



NEWS

From the Office of the New York State Comptroller **Alan G. Hevesi**

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AUDIT FINDS EXTENSIVE IMPROPRIETY BY FIRM THAT AUDITED ROSLYN SCHOOL DISTRICT & 54 OTHER SCHOOL DISTRICTS Findings Referred to District Attorney and State Board for Public Accountancy

Miller, Lilly & Pearce, the CPA firm that audited the Roslyn School District, performed work so flawed and so far below professional standards that it failed to identify millions of dollars apparently stolen by District personnel even after the firm was aware that fraud had occurred, according to an audit issued today by New York State Comptroller Alan G. Hevesi.

The Comptroller's audit examined the audit procurement procedures for the Roslyn School District and the District's contracts with the CPA firm. State auditors found:

- The CPA firm did not meet nine of 22 mandatory professional standards for conducting audits. Non-compliance with any one standard is grounds for referral to the State Board for Public Accountancy. See "Violations of Mandatory Professional Standards for Conducting Audits" attachment.
- When a whistleblower first exposed the fraud, the CPA firm investigated and found only \$223,136 in inappropriate payments. Using the same methodology, State auditors found \$1.6 million in questionable payments.
- In its testing of District spending, the CPA firm did not look at cancelled checks, which is a standard practice for audits. Even a cursory review would have revealed instances where the actual payee on the check was different than the payee listed in the firm's workpapers.
- The CPA firm's workpapers, supposedly created in 2002 and 2003, contained payment information that was put in the District's records by District officials in 2004 to cover up fraud.
- The CPA partners sold financial and other software to the District, which creates a conflict of interest and violates professional standards requiring auditors to be independent.

The CPA firm performs audits for 55 school districts on Long Island and in the lower Hudson Valley. Approximately 250 school districts statewide use the accounting software developed and sold by the firm's partners. The audit findings have been referred to the State Board for Public Accountancy for further investigation and disciplinary action and to the Nassau County District Attorney's Office.

"The work of Miller, Lilly & Pearce was so appallingly inadequate that it would shock anyone associated with the auditing profession and certainly the taxpayers who depend on the firm to safeguard their money. Our auditors found fraud so pervasive that it would have taken significant effort not to uncover it. Even a rudimentary review of disbursements and cancelled checks would have revealed many instances of wrongdoing," Hevesi said. "I am extremely troubled by our findings, and I urge the State Board for Public Accountancy and the Nassau County District Attorney's Office to pursue this matter aggressively.

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“I have referred the audit findings to the other school districts now audited by Miller, Lilly & Pearce, as well as school districts statewide,” Hevesi said. “Additionally, the 250 school districts that use the partners’ accounting software program must be sure that the controls have been activated to prevent fraud.”

District officials have already been charged with defrauding the District of more than \$2.3 million. Former Assistant Superintendent for Business and Finance Pamela Gluckin and former Superintendent Frank Tassone have been both been charged with first-degree grand larceny for allegedly embezzling more than \$1 million each from the District, and the former Accounting Clerk Debra Rigano was charged with second-degree larceny for allegedly stealing more than \$300,000.

State auditors discovered fundamental problems with every step of the audit process, including the CPA firm’s independence, its audit planning and efforts to test financial records, as well as other questionable behavior. State auditors found:

Questionable Behavior

- In early 2004, someone changed vendor names in the District’s computerized system for 2002-03 payments in an apparent attempt to cover up fraudulent activity. However, the firm’s workpapers supposedly prepared in 2002 and 2003 contain these fake vendor names, which raises questions about when the workpapers were actually prepared. State auditors also questioned the adequacy of the firm’s audit work which included supposedly reviewing what are actually fraudulent payments, but were never identified as such.
- When Miller, Lilly & Pearce was informed by a whistleblower of questionable disbursements, all three partners and staff from the firm reviewed the District’s records in October 2002 and found a total of \$223,136 in inappropriate payments. District officials later accepted the firm’s determination and had Gluckin make restitution based on that amount. When State auditors tested the same records, using the CPA firm’s criteria, they found \$1.6 million in questionable payments.

Auditor Independence

- One of the fundamental principles of auditing is that auditors are free of any conflict of interest. Miller, Lilly & Pearce does not meet this standard. Two of the three partners of the firm had 55 percent ownership in the company that sold the District its financial management software, Finance Manager. The partners’ role as a vendor violates the General Standard of Independence under Generally Accepted Government Auditing Standards (GAGAS §3.11).
- In addition, two of the three partners received a commission from the sale of a second software package, Student Manager, which is prohibited by the American Institute of Certified Public Accountants’ Rules on Commissions and Referral Fees (ET §503.01).

Planning the Audit

- The CPA firm’s planning efforts were substantially below professional standards and did not address significant risks which would have led it to detect illegal acts. These risks include the lack of oversight by the Board of Education and others, significant or unusual transactions especially close to year-end, and a lack of appropriate systems for approving or authorizing transactions.
- When planning the 2002-03 audit, the firm did not take any steps to increase testing even though it had first-hand knowledge that fraud had occurred the previous year. In fact, in the audit form that contained the standardized conclusion: “Our overall procedures indicate no indications of possible illegal actions and there is no need to follow-up in accordance with professional standards,” the CPA firm checked “N/A” (not applicable). Under the circumstances, such a conclusion is absurd.
- The CPA firm failed to test the District’s computerized accounting system, which the firm sold the District, to ensure that the controls built into the software were operating as intended. Such controls are intended to prevent inappropriate transactions. In fact, the controls had not even been activated and a wide range of employees were able to manipulate the District’s financial system.

Reviewing the Evidence

- In its testing of disbursements, the CPA firm did not look at cancelled checks. Even a cursory review would have revealed instances where the actual payee on the check was different than the payee in the firm's workpapers. For example, auditors reviewed 16 of 240 disbursements that the firm purportedly tested in 2002-03. Five of these 16 payments were paid to vendors different than those listed in the firm's workpapers — a fact instantly identified if the firm had reviewed the cancelled checks.
- The District routinely spent much more than was appropriated for specific budget items and executed an unusually large number of budget changes, primarily due to the alleged theft occurring in the District. The firm never looked at these transactions, which were obvious red flags.
- While the firm's audit program called for a review of expenditures over \$25,000, the audit manager said that none of these bills were actually reviewed. Rather the firm "eye-balled" bills for reasonableness.
- The CPA's workpapers identified instances of weak internal controls over assets that warranted further investigation, including lack of supporting documentation for purchases, blank checks kept in an unlocked cabinet, access by central office staff to approximately 20 gas credit cards, instances where the superintendent loaned out his corporate credit card. There is no evidence that the firm ever investigated these weaknesses.
- There was a lack of documentation and evidence to support the CPA firm's audit conclusions. In the 2001-02 audit, State auditors discovered 128 instances where the CPA firm did not have adequate information to support conclusions, and another 77 similar deficiencies in the 2002-03 audit.

"This is a total failure of one of the key safeguards to protect public monies," Hevesi said. "The system of districts' hiring independent auditors must be strengthened and augmented by review from the Office of the State Comptroller in order to ensure that adequate financial controls are in place. That's why I've asked the Governor and Legislature for \$5.4 million to hire 89 auditors to look at every school district around the State on a routine basis."

Findings of the audit were discussed with the new Interim Roslyn Superintendent David Helme, who indicated that the District will take the necessary steps to address the auditors' recommendations.

While State auditors found that the District's written policies and procedures to procure audit services were adequate, the District did not actually follow these policies by seeking competitive offers from other firms.

State auditors recommended that the District and Board of Education:

- Improve the quality of its acquired audit services by implementing a competitive process; change audit firms or personnel, where appropriate, when contracts expire or at least every five years; better define the scope of the service in the engagement letter and consider expanding the audit as necessary.
- Work with its recently established Citizens' Advisory Audit Committee to ensure that audit work and findings receive adequate oversight.
- Clearly define the responsibilities of the Audit Committee, including providing timely oversight of external and internal audit work, involvement in selecting external and internal auditors, reviewing the District's financial statements, and monitoring corrective action plans.
- Require the CPA firm to report directly to the Board and Audit Committee, and the Board to prepare a formal response and corrective action plan.

A separate audit of the finances of the Roslyn School District will be completed soon.