



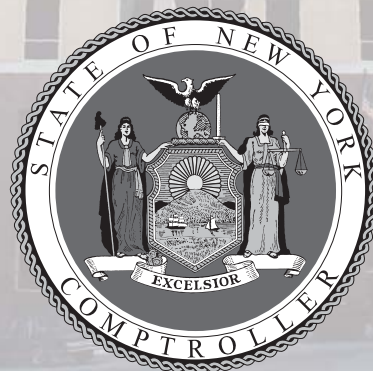
Valley Central School District Internal Controls Over Selected Financial Operations

Report of Examination

Period Covered:

July 1, 2006 — May 31, 2008

2008M-182



Thomas P. DiNapoli

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State of New York Office of the State Comptroller

Division of Local Government and School Accountability

December 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 Valley Central School District, entitled Internal Controls Over Selected Financial Operations. 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 Valley 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 Assistant Superintendent for Business also acts as the District's purchasing agent. He is responsible for approving all purchases and ensuring that they are made in accordance with District policy and General Municipal law. The Board has appointed a claims auditor to act on its behalf.

The District has established and funded a Property Loss and Liability Reserve (PL&L) for \$2 million during our audit period. General fund expenditures during our audit period were approximately \$127.5 million, including over \$1.1 million paid to professional service providers.

Scope and Objective

The objective of our audit was to examine the District's internal controls over the Property Loss and Liability Reserve, purchasing and claims auditing for the period July 1, 2006 through May 31, 2008. For the Property Loss and Liability Reserve we extended our audit period to cover June 30, 2003 through May 31, 2008. Our audit addressed the following related questions:

- Did the District properly fund the Property Loss and Liability Reserve?
- Are internal controls over purchasing appropriately designed and operating effectively to safeguard District assets?
- Are internal controls over claims auditing appropriately designed and operating effectively to safeguard District assets?

Audit Results

We found deficiencies related to the establishment and use of the PL&L reserve, as well as deficiencies in procurement and claims auditing. While the Board did establish a comprehensive procurement policy, District officials did not always follow it. In addition, the Board did not ensure that claims against the District were properly audited.

District officials established the reserve and funded it with excess fund balance, totaling over \$2 million, at the end of the 2005-06 fiscal year to cover unanticipated shortfalls in State revenue. This is not a proper use for a PL&L reserve. The District's unappropriated fund balance was already at the maximum permitted by law, which was 2 percent¹ of the District's 2006-07 budget. The \$2 million should have been used to pay off debt or to pay for non-recurring expenses, as well as to fund 2006-07 expenditures, thus reducing the real property tax levy needed to fund the 2006-07 budget. When financial information is not reported accurately, taxpayers cannot make informed decisions when voting on the District's budget.

We also found that the District is not adhering to the General Municipal Law or its own purchasing policy. The District did not issue requests for proposals for professional service providers, as required by their policy for seven of the eight service providers we tested for an aggregate of \$1,177,000. These services included \$603,000 for architectural services, \$308,500 to two legal firms and \$84,500 for advertising. Additionally, the District did not competitively bid eight of the 25 vendors we tested for a total of approximately \$146,000 in expenditures. This included \$30,000 for kitchen equipment repair, \$22,500 for doors and door parts and \$18,200 for folding partitions. As a result of not seeking competition, District officials cannot be certain that goods and services of suitable quality were procured at the lowest price and in the best interest of the taxpayers.

Furthermore, the District did not have an effective claims auditing process. The claims auditor was not independent of the Business Office function and did not perform a thorough review of all claims before approving them for payment. We found that 24 claims out of 68 tested, totaling \$321,000, did not have sufficient supporting documentation. Additionally, at least 13 claims totaling \$614,000 were paid without claims auditor approval. Unless a thorough review of all claims is accomplished and all claims are approved by the claims auditor, the District may pay claims that are not legitimate District expenses.

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.

¹ For the 2006-07 school year, unreserved, unappropriated fund balance could not exceed 2 percent of the current school year's appropriations. For the 2007-08 school year, the limit was 3 percent of 2007-08 appropriations and it has been increased to 4 percent for school years 2008-09 and thereafter.

Introduction

Background

The Valley Central School District (District) is located in the Town of Montgomery, and parts of the Towns of Newburgh and New Windsor, the Hamlets of Bullville, Campbell Hall and Rock Tavern and parts of the City of Middletown, Orange County and the Hamlet of Wallkill in Ulster 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. The Assistant Superintendent for Business also acts as the District's purchasing agent. He is responsible for approving all purchases and ensuring that they are made in accordance with District policy and General Municipal Law. The Board has appointed a claims auditor to act on its behalf.

There are seven schools in operation within the District, with approximately 5,100 students and 920 employees. The District's budgeted expenditures for the 2006-07 and 2007-08 fiscal years were \$72.4 million and \$76.9 million, respectively, which were funded primarily with real property taxes, State aid, and grants. The District has established and funded a Property Loss and Liability Reserve for over \$2 million during our audit period.

Objective

The objective of our audit was to examine the District's internal controls over the Property Loss and Liability Reserve, purchasing, and claims auditing. Our audit addressed the following related questions:

- Did the District properly fund the Property Loss and Liability Reserve?
- Are internal controls over purchasing appropriately designed and operating effectively to safeguard District assets?
- Are internal controls over claims auditing appropriately designed and operating effectively to safeguard District assets?

Scope and Methodology

We examined internal controls of the Valley Central School District for the period July 1, 2006 through May 31, 2008. For the Property Loss and Liability Reserve, we extended our audit period to cover the period June 30, 2003 through May 31, 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 is 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 General Municipal Law, 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.

Property Loss and Liability Reserve

Education law permits school districts to establish reserve funds. A reserve fund is a separate account established to finance the cost of various district purposes and can be considered a self-imposed district savings account. In general, a reserve fund is designed to segregate resources for future use. Different types of reserve funds have different statutory requirements. For example, tax certiorari, uncollected taxes, property loss and liability, tax reduction and unemployment insurance payment reserves are types of reserve funds that may be established without voter approval; however, Board approval is required. On the other hand, voter approval is required to establish a capital reserve fund, which may be used to finance capital projects as an alternative to issuing bonds. This reserve is accounted for in the general fund. A repair reserve can be established without voter approval, but can only be funded with voter approval.

There are two types of fund balance, reserved and unreserved. Reserved fund balance represents moneys that a district has set aside and may only be used for specific purposes and is therefore not available to use for other purposes. Unreserved fund balance is the amount that is uncommitted and is available for the reduction of real property taxes in the next fiscal year. The portion of the unreserved fund balance that is used to help finance the next year's budget is known as appropriated fund balance. The portion of the unreserved fund balance that is retained and can be used for cash flow purposes and unanticipated expenditures is known as the unappropriated fund balance. The amount of unappropriated, unreserved fund balance at the end of any given fiscal year has a direct impact on the amount of the tax levy needed to fund the ensuing fiscal year's budget. Real Property Tax Law limited the unappropriated fund balance a district could retain to no more than 2 percent² of the next year's budget for the 2006-07 fiscal year and 3 percent for the 2007-08 fiscal year.

A property loss is the damage, destruction or loss of property from any sudden, unexpected or unusual event such as a flood, hurricane, tornado, fire or earthquake. A property loss and liability reserve (PL&L) may be established without voter approval. Separate reserve funds must be established for property loss and unsettled liability claims. Once established, these reserves may not be reduced below the estimated amount necessary to cover unsettled claims or suits. The portion of the reserve fund not allocated for unsettled claims

² For the 2006-07 school year, unreserved, unappropriated fund balance could not exceed 2 percent of the current school year's appropriations. For the 2007-08 school year, the limit was 3 percent of 2007-08 appropriations and it has been increased to 4 percent for school years 2008-09 and thereafter.

may be used upon dissolution of a district's self-insurance to pay insurance premiums.

The District originally established a PL&L reserve in June 2003 for \$1.2 million. The District established the reserve for the purpose of covering unanticipated shortfalls in State revenue. This is not a proper use for a PL&L reserve. Further, without voter approval, the District subsequently spent the funds on repairs to the foundation of one of the District's schools. This is not an appropriate use for a PL&L reserve because the foundation repair was not caused by an unexpected event. In June 2006, the District re-established the PL&L reserve for \$2 million, again funding it from excess fund balance. The District has not used any funds from this reserve and has accrued approximately \$190,000 in interest. Furthermore, the District has not established separate funds for either property loss or liability claims as required by law.

The District's unappropriated fund balance was already at the maximum permitted by law, which was 2 percent of the District's 2006-07 budget. If District officials had not created the PL&L reserve, approximately \$2 million could have been designated for debt payment, non-recurring expenses or the 2006-07 expenditures.

Recommendations

1. The Board should establish reserve funds according to statutory requirements.
2. District officials should use the unappropriated fund balance at year end that is in excess of the legal limit to pay off debt, fund non-recurring expenses or to reduce the tax levy for the upcoming fiscal year.
3. District officials should use the monies in the PL&L reserve for property loss or liability claims, or obtain voter approval to use the moneys for other purposes, as provided for in Education Law.

Purchasing

A good system of internal controls consists of policies, practices and procedures that provide reasonable assurance that an entity is using its resources effectively and that it is complying with applicable laws and regulations. District officials are responsible for designing internal controls that help safeguard assets and ensure the prudent and economical use of its moneys when procuring goods and services. The Board is responsible for adopting policies to provide reasonable assurance that goods and services will be procured at the best available prices, that taxpayer funds will be expended in a prudent manner, and that procurements comply with statutory requirements. District officials are responsible for implementing and monitoring those policies.

The Board has adopted a comprehensive purchasing policy which adheres to General Municipal Law (Law) competitive bidding requirements, requires verbal and written quotes for purchases not subject to competitive bidding and requires requests for proposals (RFPs) for professional services. However, internal controls over implementing these policies were weak. District officials did not always obtain RFPs, competitive bids, or written quotes when required.

Requests For Proposals

The District's current policy requires that the District obtain requests for proposals for professional services. We tested eight professional service providers who were paid approximately \$1,177,000 during the audit period and determined that the District paid approximately \$1,116,000 to seven of the eight service providers without obtaining RFPs. These services included, but were not limited to, \$603,000 for architectural services, \$308,500 to two legal firms and \$84,500 for advertising.

District officials informed us that they have not sought competition because they were comfortable with their current service providers. However, by not adhering to District policy and awarding contracts for professional services without the benefit of RFPs, District officials cannot be sure that they have acquired professional services in the most economical manner and in the best interest of District taxpayers.

Competitive Bidding

The Law requires school districts to advertise for bids for purchases in excess of \$10,000 and public work contracts in excess of \$20,000. Although the District has a procurement policy with relevant procedures in place for acquiring goods and services in accordance

with the competitive bidding and procurement statutes, District officials did not always follow these procedures.

We found that the District made purchases in excess of the bidding thresholds without the benefit of a bidding process. Of approximately \$4.2 million in expenditures that required competitive bidding, we tested a total of approximately \$468,000 in payments made to 25 vendors. District officials did not use competitive bidding for purchases of approximately \$146,000 from eight of the 25 vendors. In several cases, District officials made multiple payments that were paid in installments that were below the bidding thresholds, but when aggregated, would require bidding. For example:

- Approximately \$30,000 was paid to a vendor for kitchen equipment repair in 13 payments ranging from \$89 to \$9,200. This procurement was subject to the \$20,000 bidding threshold.
- Approximately \$22,500 was paid to a vendor for doors and door parts in 13 payments ranging from \$151 to \$10,200. This purchase was subject to the \$10,000 bidding threshold.
- Approximately \$18,200 was paid to a vendor for folding partitions in three payments of \$327, \$3,780 and \$14,096. This purchase was subject to the \$10,000 bidding threshold.

Awarding contracts without the benefit of a public bid process for goods or services that exceed bidding thresholds violates State law and the District's own policies and procedures. As a result, District officials cannot be sure that they have obtained goods and services of suitable quality at the lowest price.

Written Quotes

The Board has adopted sound purchasing policies that clearly outline when to obtain quotes for purchases of goods or services that are not subject to the bidding requirements. For most of the audit period, the Board policy required more than three written quotes for purchases between \$5,000 and \$9,999 and public works contracts between \$10,001 and \$19,999. The Board changed this policy in January 2008 to require three written quotes for purchases between \$7,500 and \$9,999 and public works contracts between \$10,001 and \$19,999. District officials have not always followed the District's policy requiring written quotes for purchases.

We tested 15 purchases totaling \$99,000 that required written quotes and found that the District did not receive quotes for three of the purchases totaling approximately \$15,800. This included \$5,300 for

gym floor repairs, \$5,300 for masonry work and \$5,200 for two-way radios.

By not adhering to District policy and obtaining written quotes when required, District officials are circumventing an important internal control which helps insure that the District is obtaining goods and services at the lowest possible prices.

Recommendation

4. District officials should obtain the required competitive bids, quotes and requests for proposals as outlined in their purchasing policy.

Claims Auditor

The audit and approval of claims is one of the most critical elements of the District's internal control system. The Board is responsible for auditing the District's claims before they are paid. If the Board chooses, it may appoint a claims auditor to assume the powers and duties of the Board with respect to auditing claims. Guidance from the State Education Department (SED) reiterates that there is no provision in law to permit the Board to appoint more than one claims auditor. The claims auditor must report directly to the Board and not to any other District staff or management. The claims auditor's ability to act in a totally independent manner could be compromised if he or she is placed under the supervision or control of other District personnel. An independent claims audit function helps the Board to prevent or detect management abuses or improprieties and provides assurance that the District expends funds for authorized purposes and in accordance with Board policies.

The Board has elected to appoint a claims auditor to assume the Board's powers and duties of approving or denying claims against the District. This same person also serves as the receptionist to the Business Office and reports to the Superintendent. In addition, the Board has appointed an additional claims auditor to help when claims became backlogged. Furthermore, clear directions on the audit of claims were not provided to the claims auditors.

Our audit disclosed significant defects in the auditing of claims. The District's claims audit function is not independent and the claims auditor's review is not sufficient. In addition, we identified claims that were paid without being reviewed by the claims auditor. As a result, District officials do not have sufficient assurance that only claims for valid District purposes are being paid.

Segregation of Duties

A claims auditor must be independent and have no other responsibilities related to the District's business operations and must report directly to the Board. The District's claims auditor from December 2006 through our audit period was also the Business Office receptionist and therefore was not independent. In addition, when reviewing claims, she also entered them into the computerized accounts payable software system for check processing. Because this is an accounting function, it further impairs her independence and diminishes the effectiveness of the claims audit process. Furthermore, due to a backlog of claims, the Board appointed a second claims auditor to assist the receptionist. The Board did not comply with SED guidance when it appointed the second claims

auditor. By having two claims auditors, District officials had the ability to present claims to the assistant claims auditor instead of the claims auditor, which also weakens the process. The District has since appointed a new claims auditor, as of July 2008. However, the current claims auditor also enters the cash disbursement data into the computerized software system.

In addition to increasing the risk for unauthorized payments by requiring the claims auditor(s) to enter the claims into the computerized accounts payable system, appointing a claims auditor who reports to someone other than the Board diminishes the effectiveness of the claims audit function.

Audit of Claims

Effective internal controls over claims processing ensures that every District claim has sufficient supporting documentation to determine that it complies with District policies, and that the amounts claimed represent actual and necessary District expenses. The audit of a claim should be a deliberate and thorough process to determine that the payment is proper and just.

The claims auditor did not perform a thorough review of all claims before approving them for payment. We reviewed a total of 68 claims totaling approximately \$2.1 million and found that 24 claims totaling \$321,000 did not have sufficient supporting documentation. Without proper supporting documentation such as original invoices, receiving reports and proper authorizations, the claims auditor cannot properly verify that these are valid District expenditures. We also found that when the claims auditor was not available or there was a backlog of claims not processed, the accounts payable clerk entered the claims on the District's financial system, bypassing the claims auditor. These claims would then be paid without the approval of the claims auditor. This occurred at least 13 times for an aggregate of \$614,000.

The incomplete review of claims, or the failure to audit them at all, increases the risk that inappropriate claims will be paid.

Recommendations

5. District officials should not permit the claims auditor to perform any accounting functions in the Business Office.
6. The Board should ensure that the claims auditor performs a thorough review of all claims; this should include verifying all supporting documentation is included and all authorizations are present.

APPENDIX A

RESPONSE FROM DISTRICT OFFICIALS

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

VALLEY CENTRAL SCHOOL DISTRICT
Business Office
944 Rte 17 K
Montgomery, N.Y. 12549

Ph: (845) 457-2400
FAX: (845) 457-4254

December 16, 2008

██████████ NYS Comptroller's Office
Division of Local Government and School Accountability
33 Airport Center Drive, Suite 103
New Windsor, N.Y. 12553

Re: Valley Central School District response to OSC Audit Report

Dear ██████████:

The district administration recognizes the value of the audit by the State Comptroller to both the functioning of the district and to our taxpayers. The district administration takes some comfort in receiving a validation that some of the management and organizational steps and plans it has taken or has planned were consistent with the regulatory and good business practices reviewed by the Comptroller's Office.

The audit report refers to three main areas of investigation. This response will address each area of concern separately. The three areas of concern are 1) Property Loss and Liability Reserve, 2) Purchasing, 3) Claims Auditor.

1) Property Loss and Liability Reserve

According to district records and recollection, the reserve was initially established with the full consent and approval of the district's external auditor, the district's attorney, and the Board of Education for the purpose of covering unanticipated shortfalls in state aid revenue. It is accurate to say that the spending of the reserve was for the emergency repair to the East Coldenham foundation. It is accurate to say that the reserve was re-established for the original purpose of the reserve, and the reserve passed muster with the district's external auditor. The reserve has seen no activity since its re-funding on 8/14/06 except for the addition of interest to the balance. The district administration recognizes that the reserve, without a specific potential loss or liability identified, should see the reserve liquidated. In order to accomplish the liquidation, the administration currently proposes reducing this

reserve over a period of five years with a \$450,000 reduction in the reserve each year and a subsequent higher level of appropriated fund balance in the annual budget thus resulting in a systematic savings for the district taxpayers over a period of five years. This plan would reflect sound financial planning.

2) Purchasing

The audit states that the district is not following its own policy by sending out RFPs for many of its professional services such as architectural and attorney services. The district has experienced what it considers to be a highly successful track record in the level of services provided by its current professional providers. There is nothing in NYS law which requires bidding for these services. These services are highly specialized and the priority of the district is to focus on quality of the service as a primary consideration. The district will re-examine its policies to be sure these policies are consistent with the needs of the district as well as comply with the letter of the law. The district administration heartily acknowledges that there is value in checking pricing and, when deemed necessary, issuing RFPs for professional service to keep in check the potential of provider's over-pricing for services rendered.

The audit points out that in several cases, the district failed to use competitive bidding in its purchasing practice. This issue has been recognized by the district's Business Office, and the Business Office made significant progress in putting a dent into this issue by sending out a substantially higher number of bids in 2007-2008 than in prior years. It may be noted that the Purchasing Policy was revised in 2/08 to partially remedy the low thresholds being set for bidding requirements in the district policy. The Business Office will continue to increase the number of bids sent out and to avail itself of legal cooperative bidding solutions to comply with the law and improve the savings for its taxpayers. Our goal is to be fully compliant with the law and policy in all of our purchasing practice as well getting the best possible value for our taxpayers' dollars.

3) Claims Auditing

The district administration recognized last year that the process of the Claims Auditor inputting values for claims into the financial operating system had the potential to be flawed, and that ideally the claims auditor should be completely independent from the Business Office. While the claims auditing set-up at the time of the audit had passed muster with the external auditor, plans for changes had been made. The district engaged an independent individual to be the district's

claims auditor at the commencement of the new fiscal year. The district increased its Business Office staffing in 2008-2009 by .6 full-time-equivalent so that the function of inputting values for the claims in the financial operating system could be done by a member of the Business Office rather than by the Claims Auditor. This function should commence in December. As of the date of this letter, Claims Auditing is running smoothly and efficiently and in full compliance of the law.

The district appreciates the level of cooperation, professionalism, and communication it experienced during the Comptroller's Audit this summer from the Comptroller's team.

Sincerely,



Stephen F. Bangert
Assistant Superintendent for Business

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. We then decided upon the reported objectives and scope by selecting for audit those areas most at risk. We selected the Property Loss and Liability reserve, purchasing and claims auditing for further audit testing. We examined the following records to determine the effectiveness of internal controls pertaining to these areas:

- Board minutes
- Payment vouchers
- Cash disbursement journals
- Journal entries
- Budget status reports
- 2003, 2004, 2005, 2006 and 2007 Audited Financial Statements
- Interoffice memorandums.

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 objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

APPENDIX C

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