Drescher & Malecki LLP
3083 William Street, Suite 5
Buffalo, New York 14227
Telephone: 716.565.2299
Fax: 716.565.2201

Certified Public Accountants

October 25, 2017

Honorable Mayor and Members of the Common Council
City of Salamanca, New York

In planning and performing our audit of the basic financial statements of the City of Salamanca, New York, as of and for the year ended March 31, 2017, in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, we considered the City's internal control over financial reporting ("internal control") as a basis for designing audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we do not express an opinion on the effectiveness of the City's internal control over financial reporting.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A reasonable possibility exists when the likelihood of an event occurring is either reasonably possible or probable as defined as follows:

- *Reasonably possible*. The chance of the future event or events occurring is more than remote but less than likely.
- *Probable*. The future event or events are likely to occur.

Our consideration of internal control was for the limited purpose described in the first paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

During our audit we identified certain matters involving the internal control, other operational matters and new reporting requirements that are presented for your consideration. This letter does not affect our report dated October 25, 2017 on the financial statements of the City. We will review the status of these comments during our next audit engagement. Our comments and recommendations, all of which have been discussed with appropriate members of management, are intended to improve the internal control or result in other operating efficiencies. Our comments are summarized in Exhibit I.

The purpose of this communication, which is an integral part of our audit, is to describe for management and those charged with governance, the scope of our testing of internal control and the results of that testing. Accordingly, this communication is not intended to be and should not be used for any other purpose.

Drescher & Malecki LLP

October 25, 2017

New York State Casino Revenues and Fund Balance

The City is located almost entirely upon the Seneca Nation of Indians Reservation. The Seneca Nation completed construction of a casino in the City in 2004 which engages in Class III Gaming pursuant to authority contained in the Seneca Nation/New York State Gaming Compact (the "Compact"). The Compact provides the Seneca Nation with the exclusive right to engage in Class III Gaming throughout all of Western New York in exchange for the Seneca Nation paying an exclusivity fee to New York State. Pursuant to the provisions of Section 99-h of the State Finance Law, a portion of that exclusivity fee is paid by New York State to those municipalities in which the Seneca gaming faculties are located in order to offset the impact of the casino on those hosting municipalities.

During the year ended March 31, 2017, the Seneca Nation officials notified State officials that they would be making their final casino revenue sharing payment under the compact. For the City's adopted 2018 budget, casino revenue sharing under the Compact comprises approximately 58 percent of the total anticipated revenues to be received during the year. Currently, the City does not have a plan to replace these revenues.

Further, at March 31, 2017, the City's unassigned fund balance totaled $16,893,806 or 17.5 times the City's annual tax levy and more than 178 percent of the 2017-18 budgeted appropriations. The City has not adopted a formal comprehensive fund balance policy governing the accumulation and use of fund balance or a formal plan directing the use of the available fund balance to offset the lost casino revenue.

The City should continue to analyze the potential impact of the loss of the casino revenue in relation to its current level of fund balance. Further, we recommend that the City formally assess its financial risks and cash flow needs considering the potential impact of the loss of revenue and analyze and prioritize those risks and needs. Additionally, we recommend that the City incorporate these findings into a formalized fund balance policy that outlines the level of unrestricted fund balance that should be maintained by the General Fund.

Formalized Policies and Procedures

Although the City uses certain procedures that allow for operational efficiencies and effective internal control, these procedures have not been developed into comprehensive, formalized policies. Formalized procedures allow for the continuation of operations should there being staffing changes, can help heighten employee awareness, and improve the overall strength of the City's control environment. We recommend that the City Common Council review the following areas and formalize the current procedures into Council-adopted policies:

Journal Entry Policy

The City does not have a formal policy for the preparation, posting and review of non-recurring journal entries. A formal journal entry policy allows for consistent accounting treatment and ensures appropriate controls surround the posting of journal entries to the general ledger.

We recommend that the City adopt a formal policy regarding the preparation, posting and review and approval of journal entries. This policy should outline what review, and by whom, should occur before entries are entered into the system.

Bank Reconciliation Policy

The City does not have a policy in place to document the review of bank reconciliations. Additionally, we found that there are no formalized procedures regarding outdated outstanding checks maintained on bank reconciliations.

We recommend that the City adopt a formal policy regarding bank reconciliations including a sign off by the person performing the review and for the review of outdated checks.

Information Technology

The City's current information technology ("IT") policy does not address the following items:

- Comprehensive organization chart
- Back-ups and data recovery procedures
- Password history and password expiration
- Inactivity logout procedures
- Physical security, including storing backups at a secured, offsite location
- Disaster recovery plan

We recommend that the City review its existing IT policy and make updates to address the aforementioned items.

Inventory Policy

The City's Board of Public Utilities maintains inventory on the general ledger, which is periodically counted and reconciled to the general ledger. However, there is no formal policy for procedures for performing the periodic physical inventory counts.

We recommend that the Board of Public Utilities develop formal procedures for performing a physical inventory and tracking inventory assets. This should include the process for performing a count, how often the count is to be performed, and how often the reconciliation to the general ledger should occur.

Capital Asset Policy

The City does not have a formal policy for recording and depreciating capital assets, including ongoing projects included in the construction-in-progress balance. The City outsources the majority of its capital asset reporting to a third-party vendor; however, they maintain their own records of construction-in-progress.

We recommend that the City adopt a formal policy for capital assets which establishes the criteria and guidelines that will facilitate consistent recognition, monitoring and accounting for capital assets. This should include formalizing the capitalization threshold of assets, the useful lives, depreciation method and should also include what constitutes construction-in-progress, and how to identify when that project has been completed and should be moved to a depreciable asset.

Gaming Compact Revenue Allocations Policy

The casino revenue sharing money that has been received on an annual basis is further divided among the City, the County of Cattaraugus (the "County") and the City of Salamanca School District (the "District). The City Comptroller receives these funds and performs an allocation based on certain assumptions and calculations. This includes: 1) reimbursing the City, County and School for the tax loss as a result of Native American tax immunity, a figure calculated based on taxable values, 2) reimbursing the City and County for direct impact costs, and 3) allocating the remaining balance between the City and County for economic development.

Within the calculation for direct impact, there are certain assumptions and allocations that both the City and the County use that may potentially vary each quarter. We recommend that the City formalize the assumptions and allocations used on a quarterly basis and review these with the County to ensure that they are appropriate and consistent.

Interfund Loans

Chapter 195 of Laws of 1989 (effective June 24, 1989) added section 9-a to the General Municipal Law. It provides that municipalities may temporarily advance moneys from one fund to any other fund, except for proceeds from sale of obligations or other moneys which, by law, may be used only for stated purposes such as reserve fund moneys. However, moneys advanced must be repaid as soon as available but in no event later than the close of the fiscal year in which the advance was made. As of March 31, 2017, the City has interfund loans that have been outstanding for longer than one year.

We recommend that the City establish a process for monitoring interfund loans and that all interfund balances be repaid as soon as available but no later than the close of the fiscal year in which the advance was made to be in compliance with General Municipal Law.

Segregation of Duties

While the City has established adequate segregation of duties surrounding the various internal control functions for its normal day to day activities, due to limited staffing, there are no procedures in place to maintain this segregation if an employee is unavailable for an extended period of time.

We recommend that the City ensure appropriate rotation of duties and properly document each employee's responsibilities to ensure consistency if an employee absent for any length of time.

New Reporting Requirements

The Governmental Accounting Standards Board ("GASB") has adopted several new pronouncements, which may have a future impact upon the City:

GASB Statement No. 74—The City is required to implement GASB Statement No. 74, *Financial Reporting for Post-employment Benefit Plans Other than Pension Plans*, effective for the fiscal year ending March 31, 2018. The requirements of this Statement address the financial reports of defined benefit OPEB plans that are administered through trusts that meet certain criteria. This Statement replaces GASB Statement No. 43, *Financial Reporting for Post-employment Benefit Plans Other than Pension Plans*.

GASB Statement No. 75—The City is required to implement GASB Statement No. 75, *Accounting and Financial Reporting for Post-employment Benefits Other than Pensions*, effective for the fiscal year ending March 31, 2019. This Statement replaces GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Post-employment Benefits Other than Pensions*, and will require more extensive note disclosures and required supplementary information about their OPEB liabilities.

GASB Statement No. 80—The City is required to implement GASB Statement No. 80, *Blending Requirements for Certain Component Units*, effective for the fiscal year ending March 31, 2018. The purpose of this Statement is to clarify the financial statement presentation requirements for certain component units.

GASB Statement No. 81—The City is required to implement GASB Statement No. 81, *Irrevocable Split-Interest Agreements*, effective for the fiscal year ending March 31, 2018. This Statement will improve accounting and financial reporting by establishing recognition and measurement requirements for irrevocable split-interest agreements.

GASB Statement No. 82—The City is required to implement GASB Statement No. 82, *Pension Issues—an amendment of GASB Statements No. 67, No. 68, and No. 73*, effective for the fiscal year ending March 31, 2019. This Statement addresses issues regarding (1) the presentation of payroll-related measures in the supplementary information, (2) the selection of assumptions and the treatment of deviations from the guidance in an Actuarial Standard of Practice for financial reporting purposes, and (3) the classification of payments made by employers to satisfy employee (plan member) contribution requirements.

GASB Statement No. 83—The City is required to implement GASB Statement No. 83, *Certain Asset Retirement Obligations*, effective for the fiscal year ending March 31, 2020. This Statement establishes criteria for determining the timing and pattern of recognition of a liability and a corresponding deferred outflow of resources for asset retirement obligations (AROs).

GASB Statement No. 84—The City is required to implement GASB Statement No. 84, *Fiduciary Activities*, effective for the fiscal year ending March 31, 2020. This statement establishes criteria for identifying fiduciary activities of all state and local governments.

GASB Statement No. 85—The City is required to implement GASB Statement No. 85, *Omnibus 2017*, effective for the fiscal year ending March 31, 2019. The objective of this Statement is to address practice issues that have been identified during implementation and application of certain GASB Statements.

GASB Statement No. 86—The City is required to implement GASB Statement No. 86, *Certain Debt Extinguishment Issues*, effective for the fiscal year ending March 31, 2019. The objective of this Statement is to improve consistency in accounting and financial reporting for in-substance defeasance of debt by providing guidance for transactions in which cash and other monetary assets acquired with only existing resources—resources other than the proceeds of refunding debt—are placed in an irrevocable trust for the sole purpose of extinguishing debt. This Statement also improves accounting and financial reporting for prepaid insurance on debt that is extinguished and notes to financial statements for debt that is defeased in substance.

GASB Statement No. 87—The City is required to implement GASB Statement No. 87, *Leases*, effective for the fiscal year ending March 31, 2020. The objective of this Statement is to better meet the needs of financial statement users by improving accounting and financial reporting for leases by governments. This Statement increases the usefulness of governments' financial statements by requiring recognition of certain lease assets and liabilities for leases that previously were classified as operating leases and recognized as inflows of resources or outflows of resources based on the payment provisions of the contract. It establishes a single model for lease accounting based on the foundational principle that leases are financings of the right to use an underlying asset. Under this Statement, a lessee is required to recognize a lease liability and an intangible right-to-use lease asset, and a lessor is required to recognize a lease receivable and a deferred inflow of resources, thereby enhancing the relevance and consistency of information about governments' leasing activities.