation of certain control activities related to cash management and reporting. Management must remediate identified internal control deficiencies on a timely basis. *Green Book, p. 9*. We found, as described in detail below, that effective corrective action has not been taken to remediate control activities related to the District's accounting and oversight of cash.

Compliance with the Provisions of N.J.S.A. 18A:17-9

We performed audit procedures to determine 1) whether cash balances in the monthly financial report and reconciliations prepared by the Treasurer agreed with the cash balances in the reports generated by the District's financial accounting system in FY 2020, and 2) whether the governing body approved the monthly reports.

We discovered differences between the reported cash balances in the monthly Treasurer's Report, Board Secretary's report, and the monthly trial balances in the general fund. The monthly cash balance in the Treasurer's Report did not agree with the Board Secretary's Report for 8 of 12 months tested. These differences indicate that the District's monthly general ledger procedures are not operating effectively to ensure that the reports agree. The Treasurer's Report also did not agree with the monthly trial balance for 11 of 12 months tested. These reports should agree prior to submission to the Board for approval. Our audit procedures determined that the Board approved each monthly Treasurer's and Board Secretary's Report in FY 2020.

We also compared the monthly cash balances in the Treasurer's Report for the District's food service and transportation programs to the trial balance reports for each month in FY 2020. The cash balance on the monthly financial reports provided by the District did not agree with the cash balances reported by the Treasurer for any of the 12 months tested.

Our audit found that cash balances for the Day Plus childcare program and Unemployment Trust were not included in the monthly Treasurer's reports in FY 2020. The Day Plus program was a before- and after-school childcare program for students that was discontinued on July 1, 2018. The Unemployment Trust is a fund that accounts for the cash held in trust by the District to pay unemployment claims. Inquiries with staff revealed the bank accounts related to the Day Plus program and the Unemployment Trust were not reconciled during FY 2020. Despite the program's closure, its bank account had a balance of approximately \$74,000 at the end of FY 2020. The Day Plus program account balance was transferred to the general fund in FY 2021.

The District also maintains a payroll agency fund for the receipt and disbursement of employee and employer payroll withholdings. We learned that the District prepared reconciliations of the payroll agency account for the period August 2019 through June 2020. However, in FY 2020, only the July 2019 Treasurer's Report contained reconciliation for the payroll agency fund.

Maintenance of Payroll Agency Fund Accounting Record

When we compared the FY 2020 monthly balances in the account reconciliation to the monthly trial balance reports, the cash balance on the monthly financial reports did not agree with bank account reconciliation cash balances in the payroll agency fund for any of the 12 months tested. As a result, we performed additional testing of the fund to substantiate the liabilities in the accounting record as of June 30, 2020. These liabilities represent unremitted payroll withholding balances for federal taxes, state taxes, pension obligations, retirement accounts, and other mandatory and voluntary payroll withholdings. We summarized the liability accounts by payee and judgmentally selected a sample of five liabilities totaling \$474,618, or 88 percent, of the \$536,620 in total fund liabilities as of June 30, 2020. The District was unable to provide adequate support for the existence of the agency fund liabilities tested. We determined that bookkeeping errors, such as posting transactions to an improper account or failing to post a transaction, caused the errors in the accounting record.

Identified Account Reconciliation Variances

We performed additional procedures to determine if the District was accurately accounting for variances identified during the bank account reconciliation process. As part of its control activities, the District reconciles its bank accounts to its accounting records. Account reconciliations explain the difference between two financial records or account balances. A reconciling item is a difference between balances from two sources that are being compared, so that the balance from one source matches the balance from

the other source. When reconciling balances between bank account activity and the District's accounting records, differences due to timing, such as uncashed checks or deposits that have not cleared the bank, are expected. These differences will resolve themselves over time. However, unexplained discrepancies may be signs of errors or fraud.

Our examination of the general fund's bank account reconciliation as of June 30, 2020 revealed \$886,824 in reconciling items listed under outstanding checks that were not associated with a check number. These items were the result of, among other things, improper accounting of bank account transfers, payments to the State, and employee benefits and payroll. The general fund bank account reconciliation also improperly included deposits of \$27,595 not posted to the bank statement that the District received in March 2020 from the State. Further, an examination of the payroll agency bank account reconciliation as of June 30, 2020 revealed 100 reconciling items ranging in value from 1 cent to \$408,612. The items documented above represent differences between the District accounting records and bank account activity that require proper disposition. The District should determine the source of reconciling items and adjust the accounting records as needed for these differences.

Cause

District staff failed to follow its Standard Operating Procedures. Additionally, those charged with governance failed to remediate noted control weaknesses identified in external audits.

Effect/Potential Effect

The District's failure to compare reports for agreement allows for significant errors or fraud to occur and go undetected or uncorrected. Additionally, those charged with governance could make decisions based on inaccurate or incomplete information.

Recommendations

1. Update the Standard Operating Procedures to include changes to the District's internal controls and procedures such as changes to accounting software.
2. Implement month-end procedures to ensure that all bank accounts are reconciled, all variances identified through the bank account reconciliation process are corrected, and Board Secretary and Treasurer Report balances agree.
3. Develop and implement a process to ensure the accuracy of the payroll agency fund liability balances, including a periodic review by the Business Administrator.

Internal Control over Payroll

Objective

- Determine if controls exist to mitigate risk due to a lack of segregation of duties.

Findings

- The District does not have sufficient controls in place to mitigate the risks associated with a lack of segregation of duties for certain payroll functions.
- Information system controls over payroll are not consistent with the segregation of duties requirements in *N.J.A.C. 6A:23A-6.5*.

Criteria

N.J.A.C. 6A:23A-6.5 requires school districts to evaluate business processes annually and to allocate available resources appropriately in an effort to establish a strong control environment. Although that regulation allows the District's Business Administrator discretion with regard to segregation of duties based on available school district resources, assessed vulnerability, and the associated cost-benefit, the regulation requires, with no exception, that the functions of human resources and payroll shall be segregated and completed by different employees in all school districts. *N.J.A.C. 6A:23A-6.5(b)(1)*. Districts are required to establish access controls "for key elements of financial systems to ensure a single person does not have the ability to make system edits that would violate segregation of duties controls." *N.J.A.C. 6A:23A-6.7(c)*. The Federal Information Systems Controls Audit Manual (FISCAM)³ advises that access controls should enforce segregation of duties and notes that without adequate access controls authorized users can perform duties or make changes outside their authority. *FISCAM p. 198-222*.

Methodology

To meet these objectives, we did the following:

- Interviewed District personnel responsible for preparing, processing, and distributing payroll;
- Documented and assessed internal controls over payroll processing and distribution;
- Examined supporting documentation for manual payroll transactions to determine if transactions were reasonable, in the correct amount, and provided evidence of supervisory review; and
- Verified that employee salary data in the information system agreed with salary information approved by the Board.

Audit Results

Our audit found weaknesses in internal controls involving payroll processing and distribution that demonstrate the District has not fully complied with *N.J.A.C. 6A:23A-6.5*.

We assessed the District's system of internal controls over payroll processing and distribution. We obtained an understanding of the District's internal controls, determined which controls were key to our au-

3. The District should consider recognized authoritative guidance, such as FISCAM, in drafting its policies and procedures. <https://www.gao.gov/products/gao-09-232g>

dit objective, and assessed whether those controls were properly designed, implemented, and operating effectively.

We observed that the District did not have an effectively designed system of internal controls for issuing manual payroll checks. An entity should design control activities to achieve objectives and respond to risks. *Green Book*, p. 9. Our assessment of controls identified that the payroll/benefits coordinator (Coordinator) completed payroll processing and had direct, unrestricted access to the District's signature plate. As a result, the Coordinator had the ability to process and distribute a manual check without secondary approval.

Also, the District does not have a policy that requires a supervisory level review for issuing manual payments. We identified 28 manual checks totaling \$34,436 issued in FY 2020 that were not issued as part of the District's bi-monthly payroll and judgmentally selected 14 checks totaling \$16,536 for testing. The District provided evidence that the transactions were reasonable and in the correct amount. However, the supporting documentation did not exhibit evidence of a secondary supervisory approval.

Our audit also determined that the duties of payroll and human resources were not segregated as required by *N.J.A.C. 6A:23A-6.5(b)(1)*. Through interviews with relevant personnel, we determined that the Coordinator had the ability to perform certain human resource functions that are not segregated and increase the risk of fraud or improper transactions. The Coordinator had privileges in the District's information system that allowed the editing of payroll information. This lack of segregation of duties allows the Coordinator to alter employee salary information, including the Coordinator's own salary. Management should design the entity's information system and related control activities to achieve objectives and respond to risks. *Green Book*, p. 9. The ability of the Coordinator to perform human resources functions is not consistent with the required segregation of duties under *N.J.A.C. 6A:23A-6.5*. We judgmentally sampled records for 10 of the District's 440 employees in FY 2020, including the Coordinator, and verified that the salaries present in the District's system were the salaries approved by the Board.

Cause

The District has not properly designed control activities that mitigate risks associated with the issuance of manual checks or implemented information system controls that create a clear segregation of duties between human resources and payroll functions as required by *N.J.A.C. 6A:23A-6.5*.

Effect/Potential Effect

The District's inadequate internal controls over the issuance of manual checks and lack of segregated payroll and human resource duties increase the risk of undetected errors or fraud.

Recommendations

4. Design and implement policies and procedures to prevent the issuance of unauthorized payroll checks by physically securing the signature plate with the Business Administrator and requiring approval by the Business Administrator prior to the issuance of manual checks.

5. Implement appropriate user permissions in the District's information systems for employees performing human resources and payroll functions so that their duties are segregated as required by *N.J.A.C. 6A:23A-6.5(b)(1)* and *N.J.A.C. 6A:23A-6.7(c)* and in accordance with FISCAM section 3.2 on access controls.

Extraordinary Aid

Objectives

- *Determine if the District accurately completed its Extraordinary Aid application to calculate student costs.*
- *Determine if the District included all eligible students on its Extraordinary Aid application.*

Findings

- The District improperly characterized costs on its FYs 2018 and 2019 Extraordinary Aid applications.
- The District failed to identify all students eligible for Extraordinary Aid in FY 2020.
- The District's calculation of eligible costs in FY 2020 did not include employee benefit costs.

Criteria

School districts may apply for extraordinary special education aid (Extraordinary Aid) from the State. Districts submit applications to receive a partial reimbursement for the costs to educate individual students who meet the eligibility requirements established in *N.J.S.A. 18A:7F-55(b)(1)* through (5). Extraordinary Aid eligibility requires that an individual student meet certain instructional cost thresholds and have an individualized education plan (IEP) requiring the provision of intensive services. Eligible costs include all costs of implementing the services required by the child's IEP except for required transportation costs.

The District is eligible to seek reimbursement for public school students whose instructional costs exceed \$40,000 per year. *N.J.S.A. 18A:7F-55(b)(1)* and (2). The cost threshold is increased to \$55,000 per year for students attending a separate private school for students with disabilities. *N.J.S.A. 18A:7F-55(b)(3)*. Eligible intensive services in a student's IEP may include, but are not limited to, personal aides, interpreters, one-to-one nursing services, and one-to-one instruction for more than 50 percent of a student's instructional day. The District should have processes and procedures in place to maximize the reimbursement for the costs of eligible students.

Methodology

To meet these objectives, we did the following:

- Interviewed District personnel responsible for identifying eligible students, gathering cost information, and filing the annual application;
- Reviewed the Extraordinary Aid User Manual and Frequently Asked Questions document prepared by the New Jersey Department of Education;
- Reviewed FYs 2018 – 2020 Extraordinary Aid applications;
- Compared FY 2020 District-prepared out-of-district student cost information with the FY 2020 Extraordinary Aid application and IEPs; and
- Recalculated costs claimed in the FY 2020 Extraordinary Aid application for an in-district student and traced costs to supporting documentation.

Audit Results

Our audit identified that the District incorrectly reported costs for in-district students on its FY 2018 and FY 2019 Extraordinary Aid applications. We also identified that out-of-district students who met the Extraordinary Aid criteria were not included on the FY 2020 application. Additional testing indicated that employee benefit costs were not included for an in-district student on the FY 2020 application.

On the FYs 2018 and 2019 Extraordinary Aid applications, the District reported actual direct student classroom costs as tuition. The Extraordinary Aid application program adjusts costs reported as tuition to remove the ineligible administrative component of tuition costs. The District's incorrect classification of costs led to a decrease in Extraordinary Aid revenue of \$8,086 in FY 2018 and \$8,664 in FY 2019. When informed of the issue, the District properly classified the classroom costs on the FY 2020 application.

We evaluated whether the District had identified all students who met the eligibility criteria under *N.J.S.A. 18A:7F-55(b)*. We compared all 26 out-of-district student cost records for FY 2020 to the FY 2020 Extraordinary Aid application. Our comparison found that of the 26 students, 12 students were included on the FY 2020 application and 7 students had insufficient eligible costs. We judgmentally selected the remaining seven students who met Extraordinary Aid eligibility cost thresholds, but were not on the application, for testing. We reviewed the IEPs of the seven students and determined that two students required intensive services that met the statute's eligibility requirement and had sufficient eligible costs. The inclusion of these students on the application would have provided an additional \$33,168 in aid revenue.

We reviewed the cost calculation and supporting documentation for the costs of in-district students claimed on the FY 2020 application. The District applied for Extraordinary Aid for one in-district student. We found that the District failed to include the cost of employee benefits in its eligible cost calculation. We calculate that the District would have received an additional \$6,845 in revenue if employee benefit costs had been included in the cost calculation.

Cause

District staff did not account for the full costs of all students whose IEP required aid-eligible intensive services, were unaware of the requirements for reporting tuition costs, and failed to include relevant employee benefit cost data for the calculation of in-district student costs.

Effect/Potential Effect

The District did not maximize Extraordinary Aid revenue for all eligible students.

Recommendation

6. Design and implement procedures to identify all Extraordinary Aid-eligible students, determine their costs, and file the Extraordinary Aid application in accordance with Department of Education guidelines.

District and Co-op Shared Costs

Objective

- ***Determine if the allocation of the shared costs between the District and Co-op is supported by documentation.***

Findings

- The District was unable to provide documentation to support the allocation of the base pay for shared employees between the District and the Co-op.
- The District does not have policies and procedures in place to ensure that the calculation of the annual rental payment accurately allocates the shared expenses between the District and the Co-op.

Criteria

N.J.S.A. 18A:39-11 allows a school district to provide transportation services for other school districts. The District is the LEA for the Co-op and includes the financial activity of the Co-op in its financial statements. The District accounts for the Co-op's financial activity in a separate enterprise fund, which is a proprietary fund used to report activities for which a fee is charged to external users for goods and services. The enterprise fund for the Co-op serves to separate the fees paid by the Co-op members from other funds received by the District.

Methodology

To meet this objective, we performed the following:

- Interviewed District personnel responsible for preparing, processing, and distributing payroll;
- Reviewed Board meeting minutes to identify salaries of personnel that were shared between the District and the Co-op;
- Reviewed District payroll records of the identified personnel;
- Requested time and effort documentation to support the allocation of salaries and wages for shared employees; and
- Requested documentation to determine the method utilized to calculate the annual rent payment.

Audit Results

Our audit procedures identified three District employees that perform work for the Co-op. The shared employees included an office employee responsible for transportation duties and two maintenance workers. The District informed us that the base pay of these employees was shared equally between the Co-op and the District. The District used weekly timesheets to allocate overtime pay to the proper fund based on the work being performed. However, the District could not provide documentation demonstrating that each employee's actual time and effort supported the equal allocation of the employee's base pay between the District and the Co-op.

In addition to the shared employees, the District charged the Co-op an annual rental fee. According to the District, the fee pays for the cost of the physical office space utilized by the Co-op and reimburses the District for other costs paid on behalf of the Co-op. The payment totaled \$100,000 in FY 2018 and increased to \$200,000 in FYs 2019 and 2020. These costs included, but were not limited to, Co-op employees' pension costs, office equipment, and utilities. However, we found that the District lacked formal policies and procedures to identify all shared costs and to calculate the annual rental fee to ensure all such costs to the District were reimbursed by the Co-op. A formal process would increase transparency for District and Co-op stakeholders.

Cause

The lack of formal policies and procedures prevents the determination of all eligible shared costs and the appropriate allocation of costs between the District and Co-op.

Effect/Potential Effect

The District's failure to calculate the costs of the employees' shared services and other costs associated with the Co-op may result in either taxpayers subsidizing costs that should be borne by the Co-op's members or Co-op members subsidizing costs that should be borne by the District's taxpayers.

Recommendation

7. Develop and implement policies and procedures for ensuring that all eligible shared costs are identified and allocated based on an appropriate cost allocation methodology. The procedures should include, at a minimum, a formal process of determining the annual rental fee.

Ethics Violations

Objective

- ***Determine if payments to vendors owned by District employees violated Board policies or regulations.***

Finding

- **The District made payments to companies owned by District employees in violation of the District's purchasing manual, code of ethics, and conflict of interest policies.**

Criteria

The District has various codes of ethics for its employees. District Policy 1540 – Administrator's Code of Ethics states that:

No administrator shall act in his/her official capacity in any matter where he/she, a member of his/her immediate family, or a business organization in which he/she has an interest, has a direct or indirect financial or personal involvement that might reasonably be expected to impair his/her independence of judgment in the exercise of official duties. No administrator shall act in his/her official capacity in any matter where he/she or a member of his/her immediate family has a personal involvement that is or creates some benefit to the administrator or a member of his/her immediate family.

The policy defines an administrator, in part, as an employee of the District who holds a position that does not require certification but is responsible for making recommendations regarding hiring or the purchase or acquisition of any property or services by the local school district.

District Policy 4214 - Conflict of Interest applies to support staff and states that "no support staff member of the Board shall act in his/her official capacity in any matter wherein he/she has a direct or indirect personal financial interest." The District purchasing manual also prohibits District employees and Board members from having a financial interest in any contract with the Board. The purchasing manual states that "no employee or board member may have a direct interest in any contract or agreement for the sale of goods and services to the Board of Education, nor receive any benefit, compensation, or reward from any contract for the sale of goods and services to the Board of Education."

Methodology

To meet this objective, we performed the following:

- Compared employee addresses in the payroll file to vendor addresses to identify employee-owned vendors;
- Reviewed expenditures for FYs 2018 – 2020 for payments to employee-owned vendors;
- Reviewed supporting documentation for payments; and
- Interviewed the Business Administrator.

Audit Results

Our procedures identified 2 of the District's 2,207 vendors shared addresses with District employees and received payments in FYs 2018 - 2020. We found that one of the Co-op vendors was a business owned by an employee of the District. The District paid the employee-owned vendor \$3,824 in FY 2018, \$5,430 in FY 2019, and \$5,176 in FY 2020. The payments were for routing and billing software and web maintenance and hosting. The District was aware of the employee's relationship with the vendor. Although the software and hosting fees were charged to the Co-op, the District is the LEA of the Co-op. The District accounts for the Co-op through the District's enterprise fund. Therefore, the same laws, regulations, and code of ethics that apply to the District apply to the Co-op.

Additionally, we identified a September 2017 transaction between the District and another employee-owned vendor. The District paid the company \$9,800 for tennis court repairs. Statutes require that each school official disclose certain financial and business relationship information annually. *N.J.S.A. 18A:12-25 and 12-26*. Our review of the required annual disclosures for calendar years 2017 and 2018 revealed that the employee appropriately disclosed the ownership of the company. However, the District violated provisions in its purchasing manual and policies when it approved the purchase order for the employee-owned vendor.

Cause

The District failed to comply with its purchasing manual and policies when making purchase decisions.

Effect/Potential Effect

The District's purchase of goods and services from employee-owned businesses may present the appearance of favoritism and may result in challenges to contract awards.

Recommendation

8. Revise and implement policies and procedures to prevent the use of employee-owned businesses as vendors in accordance with the District's purchasing manual. Discontinue using any employee-owned companies as vendors.

District Use of Charge Cards

Objective

- **Determine if the District used charge cards in violation of the regulations of the New Jersey State Board of Education.**

Finding

- The District has issued and utilized charge cards and charge accounts in violation of *N.J.A.C. 5:30-9A.3*.

Criteria

N.J.S.A. 18A:19-1 requires school districts to expend funds only by the issuance of warrants. A warrant is a voucher authorizing the payment or receipt of money. *N.J.A.C. 5:30-9A.3* prohibits boards of education from utilizing “procurement cards, charge cards, or charge accounts.” As an enterprise fund of the District, the use of charge cards or accounts by entities like the Co-op is likewise prohibited.

Methodology

To meet this objective, we performed the following:

- Interviewed District personnel responsible for procurement and issuance of charge cards;
- Reviewed District procedures for credit accounts; and
- Reviewed FY 2020 check register for payments to identified charge accounts.

Audit Results

Our audit revealed that the District used three charge cards. We reviewed District procedures, analyzed expenditure records, and determined that expenditures to the three vendors totaled \$75,303 during FY 2020. Specifically, the District paid \$29,742 to two home improvement retailers and \$45,561 to its fuel card vendor. The use of charge cards and charge accounts by boards of education is prohibited by *N.J.A.C. 5:30-9A.3*.

Cause

The District’s purchasing manual and policies do not specifically prohibit the use of charge cards.

Effect/Potential Effect

The purchases made from the charge cards and charge accounts can be subject to fraud and abuse.

Recommendations

9. Obtain guidance from the Department of Education or legal counsel for appropriate alternatives to charge card usage and terminate existing charge cards and accounts, as applicable, based on that guidance.
10. Develop and implement policies and procedures to prohibit the use of charge cards or accounts, as necessary, based on guidance obtained from the Department of Education or legal counsel.

Comptroller Notification

Objective

- *Determine if the District notified the OSC regarding contracts in excess of \$2 million during the audit period.*

Finding

- The District did not notify the OSC regarding contracts exceeding \$2 million.

Criteria

N.J.S.A. 52:15C-10 requires that a contracting unit must provide notice to the OSC no later than 20 business days after the award of a contract involving consideration or an expenditure of more than \$2 million but less than \$10 million.⁴

Methodology

To meet this objective, we performed the following:

- Reviewed FY 2020 check register for potential contracts in excess of OSC's statutory threshold;
- Reviewed the District's Board minutes for awarded contracts in excess of OSC's statutory threshold; and
- Interviewed District Business Office personnel.

Audit Results

Our review of 775 vendors paid in FY 2020 and of the Board's meeting minutes revealed two contracts that exceeded \$2 million that were not reported to the OSC as required by N.J.S.A. 52:15C-10. The District paid approximately \$6.7 million to its health insurance provider. The District also entered into a contract for \$2.1 million for the sale of an easement for a cell phone tower. Both transactions required notification to OSC's Procurement Division within 20 business days after the contract awards.

Cause

The District policies and procedures and purchasing manual do not contain provisions requiring notification to the OSC regarding contracts in excess of statutory thresholds.

Effect/Potential Effect

In addition to circumventing OSC's role in auditing and monitoring the process of soliciting proposals and awarding contracts under N.J.S.A. 52:15C-10(a), the District is not obtaining the benefit of OSC's review and guidance to ensure compliance with applicable procurement laws and regulations.

Recommendation

11. Update policies and procedures and the purchasing manual to include the contract award notification requirements of N.J.S.A. 52:15C-10.

4. Effective July 1, 2020 the Comptroller's contract review threshold was increased. 52 N.J.R. 1443(b)(July 20, 2020).

Reporting Requirements

We provided a draft copy of this report to District officials for their review and comment. The District agreed with our audit findings and conclusion. The District's response indicated that it will implement corrective actions to address our recommendations. District comments were considered in preparing our final report and are attached as [Appendix A](#).

We are required by statute to monitor the implementation of our recommendations. In accordance with *N.J.A.C. 17:44-2.8(a)*, within 90 days following the distribution of the final audit report, the District is required to provide a plan detailing the corrective action taken or underway to implement the recommendations contained in the report and, if not implemented, the reason therefore. We will review the corrective action plan to evaluate whether the steps taken by the District effectively implement our recommendations.

We thank the management and staff of the District for the courtesies and cooperation extended to our auditors during this engagement.