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June 30, 2011

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, 2010 to June 30, 2011.

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.

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

• Purchasing

The Purchasing Policy needs to be updated to include the role of the Accounts Payable clerk, to reflect the current competitive bidding thresholds and establish guidelines on the appropriate use of open Purchase Orders.

Open purchase orders should be used for regular predictable purchases that recur throughout the year such as cellular services, leases and other like expenses.

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

- Purchasing (Cont.)

In addition, steps need to be taken to ensure that the staff diligently adheres to the adopted purchasing procedures. Review of the Internal Claims auditor log indicated numerous instances where services were performed and invoices received before the date of the requisition and purchase order. In addition, insufficient open purchase orders were submitted with invoices received for amounts much larger than the total purchase order.

There should also be procedures established for setting up new vendors and an approved vendor listing should be made available. An integral component of this policy should include the requirement that U.S. vendors provide a completed and signed Form W-9 prior to issuance of a purchase order. This policy helps ensure compliance with the IRS regulations concerning the issuance and accuracy of annual tax statements to vendors and avoids making inappropriate payments to fraudulent entities.

- Capital Assets

The proposed capital asset policy that is pending adoption needs to include dollar threshold amounts. In addition, the treasurer should be overseeing the recording of all capital assets on an ongoing basis to ensure accurate postings to the general and subsidiary ledgers.

- Segregation of Duties

This policy should not just be limited to segregation of duties over the payroll process. Adequate segregation of duties reduces the likelihood that errors (intentional or unintentional) will remain undetected and needs to be considered in the adoption of all of the District's procedures.

- Policy Manual

The Policy Manual should include statements on areas such as budgeting, purchasing, accounting/auditing, transportation, school lunch, operation and maintenance, toxic substances, energy conservation and disaster preparedness. These policies should be complete and updated as necessary.

The current policy manual does not address all of these areas and needs to be updated accordingly. A time line for the Erie 1 BOCES proposed policy manual should be established.

- Extra Classroom Activity Fund Policy

The current Student activities funds management policy needs to be updated and expanded to include rules and regulations for the establishment, conduct, operation and maintenance of extra-classroom activities and for the safeguarding, accounting and audit of all moneys received.

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

- **Authorized Use of School-Owned Materials and Equipment Policy**

The current policy needs to be updated 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 where staff violate the policy, the designation of staff responsible for enforcement of the policy, and the procedures for assuring the staff are informed of the policy.
- **Fiscal Accounting and Reporting Policy**

The current policy needs to be updated to cover all phases of the fiscal management process, including audit scope and internal controls.
- **Internal Controls against Over-Commitment of Funds**

The district should review the internal controls procedures for appropriations. In accordance with section 36 of the General Municipal Law, transfer must be made before purchase orders can be released.
- **Long Term Financial Plan**

The district should adopt at least a three year plan for operating expense and capital items. This plan should be updated annually.
- **Training**

The district currently does not have a formal training program for the staff. New members of the staff 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.
- **Cross Training**

The district currently does not have a formal cross training plan for continuity of services. A plan should be in place to maintain continuity and internal control safeguards.
- **Records Retention**

The district should review records retention schedule and disposition policy in accordance with the provisions of Section 65-b of the Public Officers Law. The district should also evaluate the current security and storage of long term permanent records, mainly pertaining to possible damage from moisture and handling of records in the storage area.
- **Inventory Control**

An annual physical inspection of inventory of property and equipment was performed during October 2010. This inventory report needs to be reviewed to determine that the items owned by the District are present, in usable condition, located in the assigned area and are accurately recorded in the general ledger.

Current Year Discovered Conditions (Cont.)

- Fixed Asset Policy (6645)

The policy adopted has contradictory dollar thresholds within the policy. In addition, not all of the policy thresholds are in agreement with the audit report. This policy needs to be revisited.

- Bond Coverage

The July 12, 2010 Board minutes reflect authorization of bonding of District Clerk, Deputy Treasurer, central Treasurer, Internal Claims Auditor and Cafeteria Manager in the amount of \$100,000 and the District Treasurer, Tax Collector, Deputy Tax Collector and Purchasing Agent in the amount of \$1,100,000. The insurance declaration sheet reviewed does not appear to completely agree with the Board authorization.

- Organizational Chart

The organizational chart needs to be updated.

- Payroll

A Payroll Policy needs to be adopted that encompasses the current arrangement with BOCES that includes a consistent method to handle required employee documentation. Review of employee files indicated that not all required documentation, specifically W-4's, New York IT-2104's and I-9's, have been obtained. In addition, the Employment Eligibility Employment I-9 forms are not being properly completed. The individual signing the I-9 form is required to review original identification documentation; not photocopies.

- Payroll Procedures

There should be established payroll procedures which 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.

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

- The Wage Theft Protection Act that went in to effect on April 1 established additional record-keeping requirements for individuals employed in non-teaching capacities. An employer who fails to comply with the law's record-keeping provisions may be subject to significant monetary penalties. At the time of our review, the steps necessary to comply with these new requirements had not been done.
- The adopted Leave Accrual policy (6502) that requires the District Office to provide employees four reports during the year reflecting each employee's accumulated leave record is not being complied with.
- Time sheets are not being fully completed by supervisors or building principals. Supervisory signatures were often absent.

Current Year Discovered Conditions (Cont.)

• Payroll Procedures (Cont.)

- There was no evidence that pay rates are being reviewed or approved. A proper approval process needs to be in place to prevent employees from being paid an incorrect rate.
- There was no evidence that payroll computations are being reviewed or approved. A proper 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.
- There is no formal review process of payroll tax returns.

Sincerely,

A handwritten signature in blue ink, appearing to read "J McK III CPA". The signature is stylized and cursive.

James McKee III, CPA