

Baldwinsville Central School District

**Independent Internal Audit Report
Annual Risk Assessment
June 30, 2018**

Bonadio & Co., LLP
Certified Public Accountants

January 22, 2018

**Audit Committee Members
Baldwinsville Central School District
29 East Oneida Street
Baldwinsville, New York, 13027**

Dear Audit Committee Members:

The following report summarizes our annual risk assessment for the Baldwinsville Central School District (the District). Bonadio & Co., LLP was engaged by the District to fulfill the requirements of the 2005 School Financial Oversight and Accountability Act by performing an annual risk assessment.

The purpose of the annual risk assessment is to provide the audit committee with a review of internal controls that the District has in place to prevent and detect fraud, ensure the financial reporting is accurate and that the District's assets are safeguarded.

The content of this report is intended to provide the District's Audit Committee with the baseline information necessary to develop, approve, and implement an Internal Audit Work Plan in the 2017-2018 fiscal year.

In performing our engagement, we relied on the accuracy and reliability of information provided by District personnel. We have not audited, examined or reviewed the information, and express no assurance on it. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you.

This consulting engagement report is intended solely for the information and use of the Administration, the Audit Committee, the Board of Education, and other applicable employees within the District and is not intended to be and should not be used by anyone other than those specified parties.

We appreciate the opportunity to prepare this annual risk assessment for the District and are available to assist you in carrying out other portions of the Internal Audit Plan. We are also available anytime to answer your questions.

Very truly yours,

BONADIO & CO., LLP



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EXECUTIVE SUMMARY

In 2005, the NYS Legislature issued School District accountability laws, pursuant to Chapter 263 of the Laws of 2005 (the Act), regarding increased oversight over public schools, charter schools, and boards of cooperative educational services. As part of the new laws, the District is required to implement an Internal Audit function. The Internal Audit function requires the formation of an Audit Committee and the appointment of an internal auditor.

For the 2017-2018 fiscal year, the District appointed Bonadio & Co., LLP as the District's internal audit consultants to perform an annual risk assessment, develop a proposed audit work plan based on the high risk areas identified, and then to assist in the development of the scope and timing of the internal audit areas based on the approval of the District's Audit Committee.

This report focuses on our annual risk assessment of internal controls of the District's operations, financial reporting policies, procedures and functional activities.

Our interviews with District Administration were directed toward gaining an understanding of any changes and related risks in each internal control area during the last 12 months, from the perspective of management responsible for controlling such risks. Using this information, we assessed the risk (low, moderate or high) present in each area. A summary of this annual risk assessment is included subsequently. The annual risk assessment process also drives the planned scope of the internal audit procedures, which is summarized in the internal audit work plan.

RISK ASSESSMENT AND INTERNAL AUDIT STRATEGY

Objective

The objective of the annual risk assessment is to meet the requirements of the 2005 Schools Accountability legislation. We relied on interviews with District Administration for significant processes in place, external audit reports, a review of board minutes, implementation of corrective actions related to prior audit findings and recommendations, and policy changes.

Risk Assessments Performed

We have previously conducted our initial risk assessment on the key areas and transactions in order to assess risk for each of the significant transaction cycles and functional responsibilities.

Transaction Cycles and Functions Subject to Risk Assessment

We determined the control objectives, risk, and control activities associated with each of the following transaction cycles or functions identified in order to determine the nature, timing and extent of internal auditing procedures necessary for conducting the internal audit work.

The following transaction cycles and functional responsibilities were reviewed:

- General ledger, financial reporting and budgeting
- Revenues, billings, and cash receipts
- Banking and debt
- Capital assets
- Grants - Federal and State (Financial Aid)
- Human Resources and Payroll
- Purchasing and cash disbursements
- Extraclassroom Activity Funds
- Information technology and financial software
- Governance

In addition, we assessed the adequacy of accounting policies and Board governance through inquiries, observations and discussions with Administration and other District personnel.

Intrinsic in the assessment of the District is the concept of materiality. Those areas of the District that deal with more significant dollars or a higher volume of transactions will most likely score as higher risk. The scope is primarily risk-based and is organized around the District's major internal control cycles.

RISK ASSESSMENT SUMMARY

The following methodology was used in developing our assignment of risk. There are four categories included in our assessment:

- **Inherent Risk** - The nature of some activities or assets makes them a greater risk than others. Some characteristics that generally increase inherent risk are opportunity, complexity, changes in operating environment, changes in personnel, and rapid growth. Inherent risk is a tool in determining the susceptibility of an entity, unit, or account to fraud, waste, or abuse assuming there were no related internal controls.
- **Control Risk** - This is the risk that material errors or fraud are not prevented or detected by the internal control system.
- **Materiality** - This is an expression of relative significance or importance of a particular transaction class.
- **Overall Risk** - This is the remaining and assigned risk level calculated after evaluating control and inherent risk and materiality.

The assigned overall risk of low, medium, or high is calculated after considering inherent and control risk and materiality. To establish a control risk rating, internal audit uses various testing methods such as questionnaires and discussions with staff, sample testing of key controls, and walk-through.

Not all risks are equal. Some are more likely than others to occur, and some will have a greater impact than others if they occur. Once risks are identified, their probability and significance must be assessed. Upon identifying and assessing risk, the District must decide on how to address and reduce the risk to an acceptable level. Based on a cost/benefit analysis, in some cases, the decision may be to implement additional controls or it may be to accept the risk identified. The table summarizes our evaluation of the transaction cycles and functional responsibilities we considered. The attached Appendix provides additional background and definitions to the below risk categories used.

PERSONNEL INTERVIEWED

Our interviews with employees and management were directed toward gaining a thorough understanding of the objectives and related risks in each internal control area, from the perspective of the individuals responsible for controlling such risks. Using this information and input, we evaluated the level of risk (**low, moderate, or high**) present in each area across a standard spectrum of risk categories.

We interviewed various employees within the purchasing, payroll, accounting, information technology, food service, transportation, facilities, and extra classroom activities departments of the District.

RISK ASSESSMENT

RISK ASSESSMENT SUMMARY

The table below summarizes our evaluation of the transaction cycles and functional responsibilities we considered. The attached appendix provides background and definitions to the below risk categories used.

<u>Audit Area</u>	<i>Inherent</i>	<i>Control</i>	<i>Materiality</i>	<i>Overall Assessment</i>
General ledger, financial reporting and budgeting	Moderate	Low	High	Moderate
	Financial statements are reviewed monthly with the Board. No material audit adjustments to year-end financial statements were made as a result of audit procedures. Results of budget to actual assessed regularly, and General Fund ending fund balance is within 4% of amended budget. No proprietary funds, financial reporting is not complex.			
Revenues, billings, and cash receipts	Low	Low	High	Moderate
	The District complied with the New York State's Property Tax Cap of 2% when adopting the 2016-2017 fiscal year tax levy. There is not a significant amount of cash transactions. Property tax collections are done by the District's County. There is not significant accounts receivable in relation to total revenue. The cash receipts process appears to have adequate controls and segregation of duties in place.			
Banking and debt	Low	Low	High	Moderate
	Bank reconciliations are prepared and independently reviewed monthly. There are no investments at June 30, 2017. Bank accounts are adequately collateralized. There will be a new \$32 million capital project in Spring 2018 that the district will be bonding for.			
Capital assets	Moderate	Moderate	Moderate	Moderate
	Capital Projects Fund is a major fund for the year ending June 30, 2017. There were approximately \$13 million in capital asset additions for the year ended June 30, 2017. Capitalization policy is not complex and assets are depreciated using the straight line basis. The District outsources compliance of capital projects. There will be a new \$32 million capital project in Spring 2018 that the district will be bonding for. Currently, the District does not record construction in progress activity in the footnotes to their financial statements until the project is complete and will begin to be depreciated.			
Grants - Federal and State (Financial Aid)	Low	Moderate	High	Moderate
	The District expended approximately \$2,900,000 of federal aid in the 2017 fiscal year. There were no findings reported in accordance with Uniform Guidance and the District qualifies as a low risk auditee. Programs are not unusual in nature and typical recurring awards. The Treasurer stated that grant money is received sometimes without him knowing what grant program it is for. This information needs to be more clearly communicated and current policies and procedures should be reviewed to ensure this communication occurs accurately and timely.			
Human resources and payroll	High	Moderate	High	High
	Active employee listing in WINCAP should be updated more frequently. Some payroll errors found by client where deductions were incorrect, and W-4s did not match WINCAP input. The district has 6 union contracts with different requirements for deductions and paid leave, this can be complex. The payroll cycle has not been tested in 5+ years.			
Purchasing and cash disbursements	High	Moderate	High	High
	The District has a Claims Auditor who provides internal controls over expenditures. The Claims Auditor identified instances where purchase orders were not created or were not created timely. The Purchasing Officer will be retiring after 30 years. There may be some critical functions that only she knows how to perform. The external auditors noted 5 instances in which a purchase order was created after			

RISK ASSESSMENT

	the vendor invoice. The district has sufficient segregation of duties in place over purchasing. The accounts payable personnel can no longer set up new vendors, this is an important control.		
Extraclassroom Activity Funds (ECA)	High	Moderate	Low
	Record keeping is done at club level (approximately 45-50 activities). The District conducts an annual presentation, of which attendance is required by all student treasurers and faculty advisors. Records are reviewed mid-year for all accounts and noncompliance will result in frozen accounts. Business Office staff have been overseeing ECA for a number of years. Due to findings related to internal controls over cash receipts in the ECA external audit, the District was issued a qualified opinion.		
Information technology and financial software	High	High	Moderate
	Access to financial software applications tailored to job descriptions and duties. A disaster recovery plan has been developed. The external auditor found a number of users no longer employed by the District to still have computer access rights.		
Governance	Low	Low	Low
	The Board has an active role in the functioning of the District. Newly elected members require 6 hours of training. Procedures and financial information are reviewed regularly. All policies are made available on the District's website. The District's organization structure is adequate and appropriate.		

INTERNAL AUDIT WORK PLAN

The internal audit work plan summarized below illustrates the detailed annual plan for the 2017-2018 fiscal year for the approval of the Audit Committee. The District is required to perform a reassessment of risk on an annual basis. The results of the annual reassessment will be the basis for identifying audit priorities and determining the internal audit plan in future years. These priorities will be reviewed with the District Audit Committee members and readjusted accordingly if necessary. The following chart summarizes the annual risk assessment, the high-risk areas, and other areas.

Observation

<u>Business Cycle Area</u>	<u>2016-17 Performed</u>	<u>2017-18 Suggested</u>
Annual risk assessment (Required)	X	X
General ledger, financial reporting and budgeting		
Revenues, billings, and cash receipts		
Banking and debt		
Capital assets		
Grants - Federal and State (Financial Aid)		
Human resources and payroll	X	X
Purchasing and cash disbursements		
Extraclassroom Activity Funds		
Information technology and financial software		
Governance		

Recommendation

We recommend Payroll for consideration for testing in the next phase of the internal audit procedures. Suggested procedures include:

A. Payroll Financial Review:

- Observation, inquiry and review of key personnel job responsibilities within the Payroll function
- Review existing policies and procedures and consider segregation of duties
- Conduct testing through observation, review and recalculation of:
 1. new employees
 2. terminated employees
 3. hourly employees
 4. temporary employees and/or regular substitutes
 5. focus on CSEA employees due to complication of bargaining unit agreement
- Develop and communicate recommendations as necessary

APPENDIX

Definition of Internal Control

Internal control is a management process designed to provide reasonable assurance regarding the achievement of objectives in the following categories:

- Effectiveness and efficiency of operations.
- Reliability of financial reporting.
- Compliance with applicable laws and regulations.

This definition reflects certain fundamental concepts:

- Internal control is an ongoing process.
- Internal control is performed and maintained by the actions of District personnel. It is not merely policy manuals and forms, but people functioning at every level of the District.
- Internal control is geared to achieve objectives in several overlapping categories - Operations, Finance, and Compliance.
- Internal control can be expected to provide only reasonable assurance to District administration and Board regarding achievement of operational, financial reporting, and compliance objectives.

Effective administration of a strong internal control environment involves proper planning, execution, and ongoing monitoring of activities. Internal control is a tool used to protect District assets from intentional or unintentional loss.

Risk Assessment

Risk assessment is defined as the identification and analysis of relevant risks in the achievement of the objectives and forming the basis for determining how the risks should be managed. Risk assessment is one of the five elements of internal control, which are described later in this appendix. The other components include control environment, control activities, information and communication, and monitoring. Objective setting is necessary for assessment.

Control activities are closely related to the risks in the District. Examples of control activities are policies, authorization, financial information reconciliations, asset verifications, and appropriate segregation and delegation of duties within the business operations of the District. Control activities are either **preventive** or **detective** in nature and need to be evaluated as to benefits to the District and/or associated costs to the District.

Risk arises out of uncertainty, from either internal or external sources. As a result of pursuing or not pursuing a particular course of action, there is the possibility of economic/financial loss or gain, physical damage, injury or delay. Risk is defined as the chance of something happening that will have an adverse impact upon the achievement of objectives. There will always be some risk involved in anything an individual chooses. The choice is between the actions we dare to take, given the level of risk we will accept and the level of remediation we will attempt to undertake.

Risk has two key elements: the **likelihood** of something happening and the **consequences** if it happens. The level of risk is the relationship between the likelihood of something happening and the consequences if it does. Action taken to address the level of risk must address the likelihood of the event occurring, or the consequences if it does occur, or both.

APPENDIX (Continued)

Internal Audit Process

Although every audit and each entity is unique, the internal audit development process is similar for most engagements and normally consists of five stages:

- 1) Planning
- 2) Survey
- 3) Fieldwork
- 4) Reporting
- 5) Ongoing monitoring, follow-up and corrective action

The active involvement of District personnel is critical at each stage of the process, and involves a collaborative effort from departmental personnel. We realize a certain amount of time is diverted from regular routines as a result of Internal Audit activities. Therefore, one of our key objectives is to minimize the disruption of operations by performing the internal audit in a timely and efficient manner.

Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve the District's operations, policies, procedures, and internal controls. Internal auditing is a critical element of assisting in accomplishing the District's objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes.

An internal audit is generated within the District, including all departments, at the direction of the Audit Committee for the purpose of appraising, examining, or evaluating:

- 1) Financial transactions for accuracy and compliance with Board of Education policies
- 2) Financial and operational procedures for adequate internal controls
- 3) Timeliness, reliability, and appropriateness of District records and reports
- 4) The level of compliance with required internal policies and procedures, state and federal laws, and government regulations
- 5) Management or program reviews designed to improve departmental operations and procedures

A) Five Elements of Internal Control

This report focuses on the internal audit function and annual risk assessment of the District. For purposes of reporting on internal controls, we must understand the following elements:

1) Control Environment

The control environment sets the cultural tone of compliance for the District, influencing the control consciousness of its personnel. It is the foundation for all other components of internal control, providing discipline and structure. Control environment factors include the integrity, ethical values, and competence of District personnel; management's philosophy and operating style; the way management assigns authority and responsibility, and organizes and develops its personnel; and the attention and direction provided by the Board of Education.

APPENDIX (Continued)

Internal Audit Process (Continued)

2) Risk Assessment

Every entity faces a variety of risks from external and internal sources that must be assessed. A precondition to risk assessment is establishment of objectives, linked at different levels and internally consistent. Risk assessment is the identification and analysis of relevant risks to achievement of the objectives, forming a basis for determining how the risks should be managed. Because economic, industry, regulatory and operating conditions will continue to change, mechanisms are needed to identify and deal with the special risks associated with change.

3) Control Activities

Control activities are the policies and procedures that help ensure that the administrative directives are carried out. They help ensure that necessary actions are taken to address risks to achievement of the District's objectives for compliant activities. Control activities occur throughout the District, at all levels and in all functions. They include a range of activities as diverse as approvals, authorizations, verifications, reconciliations, reviews of operating performance, security of assets and segregation of duties.

4) Information and Communication

Pertinent information must be identified, captured, and communicated in a form and timeframe that enable the personnel to carry out their responsibilities. Information systems produce reports containing operational, financial, and compliance-related information that make it possible to run and control the programs of the District. They deal not only with internally generated data, but also information about external events, activities, and conditions necessary for informed program decision-making and external reporting. Effective communication also must occur in a broader sense, flowing down, across and up to the District levels. All personnel must receive a clear message from top management that control responsibilities must be taken seriously. They must understand their own role in the internal control system, as well as how individual activities relate to the work of others. They must have a means of communicating significant information to the oversight body. There also needs to be effective communication with external parties, such as the general public, vendors and suppliers, regulators, and others.

5) Monitoring

Internal control systems need to be monitored, a process that assesses the quality of the system's performance over time. This is accomplished through ongoing monitoring activities, separate evaluations or a combination of the two. Ongoing monitoring occurs in the course of operations. It includes regular management and supervisory activities, and other actions personnel take in performing their duties. The scope and frequency of separate evaluations will depend primarily on an assessment of risks and the effectiveness of ongoing monitoring procedures. Known internal control deficiencies should be reported, with serious matters reported to the Administration and the Board of Education.

There is both synergy and linkage among these five components, forming an integrated system that reacts dynamically to changing conditions. The internal control system is intertwined with District operating activities and exists for fundamental educational reasons. Internal control is most effective when controls are built into the infrastructure and are a part of the essence of the District. "Built in" controls support quality and empowerment initiatives, avoid unnecessary costs, and enable quick response to changing conditions.

APPENDIX (Continued)

Internal Audit Process (Continued)

There is a direct relationship between the objectives, which are what the District strives to achieve, and components, which represent what is needed to achieve the objectives of its educational programs. All components are relevant to each objectives category. When looking at any one category, the effectiveness and efficiency of operations, for instance, is predicated on all five components being present and functioning effectively to conclude that internal control over operations is effective.

The internal control definition, with its underlying fundamental concepts of a process, affected by people, providing reasonable assurance, together with the categorization of objectives and the components and criteria for effectiveness, and the associated discussions, constitute this internal control framework.

Management Responsibility

All levels of management are responsible for accomplishing and adhering to the District's Mission Statement by achieving District goals and objectives through effective and efficient use of resources and compliance with applicable laws, regulations and policies.

Specific areas of responsibility include:

- Maintaining a high ethical tone throughout the District.
- Assessing and managing the District's business operation risks.
- Developing cost effective internal controls over all operations.

The internal audit process and function can assist management in discharging these responsibilities by providing an independent and objective evaluation of existing internal controls over the business operations. The internal audit can also help management develop improved controls and processes over operations. However, management always retains control over their own operations and ultimate responsibility for their performance.

Employee Responsibility

Internal controls are the responsibility of all District employees. Individual employees of the District have the responsibility for maintaining work performance in a productive and conscientious manner. In the normal course of work, employees should be aware and alert for activities or situations, which pose actual or potential risks of loss, harm, or misuse of assets, or obstruction to the attainment of the District's goals.

Individuals and department heads should commit to the principles of internal controls and support programs and activities, which strengthen systems and practices and implement any corrective action determined necessary. Individuals and department heads are responsible for development, maintenance, documentation, and supervision of internal controls.

Role of the Internal Auditor

The key role of internal audit is to provide the Board of Education, Audit Committee, and Administration with an independent and objective evaluation of internal controls over key business activities. This means we put a priority on reviewing the validity of financial and other management information, compliance with applicable laws, regulations and policies, and how the District operations can be more effective and efficient.

APPENDIX (Continued)

Role of the Internal Auditor (Continued)

The internal audit function can provide a variety of management assistance services to both District Administration and the Board. It is important to understand the services and roles of the internal auditor. Assistance services include:

- **Financial Reviews** (normally done in conjunction with external auditors) - These are "traditional" audits of financial records, such as accounts receivable or payable. The objective is to determine the accuracy of financial records and adherence to appropriate internal control procedures. Results will be communicated to the District Administration and Board and are usually incorporated in the external auditor's report on the financial statements.
- **Operational or Compliance Reviews** - These are projects directed by the Board, Administration, and the internal auditors, based on perceived business and operational risks. The focus is on assessing specific processes and identifying cost effective ways to improve internal controls, efficiency, and effectiveness. Examples would be reviewing a capital project for compliance with contract terms, bidding processes, or evaluating the internal controls over a purchasing process. Written audit reports are prepared, discussed with District Administration and staff, presented to the Audit Committee, and then submitted to the Board of Education for approval.
- **Management Assistance** - For projects with District-wide impact or of high importance to the District, consulting assistance may be provided to help design plans and achieve effective implementation. Assistance might take the form of facilitating problem solving techniques, flow charting processes, or performing program based costing analyses and financial budgetary and actual comparisons. Status reports, in various formats, depending on the project, would be provided to the management and the Board of Education. "Best practices" may be discussed and implemented.
- **Technical Research** - Internal auditors can assist with questions dealing with Board of Education policies, New York State laws, regulations and policies, accounting and internal controls, and general District practices.
- **Investigations** - At the direction of the Board of Education or the request of management, the internal auditor will investigate suspected cases of unethical behavior, including fraud, theft, and abuse of position. Depending on the facts uncovered, such cases may be referred to management, the Audit Committee, the Board, or legal authorities for further action.

Our focus is on the processes and how to make them best work to achieve the Board's and District's strategic goals and objectives. If there are issues, we identify the business risks and their root causes and work with District Administration, Audit Committee, and Board to develop and implement cost effective solutions.