BITS & PIECES

INTERNAL CONTROLS

EDUCATIONAL INSTITUTIONS
CYBER LIABILITY
MARKETPLACE UPDATE

BRINGING A UNIQUE UNDERSTANDING OF KEY ISSUES FACING THE PRIVATE SCHOOL SECTOR

FROM THE EDITOR - KEN CERINI, CPA, CFP, FABFA

PRIVATE SCHOOL BITS & PIECES

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Welcome to another school year, and welcome to a new set of opportunities and challenges.

The 2022/23 year is sure to be an interesting one. With COVID still a disrupting force, the impact of inflation, rising interest rates, worsening economic and market conditions, staff shortages, and lagging enrollment due to decreasing population trends, there will definitely be challenges in the upcoming year. The need for proper budgeting and cash management will be even more important this year, as schools face these challenges. Over the last few years, with the pandemic and changing regulations, school leadership has been reactionary. With all the challenges of the current year, school Boards and management will need to think more strategically, focusing on such long-term questions as:

► *What can we do to mitigate the decreasing enrollment brought about by declines in children? (In 2010, children made up 22.8% of the population in the tri-state area, which dropped to 20.9% in 2020, and is expected to be down to 19.8% in 2025)*

► *In order to compensate for declines in enrollment, schools are going to have to amp up their fundraising activities. What are we doing to increase our fundraising activities, especially given the trend in on-line giving?*

► *Is our leadership representative of the students and families we serve?*

► *Over the last two years, the COVID pandemic has disrupted student education. What are we doing to close some of the educational shortfalls experienced during the COVID pandemic?*

► *In order to be effective, schools need support from their Board. What are we doing to keep the Board engaged and what level of training are we providing to the Board?*

► *How are we going to differentiate our school to attract students and how are we going to incorporate the technology trends (remote/distant learning, enhanced technology, etc.)?*

Furthermore, schools need to stay cognizant of opportunities that exist. In response to the COVID pandemic, the federal government made trillions of dollars of relief available through the CARES Act and ensuing legislation. While some of the CARES Act funding, such as the PPP loans and related forgiveness, are over, there still are a few programs left for schools to tap into:

ERTC FUNDING:

There are two sets of regulations, the 2020 regulations and the 2021 regulations.

	2020	2021
Number of Employees	100	500
Maximum Salary Base	$10,000 for the year	$10,000 per quarter (*1st 3 quarters*)
Threshold	50% revenue decline from same quarter in 2019 or regulations inhibiting operations	20% revenue decline from same quarter in 2019 or regulations inhibiting operations
Safe Harbor	If meet the 50% threshold, continue to receive until revenue is done less than 20%	20% decline in quarter or prior quarter
Credit %	50% maximum base salary up to a total of $5,000 for 2020	70% of maximum base salary up to a total of $7,000 per quarter

For those schools that are eligible, there is still an opportunity to file for a refund.

CHILDCARE STABILIZATION GRANT 2.0:

These funds were made available through the **New York State Office of Children and Family Services ("OCFS")** and are available for eligible child care programs, which include OCFS licensed or registered programs, enrolled legally exempt group child care programs and NYC permitted group child care (*as defined in Article 47 of the New York City Health Code*) programs that were licensed/registered/permitted/enrolled by January 1, 2022. This includes Head Start, Early Head Start, daycare, Pre-K, and similar programs. 75% of the Child Care Stabilization Grant 2.0 must be spent on workforce support expenses. The portal closes on November 30, 2022 for application and expenses are eligible through September 30, 2023.

HEALTHCARE WORKER BONUS ("HWB"):

Another NY State incentive program, the HWB is a required program for eligible program. The regulations for this program will not be out until October, so stay tuned.

In addition to some government funding that's still available, there are other opportunities for schools. During the pandemic, many schools moved from in-person learning to remote learning. As a result, they may have overpaid their worker compensation, as the rates for in-person services are higher than remote. Schools may want to see if there is an opportunity to claim a refund.

On an accounting front, because after all we are an accounting firm, there are a few accounting issues that schools need to be aware of:

► **The New York Prudent Management of Institutional Funds Act (NYPMIFA)** requires the Board of a school to review investments to determine if they are prudently invested and to also review endowments where the Board has chosen to allow the endowment corpus to be expended. The Board needs to determine, based upon their analysis, if the endowed funds should be accrued (*the endowed funds not distributed*) or appropriated (*approved distribution of endowed funds*). **See here for more information about the NYPMIFA requirements.**

► New accounting pronouncements regarding leases (*effective for years beginning after December 31, 2021 unless the school has public debt*) and gifts-in-kind of nonfinancial assets or services (*effective for years beginning after June 15, 2021*). The new lease accounting standards can be cumbersome to implement, so we recommend that you start the process soon. **See here for the article from our Volume 5 issue of the Report Card.**

Finally, from an operations and compliance perspective, this month new regulations were put in place within NY State whereby nonpublic schools, including yeshivas, will face stricter enforcement of longstanding requirements that they provide academic instruction that is *"substantially equivalent"* to that provided by public schools. Under these regulations, nonpublic schools would have to demonstrate how they meet academic standards; for example, recognition from accrediting agencies or support provide support to public school officials in their community that they offer adequate instruction in English, social studies, math, and science. Furthermore, private schools must employ teachers competent in those core academic courses and instruction must be in English. By December 1, 2023, private schools must demonstrate that they meet one of the alternate pathways, or choose to have an LSA review. The initial review would be conducted by no later than the end of the 2024-2025 school year, though a school may request additional time to demonstrate substantial equivalency. Non-compliance could result in loss of state and federal funding and even shut-down of the school. For most schools this will not be a heavy lift, but anytime new regulations are released it always pays to document compliance.

We understand that these are difficult times, so we are here to help if you need it … and we will be back with our next issue in the Spring.

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INTERNAL CONTROLS

In July 2022, news broke that David Ostrove allegedly stole approximately $8.4 million from the Schechter School of Long Island (the "School"), where he served as the School's Chief Financial Officer, Chief Technology Officer, and Director of Operations. Ostrove oversaw all of the School's financial matters from accounting to tuition assistance and building maintenance and security. The alleged fraud spanned some eight years from 2014 until his termination in April 2022. Ostrove reportedly used the School's PayPal and Stripe accounts to transfer school funds into his own personal PayPal account. He allegedly tried to conceal this money by transferring it to personal accounts he held at various banks and buying properties through shell corporations. Unfortunately, this is just another in a long string of embezzlements that have rocked local schools over the last couple of decades.

If you consider the private school world today, enrollment is down, there are staff shortages, inflation is driving up costs, and investment declines are impacting contributions, so budget cuts must be made in order for many of the schools to make ends meet. Unfortunately, trust is not a substitute for an effective system of internal controls. While we don't have all the fact pattern as to how Ostrove allegedly embezzled the funds, we do know that if proper controls and oversight were in place, complete with segregation of duties, reconciliations, and a formal review process, the likelihood that his alleged activities would have gone unnoticed for eight years would have been greatly diminished.

There are two main categories of controls, detect controls and prevent controls.

PREVENT CONTROLS:

Prevent controls, as the name suggests, are put into place to prevent errors and irregularities from occurring. They tend to be more expensive, because they rely more heavily upon strong segregation of duties, which means a higher level of staff. They are implemented to catch issues before they occur. While most smaller organizations are not going to have a robust level of segregation of duties, there are certain places where the investment in appropriate segregation may make sense:

► The **human resource ("HR")** function and payroll functions should be segregated. HR is responsible for on-boarding staff and ensuring personal files are up to date, including having properly authorized salary notices/pay rates. As such, it should be the HR department's responsibility to enter all new employees and terminations within the payroll system and to modify staff salaries. Payroll should have no access or authority to perform these duties. Conversely, payroll's responsibility is to ensure that proper approved time records exist for all staff. It is payroll's job to ensure that all time is properly entered into the payroll system and the hours are properly charged against time worked, overtime, paid time off, etc. Under a system where HR enters employees and salary with no access to hours and payroll enters hours, with no access to enter employees or salary, without collusion between the two departments, it would be very difficult for a fictitious employee to be created and paid.

► The recordkeeping and check signing functions should likewise be segregated. Individuals with the access to record invoices into the system should not be able to sign checks. Having an extra individual who doesn't have the ability to create the invoices scrutinizing those invoices before they are signed to ensure that the invoices are appropriate, the goods or services were received, and the purchases were authorized, makes it more difficult for someone to generate a fictitious invoice, sign it, and cash it.

► Similarly, a person who has access to funds (*cash, checks, and electronic payment*) should not have the ability to record such payments into the accounting records and the ability to generate write-offs. In a strong control environment, the person who receives payments should be independent of the person who records the payments. The person receiving the payments should create a log of the payments or develop the deposit slip and send a copy of the log or deposit slip to the individual responsible for reviewing the bank reconciliation. In this way the person who is responsible for recording the receipts in the accounting or other systems (*e.g. fundraising*) would not be able to abscond with funds as there is already a log of what came in and the person who is receiving payments cannot take any of the funds because the person *"accounting"* for these funds will also be following up with the customer/donor if the funds don't arrive. This system only works if there is a reconciliation whereby the person performing the bank reconciliation review is reconciling the deposits per the log/deposit slips created by the receiver of the funds to an original copy of the bank statement either received directly by the reviewer or on-line. This is equally important for funds received under electronic payment systems such as Stripe and PayPal. These systems create logs of funds received and it is essential for the bank reconciliation reviewer to ensure that the funds received from these sources are properly finding their way into the school's bank account. Furthermore, the ability to generate credit memos or other system write-offs should be segregated from the person responsible for recording and collection activities, especially if they have access to the funds. By segregating these functions, it provides for independent follow-up/verification before an account is written-off, lessening the likelihood of theft.

DETECT CONTROLS:

These controls may also be referred to as compensating controls, and are put in place to catch an error or irregularity after it occurs. These controls are cheaper than prevent controls and often rely on a head of school, board member, or someone else that may not have the training or time to ask the right question and identify issues. Detect controls can be effective, as long as the person who is performing them is diligent in his/her responsibility. Some examples of effective detect controls are:

PAYROLL:

The Head of School reviews the final payroll register and a payroll edit report showing any edits made to the payroll (*addition/deletion of staff and pay changes*) and signs approval.

CASH RECEIPTS:

A person independent of the recording function, cash receipt function, and bank reconciliation function reviews the bank reconciliation. As part of that review, they should receive an original bank statement or have access to the statement online, and as noted above, they should reconcile the cash receipts to the monies coming into the school either through the mail or through electronic means.

GENERAL LEDGER:

A monthly reporting package should be created that shows: budget to actual (*with explanation of fluctuations*), tuition revenue and scholarships/discounts per student showing a five-year trend, days in cash, accounts payable and accounts receivable turnover, bad debt as a percentage of revenue, etc. This will help management and the Board identify fluctuations that don't make sense.

RECONCILIATIONS:

Monthly reconciliations should be performed on accounts receivable (*general ledger to the control account*), accounts payable (*general ledger to the control account*), and donations (*development records to accounting records*). These reconciliations should be reviewed by someone independent of the preparer.

GENERAL JOURNAL ENTRIES:

General journal entries provide the greatest opportunity to cover up some ones *"financial fingerprints."* All journal entries should be reviewed by an authorized person before they are recorded, and on a monthly basis, the authorized person should get a report of all journal entries posted to the system to ensure that they reviewed all of the entries and determine if any additional follow-up is necessary.

In addition, other control procedures can be implemented to further ensure financial accuracy and limit risk of theft:

► Ensure all checks are written out to the full name of the organization and not an acronym. It is much easier for someone to steal checks written out to an acronym by setting up a company with the same acronym.

► Maintain strong control over checks/check stock and the corporate seal. Many an organization have been embezzled by employees using the corporate seal and letterhead to open an account in a bank not used by the school with them as the authorized check signer.

► Consider an internal audit function, even on a limited basis. This can be outsourced and may be worth the investment for the piece of mind it brings.

► Require new vendor approval before they are entered into the system and any purchases are made from them. This will allow management to understand why the school is utilizing a new vendor and determine if they are appropriate and at arms-length.

You can never eliminate the possibility of errors or irregularities within your school, but with proper implementation of an effective control environment, diligent oversight, and establishment of a proper tone at the top, you can dissuade wrongdoers and potentially catch them early in the process. Organizations over the years have been plagued by those who didn't walk into an organization looking to steal, but the opportunity presented itself, and the dark side of human nature took over. The goal is to lessen or eliminate the opportunity through proper detect and prevent controls and not rely solely on a system based upon trust.

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EDUCATIONAL INSTITUTIONS
CYBER LIABILITY MARKETPLACE UPDATE

S ince the onset of the COVID-19 Pandemic, the cybersecurity environment has rapidly transformed. The frequency of incidents and cyber liability insurance claims have multiplied exponentially and continue to grow. Cyber Liability Insurance underwriters are on high alert and have instituted several changes for the renewal process. The process to obtain and retain key coverages has changed considerably. One of the three industries impacted the most by recent claim trends and changes has been Education Institutions and K-12 Schools (*in addition to Public Sector and Manufacturing*). All organizations should be prepared for increased due diligence, more comprehensive applications and rising premiums.

Cyber liability insurance has been at the top of headlines in recent time due to the ongoing growth of significant ransomware and fraudulent incidents, affecting educational institutions throughout the U.S. If there was any doubt that cybersecurity is not a critical business issue, the past months have taught us this is a problem that can cripple a school's ability to function. With cases where claims have been paid out in the millions of dollars, we have seen a momentous exit by carriers with remaining carriers reducing capacity and changing terms and conditions.

With all of the chaos in the marketplace from carriers exiting the business, to premiums increasing exponentially, there is hope for those that have taken steps to harden their cybersecurity infrastructure. It is now more important than ever to be able to show through an application (*which now is typically on average at least 5-7 pages long, rather than a few questions*), that a prospective policyholder is taking the necessary steps to do all that they can to protect against cyber threats. It is now mandatory to confirm that businesses have implemented **Multi Factor Authentication (MFA)** and encryption of data while at rest and in transit for coverage terms to be offered. As carriers are taking steps to deepen the underwriting process, it is critical to work closely with not only your insurance professional but also to involve qualified third party IT providers.
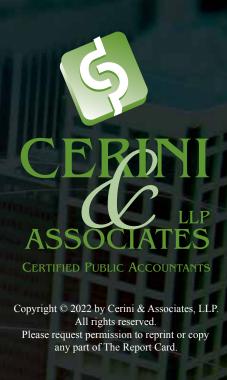
In order to be prepared for the continuing hardening of the cyber market, K-12 and Educational Institutions can take several steps to prepare for increasing premiums and in some cases difficulty qualifying for cyber insurance. Some of the key steps that can be taken include:

► Start the renewal process early, at least 4 months in advance. This will help if there are certain protocols that can be implemented to improve cybersecurity protocols, increasing the application profile.

► Use a commonly accepted application form to prevent lost time completing multiple carrier applications.

► Work with a qualified IT provider to implement the base standard of protections including **Multi Factor Authentication (MFA)**, **Endpoint Detection and Response (EDR)**, Network Backups, Encryption of Data at Rest and in Transit among other security protocols.

► Construct a narrative to describe the increased awareness that the organization has put forth (*ex. Cyber Awareness Training*).

► Form a trusted team of advisors including an Insurance Broker and IT Cybersecurity Firm.
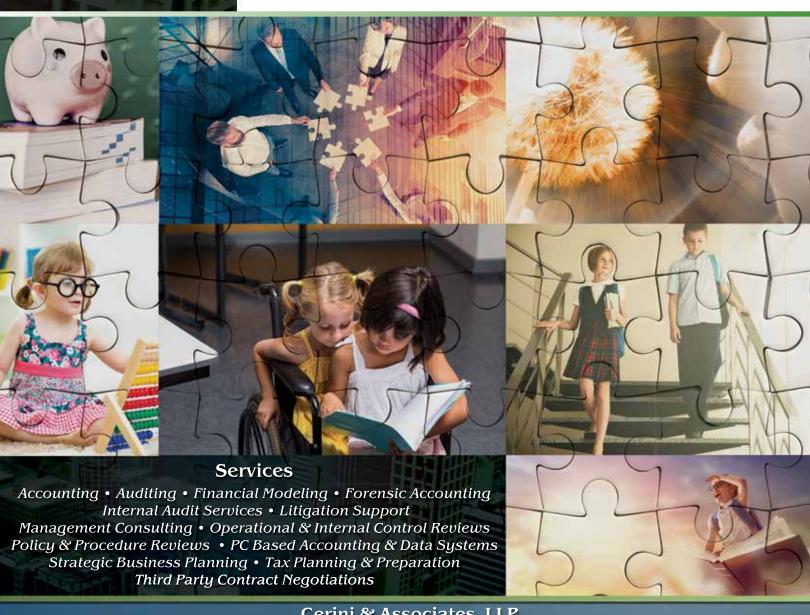
If an Educational Institution is able to demonstrate comprehensive, documented policies and procedures along with proper protections and systems in place, there is hope to have a better performance through the renewal process. However, the insurance marketplace is changing rapidly and it is critical to consult with an insurance expert to help manage the renewal process.

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