



**New Jersey State Legislature
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Office of the State Auditor**

Hudson County Schools of Technology

July 1, 2009 to June 30, 2014

**Stephen M. Eells
State Auditor**

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New Jersey State Legislature

OFFICE OF LEGISLATIVE SERVICES

OFFICE OF THE STATE AUDITOR
125 SOUTH WARREN STREET
PO BOX 067
TRENTON NJ 08625-0067

ALBERT PORRONI
Executive Director
(609) 847-3901

OFFICE OF THE STATE AUDITOR
(609) 847-3470
FAX (609) 633-0834

STEPHEN M. EELLS
State Auditor

GREGORY PICA
Assistant State Auditor

JOHN J. TERMUNA
Assistant State Auditor

The Honorable Chris Christie
Governor of New Jersey

The Honorable Stephen M. Sweeney
President of the Senate

The Honorable Vincent Prieto
Speaker of the General Assembly

Mr. Albert Porroni
Executive Director
Office of Legislative Services

Enclosed is our report on the audit of the Hudson County Schools of Technology for the period of July 1, 2009 to June 30, 2014. If you would like a personal briefing, please call me at (609) 847-3470.

A handwritten signature in black ink, reading "Stephen M. Eells".

Stephen M. Eells
State Auditor
December 29, 2014

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Scope

We have completed an audit of the Hudson County Schools of Technology for the period July 1, 2009 to June 30, 2014. Our audit included financial activities accounted for in the district's general, special revenue, and payroll funds. We focused primarily on the purchasing and payroll functions of the district. As stated in the district's Comprehensive Annual Financial Report, general fund expenditures averaged \$49 million and state aid receipts averaged \$23 million for fiscal years 2009 through 2013. The district provides a full range of educational services appropriate to grade levels 9 through 12. These include regular and vocational programs for post-secondary and high school students, as well as special education for handicapped students. The district completed the 2012-2013 fiscal year with an average daily enrollment of 2,975 students.

Objectives

An objective of our audit was to determine the primary factors that contributed to the district's fiscal years 2010 and 2011 deficits of \$1.1 million and \$0.2 million, respectively. Additional objectives were to determine whether the district's board of education (board) and administration ensured the efficient and effective use of school district funds and to determine whether financial transactions were related to the districts' programs, were reasonable, and were recorded properly in the accounting systems.

The 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, and pursuant to 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. 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.

In preparation for our testing, we studied legislation, the administrative code, and policies of the school district. Provisions we considered significant were documented and compliance with those requirements was verified by interview, observation, and through our testing of financial transactions. We read the school district budgets and board minutes, reviewed financial trends, and interviewed school district personnel to obtain an understanding of the programs and internal controls. In addition, we reviewed the annual audit reports issued by independent certified public accountants.

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. Sample populations were sorted and transactions were judgmentally selected for testing.

Conclusions

We found the mid-year cut in fiscal year 2010 state aid of \$1.0 million was the primary factor for the general fund deficits for fiscal years 2010 and 2011. The district did not make adjustments to school operations and thereby accepted the anticipated fiscal year 2010 deficit; however, the district was proactive in implementing cost-saving measures commencing with fiscal year 2011 and thereby rectifying the two-year fund balance deficits. In fiscal years 2012 and 2013, the reported fund balances were \$1.7 million and \$2.1 million, respectively. We found the district was efficient and effective in using school district funds except for its provision of other employee benefits and its payroll processing cost. We also found the financial transactions were related to the district's programs, were reasonable, and were recorded properly in the accounting systems except for summer payment program employee overpayments and unrecorded year-end liability and an unidentified surplus in the payroll agency fund which merit management's attention.

Other Employee Benefits

Certain district employee benefits are an inefficient use of county and state funds.

Accumulated Sick Leave Payments

Under state law, new employees and high level administrators are subject to a \$15,000 unused sick leave payment cap upon retirement. However, the district continues to provide generous unused sick leave payments to its previously hired employees through current contracts. Depending on the employee contract, a district employee is provided from 11 to 25 sick leave days per year. Each year, up to 15 unused sick leave days are added to their cumulative balance. When applying to the district for retirement, an employee may request a lump-sum payout for unused sick leave days or accelerated retirement. Accelerated retirement allows employees to be paid for all their accumulated sick days by remaining on the district's payroll as an active employee until their retirement date. This option increases the payments received for the first 100 days two-fold as the lump-sum option only reimburses the first 100 days at a 50 percent rate. Based on the fiscal year 2013 average daily salary rate of \$328, the added cost to the district would be \$16,400 per retiree. This also allows the employee to continue to receive full employee benefits, including but not limited to, accruing additional sick and vacation days, pension credit, and health benefits until retirement. While this provision is vague in the employee contracts, it is provided by the district as a continued practice. The employee's retirement date is effective immediately upon the exhaustion of all sick leave days. Although the employee is not physically working, the district generally does not fill this vacant position until the outgoing employee is "officially" retired which may affect the operations of the district. The following chart ranks the district's compensated absences liability as the highest of all 21 county vocational districts. This liability includes other unpaid leave, but is primarily attributable to accumulated sick leave.

| County Vocational Schools 2013 | | | |
|---|--------------------------------|---------------------|--------------|
| School District | Compensated Absences Liability | Full-time Employees | Per Employee |
| Hudson County Schools of Technology | \$11,810,805 | 387 | \$30,519 |
| Monmouth County Vocational School District | 4,781,985 | 346 | 13,821 |
| Hunterdon County Vocational School District | 330,345 | 32 | 10,323 |
| Ocean County Vocational Technical School | 1,720,573 | 236 | 7,291 |
| Sussex County Technical School | 733,207 | 110 | 6,666 |
| Passaic County Vocational School District | 3,621,150 | 551 | 6,572 |
| Gloucester County Vocational-Technical School District | 858,646 | 146 | 5,881 |
| Somerset County Vocational and Technical Schools | 625,387 | 109 | 5,737 |
| Bergen County Vocational Technical Schools | 2,504,835 | 443 | 5,654 |
| Cape May County Technical High School District | 764,886 | 137 | 5,583 |
| Union County Vocational-Technical School District | 913,619 | 170 | 5,374 |
| Burlington County Institute of Technology | 1,382,689 | 299 | 4,624 |
| Mercer County Area Vocational-Technical School District | 430,474 | 104 | 4,139 |
| Atlantic County Vocational School District | 637,474 | 162 | 3,935 |
| Middlesex County Vocational and Technical Schools | 1,109,995 | 338 | 3,284 |
| Camden County Technical School | 1,195,123 | 369 | 3,239 |
| Essex County Vocational Technical Schools | 854,500 | 314 | 2,721 |
| Morris County Vocational School District | 495,450 | 195 | 2,541 |
| Warren County Technical School | 197,980 | 82 | 2,414 |
| Cumberland County Board of Vocational Education | 148,728 | 81 | 1,836 |
| Salem County Vocational Technical School | 119,880 | 101 | 1,187 |

Sick Leave Incentive Plan

The district provides cash bonuses to all employees who have used less than four sick days through the end of the school year. This includes the superintendent and administrators. As depicted in the following chart, the district disbursed \$251,500 to 230 employees under the 2012/2013 Sick Leave Incentive Plan. The district already rewards employees for not using unused sick days by providing significant cash value for accumulated days at retirement.

| Fiscal Year 2012-2013 | | | | | | |
|-----------------------|-------------------|----------------|---------------------------|----------|---------|------------------|
| Instructional | Non-Instructional | Administrative | Total Full-time Employees | Days Out | Payout | Total |
| 90 | 64 | 31 | 185 | 0 | \$1,200 | \$222,000 |
| 18 | 1 | 0 | 19 | 1 | 800 | 15,200 |
| 10 | 3 | 0 | 13 | 2 | 600 | 7,800 |
| 8 | 4 | 1 | 13 | 3 | 500 | 6,500 |
| 126 | 72 | 32 | 230 | | | \$251,500 |

Although the district claimed the incentive plan resulted in savings of substitute teacher expenses, they could not supply us with a cost saving analysis or written justification of their claim. The \$1,200 bonus for teachers using no sick days is equivalent to paying a substitute teacher for 15 days at \$80 per day. Teachers are entitled to 16 sick days, including 3 personal days. Although the district may consider the program cost-effective, there is also the risk that some employees may come to work sick which may have an adverse affect on the health and education of the students.

Sabbatical Leave

The district provides six-month sabbatical leaves for up to four administrative or instructional employees in a school year. According to their contracts, "a sabbatical leave may be granted... by the Board for study, including study in another area of specialization, for travel, for rest, or for other reasons of value to the school system." Prior to sabbatical leave, the employee is required to sign an agreement to ensure their return to work for at least two years. During fiscal years 2010 through 2014, there were no signed agreements and none of the sabbaticals resulted in the employee returning to work. As summarized in the following chart, the accelerated retirement (sick payment) followed immediately after the employee's sabbatical leave. We concluded that these sabbatical leaves were granted to precipitate retirement. As such, these sabbaticals may be deemed an Early Retirement Incentive which may be prohibited under state pension regulations.

| Fiscal Year | Sabbatical | Accelerated Retirement | Total | Total Employees |
|--------------|--------------------|------------------------|--------------------|-----------------|
| 2011 | \$93,831 | \$311,608 | \$405,439 | 2 |
| 2012 | 168,427 | 283,761 | 452,188 | 3 |
| 2013 | 177,946 | 501,752 | 679,698 | 3 |
| 2014 | 49,842 | 49,842 | 99,684 | 1 |
| 2015 | 64,770 | 107,950 | 172,720 | 1 |
| 2016 | 299,227 | 840,770 | 1,139,997 | 5 |
| 2017 | 205,524 | 488,248 | 693,772 | 4 |
| Total | \$1,059,567 | \$2,583,931 | \$3,643,498 | 19 |

Most sabbaticals were approved for teachers, but there were also sabbaticals approved for a payroll manager and a school nurse. There is no board policy for sabbaticals. Since the board approves sabbaticals and the disbursements are significant, there should be a board policy.

Recommendation

We recommend the district:

- Consider revising future contract provisions to eliminate the accelerated leave program.
- Justify the value of the Sick Leave Incentive Plan or consider its elimination.
- Limit the approval of sabbaticals to educational purposes to ensure value is returned to the school district for these costs.
- Establish a formal board policy on sabbaticals.

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Summer Payment Program

Payments under the program violate regulations, are not properly recorded, and were erroneously calculated.

The district provides a voluntary summer payment program to its 10-month employees. This program allows these employees to be paid over 24 bi-monthly payments instead of 20 bi-monthly payments. The four additional payments are provided beyond the end of the 10-month school year during the summer months of July and August. There were on average 155 of the 190 (82%) district 10-month employees enrolled in the program during the last three school years.

This district program is not in compliance with state laws. N.J.S.A. 18A:29-3 specifies the amount to be withheld for summer payment plans is 10 percent of regular salary installment payments. The district does not withhold 10 percent, but rather recalculates the regular salary installment payments based on 24 payments instead of 20 payments. This results in a summer payment withholding equal to 17 percent of regular salary installment payments. Also, salaries withheld should be accounted for in the district's payroll agency fund.

In addition, N.J.S.A. 18:35-7.5 specifies summer payment plan withholdings are subject to tax at the time the deduction is made. The district does not withhold taxes until the summer payment. The district's 10-month employees' salary earnings and tax withholdings should be recorded over the course of the school year.

The district's method does not properly record summer payments as an expense in the correct fiscal year. The gross amount of these summer payments should be recorded as an expense when earned. The summer withholdings should be a liability in the payroll agency fund at June 30. Instead the summer payments are expensed in the subsequent fiscal year. The unrecorded summer payments liability was estimated to be \$2 million as of June 30, 2013. This liability, if recorded properly by the district, will have a negative impact on the district's fund balance.

We also found that the district miscalculated the bi-monthly payments for the summer payment program for each of the last three school years. Affected employees were overpaid on average \$179 which resulted in total overpayments of \$83,000 over this three-year period. The discrepancy was attributable to the most recent three-year contract, which gave raises to applicable employees each January instead of at the beginning of the school year. The district manually applied these adjustments to the summer payments erroneously.

Recommendation

We recommend the district:

- Revise the summer payment program to comply with all statutory and tax code requirements.
- Account for the \$2 million unrecorded summer payment program liability by recording salary earnings for all 10-month employees in the fiscal year earned and account for summer payment deductions in the district's payroll agency fund.
- Seek reimbursement from those employees overpaid by the program.

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Payroll Processing Cost

Savings could be realized by the district performing this function.

The district pays a vendor \$120,000 annually for payroll processing services. This vendor's primary functions include calculating and issuing employee payroll checks, disbursing federal and state tax deposits, and preparing wage and tax reports. The district's accounting system offers integrated personnel and payroll components with an initial cost of \$50,000 and annual licensing fees of \$20,000. The district maintains a payroll unit that, with these components, could perform the duties currently provided by the vendor, resulting in annual cost savings.

Recommendation

We recommend that the district consider acquisition of the components of the accounting system necessary to allow the district to perform all payroll functions in house and realize annual cost savings.

**Payroll Agency Fund****Implementing proper controls would enhance the accountability of these funds.**

The district uses a payroll agency fund to ensure that employee payroll withholdings, including federal and state income taxes, pension and health benefits contributions, garnishments, and annuities are deposited and subsequently disbursed to the appropriate governmental authority or financial institution. In addition, emergency payroll checks are advanced by this fund and are reimbursed by the district's payroll account. Approximately \$1.5 million in bi-monthly receipts, including net payroll, flow through this fund. This fund operates as a clearing account where the amounts received are disbursed to satisfy the terms of the withholdings, whether required or voluntary. The district utilizes off-the-shelf accounting software to record this fund's transaction activity.

In our review of access controls for this accounting software, we found that available individual user identifiers (IDs) are not created for each employee authorized to process transactions. User IDs facilitate the maintenance of a transaction audit trail. Without User IDs, transactions processed cannot be traced to any specific employee able to access this accounting software.

Our review of the procedures established for accounting for these funds disclosed that the district does not reconcile the liabilities created by payroll withholdings to the fund's cash balance. Our six-month analysis of liabilities disclosed a \$116,000 unidentified surplus at June 30, 2014. The \$116,000 unidentified surplus appears to have resulted from prior years employee payroll withholdings that were not disbursed to the appropriate payees. Unidentified surplus funds pose a risk for fraud which may not be detected timely. As currently recorded in the accounting software, the district's payroll department does not record a liability in an appropriate subsidiary account when withholdings are received and offset this liability when the disbursements are made. Setting up proper liability accounts in the accounting software will detect surpluses and ensure that outstanding employee withholdings are paid timely.

As part of our review, we examined 10 outstanding checks totaling \$5,000 which were over one year old. One check for \$2,000 was duplicated and the remaining nine checks were for garnishments, college savings plans, and employee miscellaneous reimbursements. The district has not been proactive in determining why these checks are still outstanding.

We also noted the following questionable uses of this fund.

- A lump-sum payment of \$29,000 for unpaid vacation was made in May 2014 to an estate of a deceased employee. Reimbursement was received in September 2014, five months later from the general operating account.
- Pension late filing and depositing penalties in July 2013 of \$700 were not reimbursed from the general operating account.

Recommendation

We recommend the district:

- Create user IDs for each individual employee authorized to process transactions within the accounting software utilized.
- Establish liability accounts in the system for the amounts withheld to ensure the proper disbursement of funds.
- Identify the transactions associated with the \$116,000 unidentified surplus.
- Limit the use of the payroll agency account to its intended purpose.

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Observation

Operating Transparency

Greater transparency of district operations would be of value to county taxpayers.

The district is one of three county vocational districts that does not post their board minutes on its public website. Although Open Public Records Act compliant, copies of board minutes are only available upon request. In addition, the information presented in the district's audited Comprehensive Annual Financial Report contains misclassified expenditures.

Our review of board minutes disclosed the omission of the total cost associated with board approved sabbatical and accumulated sick leave payments. In addition, sick and sabbatical payments are reported as "Regular Employee Salaries" and not properly disclosed in the district's financial statements as "Other Employee Benefits".

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December 19, 2014

Mr. John J. Termyna
Assistant State Auditor
Office of Legislative Services
Office of the State Auditor
125 South Warren Street
Post Office Box 067
Trenton, New Jersey 08625-0067

RE: Audit Responses for the period July 1, 2009 to June 30, 2014

Dear Mr. Termyna:

Upon reviewing the recommendations noted in the findings we are open to change and appreciate the opportunity to reflect on our own internal processes. Of the twelve recommendations cited we have already begun to address nine of them. We are also grateful to the State for acknowledging the mid-year reduction in State Aid resulting in our deficit and recognizing our *efficient* and *effective* administration of school funds.

Other Employee Benefits – Accumulated Sick Leave Payments

While we may not necessarily agree with the current administration of compensated absences, this is a contractual benefit that will be more closely reviewed in the future. In our current contracts, we did negotiate the elimination of the additional accrual of time and salary adjustments for employees on terminal leave/sabbatical.

Sick Incentive:

The sick leave incentive plan has been modified in our current contracts to provide incentives for *only* zero and one day out. While the cost benefit for substitute coverage was not as apparent, there is a benefit in the continuity of instruction provided by a teacher as opposed to a substitute. This benefit is less tangible from a budgetary perspective but more valuable to the educational process.

Sabbatical Leave:

All of the individuals granted sabbatical met the contractual criteria for leave. We have reduced the sabbaticals to one per year for Administrative Staff members. We are in the process of establishing a formal board policy regarding sabbaticals aligned to the negotiated agreements. This will be approved at our January board meeting.

Mission Statement:

*We are a passionate multi-dimensional learning community
that prepares our learners to succeed by providing quality educational opportunities.* 1 | Page

Summer Payment program:

Historically we have given our 10 month employees the option to be paid over 12 months. Our previous contract negotiated increases for instructional staff to be effective mid-year as opposed to September. This unprecedented distribution resulted in overpayments which are in the process of being satisfied. We are exploring our options to adjudicate the summer payment program and continue to provide this service to our employees within all statutory and tax code requirements. We have determined that all new 10 month employees will be paid over 10 months only. Through attrition, this situation will correct itself.

Payroll Processing Costs:

We are always examining the cost benefit of services supplied through our current provider and try to function as cost effectively as possible. We have visited alternatives in the past and will continue to reevaluate our options moving forward.

Payroll Agency Fund:

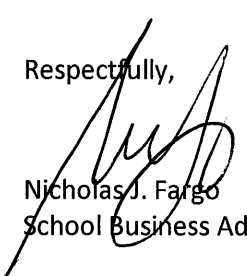
We recognize that this should function as a clearing account and the business office and payroll are working cooperatively to insure the reconciliation of the surplus and transactions.

Operating Transparency:

We have always been compliant with OPRA requests and our district website features a wealth of information to inform the public, including but not limited to our board policies and bidding requirements. We will consider utilizing our website for enhanced communication in the future.

Thank you for giving us the opportunity to respond to your recommendations.

Respectfully,



Nicholas J. Fargo
School Business Administrator

Hudson County Schools of Technology

c: P. Baron, Office of Legislative Services
J. Coyle, Office of Legislative Services
F. Gargiulo, HCST
J. Sirangelo, HCST
C. Smith, HCST