



# Shoreham-Wading River Central School District

## Internal Controls Over Payroll and Selected Purchasing Transactions

### Report of Examination

Period Covered:

July 1, 2006 — July 31, 2007

2008M-50



Thomas P. DiNapoli

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# State of New York Office of the State Comptroller

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## **Division of Local Government and School Accountability**

June 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 Shoreham-Wading River Central School District, entitled *Internal Controls Over Payroll and Selected Purchasing Transactions*. 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

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# EXECUTIVE SUMMARY

The Shoreham-Wading River Central School District (District) is governed by the Board of Education (Board) which comprises seven elected members. The Board is responsible for the general management and control of the District's financial and educational affairs. 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 District's payroll supervisor processes payroll for about 600 employees on a bi-weekly basis. Total payroll expenditures for the 2006-07 school year were \$26.4 million.

The purchasing agent is responsible for developing and administering the purchasing program of the District. The Board adopted its purchasing policy in 1997.<sup>1</sup> This policy governs District purchasing activities and provides guidance to the purchasing agent in carrying out his responsibilities.

### **Scope and Objective**

The objective of our audit was to determine if internal controls over payroll and purchasing transactions were appropriately designed and operating effectively to adequately safeguard District assets for the period July 1, 2006 to July 31, 2007. Our audit addressed the following related questions:

- Are internal controls over payroll appropriately designed and operating effectively to adequately safeguard District assets?
- Are internal controls over purchasing appropriately designed and operating effectively to adequately safeguard District assets?

### **Audit Results**

The internal controls over payroll processing are inappropriately designed. The Board has not established formal policies and procedures describing employee responsibilities for the processing of payroll. As a result, the payroll supervisor had the ability to create new employees, inactivate and reactivate existing employees, input contract wages, set up deductions and direct deposits, and to print and distribute payroll checks or direct deposit vouchers. Although District officials improved the process as of January 2007 by requiring employees to provide identification and sign for payroll checks or direct deposit vouchers, and by taking away the payroll supervisor's ability to add new employees, other internal control weaknesses were not addressed. Despite these internal weaknesses, our audit did not identify any major discrepancies in the District's payroll transactions.

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<sup>1</sup> A revised purchasing policy was adopted on September 4, 2007 subsequent to our field work.

While the District had established internal controls over purchasing practices to safeguard against fraud, abuse and professional misconduct, there were instances where these controls were not operating effectively. We found that the District did not comply with the requirements of General Municipal Law or its procurement policy for 10 of the 26 purchases we tested. Seven purchases totaling \$129,580 out of the sample of eighteen purchases totaling \$517,843 should have been bid. Furthermore, out of our sample of six purchases that met the criteria for obtaining three written quotes, totaling \$64,905, three purchases, totaling \$30,675, failed to do so. As a result, there is no assurance that the District obtained these items at the best price.

### **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.

# Introduction

## Background

The Shoreham-Wading River Central School District (District) is located in the Towns of Brookhaven and Riverhead, Suffolk County. The District is governed by the Board of Education (Board) which comprises seven elected members. The Board is responsible for the general management and control of the District's financial and educational affairs. 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.

There are five schools in operation within the District, with approximately 2,800 students and 600 employees. The District's budgeted general fund expenditures for the 2006-07 fiscal year were \$48.7 million, which were funded primarily with State aid, real property taxes, and grants.

The District's payroll supervisor processes payroll for about 600 employees on a bi-weekly basis. Total payroll expenditures for the 2006-07 school year were \$26.4 million. The payroll supervisor added new employees to payroll through December 2006; thereafter, the head clerk performed the function. Either the payroll supervisor or the head clerk can inactivate or reactivate employees. The payroll supervisor processes the payroll from attendance records. The payroll supervisor's duties include changing pay rates, processing the payroll, printing the audit log and payroll checks and bundling the checks for distribution.

The Board is responsible for appointing the purchasing agent annually. For the 2006-07 school year, the interim Business Manager was appointed as purchasing agent and provided services for both positions until October 24, 2006 when the District hired a Business Manager. In 1997,<sup>2</sup> the Board adopted a purchasing policy, with accompanying rules and regulations that governs the procurement process. The District processes its purchases through the Business Office. The purchasing agent is responsible for approving all purchase requisitions before a purchase order is issued.

## Objective

The objective of our audit was to determine if internal controls over payroll and purchasing transactions were appropriately designed and

<sup>2</sup> A revised purchasing policy was adopted on September 4, 2007 subsequent to our field work.

operating effectively to safeguard District assets. Our audit addressed the following related questions:

- Are internal controls over payroll appropriately designed and operating effectively to adequately safeguard District assets?
- Are internal controls over purchasing appropriately designed and operating effectively to adequately safeguard District assets?

**Scope and Methodology**

During this audit, we examined internal controls over payroll and purchasing for the District for the period from July 1, 2006 through July 31, 2007.

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 have been considered in preparing this report.

The Board has the responsibility to initiate corrective action. Pursuant to Section 35 of the General Municipal Law, Section 2116-a (3) (c) of the Education Law and Section 170.12 of the Regulations of the Commissioner of Education, the Board must approve a corrective action plan that addresses the findings in this report, forward the plan to our office within 90 days, forward a copy of the plan to the Commissioner of Education, and make the plan available for public review in the District Clerk's office. For guidance in preparing the plan of action, the Board should refer to applicable sections in the publication issued by the Office of the State Comptroller entitled *Local Government Management Guide*.

## Payroll

The primary objective for internal controls over payroll processing is to ensure that employees are paid wages and salaries, and provided benefits, to which they are duly entitled. Internal controls for payroll normally consist of written policies and procedures, including an employee manual that delineates employee responsibilities in preparing and disbursing payroll, and provides guidance regarding employee entitlements. An important component of any internal control system is proper segregation of duties, ensuring that no one person controls all phases of a transaction. Concentrating key duties (i.e. authorization, recordkeeping and custody) with one individual with little or no oversight weakens internal controls and significantly increases the risk that errors and/or irregularities might occur and go undetected and uncorrected in a timely manner. Another important component is management oversight.

We found that internal controls over payroll were not appropriately designed. Not only did the payroll supervisor add new employees for a portion of the year, she also had the ability to control the Treasurer's signature disk during the printing of the payroll checks and direct deposit vouchers. In addition, she also printed the audit log for the Superintendent to use when certifying the payroll and any checks not distributed to employees at the schools and departments were returned to the payroll supervisor for distribution. Also, the Board has not adopted written payroll policies and procedures. Nor have District officials developed an employee manual that would delineate employee responsibilities in preparing and disbursing payroll, and provide guidance regarding employee entitlements.

Segregation of Duties — The District had a payroll supervisor whose duties included adding new employees, controlling employees' status (active/inactive), updating employee salaries for promotion and pay increases, processing the payroll, printing the payroll checks and audit log for each payroll, distributing the checks to the individual school-designated person and department heads, and receiving the returned payroll checks and vouchers that were not distributed to employees.

Effective January 2007, the District hired a head clerk to act as the human resource person, taking over the function of adding new employees. The District's payroll is processed using a computerized financial system.

The District's computer system provides a methodology for the segregation of duties between the processing of payroll and the

ability to add and inactivate employees to the payroll system. The Information Technology (IT) System Administrator assigns access rights to various computer screens to employees based on their function within the District. Access rights to selected screens can define the ability to add, change, inactivate and reactivate employees in the payroll system. For the period July 2006 through December 2006, the payroll supervisor performed the function of adding new employees including their contract rates to the payroll system. In addition, the payroll supervisor can inactivate employees that are no longer employed with the District and reactivate employees that were previously inactivated. Effective January 2007, the function of adding new employees and their related contract rates was taken away from the payroll supervisor and given to the head clerk acting in a human resource function. This provided some control over new employees, but did not address the ability to inactivate employees that left the District or restrict the payroll supervisor's ability to reactivate those same employees. In addition, the payroll supervisor also retains the ability to make changes to the base contract amount for active employees.

Payroll Certification — The Board appointed the Superintendent to certify the bi-weekly payroll. As part of the certification process, the Superintendent receives an audit log of changes made to payroll during the bi-weekly period. The audit log is used in conjunction with the payroll review. A review of any changes made to the payroll is a good control to ensure that the changes are appropriate. However, having the person that processed the payroll, the payroll supervisor, print the audit log for the Superintendent weakens the effectiveness of the control.

Signature Disk — The District's Treasurer is the custodian of all District monies. As such, the Treasurer should sign accounts payable checks, payroll checks and any other disbursements on behalf of the District. The Treasurer should properly secure his or her signature to prevent its misuse.

The Treasurer for the District uses a signature disk to imprint her signature onto computer-generated checks. For the signature disk to be used, a separate software program that is password protected is utilized. The Treasurer secures this disk when not in use, then gives the disk to the payroll supervisor or the accounts payable clerk to use for computer generated checks. The accounts payable checks are given to the claims auditor, and then initialed by the Treasurer before they are distributed. The Treasurer does not review the payroll checks, but the payroll supervisor reports the total amount of the payroll to the Treasurer to facilitate cash transfers. Therefore, the payroll supervisor has the ability to sign checks without the Treasurer being aware of the

transaction. Lack of control over the signature disk, including careful review of its use, could result in the misuse of District funds.

We reviewed District policies and procedures relevant to payroll processing and interviewed the personnel responsible for processing payroll. We compared the payroll records of 10 District employees to the salary and benefit entitlements that were documented in written agreements, personnel records, and Board actions. We also compared the payroll records with time and attendance records, and traced salary notices and timesheets through the payroll records to the pay registers, cancelled checks, and leave accrual statements. In addition, we identified any non-standard payments and reviewed them for appropriateness for the 10 employees. We tested payments made to the 10 District employees for the November 9, 2006 and February 2, 2007 payroll runs. We found no inappropriate changes made in salary or payroll information. We determined that all new employees who were paid over \$5,000 and added to the payroll during our audit period, by the payroll supervisor were paid in accordance with Board directives. We selected 20 employees from the list of checks and vouchers not picked up and reviewed their personnel files and the District roster to determine if they were valid employees of the District. We tested five employees that left the District during our audit period to determine that any distributions were in compliance with contractual agreements. Despite these internal control weaknesses, our audit did not identify any major monetary discrepancies in the District's payroll transactions.

## **Recommendations**

1. District officials should properly segregate duties between the personnel and payroll departments by developing policies and procedures that establish and define the segregation of duties necessary to process payrolls.
2. The District Treasurer should maintain control of the signature disk when it is used to imprint checks with her signature.
3. The Board should assign the printing and retrieval of the audit log to someone other than the personnel that process the payroll.
4. District officials should require that someone other than the person that processes the payroll distribute the payroll checks or direct deposit vouchers, and then maintain control of the undistributed payroll checks or direct deposit vouchers.

## Purchasing

A good system of internal controls consists of policies, practices and procedures that provide reasonable assurance that the District is using its resources effectively (i.e., prudently and economically) and that it is complying with applicable laws and regulations. A major component of a good system of internal control is management's attitude and support for internal controls, and its regular monitoring of controls to make sure they are working effectively. The Board is responsible for designing internal controls that help safeguard the District's assets, ensure the prudent and economical use of District monies when procuring goods and services and protect against favoritism, extravagance, fraud, and corruption. The objectives of a procurement process are to obtain services, materials, supplies, or equipment of the desired quality, specified quantity, and at the lowest price in compliance with applicable Board and legal requirements. This helps ensure that taxpayer dollars are expended in the most efficient manner.

General Municipal Law (GML) requires the Board to adopt written policies and procedures for the procurement of goods and services that are not subject to competitive bidding requirements. These policies and procedures should contain provisions requiring that such goods and services be purchased based on a written request for proposal (RFP), written or verbal quotations. Policies and procedures should set forth each method of procurement, the procedures for determining which method will be used, and how to provide adequate documentation of the actions taken. Accordingly, the District's purchasing policy was adopted in 1997.<sup>3</sup>

Although the District has established internal controls to protect against fraud, abuse, and professional misconduct related to the Districts' purchasing practices, there were instances where the controls were not operating effectively. As a result, purchases were made that did not comply with District policy and statutory requirements.

The Board and the purchasing agent are responsible for establishing and implementing the procedures and standard forms for use in all District purchasing and related activities. According to the District's competitive bid and quotation policy (policy), government contracts should be the first source for goods and services that are not required

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<sup>3</sup> A revised purchasing policy was adopted on September 4, 2007 subsequent to our field work.

by law to be procured through the competitive bid process. When this is not feasible, the policy requires a minimum of three telephone, fax, or written quotations for purchases \$250 to \$3,000 and a minimum of three written or fax quotations for purchases greater than \$3,000. The policy requires documentation to support the solicitation of quotes, which includes the name, address, and telephone number of the vendor; name of the contact person at the company; items to be purchased; and the unit and total cost of the order. The policy also states that for contracts that are exempt from bid requirements such as professional services, “the Board may decide if the solicitation of request for proposals is in the best interest of the District.”

We judgmentally selected 26 vendors that individually received payments for the 2006-07 school year in excess of \$3,000. We compared the documentation in the claims packet for the payments against the District’s policy requirements. Of the 26 purchases tested totaling \$629,606, 18 purchases totaling \$517,843 required competitive bids and 6 purchases that totaled \$64,905 required three written or faxed quotations. The District did not comply with GML or its policy for 10 vendors that required bids or quotes.

Without proper adherence to laws and established policies and procedures, the District cannot be sure they are securing goods and services in the most economical manner and in the best interest of taxpayers.

Competitive Bidding — Of the 18 purchases that required competitive bids, seven purchases totaling \$129,581 were not competitively bid. For example, the District spent \$17,820 on field marking paint. The purchasing agent informed us the paint was of higher quality than other paints. There was no further explanation why the purchase was not subjected to competitive bid. Another example was the purchase of fuel oil. The District spent over \$14,800 for fuel oil on two deliveries from a company that was not awarded the bid. There was over \$18,000 spent for an amplification system without a bid. Lastly, \$40,558 in sports clothing and equipment was purchased from a local vendor because the service that the District uses for educational supplies did not provide the specifications correctly for uniforms. Therefore, the company that won the bid was not used.

Quotations — Of the six purchases that required three written or faxed quotes, three purchases totaling \$21,180 were obtained through other government contracts as provided for in the policy. Of the remaining three purchases, one vendor was awarded a contract for building repairs for \$13,050 based on quotes obtained from four vendors. The District paid this vendor an additional \$2,460 for related roof drains without

obtaining the required quotes because he had done the original work. Purchases from the two remaining vendors totaling over \$28,200 did not comply with the policy. One vendor was paid over \$9,600 for heating repairs that were considered “emergency” despite the lack of evidence that a true emergency existed. Services from the other vendor for \$18,610 were for repairs to the lighting systems. Quotes for this repair could not be found.

## **Recommendations**

5. The Board and the purchasing agent should adhere to the requirements of General Municipal Law and District policy when purchasing goods and services subject to the competitive bidding laws.
6. District officials should monitor and enforce compliance with the District’s policy as it relates to the required number and type of quotations required for those purchases that fall below the competitive bidding thresholds. This should include the documentation to support all quotes.

## **APPENDIX A**

### **RESPONSE FROM DISTRICT OFFICIALS**

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

# **SHOREHAM-WADING RIVER CENTRAL SCHOOL DISTRICT**

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Harriet Copel, Ed.D.  
Superintendent of Schools

William J. Bushman, Ph.D.  
Director of Student Services

R. Terri McSweeney, Ed.D.  
Assistant Superintendent for Curriculum and Instruction

Joseph F. Singleton  
Interim Assistant Superintendent for Business

Camille Sullivan  
Assistant Superintendent for Administrative Services

John Fleming  
Interim Plant Facilities Administrator

April 10, 2008

████████████████████  
Office of the State Comptroller  
Division of Local Government Services  
State Office Building, Room 1702  
44 Hawley Street  
Binghamton, NY 13901-4417

Dear ██████████

On behalf of the Board of Education, Administration, staff and residents of the Shoreham-Wading River Central School District, we thank your office and the members of your staff for the professional review of the Internal Controls Over Payroll and Purchasing Transactions of the District during the period of July 1, 2006 to July 31, 2007.

We are pleased that your review stated that "Our audit did not identify any major discrepancies in the District's payroll transactions". Your audit also reported that "We found no inappropriate changes made in salary or payroll information" and during your audit, "all new employees who were paid over \$5,000...were paid in accordance with Board directives". The District is also pleased that you reported that "our audit did not identify any major monetary discrepancies in the District's payroll transactions".

The District concurs in all of the Payroll Recommendations of the Report of Examination.

The following is response to the four recommendations regarding the payroll process made in the audit report:

1. District officials should properly segregate duties between the personnel and payroll departments by developing policies and procedures that establish and define the segregation of duties necessary to process payrolls.

*RESPONSE: The District has segregated duties and access to input or change salary data between the payroll supervisor and the Personnel Department. All new staff must be added by the Personnel Department. Computer access has been modified to limit access by the payroll department over input data.*

*Written procedures will be developed in the next 12 months to provide clear guidelines for all staff involved.*

2. The District Treasurer should maintain control of the signature disk when it is used to imprint checks with her signature.

*RESPONSE: The Treasure will be present and maintain control over the signature disk at all times, including when used to imprint payroll checks.*

3. The Board should assign the printing and retrieval of the audit log to someone other than the personnel that process the payroll.

*RESPONSE: Based on the recommendations contained in this report the audit log will be printed in the office of the Assistant Superintendent for Business, and reviewed and signed by the Assistant Superintendent for Business, prior to being submitted to the Superintendent for approval.*

4. District officials should require that someone other than the person that processes the payroll distribute the payroll checks or direct deposit vouchers, and then maintain control of the undistributed payroll checks or direct deposit vouchers.

*RESPONSE: All undistributed checks or payroll deposit vouchers are returned to a Business Office staff member other than the payroll supervisor. This staff member follows up on all unclaimed checks/vouchers. All payroll checks and/or vouchers for permanent employees are signed for each payroll period.*

The District concurs in both of the Purchasing Recommendations of the Report of Examination.

5. The Board and the purchasing agent should adhere to the requirements of General Municipal Law and District policy when purchasing goods and services subject to the competitive bidding laws.

*RESPONSE: Since the time of the audit, the Board of Education has revised all purchasing policies of the District. In addition:*

*The District will also implement a coding system to signify the method of purchase for each purchase order issued. The purchasing agent will select from one of the following codes for each purchase order:*

- A. Single Source
- B. Bid
- C. County or BOCES contract bid
- D. Delivery requirements
- E. Emergency effecting the health or safety of students
- Q. Telephone quote
- S. State bid
- T. Technical
- W. Written quote

*With the above coding system, the review of compliance with competitive bidding laws and Board policies can be monitored by all interested parties.*

6. District officials should monitor and enforce compliance with the District's policy as it relates to the required number and type of quotations required for those purchases that fall below the competitive bidding thresholds. This should include the documentation to support all quotes.

*RESPONSE: Based on recommendations in this audit report, the Assistant Superintendent for Business will review a listing of daily approved purchase orders, prior to their release, to insure compliance with competitive laws and Board Policies.*

The Board of Education and Superintendent, on the behalf of the taxpayers of the District, wish to thank you for improving the District accountability to residents of the District.

Very truly yours,



Harriet Copel, Ed.D.  
Superintendent of Schools

cc: SWR Board of Education  
SWR Audit Committee  
Joseph F. Singleton

## 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, payroll and personal services and information technology.

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. We then decided upon the reported objectives and scope by selecting for audit those areas most at risk. We selected payroll and purchasing for further audit testing.

We reviewed the policies and procedures to determine if there were any relevant to payroll processing and interviewed the personnel responsible for processing payroll. We testing payroll by judgmentally selected 20 employees from a list of employees that failed to pick up a payroll check or direct deposit voucher during the last 6 months. We reviewed each employee personnel file and the District staff list to determine that they were currently working for the district. We judgmentally selected 10 employees, five officials and five other employees, and compared their payroll disbursements for two of the months within our audit scope to contractual agreements to determine that the checks were appropriate. We also compared the payroll records with time and attendance records, and traced input documents (e.g., salary notices, timesheets) through the payroll records to the output documents (e.g., pay registers, cancelled checks, leave accrual statements). In addition, we reviewed all payments made against their contractual agreements and verified any additional payments were in accordance with contract. We selected all new employees added by the payroll supervisor during our audit period that received more than \$5,000. We traced the employees to the Board minutes and verified their contract rates.

In addition, for two months within our audit period, we traced the employee's and employer's portion of State and Federal withholdings, FICA, and Medicare, into the trust and agency account and through to the deposits made into various governmental accounts. We reviewed contractual agreements and compared the payments made to five individuals who left the District during our audit period.

We reviewed the purchasing policies and procedures and interviewed the personnel responsible for purchasing goods and services. We judgmentally selected 26 vendors that individually received payments for the 2006-07 school year in excess of \$3,000. We compared the vendor claims packets

against the District's purchasing policy requirements. We reviewed bid awards, and obtained information pertaining to the awards. We compared the goods and services supplied by the vendors within the test to determine if they were similar in nature to determine if they should have been combined for competitive bidding purposes.

We conducted our 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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Steven J. Hancox, Deputy Comptroller  
John C. Traylor, Assistant Comptroller

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