



Town of Orwell

Financial Management

Report of Examination

Period Covered:

January 1, 2010 — September 30, 2011

2012M-22



Thomas P. DiNapoli

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State of New York Office of the State Comptroller

Division of Local Government and School Accountability

April 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 Town of Orwell 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 Orwell (Town) is located in Oswego County and has a population of approximately 1,170. The Town is governed by an elected five-member Town Board (Board), which consists of the Town Supervisor (Supervisor) and four council members. The Board is responsible for overseeing the Town's operations and finances, and for the overall management of the Town, including annually auditing departments that receive and disburse cash. The Supervisor, as chief fiscal officer, is responsible for overseeing the financial management of the Town's moneys.

The Town provides various services to its residents, including street maintenance, water, and general government support. The Town's budgeted appropriations for the 2011 fiscal year were \$328,125 in the general fund and \$702,700 in the highway fund. These expenditures were primarily funded with revenues from local property and sales taxes, payments in lieu of taxes, and State aid.

Objective

The objective of our audit was to assess the Board's system of internal controls over financial management. Our audit addressed the following related question:

- Did the Board institute financial management procedures to maintain a reasonable level of fund balance and to annually audit the records and reports of Town employees who receive and disburse cash?

Scope and Methodology

We examined the Town's financial management procedures relating to fund balance and the annual audit for the period January 1, 2010 to September 30, 2011. We extended our analysis of fund balance back to fiscal years 2008 and 2009, and forward to December 31, 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 C 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. Except as specified in Appendix A, Town officials generally agreed with our recommendations and indicated that they planned to initiate corrective action. Appendix B includes our comments on the issues raised in the Town's response letter.

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 Town 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 interests of the Town and the taxpayers. This requires the Board to balance the level of services desired and expected by the Town's residents with the ability and willingness of the residents to pay for such services. A basic component of local government budgeting is the prudent use of fund balance, which is the difference between revenues and expenditures accumulated over time.

It also is important that the Town has long-term financial plans in place to ensure that moneys accumulated in fund balances are used and maintained at reasonable levels. Therefore, the Board should adopt budgets that include realistic estimates of revenues and expenditures and use surplus fund balance as a funding source, when appropriate. If these practices are followed, only the necessary amount of real property taxes will be raised. In addition, Town Law requires that the Board audit, or cause to be audited, the records and reports of each department that receives and disburses cash.

We found that fund balances for the general and highway funds were significant, and portions of the fund balance for the highway fund set aside as a funding source for the following year's appropriations were not needed, resulting in a higher tax levy than necessary. We also found that the Board did not perform an adequate audit of each department that receives or disburses cash.

Fund Balance

Town officials can legally set aside, or reserve, portions of fund balance to finance future costs for a specified purpose, or can designate the unexpended surplus¹ portion of fund balance to either help finance next year's budget or be retained for future use. The Town may retain a reasonable level of unexpended surplus funds as a financial cushion in the event of unforeseen financial circumstances. Maintaining a reasonable level of unexpended surplus funds is a key element of effective long-term financial planning. It is sound practice for a Board to adopt budgets that are based on realistic estimates

¹ The Governmental Standards Board (GASB) issued Statement 54, which replaces the fund balance classifications of reserved and unreserved with new classifications: nonspendable, restricted, and unrestricted (comprising committed, assigned, and unassigned funds). The requirements of Statement 54 are effective for fiscal years ending June 30, 2011 and beyond. To ease comparability between fiscal years ending before and after the implementation of Statement 54, we will use the term 'unexpended surplus funds' to refer to that portion of fund balance that was classified as unreserved, unappropriated (prior to Statement 54), and is now classified as unrestricted, less any amounts appropriated for the ensuing year's budget (after Statement 54).

and long-term financial plans, and to actually use the fund balance it appropriates. These practices help to ensure that the real property taxes levied are necessary.

The Board has taken measures to reduce the unexpended surplus funds in the general and highway funds by appropriating fund balance over the past four years. At December 31, 2008, the unexpended surplus funds were \$322,205 in the general fund, or 103 percent of the following year's appropriations, and \$576,318 in the highway fund, or 84 percent of the following year's appropriations. At December 31, 2011, the unexpended surplus funds for the general and highway funds remained high at \$137,521 and \$267,311, or 42 percent and 39 percent of the following year's appropriations, respectively. The following chart illustrates the percentage of unexpended surplus funds, in relation to the following years' budgeted appropriations and taxes levied, for completed fiscal years 2008 through 2011.

| Table 1: Fund Balance | | | | | |
|------------------------------|----------------------------------|---------------------------------|---|---|---------------------|
| General Fund | | | | | |
| Fiscal Year End | Appropriated Fund Balance | Unexpended Surplus Funds | Following Year's Budgeted Appropriations | Unexpended Surplus Funds as % of Following Year's Appropriations | Taxes Levied |
| 2008 | \$95,000 | \$322,205 | \$312,037 | 103% | \$56,343 |
| 2009 | \$125,000 | \$253,733 | \$331,686 | 76% | \$56,912 |
| 2010 | \$125,000 | \$182,803 | \$328,125 | 56% | \$64,463 |
| 2011 | \$109,300 | \$137,521 | \$330,132 | 42% | \$70,522 |
| Highway Fund | | | | | |
| Fiscal Year End | Appropriated Fund Balance | Unexpended Surplus Funds | Following Year's Budgeted Appropriations | Unexpended Surplus Funds as % of Following Year's Appropriations | Taxes Levied |
| 2008 | \$285,000 | \$576,318 | \$684,000 | 84% | \$52,366 |
| 2009 | \$285,000 | \$483,929 | \$700,500 | 69% | \$52,871 |
| 2010 | \$285,000 | \$361,110 | \$702,700 | 51% | \$102,428 |
| 2011 | \$285,000 | \$267,311 | \$693,500 | 39% | \$107,728 |

The Board has taken steps to reduce unexpended surplus funds by appropriating fund balance in the general and highway funds annually. However, Board members told us that they have no long-term plan in place for operating or capital expenditures. A formal

long-term operational or capital plan would help the Board to fulfill its oversight responsibility. Planning on a multi-year basis allows Town officials to identify developing revenue and expenditure trends and to set long-term priorities and goals. It also allows Town officials to assess the impact and merits of alternative approaches to address financial issues such as the use of unexpended surplus funds to finance operations. Any long-term financial plans should be monitored and updated on an ongoing basis to ensure that decisions are guided by the most accurate information available.

Board members told us that, from the late 1990s to 2004, they intentionally increased property taxes to accumulate fund balance in the general and highway funds in anticipation of paying out expenses pertaining to a legal suit with a hydropower company that disputed its assessment. Board members stated they increased property taxes at that time because they did not wish to incur debt. The legal suit ended with a payment in lieu of taxes (PILOT)² agreement among the Town, County, local school district and the hydropower company effective with the municipalities' 2006 fiscal year. Board members also told us that they have employed conservative budgeting practices because the Town's PILOT agreement is set to expire at the end of fiscal year 2012. In addition, they have concerns regarding the uncertainty of anticipated expenditures during the winter months, such as snow plowing.

While the Board has made progress in reducing unexpended surplus funds in the general fund in recent years, it overestimated expenditures by \$56,745 in total, or about 10 percent, as compared to actual expenditures during the 2009 and 2010 fiscal years. We found that approximately \$46,500 of this total was due to overestimates for the attorney, engineer, buildings, insurance, garage, street lights, and retirement expenditures. These overestimates created operating surpluses, and, as a result, the unexpended surplus funds were not reduced as much as indicated by the Town's budgets.

In the highway fund, the Board overestimated budgeted expenditures by \$319,591 in total, or more than 30 percent, as compared to actual expenditures during the 2009 and 2010 fiscal years. We found that approximately \$289,000 of this total was due to overestimates for general repairs, machinery, and snow removal expenditures. Therefore, even though the Board appropriated fund balance each year for the highway fund, the Town has not used all of the appropriated fund balance because of the overestimated expenditures. As a result, Town officials may have raised more taxes than necessary in the highway fund. For example, the Board increased the highway fund tax levy

² The Town has a seven-year PILOT agreement (2006 through 2012) with this hydropower company.

from \$52,871 in 2009 to \$102,428 in 2010 (94 percent), despite having unexpended surplus funds of about \$484,000 at the end of 2009, which was 69 percent of the 2010 budget.

An important aspect of budget preparation includes a reasonable estimate of the amount of fund balance that will be available at the end of the fiscal year. Information concerning the amount of fund balance available for appropriation has an impact on the amount of tax levy needed to fund the subsequent fiscal year's budget. It is prudent to maintain enough unexpended surplus funds to protect against unforeseen circumstances or to budget conservatively. When budgets are small, a reasonable amount of unexpended surplus funds may be a higher percentage of the next year's expenditures than it would be with a large budget. However, maintaining substantial unexpended surplus funds in addition to budgeting very conservatively results in a higher tax levy than necessary.

Annual Accounting

Town Law requires that each Town officer and employee who received and disbursed any moneys in the previous fiscal year account to the Board for such moneys and produce all supporting books, records, receipts, warrants, vouchers, and canceled checks or check images (including backs of canceled checks). The Board is required to audit the accounting records and reports, or it may engage the services of an independent auditor to complete an audit. If the Board chooses to contract for the annual audit, it should enter into a written agreement with the independent auditor that stipulates the services to be provided and the basis for compensation. An annual audit helps the Board fulfill its fiscal oversight responsibilities by providing the Board with an opportunity to assess the reliability of the Town's books, records and supporting documents.

The Board does not have an effective and thorough process for annually auditing departments that receive and disburse cash. The Supervisor presented her records³ to the Board for audit but the Board did not provide a thorough audit of her records. The Board's review of the Supervisor's work was not formalized or documented. Board members told us that they sign off on the records to signify their review. However, the Board does not perform a meaningful audit or review because the Supervisor does not submit all documents supporting her receipts, and no one compares receipt records to deposits. Also, no one reviews the accuracy of the completed bank reconciliations (verifies the adjusted bank balances to the accounting records).

³ The Supervisor's records included manual journal entries, general and subsidiary ledgers, general journals and a copy of the Annual Update Document that was filed with the State Comptroller.

Although we found the Board's annual audit process to be weak, one Board member told us that he periodically (two or three times per year) compares the cash balances on the bank statement to the Supervisor's reconciliation of cash balances, and traces from the cash disbursements on the bank statements to the vouchers. However, he does not document his review. While we consider this Board member's periodic review to be a good oversight procedure, it is important to document such review for audit purposes.

We also found that the Town Clerk does not present her records to the Board, and the Board does not audit her records annually. In addition, the Town Justice does not present his records to the Board for audit. The Supervisor performed only a cursory review of the Justice's records for the first quarter of 2010. The Supervisor told us that she did not trace receipts or disbursements to source documents and did not perform an audit or thorough review of the Justice's records. Instead, she merely obtained an understanding of the process in order to complete a checklist required by the Uniform Justice Court Act.⁴

Board members also told us that the Town receives assistance from an outside accountant who prepares the annual financial report. The Board believed the work done by the accountant would satisfy the audit requirement. However, the accountant told us that he was not conducting an audit; he was merely preparing the closing and opening journal entries, and preparing and filing the annual financial report on the Town's behalf. Furthermore, the Town did not enter into a written agreement with the accountant that stipulated what services were to be provided or the extent of any audit work performed. The Board's failure to effectively perform required annual audits diminishes its ability to effectively monitor the Town's financial operations and could result in errors or irregularities occurring and remaining undetected and uncorrected.

Recommendations

1. The Board should establish a formal long-term financial plan for operating and capital expenditures.
2. The Board should develop a formal plan to reduce the unexpended surplus funds in the general fund and the highway fund. If the Board believes it is necessary to accumulate money for a future planned purpose, it should consider formally establishing an authorized reserve. Otherwise, officials should use the unexpended surplus funds in a manner that benefits taxpayers.

⁴ The checklist requires that town justices annually provide their court records and dockets to their respective town board. The board should then examine or audit these records and document the examination in the minutes of the board's proceedings.

Such uses could include, but are not limited to, financing one-time expenses and reducing property taxes.

3. The Board should require the departments who receive or disburse cash to make all records available for its review.
4. The Board should gain an understanding of the annual audit process⁵ and effectively audit, or cause to be audited, the records of Town officials and employees that receive and disburse Town moneys.
5. The Board should enter into a written agreement with the accountant that clearly stipulates the services to be provided and the basis for compensation.

⁵ For guidance on conducting annual audits, Town officials should refer to our publication entitled, “Local Government Management Guide – Fiscal Oversight Responsibilities of the Governing Board.”

APPENDIX A

RESPONSE FROM LOCAL OFFICIALS

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

Town of Orwell
PO Box 5
Orwell NY 13426
Marilyn J. Roser, Supervisor

Phone (315) 298-3236

Fax (315) 298-4705

April 10, 2012

NYS Comptroller
Syracuse Regional Office

State Office Building
333 E. Washington St
Syracuse, NY 13202-1428

Dear [REDACTED]:

This letter is in response to the Draft Audit Report entitled "Financial Management of the Town of Orwell" covering the time period of January 1, 2010 through September 30, 2011.

After reviewing this audit report, the Orwell Town Board agrees with the majority of the findings contained within the report with the following exceptions:

- Fund balances were not increased starting in 2005. Those fund balances were accumulated during the time period of 1999 through 2004 to cover anticipated legal expenses for a protracted period of negotiations and pending legal suit disputing the property assessments for the hydro-power plants. Once a settlement was made in the form of a PILOT Agreement, these fund balances were used to reduce property taxes starting in 2006.
- Expenditures were over budgeted for 2010 and 2011 as a direct result of New York State and Local Retirement System over projecting our liability primarily for the year 2011. For 2010 the projection provided was \$35,416, budgeted was \$42,000, and actual billing equaled \$36,438.96. This resulted in an amount of \$5,561.04 being over budgeted for 2010. For 2011 the projection provided was \$53,637, budgeted amount was \$53,650, and the actual billing equaled \$25,644.64 resulting in \$27,992.36 being over budgeted for 2011. Again, budgeting was based on liability projections as provided by New York State and Local Retirement System.

See
Note 1
Page 13

See
Note 2
Page 13

Based on the recommendations of this audit report, we are currently evaluating our policies and procedures to more effectively oversee Financial Management for the Town of Orwell. Once our Corrective Action Plan is completed, we will submit the plan to your office for review.

We thank you and your staff for the assistance and cooperation provided during this audit process.

Sincerely,



Marilyn J. Roser
Supervisor, Town of Orwell

MJR/wgp

APPENDIX B

OSC COMMENTS ON THE TOWN'S RESPONSE

Note 1

We adjusted the report to reflect the appropriate time period for the fund balance increase.

Note 2

The audit report only addressed budget variances in 2009 and 2010 because the Town had not yet completed the 2011 fiscal year at the time of our audit fieldwork. The Supervisor acknowledged that the projection provided by the New York State and Local Retirement System (NYSLRS) was consistent with the amount billed in 2010, but the Town budgeted an additional 19 percent for this expenditure. Further, in 2010, the Town had two retirements that ultimately affected the NYSLRS projection for 2011. Thus, the NYSLRS projection for 2011 was higher than actual billings because it was based on more employees than were actually working at the Town. Any surplus resulting from the 2011 variance should have been factored in when determining the amount of fund balance available to finance the 2012 budget.

APPENDIX C

AUDIT METHODOLOGY AND STANDARDS

During the initial assessment, we interviewed Town officials, performed limited tests of transactions, and reviewed pertinent documents such as Town policies, Board minutes, and financial records and reports. After reviewing the information gathered during our initial assessment, we decided upon the reported objective and scope by selecting for audit the area most at risk. We selected financial management for further testing.

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

- We reviewed Board minutes and documentation, and made inquiries of Town officials.
- We reviewed the Town's financial records and reports, including analysis of the fund balance.
- We inquired about the budget process and determination of the amount of appropriated fund balance.
- We reviewed budget versus actual statements and compared them to the approved budget to confirm the accuracy of the budget to actual reports.
- We compared budget estimates to actual revenues and expenditures to determine if the revenue and expenditure estimates were reasonable.
- We analyzed changes in fund balance by calculating ending fund balance as a percent of the following year's budget.
- We calculated the operating deficit and/or surplus and determined the cause of the deficit or surplus.
- We compared fund balance changes for 2008-2011 to real property taxes raised over the same time period.

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.

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Steven J. Hancox, Deputy Comptroller
Nathalie N. Carey, Assistant Comptroller

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