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To the Audit Committee of the Board
of Education of the Putnam Valley Central
School District
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Re: Risk Assessment Report

Ladies and Gentlemen:

We have performed the procedures enumerated below, in accordance with terms of our consulting services engagement with the Putnam Valley Central School District Board of Education, solely to assist you in evaluating and assessing risk related to the District's fiscal operations. The risk assessment is an integral part of the internal audit function currently required by state law. The annual risk assessment results will illustrate the areas determined to be of high, moderate and low risk, which will then be used as a tool of the audit committee to decide which areas to schedule for internal audit services.

One partner and two staff accountants were on-site at the District's offices to accumulate data and pertinent information. Based on our professional judgment, knowledge and experience, our risk assessment approach and methodology consisted of inquiry, inspection and observation. Also, when useful, we applied analytical procedures and performed limited tests of controls, if feasible. We utilized specific audit programs, questionnaires and checklists designed for risk assessment as our principle tools in developing the areas of focus and the related risks.

During our visits, we interviewed District employees, inspected an assortment of transactional documentation, accounting reports, electronic files, reviewed the Board of Education policies, and Board of Education meeting minutes relating to financial activities. Initially we read, reviewed and analyzed the Board of Education policies and minutes to establish our perspective regarding the District's approach to governance and control environment. This perspective was further developed in conjunction with the control procedures established, required and monitored.

We made inquiries of various members of the District's management, as well as employees in the business office. From those inquiries we were able to document the responses in our programs and checklists and obtain information useful in assessing risk.

We inspected a variety of source documentation pertaining to bank accounts, cash receipts, cash disbursements, payroll, personnel, receiving, transportation, cafeteria operations and extraclassroom activities. Additional items inspected included monthly accounting and budgetary reports as well as annual external audit reports and related findings. The objective of these inspections is to verify and corroborate the information obtained from inquiries with District employees. This process helps to identify possible discrepancies between policy and practice and further develop our understanding of the fiscal controls in operation and their effectiveness. During the procedures performed for the initial risk assessment no such discrepancies between written policies and business office practice were found.

Education Law Section 2116-b of the laws of the State of New York require the operation of an internal audit function. The law specifies that the internal audit function include two phases annually. These required phases are as follows:

- 1) Annual review and update of the District's risk assessment
- 2) Preparation of reports, at least annually, analyzing significant risk assessment findings with recommendations and implementation time frames

The risk assessment is a required element of the audit committee's responsibilities surrounding the internal audit function. Once the audit committee has reviewed this report, the committee will need to select which of the audit areas will be subjected to internal audit and the timing of the internal audit procedures in the upcoming year. Although the law requires analyzing significant risk assessment findings, we recommend that an internal audit plan be developed and adopted addressing all potential areas of risk to the District. We understand that you are not necessarily trained as auditors and we would be pleased to meet with you, address any questions you may have and help direct you through the process. However, please be advised that it is the audit committee's responsibility to make the recommendations to us as the internal auditor for the work that you want performed in the chosen areas of risk. We will also be available to meet with your external auditors to discuss the audit areas that are ultimately covered by the internal audit procedures including findings and recommendations.

An integral part of the risk assessment is internal control over financial reporting. Internal control over financial reporting consists of five interrelated components. These components and a brief description are as follows:

- 1) Control Environment—The core of any entity is its people—their individual attributes, including integrity, ethical values and competence—and the environment in which they operate. They are the engine that drives the entity and the foundation on which everything rests.

2) **Risk Assessment**—The entity must be aware of and deal with the risks it faces. It must set objectives, integrated with the administration, financial, operational and other activities so that the entity is functioning in concert. It also must establish mechanisms to identify analyze and manage the related risks.

3) **Control Activities**—Control policies and procedures must be established and executed to help ensure that the actions identified by management as necessary to address risks to achievement of the entity's objectives are effectively carried out.

4) **Information and Communication**—Surrounding these activities are information and communication systems. These enable the entity's people to capture and exchange the information needed to conduct, manage and control its operations.

5) **Monitoring**—The entire process must be monitored, and modifications made as necessary. In this way, the system can react dynamically, changing as conditions warrant.

The overall risk assessments are the product of evaluating the above internal control components and several different types of risks applicable to the audit areas. The different types of risk considered include the following:

- 1) **Inherent Risk** - The susceptibility of an area to a material misstatement, assuming that there are no related internal controls.
- 2) **Control Risk** - The risk that a material misstatement that could occur in an area will not be prevented or detected on a timely basis by the District's internal controls.
- 3) **Fraud Risk** - The susceptibility of an area to fraud including theft, misappropriation and/or financial reporting.
- 4) **Other Risk** - The additional risk impact to an area based on professional judgment given the District's specific fact, circumstances and practice.

The following table illustrates the internal audit risk areas and our resulting risk conclusion by area. An area classified as high risk is an area where fraud is most likely to occur, based on the types of transactions and dollar amounts involved. The areas noted as high for Putnam Valley are the same areas that are typically classified as high risk in all School Districts throughout the state in that they contain most of the risk elements described above. Putnam Valley Central School District has internal control procedures in place, but with all entities, changes occur and require modifications at times to their internal controls. The internal audit function serves as a review of controls and assists management in reporting on areas that may need additional mitigating controls implemented. A high risk classification indicates that internal audit services should be performed on the area even with strong internal controls in place. The areas in the Putnam Valley Central School District that fall under that category would be:

1. Cash receipts and revenue recording.
2. Payroll and personnel.
3. Fixed asset and inventory controls.
4. Extraclassroom activities funds.

<u>Internal Audit Area</u>	<u>Risk Assessment</u>
1. Governance and Control Environment	Low
2. Strategic Planning, Budget Development and Administration <ul style="list-style-type: none"> • Budget Management 	Moderate
3. Assessing Financial Condition	Moderate
4. Financial Accounting and Reporting <ul style="list-style-type: none"> • Management Oversight 	Moderate
5. Auditing	Low
6. State Aid and Grant Revenue <ul style="list-style-type: none"> • Accounting and Reporting 	Moderate
7. Cash Receipts and Revenue Recording <ul style="list-style-type: none"> • Documentation of Procedures 	High
8. Cash Management and Investments <ul style="list-style-type: none"> • Management Oversight 	Low
9. Petty Cash	Low
10. Purchasing <ul style="list-style-type: none"> • Computer Controls • Management Oversight 	Moderate
11. Accounts Payable and Cash Disbursements <ul style="list-style-type: none"> • Segregation of Duties • Documentation of Procedures 	Moderate
12. Payroll and Personnel <ul style="list-style-type: none"> • Accounting and Reporting • Documentation of Procedures 	High
13. Travel and Conferences <ul style="list-style-type: none"> • Management Oversight 	Low
14. Facilities Maintenance	Low
15. Capital Projects	Moderate

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| 16. Fixed Asset Inventory and Controls | High |
| • Documentation of Procedures/Physical Inventories | |
| • Written Procedures | |
| • Management Oversight | |
| 17. Cafeteria Area | Low |
| 18. Student Transportation | Moderate |
| 19. Extraclassroom Activity Funds | High |
| • Management Oversight | |
| • Written Procedures | |
| • Segregation of Duties | |

Of the nineteen internal audit areas presented for risk classification, 4 areas are determined as High, 8 areas determined as Moderate, and 7 areas as Low risk. The areas that we have classified as High risks suggest that these areas have the highest potential for misstatement and/or fraud. Consequently, these areas should be evaluated by management for possible improvements in the internal control structure, and should be the main areas to focus on with regard to internal audit services, but the moderate and low areas need similar consideration as well.

This report is intended solely for the information and use of the Audit Committee, the Board of Education and management of the Putnam Valley Central School District and is not intended to be and should not be used by anyone other than these specified parties.

Respectfully Submitted,

Nugent & Haeussler, P.C.
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