Office of the New York State Comptroller

Division of Local Government
& School Accountability

Town of Royalton

Financial Management

Report of Examination

Period Covered:

January 1, 2006 — August 5, 2011

2011M-207

Thomas P. DiNapoli

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State of New York
Office of the State Comptroller

Division of Local Government
and School Accountability

December 2011

Dear Town Officials:

A top priority of the Office of the State Comptroller is to help local government officials manage government resources efficiently and effectively and, by so doing, provide accountability for tax dollars spent to support government operations. The Comptroller oversees the fiscal affairs of local governments statewide, as well as 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 operations and Town Board governance. Audits also can identify strategies to reduce costs and to strengthen controls intended to safeguard local government assets.

Following is a report of our audit of the Town of Royalton, entitled Financial Management. 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 local government 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

Introduction

Background

The Town of Royalton (Town) is located in Niagara County (County), has a population of approximately 7,660, and encompasses 70 square miles. The Village of Middleport (Village) is located within the Town. The Town is governed by a Town Board (Board) which comprises four elected Board members and an elected Town Supervisor (Supervisor). The Supervisor is the chief executive officer and chief fiscal officer, and is responsible for maintaining the Town's accounting records and preparing financial reports.

The Town provides various services to its residents, including street maintenance, water and sewer service, recreation programs, refuse collection, fire protection, drainage services, and general government support. The Town funds these services primarily with real property taxes, sales tax, State aid, user fees, and various local revenues. The Town's 2010 reported operating expenditures totaled $5.6 million.

Objective

The objective of our examination was to evaluate the Town's financial management practices. Our audit addressed the following related question:

- Did the Board properly allocate sales taxes and ensure that interfund activity was properly recorded?

Scope and Methodology

We examined aspects of the Town's financial management practices from January 1, 2006 to August 5, 2011.

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 Town Officials and Corrective Action

The results of our audit and recommendations have been discussed with Town officials and their comments, which appear in Appendix A, have been considered in preparing this report. Except as indicated in Appendix A, Town officials generally agreed with our findings and recommendations and indicated they would take corrective action.

The Board has the responsibility to initiate corrective action. A written corrective action plan (CAP) that addresses the findings and recommendations in this report should be prepared and forwarded to our office within 90 days, pursuant to Section 35 of the General Municipal Law. 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. We encourage the Board to make this plan available for public review in the Town Clerk's office.

Financial Management

The Board is responsible for making sound financial decisions that are in the best interest of the Town and the taxpayers that fund its operations. Because the Village of Middleport (Village) is located within the Town, the Town must maintain separate funds to account for transactions which are required by law to be accounted for in town-wide funds (which have a tax base that encompasses the entire Town, including the Village) and in town-outside-village funds (which have tax bases that encompass only the portion of the Town which lies outside the incorporated boundaries of the Village). Accordingly, financial reports issued by the Town should disclose transactions within the correct fund, in accordance with generally accepted accounting principles, and demonstrate the Town's compliance with statutes requiring segregation of town-wide and town-outside-village resources.

We found that Town officials do not have a comprehensive understanding of financial management, especially concerning interfund financial transactions. Because sales tax revenues were improperly allocated and interfund activity was improperly recorded, Town residents were not treated equitably. Furthermore, these actions have resulted in an inaccurate depiction of the actual financial condition of certain Town operating funds.

Use of Sales Tax — Tax Law provides that if a town and the villages therein elect to receive their shares of county sales tax directly from the county (which is the case with the Town of Royalton and Village of Middleport), the town shall first apply its share to reduce taxes levied for town-outside-village activities. If any balance remains, the Board may apply the remainder to reduce general town-wide taxes.

We reviewed the allocation of sales tax received by the Town from the County from 2006 through 2010 and found that the general fund town-wide was credited with $672,000 in sales tax revenue even though the Board had levied real property taxes of $2 million in the highway fund town-outside-village over the same time period. Since the Town did not eliminate the tax levy for the highway fund with a town-outside-village tax base, the general fund in effect owes the highway fund town-outside-village $672,000. Because the general fund town-wide reported a fund balance of $611,000 at December 31, 2010, a return of the sales tax would result in a deficit fund balance of $61,000. This adjustment would also increase fund balance in the highway fund town-outside-village to approximately $1 million.

Even though the Board improperly allocated sales tax during the annual budget process, the Supervisor, one Board member, and the bookkeeper told us they were not aware of the sales tax allocation requirement until the Town's external accountant brought this to their attention in 2011. However, our previous audit report,[1] issued in August 2007, had established that the Board was improperly allocating sales tax at that time.

Interfund Advances — General Municipal Law (GML) authorizes cash advances between town funds and requires that repayment be made as soon as monies are available, but no later than the close of the fiscal year in which the advance was made. These advances must be authorized by Board action. If advances are made between funds with different tax bases, the statute requires that interest be assessed to the debtor fund. When these advances are not repaid in a timely manner and are maintained for period of time, they are, in effect, transfers of monies instead of temporary advances of cash.

The Supervisor made a significant number of interfund advances to provide cash from one fund to another. At the end of the 2008 fiscal year, approximately $3.3 million was owed between the Town's funds. Town officials have reduced that amount to approximately $725,000 at the end of the 2010 fiscal year.

We found no indication that the Board authorized these advances, and interfund advances were not repaid within the same fiscal year. The Supervisor also did not ensure that the interfund activity was properly recorded: the records did not indicate the date the advances were made and which specific funds owed, or were due, monies from other funds. Since the Town has funds and districts that represent different tax bases, it is unclear to what extent interfund activity occurred between such different tax bases.

The Supervisor recently attempted to address the outstanding interfund activity by simply "netting out" interfund activity within a particular fund without knowing the initial source of the advances – that is, balancing the loans due with the loans owed, regardless of the different tax bases represented by the funds involved. For example, in 2010, the Supervisor offset the water district's $1.4 million due to other funds with the $1.4 million due from other funds. Similarly, $1.1 million due to other funds, and due from other funds, reported in the capital projects fund were also offset against each other. The Supervisor's method of addressing this issue was not appropriate because different tax bases were probably involved, and no interest was computed and recorded to the funds that advanced these loans.

[1] Town of Royalton: Financial Operations (Report No. 2007M-115)

We also found that the Supervisor could not identify which funds may have owed cash to the Town's debt service fund, and, further, could not demonstrate that the Town should be maintaining a debt service fund. Debt service funds are used to account for the accumulation of resources for the payment of debt, which includes monies restricted for specific, legally defined purposes. GML and Local Finance Law stipulate that monies be restricted based on certain circumstances. For example, unexpended debt proceeds and interest earned on them must be restricted and used to pay debt service on that debt issue or for related capital expenditures. Pursuant to GML, the Town could also establish a debt reserve for the payment of bond indebtedness. Such restrictions of monies for the payment of debt should be accounted for in the debt service fund.

Town officials could not provide documentation of the circumstances requiring the Town to establish a debt reserve, or evidence that the Board had authorized the establishment of a debt reserve. The Board annually budgets for transfers from the debt service fund to the water district fund to pay certain debt service. Town officials indicated that they plan to continue this practice until the amount in the debt service fund is reduced to zero, even though they could not demonstrate that these monies were from debt issuances related to the water district.

Recommendations

1. The Board should adopt budgets that properly allocate sales tax revenues in accordance with statutory requirements.

2. The Supervisor should maintain accurate and complete financial records.

3. The Board should review all outstanding balances of interfund advances and take appropriate action to eliminate them by the end of the fiscal year.

4. The Supervisor should comply with statutory requirements by properly maintaining and recording interfund activity to ensure timely repayment and the computation and payment of interest, where required.

5. The Supervisor should determine whether a debt service fund is required to be maintained by identifying the source of monies that are accounted for in the debt service fund.

6. The Board and Town officials should review the relevant publications on accounting, financial management, and municipal operations available on the State Comptroller's website[2] and consider attending financial management training.

[2] *http://www.osc.state.ny.us/localgov/pubs/index.htm*

APPENDIX A

RESPONSE FROM TOWN OFFICIALS

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

TOWN OF ROYALTON

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December 15, 2011

Office of the State Comptroller
Buffalo Regional Office
295 Main St.- Suite 1032
Buffalo, NY 14203-2510

Dear Mr. Meller,

Enclosed please find the audit response letter from the Town of Royalton to the Office of the State Comptroller. If there is any further information you need, please do not hesitate to contact me. Thank you for your time in this matter.

Sincerely,

Richard J. Lang
Royalton Supervisor
(716) 772-7531

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December 15, 2011

State of New York
Office of the State Comptroller
Division of Local Government
and School Accountability

RE: Town of Royalton Audit

Dear Office of the State Comptroller:

Please be advised that I am the Attorney for the Town of Royalton. The Town has reviewed your draft "Financial Management Report of Examination for the period January 1, 2006 – August 5, 2011"(hereinafter referred to as Audit Report). The Audit Report noted that the Town had improperly allocated Sales Tax from 2006 through 2010. The improper allocation was corrected by the Town for the 2011 budget year. The report also noted that there were inter-fund advances that had not been authorized by the Board and not repaid within the same fiscal year. Finally, the report noted that the Town maintained a debt service fund without a specific, legally defined purpose.

The Town participated with the local representative of the Office of the State Comptroller and informally reviewed the Audit Report. The Town understands the necessity for the correct allocation of sales tax. To that end, the Town will pass a resolution, to be made part of the yearly resolutions passed at the beginning of each year, indicating that sales tax must be allocated to the "whole town outside of village"portion of the Town's Budget. The yearly resolutions are, for the most part, simply repeated year to year. It is anticipated that this will provide a continuing informational and legal directive to ensure the correct allocation. In terms of correcting the previous misallocation, the Town has determined that at the end of 2011 it will transfer approximately $415,000 of the fund balance from the "whole town, including village" side of the budget, where it was improperly credited, to the "whole town outside of village" side of the budget. Although not a complete correction, the Town has determined that the amount of this correction would be consistent with the Town's finances as a whole.

Turning to the inter-fund advances, both the town's outside auditors and the Office of the State Comptroller have noted that during the first years of the period of time covered by the Audit Report, there was insufficient record-keeping to determine the amount of interfund advances and which funds should be repaid. The Town Board at the present time can do nothing about that lack of information. Moving forward, the Town, through the Town Board, Town Bookkeeper, and the Town's outside auditor will only make interfund advances that are authorized by the Town Board by resolution, with a specifically identified fund, amount of money, and repayment date. The advances will be identified as "advances." The interfund advances will be distinguished from "transfers" within the same taxpayer fund. The Town has for the last couple years consistently authorized these transfers by resolution, with line item description and specific amounts.

Finally, at the audit conference the Town representatives explained that the existing debt service fund contained monies that were raised through bonding but were not necessary to pay for a water project which came in at a lower cost. Those monies are being used to make bond payments on the water projects. It is our understanding that this is permissible. This arrangement will be memorialized by resolution. It must be remembered the Town does not have any water districts. The water districts were dissolved by referendum over 20 years ago. After the dissolution, the Town created a "Town wide water area, outside of the village." The Town understands that only funds that are "town wide, outside of the village" can be used to make payments on any water project debt.

The Audit Report made six recommendations. Five of the recommendations will be followed by the Town. At this point, the Town will be unable to "review all outstanding balances of interfund advances and take appropriate action to eliminate them by the end of the fiscal year." (Recommendation #3). As the Audit Report notes, and as our external auditor has advised, the records from the earlier years of the period under review do not contain sufficient data to decide how much the interfund advances were, which fund they came from, and which fund they are due to. This did not occur during the latter part of the period under review, and the Town will ensure that it does not occur in the future.

Very truly yours,

BRANDT, ROBERSON & BRANDT, P. C.

By: Thomas H. Brandt

THB/md

Cc: Supervisor, Town Board members, Town Bookkeeper, Town Auditors

APPENDIX B

AUDIT METHODOLOGY AND STANDARDS

During our initial assessment, we interviewed appropriate Town officials, performed limited tests of transactions, and reviewed pertinent documents, such as the Town budget, Board minutes and financial records and reports.

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 objective and scope by selecting for audit those areas most at risk. We selected certain aspects of financial management for further audit testing.

To achieve our objective and obtain valid audit evidence, we performed the following audit procedures:

- We reviewed Board minutes and interviewed the Supervisor, bookkeeper, and a Board member.

- We verified monthly sales tax distributions from the County to the allocation in each Town fund in 2010 to test financial data accuracy.

- We analyzed the allocation of sales tax received in the last five years and the highway fund town-outside-village tax levy to determine whether sales tax was allocated in accordance with statute.

- We analyzed and summarized interfund activity reported in the last five years to determine whether it was properly recorded and in accordance with statute.

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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APPENDIX D

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