

James McKee III, CPA, PC

CERTIFIED PUBLIC ACCOUNTANT & PERSONAL FINANCIAL SPECIALIST

174 Finney Blvd.
Malone, New York 12953
Tel: (518) 483-4041
Fax: (518) 483-5424

September 18, 2012

MEMO TO:
Salmon River Central School District
Audit Committee

Committee Members:

We performed various procedures to review the internal controls of the Salmon River Central School District.

We reviewed policies and procedures, and also examined the District's Business Office financial operations for the period of July 1, 2011 to June 30, 2012.

We obtained an understanding of the design of the relevant policies and procedures and whether they have been placed in operation, and we assessed control risk. Tests of controls were performed to test the effectiveness of certain policies and procedures that we consider relevant to preventing and detecting errors and fraud in addition to preventing and detecting misstatements resulting from illegal acts and other noncompliance matters.

Proper controls need to be in place and operating effectively to help ensure that appropriate authorizations and approvals exist over transactions, incompatible duties among staff are adequately segregated, assets are safeguarded, and financial records are reliable.

During the course of our review, reportable conditions came to our attention. Reportable conditions involve matters relating to significant deficiencies in the design or operation of the internal controls that, in our judgment, could adversely affect the entity's ability to record, process, summarize, and report financial data consistent with the assertions of management in the general purpose financial statements.

Some of the discovered conditions are as follows:

Discovered Conditions identified in Prior Year(s) that remain outstanding

- Policy Manual and Procedures

The Policy Manual was formally adopted in February 2012 and consists of broad guidelines designed to ensure that staff members follow the wishes of the Board. Due to

Discovered Conditions identified in Prior Year(s) that remain outstanding (Cont.)

constantly changing conditions and priorities, the development and changes to policies is an ongoing continual process.

The development of procedures that offer specific guidance on the methods that should be employed on a day-to day basis to ensure that the established policies are properly implemented is an integral part of this process.

In addition, in order to ensure compliance, it is also important that the manual and guidelines are made readily available to all staff members and that they familiarize themselves with its contents.

Now that the policy manual has been adopted, concentration needs to be directed on formalizing the district's operational procedures.

Interviews and Review of the policy manual and existing procedures indicated that additional formal written policies and procedures are needed in the following areas:

- Accounting Policy and Procedures that adhere to the Uniform System of Accounts. These guidelines need to cover all phases of the fiscal management process, including audit scope and internal controls as well as provide the staff with specific guidelines on how to properly perform their duties.

Examples of Accounting areas that necessitate written policies and procedures:

- Adequate written payroll procedures need to be formally adopted that encompass the current arrangement with BOCES. In order to be comprehensive, this procedure needs to include the forms required and instructions for collecting the information needed to prepare the payroll, steps in producing the payroll and related reports, creation and distribution of checks, certification of the payroll and titles of people responsible for each task in the payroll process.
- Internal Claims Auditing procedures which provide instruction on the claims approval process, including the forms being used.
- Purchasing procedures that govern all purchases of goods and services not required to be competitively bid and include the role of the accounts payable clerk.
- Petty Cash rules and regulations that specify appropriate use and recordkeeping of those funds.
- Personnel procedures that encompass all phases of the recruitment/hiring process from inception to termination.
- Position guides and job descriptions for all employees in the business function need to be updated to provide an accurate outline of their duties.

Discovered Conditions identified in Prior Year(s) that remain outstanding (Cont.)

- Formal Training Program for the staff. New members need to be properly indoctrinated in the district's methods and procedures, while experienced staff needs to be able to update their knowledge and skills. Without ongoing comprehensive training, it is possible that assets, liabilities, revenues and expenditures could be inadvertently misstated.
- Formal Cross Training Plan that is designed to maintain continuity as well as serve as an internal control safeguard. This is particularly important for preparing payroll, paying bills and maintaining accounting records.
- Long-Term Financial Plan for both operating expenses and capital items needs to be implemented and updated annually.
- Disaster Relief Plan is recommended to ensure that, in the case of an emergency (such as a fire or flood), operations could be resumed as soon as possible.
- Data backup plan that specifies how often and to what extent backup's will be performed as well as where back-ups are to be securely stored.

• Purchasing

Review of the current year's activity indicates that there were still instances where services were performed and goods received before the date of the requisition and purchase order. Although it appears there has been an improvement in this area and an earnest effort to procure goods and services properly, this remains an ongoing area of concern.

In response to the prior year's observation that there should be procedures established for setting up new vendors and an approved vendor listing should be made available, Requests for Taxpayer Identification Number and Certification (Form W-9's) have been obtained and annual tax statements to vendors (Form 1099's) have been issued. In order to ensure compliance with IRS regulations, this practice needs to be formalized.

• Payroll Procedures

Interviews and review of the payrolls identified the following weaknesses in the current informal payroll processing system that still need to be addressed and remedied:

- Although improvement in this area was noted, time sheets are still not being fully completed by supervisors or building principals. In addition, there were instances where Employee signatures were absent.
- There was no evidence that payroll computations are being reviewed or approved at BOCES prior to being sent to the District. This process should include steps designed to ensure that all time sheets received are correctly processed. This approval process needs to be in place to prevent employees from being paid incorrectly.
- There are no established payroll procedures in place to handle the processing of personnel changes such as new hires and terminations.

Discovered Conditions identified in Prior Year(s) that remain outstanding (Cont.)

- The existing payroll return review process needs to be formalized.
- **Authorized Use of School-Owned Materials and Equipment Policy**
The current policy manual needs to clearly communicate that district assets can only be used for official business. The policy should include a prohibition against the unauthorized use of personal property and the theft or conversion of personal property, a statement of the actions to be taken when staff violates the policy, the designation of staff responsible for enforcement of the policy, and the procedures for assuring the staff are informed of the policy.
- **Records Retention**
The District, as required by Section 57.19 of the Arts and Cultural Affairs Law and the Regulations of the Commissioner, Section 185.2(1), has designated a Records Management Officer to oversee records retention and disposition. In addition to this, the district must also provide for certain minimum retention periods as outlined in the State Archives and Records Administration's, "Records Retention and Disposition Schedule ED-1". A formal records disposition procedure needs to be established that complies with these guidelines.

Current Year Discovered Conditions

- **Board Minutes**
The minute's book should be kept current.
- **Supervisory review of Accounting Transactions**
All accounting transactions, including journal entries, need to be supported by adequate documentation that includes the amount, reason and supervisory approval.

Review of the current year activity indicated that supervisory approval is not always being timely obtained. Supervisory review and evidence of approval needs to be obtained on a regular basis to ensure that transactions have been properly accounted for and recorded.

- **Internal Claims Audit Function**
The internal claims auditor performs one of the most crucial aspects of monitoring a school district's financial accounting system. The Claims Auditor is depended upon to protect the District's resources and improve its purchasing and claims processes. The Claims Auditor needs to report weaknesses observed in the districts purchasing, receipt, payment, and business functions as well as recommend policy changes, when needed, to the Board.

Current Year Discovered Conditions (Cont.)

It is important for the claims auditor to furnish reports directly to the Board of Education on a regular basis. During the year ended June 30, 2012, only one internal claims report was provided to the Board. In order to keep the Board properly informed, it is recommended that reports be provided more often.

● Accounting of Funds

The adopted accounting of funds policy requires that procedures be implemented that specify who is authorized to initiate, approve, transmit, record, review and reconcile electronic transactions. It further specifies that at least two (2) individuals need to be involved in each transaction and that dual approval controls need to be established for non-routine wire transfers.

This policy needs to be reviewed and appropriate procedures developed accordingly. The policy should require management authorization and documentation of transfers before they are initiated.

● Inventories and Accounting of Fixed Assets

The recently adopted Inventories and Accounting of Fixed Assets policy requires that the following items be included in the record of fixed assets:

- Land Improvements, \$10,000 or more
- Buildings and Improvements, \$10,000 or more
- Equipment, \$5,000 or more
- Computer Hardware, \$500 or more
- Durable Supplies (furniture, musical instruments, athletic items, maintenance items and other durable goods), \$1,000 to \$9,999
- All Mobile Items (cell phones personal digital assistants and radios)

Since the District Treasurer is no longer maintaining inventory records on items that do not meet the capitalization threshold (\$5,000 for Equipment and \$15,000 for non-equipment capital assets), to ensure compliance with this policy, it is important that all building and department administrators responsible for maintaining these inventory records familiarize themselves with its requirements.

● Extraclassroom Activity Fund

The District has adopted a written policy addressing the Extraclassroom Activity Fund. The Policy states that the School Business Executive, with approval of the Superintendent of Schools, shall set up procedures for receipts and payment from the extraclassroom activity fund in their respective schools. In addition, the policy specifies that all of the extraclassroom activity funds need to be handled in accordance with the financial procedures illustrated by Finance Pamphlet No. 2, the Safeguarding, Accounting and Auditing of Extraclassroom Activity Funds. In order to comply with the adopted policy, at the beginning of the school year, training was provided and each club

Current Year Discovered Conditions (Cont.)

received a binder with relevant job descriptions, instructions and sample forms to be used.

Based on interviews and the examination of student club ledgers and records, not all of the Student Activity Treasurers are keeping their own ledgers and of the sixteen (16) student club ledgers reviewed, only four (4) student ledgers had balances that agreed with the Central Treasurer's Report balance at June 30, 2012.

Review of the student records and ledgers identified the following areas of concern:

- The Activity Treasurers are not determining which of the activities of his/her organization is subject to sales tax.
- Sales tax collected is not being identified on the deposit forms.
- All parts of the Payment Orders are not being filled out
- Copies of the bills are not being kept by the Student Treasurers.
- Fundraiser Profit and Loss Statements are not being prepared.

In addition, consistent with the Finance Pamphlet No. 2 suggested plan, the Extraclassroom Activity Fund Faculty Advisor needs to audit the profit and loss statements and posting to student account ledgers. Based on the job description provided, the Faculty Advisor is to audit the statements and sign them as verification of the profit and loss to be attached to deposit slips. In addition, the Faculty Advisor should, from time to time, check the balances of the activity treasurer's accounts and the completeness of the supporting evidence. There was no indication in the records reviewed that this was being done.

Sincerely,



James McKee III, CPA