



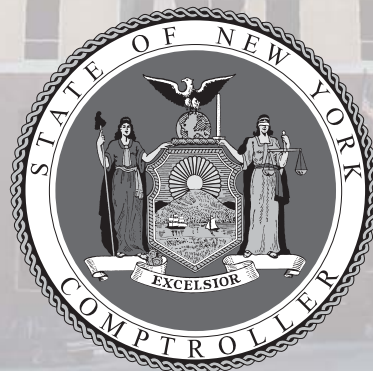
Red Creek Central School District Internal Controls Over Selected Financial Activities

Report of Examination

Period Covered:

July 1, 2007 — January 9, 2009

2009M-45



Thomas P. DiNapoli

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State of New York Office of the State Comptroller

Division of Local Government and School Accountability

July 2009

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 Red Creek Central 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 Red Creek 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 Treasurer performs all job duties associated with cash transactions. The Assistant Superintendent of Business, who is also the purchasing agent, is responsible for all of the District's purchasing decisions.

Scope and Objective

The objective of our audit was to review the District's internal controls over information technology, and to examine the District's reserve funds for the period July 1, 2007 through January 9, 2009. Our audit addressed the following related questions:

- Have District officials properly established and used reserve funds?
- Are internal controls over information technology appropriately designed and operating effectively to adequately safeguard District assets?

Audit Results

The District has properly established reserve funds, but the balance retained in the employee benefit accrued liability reserve (EBALR) was not calculated properly. In addition, the liability and insurance reserves have had no activity since their creation and therefore, they are not necessary. The failure to maintain only necessary reserves has resulted in the accumulation of a significant amount of resources. We calculated that the District has overfunded these three reserves by approximately \$1.28 million. Had these moneys been reported as general fund unreserved fund balance, real property taxes would necessarily have been reduced, since the Board would have been required to comply with the statutory limits for fund balance.

The Board and District officials did not establish adequate policies and procedures to effectively safeguard the District's computer systems and data. Specifically, our audit disclosed that a formal District-wide security plan has not been developed and the Disaster Recovery Plan that is in place is neither up-to-date nor complete. In addition, there are no policies and procedures for the use of mobile storage devices such as flash drives. As a result, there is an increased risk that the security measures

that are in place may not be effective or followed, the District may not be able to quickly restore operations if a disaster occurred, and the security of the District's computer system and sensitive, confidential data may be compromised.

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. Except as indicated in Appendix A, District officials generally agreed with our recommendations and indicate they planned to take corrective action. Appendix B includes our comments on the issues raised in the District's response letter.

Introduction

Background

The Red Creek Central School District (District) is located in the Towns of Conquest, Sterling, and Victory in Cayuga County, and the Towns of Butler and Wolcott in Wayne 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.

Although the Superintendent, administrators, Business Office personnel, faculty, and other support staff are responsible for carrying out the day-to-day operations of the District, the Board is responsible for establishing the framework, or control environment, within which the District operates.

There is one school building complex in operation within the District, with more than 1,000 students and 250 employees. The District's budgeted expenditures for the 2008-09 fiscal year were \$17 million, which were funded primarily with State aid, sales tax, real property taxes, and grants.

Objective

The objective of our audit was to review the District's internal controls over information technology, and to examine the District's reserve funds for the period July 1, 2007 through January 9, 2009. Our audit addressed the following related questions:

- Have District officials properly established and used reserve funds?
- Are internal controls over information technology appropriately designed and operating effectively to adequately safeguard District assets?

Scope and Methodology

We reviewed internal controls over information technology and examined reserve funds of the Red Creek Central School District for the period of July 1, 2007 through January 9, 2009.

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 C 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. Except as indicated in Appendix A, District officials generally agreed with our recommendations and indicate they planned to take corrective action. Appendix B includes our comments on the issues raised in the District's response letter.

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.

Reserve Funds

Reserve funds may be established by Board action, pursuant to various laws, and are used to finance specific purposes. The reserves are established pursuant to statutes that determine how the reserves may be funded, expended or discontinued. Generally, reserve funds do not have legal restrictions as to the balance carried. However, the District is responsible for properly establishing and maintaining reserve funds and for crediting reserve funds with the amount of interest earned from the investment of those funds.

The District has properly established reserve funds totaling \$3.1 million. The unemployment reserve was established to pay the cost of reimbursements to the State Unemployment Insurance Fund for payments made to claimants. Although the fund has not had much activity recently, District officials told us that they expect that substantial monies from the reserve will be used in the 2009-10 fiscal year because of the elimination of seven teaching positions due to the economic downturn. The retirement reserve was created in 2005 for the purpose of financing retirement contributions to the Employees Retirement System. No payments have been made from the fund since its inception, but District officials indicated that these monies will be used in the 2009-10 fiscal year because they expect that contribution rates will increase dramatically due to the recent poor performance of capital markets. If the District does not use these reserves as planned then they could consider transferring the moneys to other legally established reserves, as applicable, or using the balances to reduce the tax levy.

The capital bus and capital building reserves have been used to pay the cost of bus purchases and building projects. Expenditures from these funds were made for a specific purpose as authorized by the voters. The tax certiorari reserve has been established for tax certiorari cases, and the monies held in reserve have not exceeded the amount that might reasonably be deemed necessary to meet anticipated judgments and claims.

Our analysis found that the employee benefit accrued liability reserve (EBALR) fund balance was not calculated properly, and that the liability and insurance reserve funds have had no activity since their creation and therefore, they are not necessary. As a result, the failure to maintain only necessary reserves has resulted in the accumulation of a significant amount of resources. We calculated that the District has overfunded these three reserves by approximately \$1.28 million. Had these moneys been reported as general fund unreserved fund

balance, real property taxes would necessarily have been reduced, since the Board would have been required to comply with the statutory limits for fund balance. The moneys in these reserve funds could be transferred to other legally established reserves, as authorized by General Municipal Law (GML) and Education Law.

As of June 30, 2008, the District had accumulated reserve balances totaling over \$3.1 million. Although these reserves were properly established by Board resolution, the District had not adopted a written policy or documented a plan that communicated why moneys were being set aside in reserve funds, the objectives for each reserve established, the optimal or targeted funding levels, and the conditions under which the fund's assets will be used. The following table summarizes information about the District's reserve funds:

Reserve	Balance as of June 30, 2008	Excessive Amount of Reserve
EBALR	\$1,217,000	\$470,000
Insurance	\$578,000	\$578,000
Unemployment Insurance	\$426,000	
Retirement	\$247,000	
Liability	\$231,000	\$231,000
Capital Bus	\$218,000	
Capital Building	\$190,000	
Tax Certiorari	\$39,000	
Totals	\$3,146,000	\$1,279,000

We analyzed these reserves for the past six fiscal years and identified the following concerns:

Employee Benefit Accrued Liability Reserve (EBALR) – The EBALR is used to pay the monetary value of accumulated or accrued but unused sick leave, holiday leave, vacation leave, etc. due to employees upon separation from service. District officials have maintained this reserve for more than six years. As of June 30, 2008, the reported EBALR balance was \$1.2 million. At this level, the District has more than sufficient reserves to fully fund the entire amount reported as a compensated absence liability. While there is no statutory limit on the amount a school district can maintain in its EBALR, reserving excess amounts in an EBALR is neither a necessary nor a prudent use of school district revenues. The District's calculation of \$1,228,000, of which \$1,217,000 is funded, consists of retired teachers' sick leave credit (\$231,000), certified employees' sick leave accrual (\$651,000) and classified employees' sick leave accrual (\$346,000). The Board had not adopted a policy for funding

levels for this reserve that established how much money would be placed in the reserve or when the reserve would be used. District officials fully funded this liability, even though the liability will be paid over several years.

We determined that the reserve is overfunded by approximately \$470,000 for two specific reasons:

- The retired teachers' sick leave credit is overstated by \$124,000 because it includes an employee who retired based on an agreement to pay his and his wife's health insurance for life, with no consideration as to any sick leave benefits.
- We question the need to reserve money for classified employees (CSEA) because the liability to pay these employees is uncertain. The District has \$346,000 reserved for this purpose even though no employees are currently entitled to any payment. By contract, CSEA employees can only be paid at retirement for sick days in excess of 165 to a maximum of 20 days. At this time, because there are no classified employees that have more than 165 sick days accumulated, there is no reason to fund the liability.

The difference between EBALR fund balances and a District's liability for compensated absences are resources that could have been used for other District purposes or money that the District unnecessarily raised in taxes.

Insurance Reserve – The insurance reserve was established for certain uninsured losses, claims, actions, or judgments for which the District is authorized or required to purchase insurance. Although the Board approved and transferred \$500,000 into this reserve in October 2003 and annually credited interest earnings to the reserve, no payments have been made from this reserve during the period we reviewed. The District has not used this reserve to pay for losses, claims, actions or judgments. The District has adequate insurance policies to cover any losses including a \$10,000,000 umbrella policy. Therefore, we question the necessity of this reserve fund. If the Board decides to discontinue this reserve, GML and Education Law authorize the transfer of insurance moneys only to another reserve, subject to certain restrictions.

Liability Reserve – The liability reserve was established for liability claims incurred. This reserve was properly established in 1993 in the amount of \$60,000. During our audit period the only additional money credited to this reserve was interest. We found that no liability claim payments were made from this fund during the period we

reviewed and that the District's insurance policies included adequate liability coverage including a \$10,000,000 umbrella policy. Therefore, we question the necessity of this reserve fund. If the Board decides to deplete the unneeded balance, payments cannot be made for other purposes unless they are authorized by vote of the electors of the District.

The failure to properly maintain only necessary reserves in these funds and to appropriate moneys from these funds for payment of expenses has resulted in the accumulation of significant resources in a manner that is not consistent with the reserves statutory purposes. Had the \$1.28 million been reported as general fund unreserved fund balance, real property taxes would necessarily have been reduced, since the Board would have been required to comply with the statutory limits for fund balance. The moneys in these reserve funds could be transferred to other legally established reserves, as authorized by GML and Education Law.

Recommendations

1. The Board should adopt a policy to establish how reserves will be funded, the maximum balance that will be accumulated, and how the reserve will be used.
2. The Board should reduce the balance in the EBALR to a level that is reasonable.
3. The Board should eliminate the insurance reserve and liability reserve, unless a valid need is identified.

Information Technology

District management relies on its information technology (IT) system to maintain financial and student data, process financial transactions, provide computer education, access the Internet, communicate by electronic mail (e-mail), and to report to State and Federal agencies and the general public. The potential consequences of a system failure can range from inconvenient to severe; even small disruptions in processing can require extensive time and effort to evaluate and repair. Computerized personal data can also be a potential liability to the District if it is lost or improperly disclosed. Accordingly, the Board and District officials are responsible for establishing a District-wide security plan, Disaster Recovery Plan, and policies and procedures for use of mobile storage devices to provide reasonable assurance that the District's valuable IT assets – including computer data, equipment, systems, and media – are properly used and safeguarded against waste, loss, and misuse.

The Board and District officials did not establish adequate policies and procedures to effectively safeguard the District's computer systems and data. Specifically, our audit disclosed that a formal District-wide security plan and Disaster Recovery Plan have not been developed. In addition, there are no policies and procedures for the use of mobile storage devices such as the 35 flash drives assigned to staff members at the school campus.¹ Explanations of these plans and policy items are as follows.

District-Wide Security Plan – District officials are responsible for developing a formal, written District-wide security plan to document the process for evaluating security risks, to identify and prioritize the more dangerous issues, and to document the planned process for discussing and determining solutions. The plan should establish a framework and continuing process to identify areas of risk, and to develop the policies and procedures to control the risk and monitor the effectiveness of the policies and procedures that were developed.

Disaster Recovery Plan – The District's IT system – including equipment, software, and data – is a critical resource that must be protected against loss, damage or misuse. A Disaster Recovery Plan, sometimes referred to as a Business Continuity Plan or Business Process Contingency Plan, describes how an organization should deal with potential disasters. An effective internal control system for IT requires that a formal disaster recovery plan be developed,

¹ Executable files cannot be run from the flash drives, and the use is monitored by the network technician.

which includes the precautions to be taken (e.g., the routine backup of software and data) to minimize the effects of a disaster, and the procedures necessary for the District to either maintain or quickly resume mission-critical functions. In addition, the Disaster Recovery Plan must be updated periodically to address changing conditions. Typically, disaster recovery planning involves an analysis of business processes and continuity needs, and may also include a focus on disaster prevention.

Flash Drives – Due to advances in computer technology, the use of mobile storage devices such as flash drives to store and transport information has become very commonplace. These devices can be used almost anywhere, are easily transportable, and can store large amounts of data, documents, and other computerized material. Consequently, there are risks associated with their use, such as loss, theft or access by unauthorized individuals. It is therefore necessary for Board and District officials to develop written policies and procedures to indicate what devices may be used, which individuals are allowed to use them, and how to protect and secure the devices and materials stored on them. The policies and procedures must address the acceptable use of the devices and what to do if problems arise with the devices.

Without a formal District-wide security plan, a Disaster Recovery Plan, or policies and procedures for the use of mobile storage devices such as flash drives in place, there is an increased risk that the security measures that are in place may not be effective or followed, the District may not be able to quickly restore operations if a disaster occurred, and the security of the District's computer system and sensitive, confidential data may be compromised.

Recommendations

4. District officials should develop a formal, written, District-wide security plan.
5. District officials should develop a Disaster Recovery Plan that is comprehensive and provides the direction and guidance necessary to maintain District operations, or restore them as quickly as possible during or following a disaster.
6. The Board and District officials should develop comprehensive written policies and procedures for the use of mobile storage devices such as flash drives.

APPENDIX A

RESPONSE FROM DISTRICT OFFICIALS

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

RED CREEK CENTRAL SCHOOL DISTRICT



ADMINISTRATION CENTER, P.O. BOX 190, RED CREEK, NEW YORK 13143

Telephone (315) 754-2010

Fax (315) 754-8169

DAVID G. SHOLES
Superintendent of Schools

June 18, 2009

Edward V. Grant, Chief Examiner
Office of the State Comptroller
Division of Local Government and School Accountability
16 West Main Street – Suite 522
Rochester, New York 14614

Dear Mr. Grant:

This letter will serve as the official response from the Red Creek Central School District to the initial draft audit report prepared by your office for the period July 1, 2007 through January 9, 2009. First I would like to commend your staff, [REDACTED] and [REDACTED], for conducting this audit in a very thorough, professional and courteous manner. They were very courteous and respectful of the business office and other district staff. The district appreciates the recommendations, both written and verbal, that were offered as part of the audit.

RESERVE FUNDS

Comptroller's Recommendations:

1. The Board should adopt a policy to establish how reserves will be funded, the maximum balance that will be accumulated, and how the reserve will be used.
2. The Board should reduce the balance in the Employee Benefit Accrued Liability Reserve to a level that is reasonable.
3. The Board should eliminate the Insurance Reserve and Liability Reserve unless a valid need is identified.

District Response

1. **The Board should adopt a policy to establish how reserves will be funded, the maximum balance that will be accumulated, and how the reserve will be used.**

The District accepts the audit findings that the Board of Education should adopt a policy to establish how reserve funds will be funded and how the reserve will be used. The recommendation that the maximum balance to be accumulated in each reserve be included in the policy will be examined by the district. Some reserve funds, such as capital reserves, by law, must have an ultimate amount that is approved by the voters. The District already has complied with this law and has not, or will not, exceed the maximum balance as approved. Other reserve funds, by law, have no required maximum balances. Given the State's economic climate, Red Creek's high dependence on state aid, and known and unknown possible future litigation issue, it would be difficult

See
Note 1
Page 17

for the District to determine maximum balances for reserve funds when there is no requirement for maximum balances in New York State Law.

2. The Board should reduce the balance in the Employee Benefit Accrued Liability Reserve to a level that is reasonable.

The District accepts the audit findings regarding the recommendation to reduce the balance in the Employee Benefit Accrued Liability Reserve (EBALR) to a level that is reasonable. The auditors have recommended the EBALR decrease the balance in the amount of \$470,000. The District disagrees with the \$470,000 figure due to the auditors' reasons as stated in the report. The District has an obligation to account for agreements to pay for health insurance for employees, and possibly spouses, in retirement. The District also believes that in this day and age of possible pandemics, i.e. swine flu, that a reasonable balance must be maintained in the event that the school is ordered to close for a period of time with an obligation to pay employees during a school closure.

See
Note 2
Page 17

3. The Board should eliminate the Insurance Reserve and Liability Reserve unless a valid need is identified.

The District accepts the audit findings regarding the recommendation to eliminate the Insurance and Liability Reserves, unless a valid need is identified. The auditors stated that these two reserves have not been utilized over a period of time. The District disagrees with the auditors and maintains that these reserves have been used, even though bookkeeping entries were not made. Since these reserves have been established, the District has saved the taxpayers money by raising insurance deductibles (\$10,000 per occurrence) and paying out-of-pocket for small claims, rather than claiming insurance reimbursement, which would adversely affect the District's annual premium. Official records do not show these reserves being accessed. However, when closing the books at the end of the year, if a surplus of funds existed in the General Fund budget, the District would utilize these funds while maintaining the original reserve balance. In the future, the District will pay for eligible occurrences out of the reserves. The reserves were legally established and are legally maintained. A district may go years without filing a claim. However, when a claim occurs, it is critical that the proper insurance and/or reserves be available. The District believes there is a valid need for these reserves.

INFORMATION TECHNOLOGY

Comptroller's Recommendations

1. District officials should develop a formal, written, District-wide security plan.
2. District officials should develop a Disaster Recovery Plan that is comprehensive and provides the direction and guidance necessary to maintain District operations, or restore them as quickly as possible during or following a disaster.
3. The Board and District officials should develop comprehensive written policies and procedures for the use of mobile storage devices such as flash drives.

District Response

1. District officials should develop a formal, written, District-wide security plan.

The District agrees with the auditors' findings and will begin a process to develop a district-wide security plan.

2. District officials should develop a Disaster Recovery Plan that is comprehensive and provides the direction and guidance necessary to maintain District operations, or restore them as quickly as possible during or following a disaster.

The District agrees with the auditors' findings. However, the District has already taken the necessary steps to have sufficient back-ups in place, including in-district and out-of-district processes to restore operations in the event of a disaster. As such a plan will be developed.

3. The Board and District officials should develop comprehensive written policies and procedures for the use of mobile storage devices such as flash drives.

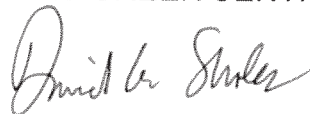
The District agrees with the auditors' findings. However, developing comprehensive written policies and procedures for the use of mobile storage devices, such as flash drives, would again be very time consuming and labor intensive. The District believes it currently has adequate safeguards in place preventing any possible threat that a flash drive may impose on a computer system. The District is concerned that after spending the resources necessary to develop comprehensive written policies and procedures that to adequately police these policies and procedures would be costly and labor intensive.

See
Note 3
Page 17

The District will be submitting a separate Corrective Action Plan to address the findings identified in your report. Again, the District would like to thank you and your staff for your recommendations that will improve district operations and the safeguarding of district assets.

Very truly yours,

RED CREEK CENTRAL SCHOOL



David G. Sholes
Superintendent of Schools

DGS/jw

cc: Members, Board of Education
Andrew J. DiBlasi, Business Administrator
Jolean B. Bliss, District Treasurer

APPENDIX B

OSC COMMENTS ON THE DISTRICT'S RESPONSE

Note 1

Determining a maximum amount for reserves is an important aspect of financial planning, one that District management should revisit periodically. It is important to communicate to District taxpayers that moneys the District is reserving are necessary and in the best interests of the District taxpayers.

Note 2

The purpose of this reserve is to pay the monetary value of accumulated or accrued but unused time earned (such as sick leave, holiday leave, or vacation leave) due to employees upon separation from District employment. The fact is that the amount in the reserve exceeds the total liability by \$470,000. While the District may have an obligation to pay for health insurance for employees in retirement, these amounts cannot be paid from the EBALR. In addition, the District could not use the EBALR to make salary payments in the event of a school closure, which is the example used by the District in its response.

Note 3

Mobile storage devices increase the risk of viruses, malicious software, and the loss of sensitive information, so inaction can prove costly. By developing a written policy for the use of mobile storage devices such as flash drives, District management can help ensure that students and District personnel know what uses are acceptable or unacceptable. To limit the time and labor necessary to develop a policy on mobile storage devices, District management could consult with other school districts to review their policies and adapt them for inclusion in their Computer Acceptable Use policy.

APPENDIX C

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 on the reported objectives and scope by selecting for audit those areas most at risk. We selected reserves and information technology for further audit testing.

We analyzed the activity in the District's eight reserve funds for the past six fiscal years. Specifically, we evaluated if expenditures complied with legal statutes, if balances appeared reasonable, and if interest earnings were properly credited. We also examined Board resolutions to determine if each reserve was properly established.

We interviewed staff members to determine what internal controls were in place for information technology, including the existence of policies and procedures for security, disaster recovery and the use of mobile storage devices.

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 D

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