

RAYMOND G. PREUSSER, CPA, P.C.

Certified Public Accountants
PO Box 538
Claverack, New York 12513

Telephone: (518) 851-6650

Fax: (518) 851-6675

To the Board of Education of the
Carmel Central School District:

We have audited the financial statements of the Carmel Central School District at June 30, 2007, and have reported thereon under date of October 15, 2007. As an inherent part of our audit, we reviewed those accounting procedures and internal controls used to effect the accurate and suitable recording and summarization of authorized financial transactions.

As a result of such review, we are submitting for your consideration a memorandum of suggestions intended to improve internal control and to achieve certain operating efficiencies. Such suggestions are listed by subject, rather than in order of importance, and refer exclusively to accounting principles and operating techniques. Please understand that our comments should not be construed as a reflection upon the integrity, competence or character of your personnel, but are made solely to assist you in improving operations.

After you have had the opportunity to review the accompanying comments and recommendations, we shall be pleased to discuss any questions you might have.

Internal Controls:

The internal controls of a school district are the checks and balances that exist within the business operations. The key element in any internal control system is the concept of **segregation of duties**. This concept ensures that one person can not execute a transaction without at least one other individual checking his or her work.

In addition, there are some important concepts that should be understood when reviewing internal controls. These concepts are:

- An internal control system is designed to provide reasonable but not absolute assurance in safeguarding the assets of the district.
- The concept of reasonable assurance recognizes that the cost of the internal control should not exceed the benefits derived.

See auditors' report.

Internal Controls: (Continued)

- There are inherent limitations that should be recognized in considering the potential effectiveness of any internal control system, e.g., errors can result from misunderstanding of instructions, mistakes of judgment, carelessness, or other personal factors. More importantly, it is **collusion** that poses the greatest threat to any internal control system. If two employees collude in order to circumvent the controls set up by the district, they could perpetrate a fraud.

The following comments are recommendations for consideration in the improvement of internal controls. As always, any enhancement of controls should be done after a careful cost-benefit analysis.

Issues Related to Changing Environment:

It was noted that there is no Business Office Procedures Manual in place. The District operates in a complex or frequently changing compliance environment. The risk to the District is that as compliance regulations change, complexities place task burdens on the District employees. The complexity of the tasks increases the risk that the District could feel adverse consequences if it were to lose a key person in the Business Office with no written procedures to be followed by a new employee.

We recommend that the District document all critical financial processes. These process documents should be reviewed for accuracy and completeness. Once prepared, employees should be required to maintain the documents in a manner that reflects any changes to the procedures.

Issues Related to Cash:

We noted that bank reconciliations are prepared by the accountant and subsequently reviewed by the Treasurer. There are compensating controls relating to the disbursements function as the internal claims auditor does account for the check sequence each month during the process of approving disbursements. However, there is no compensating control relating to the receipts function, although the ability to implement a control is present.

To obtain this control over receipts, all mail should be opened by an individual having no access to cash records. At this point, the individual should immediately apply a restrictive bank endorsement to all checks received. A log should also be created and maintained for all checks received prior to giving the checks to the person preparing the bank deposit. As an added duty, we suggest that a person independent of the cash receipts function would review the receipts log monthly and match the recorded log amounts to the actual bank deposits posted to the bank statement.

Payroll:

The payment of salaries and fringe benefits represents one of the largest expenditures of the District. A certain segregation of duties is recommended to safeguard the payroll procedures. An important aspect of this segregation is to have someone input new employees into the system apart from the Payroll Clerk. At present, the Human Resources Department does input new employees names, but not their salaries. The Payroll Clerk inputs the salaries. We suggest that if the Human Resources Department cannot input the salaries that the Payroll Clerk prepare a report that would show the new employees with their salaries which would be given to Human Resources to verify and sign off on.

In addition, we suggest that a person independent of Payroll be given the task of payroll review. This person should review a "payroll exception" report and verify all additions and changes to the payrolls. In addition, he/she could periodically perform tests to the payroll system to ensure that salaries are being paid correctly and he/she could also review payroll documents such as W-4's and I-9's to be sure that all documents are properly on file.

Signature Disk:

During our audit, we noted that both the accounts payable and payroll clerks had access to the Treasurer's signature disk. Only the Treasurer should have access to the signature disk.

Documentation of Invoice Processing:

An important element of the auditor's function is to perform a proper evaluation of the existing system of internal control in order to determine the degree of reliance which may be placed on the system in performing the various auditing procedures. As part of our audit of the School District's financial statements, we reviewed, evaluated and tested the controls with respect to purchasing.

During our audit, we noted that within the sample of transactions we tested:

1. One instance where purchases from a vendor exceeded \$10,000 and was not bid.
2. One instance where a receipt of goods was not signed.
3. Several instances where purchase orders lacked detail information that the district obtained verbal or written quotes for public works jobs.
4. One instance where District reimbursed for sales tax.
5. One instance where the district prepaid a lease.

Claims Auditor:

During our review of the minutes, we noted that the Claims Auditor did not report to the Board.

Once a Claims Auditor is appointed, the Board no longer has the authority to audit and approve District bills. The Claims Auditor reports directly to the Board, the results of their audit, and any concerns. The Claims Auditor is an integral part of the internal control, and separation of duties must be maintained. They can not be involved in any accounting function within the District and should not report any problems to management.

We recommend that the Board should direct the Claims Auditor to provide reports in a desired format, and the frequency of such reports.

See auditors' report.

Fixed Assets:

During our audit of the fixed assets, we noted that the District did not perform an annual physical inspection of their asset inventory to determine that all assets are present. This is necessary to strengthen the internal control over inventory and also for the proper insurance coverage.

Computer Technology and Security:

Computer technology and security are an integral part of today's business operation.

We noted that employees did not have training or written instructions for a disaster recovery plan. With the heavy reliance on computer technology, we suggest that such a plan be written and distributed to all applicable employees.

Fund Equity:

Section 1318 of Real Property Tax Law establishes the maximum undesignated fund balance that can be retained by a school district. The current law limits this amount to 3% of the ensuing year's budget. The District's financial statements for the year ended June 30, 2007, indicate that the undesignated balance of is in excess of the legal limit.

We would like to acknowledge the Business Office personnel for their courtesies received during the course of our audit.

Very truly yours,
RAYMOND G. PREUSSER, CPA, P.C.

Raymond G. Preusser

RGP/srp