



Hawthorne Cedar Knolls Union Free School District Internal Controls Over Selected Financial Activities

Report of Examination

Period Covered:

July 1, 2006 — April 15, 2008

2008M-167



Thomas P. DiNapoli

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State of New York Office of the State Comptroller

Division of Local Government and School Accountability

October 2008

Dear School District Officials:

A top priority of the Office of the State Comptroller is to help school district officials manage their districts efficiently and effectively and, by so doing, provide accountability for tax dollars spent to support district operations. The Comptroller oversees the fiscal affairs of districts statewide, as well as districts' compliance with relevant statutes and observance of good business practices. This fiscal oversight is accomplished, in part, through our audits, which identify opportunities for improving district operations and Board of Education governance. Audits also can identify strategies to reduce district costs and to strengthen controls intended to safeguard district assets.

Following is a report of our audit of the Hawthorne Cedar Knolls Union Free School District, entitled *Internal Controls Over Selected Financial Activities*. This audit was conducted pursuant to Article V, Section 1 of the State Constitution, and the State Comptroller's authority as set forth in Article 3 of the General Municipal Law.

This audit's results and recommendations are resources for district officials to use in effectively managing operations and in meeting the expectations of their constituents. If you have questions about this report, please feel free to contact the local regional office for your county, as listed at the end of this report.

Respectfully submitted,

*Office of the State Comptroller
Division of Local Government
and School Accountability*



State of New York Office of the State Comptroller

EXECUTIVE SUMMARY

The Hawthorne Cedar Knolls Union Free School District (District) is located 30 miles north of New York City in Westchester County. The District was created in 1939 as a Special Act school district to educate the children in the Hawthorne Cedar Knolls and Linden Hill Residential Treatment Centers. The students range in ages from 9 to 21 years. The District is governed by the Board of Education (Board) which comprises seven members, two of which are appointed by the State Education Commissioner (Commissioner). The District receives funds needed to meet its expenditures mostly from billings to its students' home school districts and/or counties of residency and State aid. The State Education Department establishes, and the New York State Division of Budget approves, the rates that the District may bill to each district and/or county.

The District has on average approximately 410 students and 350 employees. The District's budgeted expenditures for the 2006-07 and 2007-08 fiscal years were \$18.6 million and \$20.1 million respectively.

The Superintendent of Schools (Superintendent) is the chief executive officer of the District and is responsible, along with other administrative staff, for the day-to-day management of the District under the direction of the Board. The Board is responsible for adopting policies to govern District activities. The Board has appointed a claims auditor to examine and approve all claims for payment. During our audit period, the District paid claims totaling approximately \$29.3 million from the general fund.

Scope and Objective

The objective of our audit was to examine internal controls over selected financial activities for the period July 1, 2006 through April 15, 2008. Our audit addressed the following related questions:

- Are internal controls over purchasing appropriately designed and operating effectively to adequately safeguard District assets?
- Are internal controls over the District's claims processing function designed appropriately and operating effectively to safeguard District assets?
- Are internal controls over computer access appropriately designed and operating effectively to adequately safeguard District assets?

Audit Results

District officials have not developed clear and comprehensive policies and procedures for the procurement of goods and services that are not subject to competitive bidding or for the safeguard of computer data. While the Board adopted policies and provided job description for the claims auditing function, the claims auditor did not always follow them. These weaknesses resulted in the procurement of significant amounts of goods and services without the benefit of competition; payments to vendors before the audit of the related claims; and computer access granted to some employees that exceeds what is necessary for their job duties.

Because of the inadequate purchasing policy, District officials did not obtain written or verbal quotes prior to making 368 purchases between \$500 and \$10,000 at a total cost of \$1,010,939. This increases the risk that goods and services are not procured in the most prudent and economical manner.

The District's claims auditor did not always audit claims before payments were made to vendors. We observed payments totaling \$273,173 made to vendors before the claims auditor audited the claims. Although our testing of 85 payments totaling approximately \$521,000 did not reveal significant discrepancies, when the audit of claims is not adequate, the Board cannot be assured that payments made for goods and services represent legitimate and necessary charges to the District. As a result, District moneys could be misused.

Finally, District officials have not implemented computer access controls to ensure proper segregation of duties within the computer system and limit access to users based on their job descriptions and responsibilities. The Treasurer and secretary have financial and administrative access to both the business and payroll applications which creates lack of segregation of duties within the computer system. In addition, the District did not generate audit logs to monitor financial activities and check for unusual transactions. Although we found no discrepancies, inadequate access controls within the software applications increases the risk that errors and irregularities may occur and go undetected.

Comments of District Officials

The results of our audit and recommendations have been discussed with District officials and their comments, which appear in Appendix A, have been considered in preparing this report. District officials generally agreed with our recommendations and indicated they planned to initiate corrective action.

Introduction

Background

The Hawthorne Cedar Knolls Union Free School District (District) is located 30 miles north of New York City in Westchester County. The District was created in 1939 as a Special Act school district to educate the children in the Hawthorne Cedar Knolls and Linden Hill Residential Treatment Centers. The Hawthorne Cedar Knolls campus is owned and operated by the Jewish Board of Family and Children's Services (JBFCS). The District works in collaboration with JBFCS to provide educational services to day students and students in JBFCS residential programs who range in ages from nine to 21 years of age. The students are placed in the District by their local Committees on Special Education and the Administration for Children's Services, New York State Office of Mental Health, and New York State Office of Children & Family Services.

The District is governed by the Board of Education (Board) which comprises seven members, two of whom are appointed by the State Education Commissioner (Commissioner). Typically, residents of the geographic area that a district encompasses elect board members and vote on the district's budget. In this District's case, the other 5 members of the Board are picked by, and serve at the pleasure of, JBFCS. Local residents do not vote on the District's budget, or pay real property taxes directly to fund its operations. The District receives funds needed to meet expenditures mostly by billing the students' home school districts and/or counties of residency and State aid. The State Education Department establishes, and the New York State Division of Budget approves, the rates that the District may bill to each district and/or county.

The Board is responsible for the general management and control of District finances and educational affairs. The Superintendent of Schools (Superintendent), who is the chief executive officer of the district, along with other administrative staff are responsible for the day-to-day management of the District under the direction of the Board. Generally, the Board meets six times a year to conduct District business.

The District has on average approximately 410 students and 350 employees. There is a high turnover of the student population because students are discharged and admitted throughout the school year. The District's budgeted expenditures for the 2006-07 and 2007-08 fiscal years were \$18.6 million and \$20.1 million respectively. During our audit period, the District paid claims totaling approximately \$29.3 million from the general fund.

Objective

The objective of our audit was to examine internal controls over selected financial activities. Our audit addressed the following related questions:

- Are internal controls over purchasing appropriately designed and operating effectively to adequately safeguard District assets?
- Are internal controls over the District's claims processing function designed appropriately and operating effectively to safeguard District assets?
- Are internal controls over computer access appropriately designed and operating effectively to adequately safeguard District assets?

Scope and Methodology

We examined internal controls of the District for the period July 1, 2006 to April 15, 2008.

We conducted our audit in accordance with generally accepted government auditing standards (GAGAS). More information on such standards and the methodology used in performing this audit are included in Appendix B of this report.

Comments of District Officials and Corrective Action

The results of our audit and recommendations have been discussed with District officials and their comments, which appear in Appendix A, have been considered in preparing this report. District officials generally agreed with our recommendations and indicated they planned to initiate corrective action.

The Board has the responsibility to initiate corrective action. Pursuant to Section 35 of the GML, Section 2116-a (3)(c) of the Education Law and Section 170.12 of the Regulations of the Commissioner of Education, a written corrective action plan (CAP) that addresses the findings and recommendations in this report must be prepared and forwarded to our office within 90 days. To the extent practicable, implementation of the CAP must begin by the end of the next fiscal year. For more information on preparing and filing your CAP, please refer to our brochure, *Responding to an OSC Audit Report*, which you received with the draft audit report. The Board should make the CAP available for public review in the District Clerk's office.

Procurement

A sound internal control structure is necessary to safeguard District assets and to ensure that the procurement of goods and services is prudent and economical. An effective system of controls and good management practices require the use of competition such as bids, requests for proposals (RFPs) and quotes to procure goods and services.

The District has not established adequate internal controls over purchasing to ensure that District assets are properly safeguarded. District officials did not develop an adequate purchasing policy. As a result, the District made purchases in amounts between \$500 and \$10,000 and totaling \$1,010,939 without soliciting written or verbal quotes. In addition, District officials did not solicit competitive proposals to procure professional services totaling \$90,330. Because the District failed to establish and adhere to effective purchasing policies and procedures, there is an increased risk that the District could pay more than necessary for goods and services, and that District monies could be misused.

General Municipal Law (Law) requires that school districts adopt internal policies and procedures for the procurement of goods and services when competitive bidding is not required. Some of the items that are exempt from competitive bidding include purchase and public work contracts below \$10,000 and \$20,000, respectively, payments for professional services, insurance, emergency purchases, and purchases from a sole source. Policies and procedures should require the use of competitive methods such as requests for proposals (RFP) and written or verbal quotations. The policies and procedures should describe procurement methods, explain when to use each method, and require the documentation of the procurement decisions. The purpose of this requirement is to assure the prudent and economical use of District moneys, to facilitate the acquisition of goods and services of desired quality at the lowest cost and to guard against favoritism, extravagance, fraud and corruption.

The District's purchasing policy is inadequate. The policy does not require the use of competitive methods or contain procedures to be used for purchases exempt from competitive bidding. The District's current policy only contains requirements for purchases over \$10,000 and public works contracts over \$20,000. Because the District's purchasing policy was inadequate, we reviewed cash disbursements that the District made during our audit period and found that the District made 368 individual purchases between \$500 and \$10,000

for a total of \$1,010,939 without the solicitation of any written or verbal quotes. Examples of purchases that the District made include wall phone and mounting (\$2,172), cameras (\$5,998), shades and installation (\$5,672), drawers and locks for cabinets (\$1,293), and antivirus software and mail services (\$1,567). The District Treasurer informed us that written or telephone quotations are not solicited when obtaining goods and services that are not subject to public bidding requirements.

Also, the District's purchasing policy does not address insurance, professional services and other items not required to be competitively bid. For example, we noted that the District spent \$75,623 in attorney fees and \$14,707 for air conditioning and heating system maintenance services without soliciting RFPs. Without an adequate purchasing policy, there is an increased risk that goods and services were not obtained in the most prudent and economical manner.

Recommendation

1. District officials should develop and implement policies and procedures for the procurement of goods and services when competitive bidding is not required by law. Such procedures should include, but need not be limited to, the following:
 - Required solicitation of written price quotations for the procurement of goods and services of significant value.
 - Required solicitation of telephone price quotations for the procurement of goods and services of lesser value, or when time does not allow for the solicitation of written quotation. Telephone quotations should be documented.
 - Procedure or manner of selection of vendor providing professional services such as those provided by a District's attorney, insurance, services requiring special skill or training and medical services.

Claims Processing

Conducting a proper audit of claims before the District pays them is an integral part of any internal control system. Education Law requires the Board to audit each claim before authorizing payment. Education Law further authorizes the Board to appoint a claims auditor to perform this important function. At a minimum, the claims auditor's duties should include reviewing each payment or voucher packet for complete documentation, legitimacy of expenditure, mathematical accuracy, proper approval in accordance with District policy, and compliance with GML and Board policy. With limited exceptions, the Treasurer may not pay claims unless the claims auditor has reviewed and certified the claims. Additionally, the claims auditor should periodically report directly to the Board to ensure his ability to act independently.

The District's claims auditor has not performed his duties as required by Education Law. While the Board had adopted policies and provided description for the claims auditing function, the claims auditor did not always follow them, nor did the Board enforce the policies and procedures.

The claims auditor informed us that he only audited claims when he had time, and not on a regularly scheduled basis. He stated that sometimes it took more than a week after he received the claims before he had a chance to audit them, and that he was not sure if checks were mailed before his review was completed. We also observed that District officials printed vendor checks totaling \$273,173 and mailed the checks to vendors before the claims auditor reviewed the payments. According to the Treasurer, the Superintendent's secretary usually holds the checks once they are printed and mails them only when the claims auditor brings back the claims package. He also said the account payable clerk acted on her own when she mailed the checks and that no one authorized her to do so.

Because of this control weakness, we reviewed all the warrants issued during our audit period, which totaled approximately \$19 million, to determine whether they were appropriately signed and dated. While the claims auditor and the Assistant Superintendent for Finance signed all warrants, none of the warrants were dated. Therefore, District officials have no evidence that claims were actually audited and approved prior to payment. We reviewed 85 payments totaling \$520,996. Our examination included tests to determine whether purchase requisitions were authorized, issued and approved prior to expenditures being made, that purchases were properly documented

and audited, and that the purchases were proper District expenditures. We noted no exceptions. Further, the Assistant Superintendent for Finance told us that the claims auditor reports to the Board once a year but we found no evidence of the claims auditor reporting to the Board. The claims auditor told us that he reported any discrepancies to the Assistant Superintendent for Finance or to the Treasurer.

When claims processing is not adequate, such as mailing vendor checks before the related claims are audited and approved, the Board cannot be assured that payments made for goods and services represent legitimate and necessary charges to the District. As a result, District moneys could be misused and not be detected or corrected in a timely manner.

Recommendations

2. The Board should ensure that the claims auditor performs his duties as required by the law and review the claims prior to payments. The claims auditor should also include a review date on the warrants.
3. The Board should meet periodically with the claims auditor to discuss and resolve issues identified during the claims audit.

Computer Access Rights

The concept of segregation of duties in a computer environment is the same as in a manual process. Key tasks and responsibilities should be divided among various employees and sub-units of the computer operations. No one individual should control all of the primary elements of a transaction, event or process. Identifying incompatible duties and implementing policies to separate those duties can be addressed through the use of access controls. The District has not implemented appropriate access controls within its information technology environment and does not monitor transactions occurring within the computer system.

District officials have not implemented access controls to ensure proper segregation of duties and to limit access for users based on their job responsibilities. The Treasurer has financial and administrative access to both the business and payroll applications. As such, the Treasurer is able to add new employees and vendors, adjust salaries, change payment instructions, update employee and vendor files, enter salaries, and print payroll and disbursement checks. The Business Office secretary can add and update vendor files. She is also able to print and void disbursement checks. In addition, the District did not generate audit logs to monitor financial activities and check for unusual transactions that were processed within the computer system. Because of the lack of segregation of duties within the computer system and the failure to monitor transactions, we tested 100 payroll transactions (including authorization of new hires and terminations, verification of employment, pay rates, overtime, amounts reported to the retirement system, and approval and recording of absences) and 127 cash disbursement transactions totaling \$537,631. We did not identify any errors or irregularities. In addition, we tested two months (November and December 2007) of tuition billing which totaled \$3.2 million and traced them to the cash receipts journal and the bank deposits. We did not find any discrepancies.

Although we found no discrepancies, inadequate access controls within the software applications increases the risk that errors and irregularities may occur and go undetected.

Recommendations

4. The Superintendent should ensure that access to the computer system is given to users based on their job descriptions and responsibilities.

5. The Superintendent should ensure that audit logs are routinely generated and used to monitor the administrative and financial activity for unusual transactions or adjustments.

APPENDIX A

RESPONSE FROM DISTRICT OFFICIALS

The District officials' response to this audit can be found on the following pages.

HAWTHORNE CEDAR KNOLLS UNION FREE SCHOOL DISTRICT
226 Linda Avenue, Hawthorne, New York 10532-3795

September 24, 2008

Office of the State Comptroller
Division of Local Government Services
33 Airport Drive
Newburgh, New York 12253

[REDACTED]

Dear [REDACTED]

On behalf of our Board of Education, administration and central office staff, we would like to thank you for the professional and knowledgeable manner in which you conducted the State Comptroller's audit of our district. This process was a learning experience. Even our informal interactions with you resulted in improvements to our procedures in the business and personnel offices. Hawthorne Cedar Knolls Union Free School District believes in continuous improvement and we take seriously every opportunity to become more efficient and stretch our limited resources to meet the very challenging needs of the students we serve.

We have considered carefully the feedback in the draft report. We have corrected many of these issues and implemented new Board Policy and new central office procedures already as a result of informal interactions during the audit process. Attached, please find our corrective action plan and the amended Board Policy on Purchasing that was adopted by our Board at a meeting of the Board of Education on June 23, 2008. You can be assured that we have taken your input very seriously and will use it to make the necessary changes in order to be more in line with best practices as determined by the Office of the State Comptroller.

Although the audit process can be stressful, we need to thank you again for your high level of professionalism, your clear and consistent guidance and your sincere effort to not disrupt district operations. Most of all, we appreciate the way you made the audit a learning experience.

We look forward to hearing from you in the near future.

Sincerely,



Mark K. Silverstein
Superintendent

cc: [REDACTED] Office of the State Comptroller
Board of Education, Hawthorne Cedar Knolls UFSD



A Special Act Public School District Created by the New York State Legislature in 1939

**Hawthorne Cedar Knolls Union Free School District
Hawthorne, New York**

**CORRECTIVE ACTION PLAN
September 2008**

This document presents the actions taken and produres planned as a result of the review, informal interactions and the draft report resulting from the State Comptroller Audit in Spring 2008. The Hawthorne Cedar Knolls Union Free School District is committed to the proper management of District operations in order to properly safeguard District assets and maximize efficiency of operations. To that end, we have learned from the various tests of our operations and will make any adjustments that have been identified and recommended by the auditor(s) assigned to our spring audit.

In three major areas, we have developed improvements.

I. Over all policy and procedure updates by the board and administration regarding procurement

This audit experience prompted the administration to update board policies regarding fiscal manangement. The administration updated and revised procedures that correspond to the board policies.

The administration and counsel collected and reviewed district Board Policy in purchasing and procurement. The HCKS school district spent time reviewing other school district policies in the area of fiscal management. Following this research and discussion with district legal counsel, we have proposed board policy to amend and revise our existing policy. The amended policy was adopted by the Board of Education on June 23, 2008.

This amended policy created the need to modify current business and personnel department procedures to align with this policy. Proper documentation and board approval will be secured if there are any departures from the procedures due to an emergency situation. Highlights of the changes include:

1. When purchases for materials or supplies exceed \$3,000 and up to \$7,000, a minimum of three telephone, fax, digital or written price quotations must be obtained.
2. A written Request for Proposal (RFP) will be sent when the amounts are between \$7,000 and less than \$10,000. This documentation will include the name, address and telephone number of the vendor, the items to be purchased, specifying the quantity, brand name and model number or a description of the item and the unit price of each item, the extended price and the total price of the items to be purchased. The responses to the RFP will be reviewed by the Purchasing Agent and the Superintendent.
3. Public works contracts: Under \$5,000 - no quotations needed but due diligence will be done in examining the qualifications of the contractor (ie: references, prior experience, local chamber of commerce, professional oranzations, etc.)
4. Between \$5,000 and \$10,000, there shall be a minimum of three telephone, fax or written quotations.
5. Between \$10,000 but less than \$20,000, there shall be minimum of three written quotations.

6. Clinical services for this special education school district are often very specific and require professionals with highly specialized knowledge and skills. Although we will seek quotes whenever possible, we will hire appropriately skilled consultants to serve our special needs population and/or effectively train our staff. These exceptions to competitive bidding will be brought to the Board's attention in order to ensure that we have their approval and oversight of the expending of district funds. The qualifications of the consultants or service providers will be documented and contracts will be brought before the board for approval.

Summary of Internal Procedures Governing Procurement of professional services Under GML (104-B) based on Board Policy 5410 adopted 2008:

Internal Procedure

Requests for Proposals: the district will contact a number of professionals (e.g., architects, engineers, accountants, lawyers, underwriters, fiscal consultants, etc.) and request that they submit written proposals. The RFP's may include negotiations on a fair and equal basis. The RFP's and evaluation of such proposals will consider price plus other factors such as:

- a. the special knowledge or expertise of the professional or consultant service
- b. the quality of the service to be provided
- c. the staffing of the service, and
- d. the suitability for the district's needs
- e. when providing direct service to students, evidence of fingerprinting and background checks as required by the State Education Department.

The district will first locate prospective qualified firms by:

- a. advertising in trade journals
- b. checking listings of professionals, or
- c. making inquiries of other districts or other appropriate sources
- d. internet inquiries

The district will then prepare a well-planned RFP which will contain critical details of the engagement, including the methods which it will use in selecting the service.

II. Claims processing: New procedures to ensure that vendor checks are not released until the Claims Auditor has authorized the claim(s) and returned the approved claim(s) to the district.

This new procedure will create more internal controls over disbursements and has been established as a result of the recommendation in our audit. The Treasurer secures all vendor checks in a fireproof lock box immediately upon printing. The Treasurer has sole possession of the access key. Upon return of the approved claims, checks are then released to Superintendent's office for reconciliation to check warrants and finally, mailing.

We believe these four areas of improvement will allow us to develop a more effective system of internal controls and checks and balances within the challenges of a small staff implementing the necessary segregation of duties. These modifications will improve our Business Office, Human Resources and the overall oversight of district management and operations.

The Board will ensure that the claims auditor will perform the duties as required by law and review claims prior to payments. The claims auditor will be instructed to include a review date on the warrants. The Assistant Superintendent for Finance will review these documents to ensure they are properly executed. A new job description reflecting these changes has been developed.

The Board will meet with the claims auditor periodically to discuss and resolve issues identified during the claim process. These meetings will be noted in the minutes of the Board.

III. Computer Access Rights: Levels of authority and access in the financial software system

The Superintendent and the Assistant Superintendent will ensure that access to the computer system is provided to users based on their job descriptions and responsibilities.

We are a small district with a small number of employees, so the segregation of duties for key positions such as the Treasurer and Secretary to the Assistant Superintendent were challenging. Here are some of the changes we made to limit the authority and access in our [REDACTED] software.

[REDACTED] The Treasurer is limited to view and print access only within these screens.

[REDACTED] The Treasurer access in this module has been removed.

[REDACTED] The Treasurer's access to functions in this module no longer includes changing vendors on purchase orders prior to payment, increasing purchase order amounts, and adding, deleting or modifying customers.

[REDACTED] Treasurer's access in this module remains the same. Office size and limited staffing does not allow for any further segregation of duties. However, additional mitigating controls from spot checks by the Assistant Superintendent for Finance will be added to the procedures.

Administrative Assistant in the Business Office can print and void checks, as well as add, delete, and update vendors in [REDACTED].

Access to add, delete and update vendors in [REDACTED] has been removed from the Treasurer's responsibilities. Since this position is responsible for the processing of Trust and Agency and Federal checks as part of the Payroll process, access to printing and voiding checks is necessary and will be supplemented with a periodic independent review.

The Superintendent will review audit logs generated by the Assistant Superintendent to monitor administrative and financial activity for unusual transactions and adjustments.

Submitted by:



Mark K. Silverstein
Superintendent

APPENDIX B

AUDIT METHODOLOGY AND STANDARDS

Our overall goal was to assess the adequacy of the internal controls put in place by officials to safeguard District assets. To accomplish this, we performed an initial assessment of the internal controls so that we could design our audit to focus on those areas most at risk. Our initial assessment included evaluations of the following areas: financial oversight, cash receipts and disbursements, purchasing, and payroll and personal services.

During the initial assessment, we interviewed appropriate District officials, performed limited tests of transactions and reviewed pertinent documents, such as District policies and procedures manuals, Board minutes, and financial records and reports. In addition, we obtained information directly from the computerized financial databases and then analyzed it electronically using computer-assisted techniques. This approach provided us with additional information about the District's financial transactions as recorded in its databases. Further, we reviewed the District's internal controls and procedures over the computerized financial databases to help ensure that the information produced by such systems was reliable.

After reviewing the information gathered during our initial assessment, we determined where weaknesses existed, and evaluated those weaknesses for the risk of potential fraud, theft and/or professional misconduct. Based on that evaluation we determined that controls appeared to be adequate and limited risk existed in most of the financial areas we reviewed. We then decided upon the reported objectives and scope by selecting for audit those areas most at risk. We selected purchasing, claims processing and computer access rights for further audit testing. Our testing included review and examination of the following:

- Deposit slips
- Receipts book
- Tuition billing spreadsheet
- Invoices
- Purchase orders
- Claim forms
- Bid files
- Bank Statements
- General Ledger

We conducted this performance audit in accordance with generally accepted government auditing standards (GAGAS). Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

APPENDIX C

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John C. Traylor, Assistant Comptroller

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