



Town of Ischua

Internal Controls Over Selected Financial Operations

Report of Examination

Period Covered:

January 1, 2011 — June 13, 2012

2012M-147



Thomas P. DiNapoli

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State of New York Office of the State Comptroller

Division of Local Government and School Accountability

November 2012

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 Ischua, 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 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*



State of New York Office of the State Comptroller

EXECUTIVE SUMMARY

The Town of Ischua (Town) is a small rural community with a population of approximately 850. The Town is located in Cattaraugus County, in western New York State. The Town provides various services to its residents, including road maintenance, snow removal, fire protection and general governmental support. The Town's 2012 budgeted appropriations total approximately \$413,000, funded primarily by real property taxes, sales tax and State aid.

The Town Board (Board) comprises four elected Council members and an elected Town Supervisor (Supervisor). The Board is the legislative body responsible for managing Town operations, establishing policies and procedures governing the Town's general operations, auditing and approving claims submitted for payment, and exercising oversight over Town employees who receive and disburse Town funds. The Supervisor is the Town's chief executive and chief fiscal officer, responsible for maintaining the accounting records and preparing financial reports. The Supervisor disburses Town moneys following authorization by the Board.

Scope and Objective

The objective of our audit was to examine and evaluate internal controls over cash receipts and disbursements, and the Town's accounting records and reports for the period January 1, 2011 through June 13, 2012. Our audit addressed the following related questions:

- Are internal controls over cash receipts and disbursements for which the Town Clerk is responsible appropriately designed and operating effectively to adequately safeguard Town assets?
- Did the Supervisor maintain complete and accurate accounting records and prepare timely reports of the Town's financial activities?

Audit Results

The Town Clerk (Clerk), who also is bookkeeper to the Supervisor, has cash receipt and disbursement duties that are not segregated, and there are no compensating controls. Furthermore, the Clerk should not hold the position of bookkeeper to the Supervisor because the two positions are incompatible. These positions have functions that serve as checks against one another that do not exist unless they are performed by separate individuals. In addition, we found that the current and former Supervisors routinely signed blank checks, which severely weakens controls over disbursements. Because of

these weaknesses, there is an increased risk that the Clerk could misappropriate funds and conceal transactions from other Town officials without detection.

The former and current Supervisors¹ did not ensure that appropriate accounting records were maintained, adequate monthly financial reports were prepared and provided to the Board for review, or that annual financial reports were completed and filed with the Office of the State Comptroller as required. Without complete, timely and accurate periodic and annual reports, the Board is limited in its ability to effectively monitor and make informed decisions concerning the Town's financial activities.

Comments of Local Officials

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

¹ Term started January 1, 2012

Introduction

Background

The Town of Ischua (Town) is a small rural community with a population of approximately 850. The Town is located in Cattaraugus County, in western New York State. The Town provides various services to its residents, including road maintenance, snow removal, fire protection and general governmental support. The Town's 2012 budgeted appropriations total approximately \$413,000, funded primarily by real property taxes, sales tax and State aid.

The Town Board (Board) comprises four elected Council members and an elected Town Supervisor (Supervisor). The Board is the legislative body responsible for managing Town operations, establishing policies and procedures governing the Town's general operations, auditing and approving claims submitted for payment, and exercising oversight over Town employees who receive and disburse Town funds. The Supervisor is the Town's chief executive and chief fiscal officer, responsible for maintaining the accounting records and preparing financial reports. The Supervisor disburses Town moneys following authorization by the Board.

Objective

The objective of our audit was to examine and evaluate internal controls over cash receipts and disbursements, and the Town's accounting records and reports. Our audit addressed the following related questions:

- Are internal controls over cash receipts and disbursements for which the Town Clerk is responsible appropriately designed and operating effectively to adequately safeguard Town assets?
- Did the Supervisor maintain complete and accurate accounting records and prepare timely reports of the Town's financial activities?

Scope and Methodology

We examined cash receipt and disbursement records from January 1, 2011 through June 13, 2012. We also reviewed all financial reports prepared by the Town Clerk and Supervisor for the same period.

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
Local 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. Town officials generally agreed with our recommendations and indicated they plan to initiate 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 Clerk's office.

Cash Receipts and Disbursements

Board members should provide effective oversight of those charged with handling public moneys, and ensure that financial duties are adequately segregated so that the work of one employee is verified in the course of another employee's regular duties. If it is not practical to segregate financial duties, the Board should establish and implement compensating controls such as its periodic review of financial activity and the annual audit required by statute.

The Town Clerk (Clerk), who also is bookkeeper to the Supervisor, has cash receipt and disbursement duties that are not segregated, and there are no compensating controls. Furthermore, the Clerk should not hold the position of bookkeeper to the Supervisor because the two positions are incompatible. These positions have functions that serve as checks against one another that do not exist unless they are performed by separate individuals. In addition, we found that the current and former Supervisors routinely signed blank checks (see next section entitled "Supervisor's Record and Reports"), which severely weakens controls over disbursements. Because of these weaknesses, there is an increased risk that the Clerk could misappropriate funds and conceal transactions from other Town officials without detection.

Segregation of Duties

An effective internal control system over cash receipts and disbursements includes procedures ensuring that cash transactions are properly documented and recorded and that all disbursements are properly authorized, supported by appropriate documentation, and are for valid business purposes. It also consists of effective management oversight of those charged with handling public moneys, and the segregation of financial duties so no one individual can control all aspects of financial transactions. For example, the same employee should not collect and deposit cash and record transactions in the accounting records, and should not be solely responsible for processing and recording payments made.

The Clerk's duties are not segregated. Acting as both the Clerk and bookkeeper to the Supervisor, she is solely responsible for receiving and recording all cash transactions. In addition, the Clerk, as bookkeeper to the Supervisor, is responsible for preparing and mailing checks, and recording disbursements in the books of account. As a result, internal controls are severely compromised because the Clerk has the opportunity to misappropriate funds and conceal transactions from other Town officials.

We reviewed all cash receipts and disbursements activity that the Clerk was responsible for from January 1, 2011 through June 5,

2012. While we found only minor exceptions with receipts and disbursements that normally the Supervisor would be responsible for, we found significant exceptions with the Clerk's office functions, as detailed below:

- Clerk collections were not remitted to the Supervisor in a timely manner. According to Town Law, the Clerk must remit all fees collected to the Supervisor by the 15th of the following month. As of June 5, 2012, the Clerk failed to remit any fees to the Supervisor for 2011 and 2012 totaling \$3,646.²
- Deposits were not made timely or intact. The Clerk is required to deposit all funds collected within three days after the total collected exceeds \$250. If \$250 has not been collected, minimally, the Clerk should deposit fees collected at least by month's end. For example, according to the Clerk's records, she collected \$1,396 during the months of January through March 2011 but did not make the first deposit until March 31. This deposit was for only \$485, and included \$38 that was not related to activity recorded during that period. The next deposit was made April 7 for \$919. Finally, two checks totaling \$30, recorded as received in March, were deposited on May 23, 2011.

We performed an accountability of the Clerk's account at June 5, 2012 and found an overage totaling \$355. Although this amount is minor, it demonstrates that, due to weaknesses in the Town's internal controls, errors and irregularities can occur without the Board's detection or correction. This overage could have been avoided if the Clerk's duties had been adequately segregated or if the Board had provided for an independent review of her work.

Annual Audit

Town Law requires the Board to annually audit, or provide for the audit of, the records and reports of any Town officer or employee who received or disbursed moneys on behalf of the Town in the preceding fiscal year. An annual audit helps the Board fulfill its fiscal oversight responsibilities by providing an opportunity to assess the reliability of each officer's or employee's books, records and supporting documents. An annual audit is particularly important when an inadequate segregation of duties exists, as detailed above.

According to the Clerk, the Board did not perform, or provide for, an annual audit of the Supervisor's records (which the Clerk was responsible for) or the Clerk's records for the 2011 fiscal year. Without an annual audit, Town officials are at risk of public moneys being

² We determined that \$51 was collected during May and June 2012 and would not be due until after June 15, 2012.

mishandled and failing to detect and correct errors, irregularities, or fraudulent activity in a timely manner.

Recommendations

1. The Supervisor should designate a person other than the Clerk as the Town's bookkeeper.
2. The Clerk should attempt to determine the source of the unidentified moneys, remit as required, and turn over any remaining unidentified moneys to the Supervisor.
3. The Clerk should deposit receipts no later than the third business day after total collections exceed \$250 or, if \$250 is not received, by the end of the month in which fees are collected.
4. The Clerk should prepare a written accountability at least monthly and remit payment to the appropriate person or agency. The Supervisor should be paid by the 15th of the month following collection.
5. The Board should annually audit, or arrange for an audit of, the records and reports of all Town officials and employees who receive or disburse money.

Supervisor's Records and Reports

The Town's financial data must be complete, accurate and up-to-date to be relevant and useful for managing Town operations. The Supervisor, as chief fiscal officer, is responsible for performing basic accounting functions, including maintaining accounting records by fund, providing monthly financial reports to the Board, and filing the annual update document (AUD) with the Office of the State Comptroller (OSC).

The former and current Supervisors³ did not ensure that appropriate accounting records were maintained, adequate monthly financial reports were prepared and provided to the Board for review, or that annual financial reports were completed and filed with OSC as required. Without complete, timely and accurate periodic and annual reports, the Board is limited in its ability to effectively monitor and make informed decisions concerning the Town's financial activities.

Accounting Records

The Supervisor, as chief fiscal officer, is required by Town Law to keep a complete and accurate account of the receipt and disbursement of all moneys. Accordingly, general ledgers, cash receipt and disbursement journals, and subsidiary revenue and appropriation ledgers must be maintained by fund in a complete, accurate, and timely manner. If the Supervisor assigns these duties to a bookkeeper, the Supervisor must provide sufficient oversight to ensure that the bookkeeper maintains suitable records and accurately records financial information.

The Supervisor assigned his accounting duties to the Clerk, but did not provide sufficient oversight to ensure that the Clerk performed these duties adequately. We found that the Clerk did not maintain complete and accurate accounting records. For example, the accounting records were not prepared on a fund basis as required; instead, one set of records combined all Town activity⁴ together. The Supervisor's lack of oversight with respect to the bookkeeping function has resulted in the Town's accounting records being incomplete and inaccurate. As a result, Town officials could not determine what portion of approximately \$70,000 recorded in the Town's "savings account" at December 31, 2011 was attributable to either the general fund or the highway fund. The Board's ability to monitor and manage the Town's financial resources is compromised by the lack of accurate and complete accounting records.

³ Term started January 1, 2012

⁴ This account included the general, highway and trust and agency funds; each fund was required to have its own set of accounts.

Financial Reports

Adequate accounting records and effective procedures are needed to properly account for and report the Town's financial activities. Financial records must be accurate and maintained in a timely manner, and the Supervisor is required to submit detailed financial reports to the Board on a monthly basis. The monthly report to the Board must provide a detailed accounting of moneys received and disbursed and should include information with which the Board can monitor the Town's budget.

Because the Supervisor did not ensure that the Clerk maintained an appropriate accounting system, she was unable to prepare accurate and complete reports for the Board's consideration on a fund basis. Neither the former nor current Supervisor requested that the Clerk prepare and submit budget status reports to the Board on a monthly basis. These reports are critical for the effective review and management of Town operations. In addition, the Supervisor did not ensure that the monthly reports that were prepared by the Clerk were accurate and contained sufficient detail for the Board to gain a thorough understanding of Town operations. Reports provided by the Clerk included only beginning bank balances and total receipts and disbursements, but did not provide any detail regarding the prior month's activity. When adequately detailed reports are not provided and reviewed, the likelihood that mistakes or fraudulent activity occurring and being undetected significantly increases.

Annual Report

The Supervisor also is responsible for filing the Town's annual financial report, referred to as the Annual Update Document (AUD), with OSC within 60 days following the close of the fiscal year.⁵ The annual report summarizes all the financial activity conducted by the Town in the preceding year and is not only a critical tool for the Board to use when managing Town operations, but also is a means for residents to evaluate the Town's financial affairs.

As of June 13, 2012, the Town's AUD for fiscal years 2010 and 2011 had not been filed by the bookkeeper or the previous or current Supervisors.

We reviewed a sample of monthly reports⁶ prepared and distributed to the Board by the Clerk and reviewed accounting records for accuracy and completeness. We found only minor exceptions, which we discussed with Town officials. However, during our review of canceled checks, we found gaps in the number sequence of issued checks. The Clerk provided us with nine blank checks signed by

⁵ General Municipal Law Section 30

⁶ We judgmentally selected reports for the months of October, November and December 2011 to confirm the Town's financial condition at December 31, 2011.

the previous Supervisor and 32 blank checks signed by the current Supervisor. The Clerk explained that, to pay bills on time, it was common practice to have the Supervisor sign blank checks. Although further audit testing did not disclose any inappropriate use, when the Supervisor relinquishes such a vital internal control - his signature - to another, the threat that fraudulent activity could occur and not be detected dramatically increases.

The Town does not currently appear to be experiencing fiscal stress. However, we believe the Town has not developed significant budget problems because of its small size, limited services, and adequate cash balances. Without complete, timely and accurate periodic and annual reports, the Board is limited in its ability to effectively monitor and make informed decisions concerning the Town's financial activities.

Recommendations

6. The Supervisor should ensure that the Town's accounting records are complete, accurate, and maintained in a timely manner.
7. The Board should ensure the Supervisor provides it with complete, accurate and more detailed monthly financial reports to allow for the monitoring of the Town's financial operations, including the budget.
8. The Board should ensure that the Supervisor submits the annual report to OSC in a timely manner, as required by statute.
9. The Supervisor should discontinue the practice of signing blank checks and immediately void those currently on hand.

APPENDIX A

RESPONSE FROM LOCAL OFFICIALS

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

TOWN OF ISCHUA

1850 MILL ST.
ISCHUA, NY 14743

15 October 2012

Mr. Robert E. Meller
Chief Examiner
Office of the State Comptroller
Division of Local Government and School Accountability
Buffalo Regional Office
295 Main St. Suite 1032
Buffalo, NY 14203-2510

Dear Mr. Meller:

On behalf of the town board of Ischua, I am responding to the Examination of Internal Controls over Selected Financial Operations for the period January 1, 2011 to June 13, 2012. The town board appreciates the thoroughness and accuracy of the report. We will be taking corrective action and will submit the CAP within the 90-day deadline.

Sincerely,

Thomas J. Schaeper
Town Supervisor

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 Town assets and monitor financial activities. 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.

During the initial assessment, we interviewed Town officials, performed limited tests of transactions, and reviewed pertinent documents such as Town policies and procedures manuals, 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 for further testing cash receipts and cash disbursements, and the Supervisor's records and reports.

We interviewed local officials to gain an understanding of practices and procedures for Town management. We reviewed the Supervisor's monthly reports to determine if they were accurate and complete. Other specific audit procedures included the examination of cash receipt and cash disbursement records as well as the Supervisor's records for the period January 1, 2011 to May 31, 2012. We requested and reviewed bank deposit compositions for the general, highway, and Clerk accounts for the fiscal year 2011. We compared images of canceled checks to the accounting records to verify that disbursements were appropriately recorded.

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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