



Town of Hamlin

Financial Oversight and Information Technology

Report of Examination

Period Covered:

January 1, 2010 — August 9, 2012

2012M-197



Thomas P. DiNapoli

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State of New York Office of the State Comptroller

Division of Local Government and School Accountability

March 2013

Dear Supervisor Breslawski and Members of the Town Board:

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 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 Hamlin, entitled Financial Oversight and Information Technology. 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 Hamlin (Town) is located in Monroe County and had a population of 9,045 as of the 2010 U.S. Census. The Town provides various services to its residents, including street maintenance, snow removal, sewer, lighting, and general government support. Budget appropriations for 2012 were approximately \$3.8 million, funded primarily by real property taxes, sales tax, planned use of fund balance, and State aid.

The Town is governed by the Town Board (Board), which comprises four elected members and an elected Town Supervisor (Supervisor).¹ While Town Law gives the Board responsibility for the general management and control of Town finances, the Supervisor is the Town's chief executive officer and chief financial officer, and has overall responsibility for the Town's accounting records. The Town's bookkeeper maintains the accounting records and uses a computer to process and store financial and non-financial data. Although the Board primarily is responsible for the effectiveness and proper functioning of internal controls, the Supervisor and department heads share this responsibility. The Board is responsible for reviewing and approving payment for claims against the Town.

We performed an initial on-site risk assessment of the Town's internal controls and financial operations in June 2011 and identified significant deficiencies. Due to the identified deficiencies in the Board's and Supervisor's oversight over financial management and recordkeeping, we returned to the Town in November 2011 to perform an audit.

Scope and Objective

The objective of our audit was to determine if the Board and Supervisor provided adequate oversight over Town financial operations, accounting functions and information technology to properly account for and safeguard Town assets for the period January 1, 2010 through August 9, 2012. Our audit addressed the following related questions:

- Has the Board provided adequate oversight over the Town's financial operations?
- Did the Supervisor maintain adequate, timely, and accurate accounting records and reports?
- Are controls over information technology (IT) adequately designed to ensure the Town's IT assets and computerized data are safeguarded?

¹ Board members are elected for rotating four-year terms, and the Supervisor is elected to a two-year term; thus, the Board's membership changes periodically, resulting in different individuals who share the Board's ongoing oversight responsibilities during different periods of time.

Audit Results

The Board did not provide necessary guidance to the Supervisor and employees, and did not establish internal controls that ensured the Town's financial activity was accurately recorded and reported. The Board did not ensure that the Supervisor assigned accounting duties to properly trained personnel or that those duties were adequately segregated and performed. As a result, significant accounting deficiencies occurred and the Board did not have reliable information on which to base management decisions. In addition, the Board did not annually audit the records and reports of the Supervisor, or other departments which received or disbursed moneys on the Town's behalf, as required. Further, the Board did not audit all claims before they were paid, and had not established adequate controls over credit card use, which increased the risk that Town moneys could have been spent for inappropriate purposes.

The Supervisor has traditionally designated a bookkeeper to assist with the accounting and recordkeeping functions. The same individual has worked as bookkeeper under the last four Supervisors, including the current Supervisor who took office on January 1, 2012.² The Town's accounting records and resultant financial reports were in considerable disarray. For example, the Town failed to accurately report the cash position of any Town fund in its annual report to the Office of the State Comptroller. Further, the Supervisor did not review the bank reconciliations prepared by the bookkeeper for completeness and accuracy.

Due to errors and unclear explanations, we were unable to determine with any certainty the amount by which the Town's accounts were over or under reported, individually or in total. These deficiencies occurred because the Supervisor did not adequately segregate accounting duties, and did not provide adequate oversight to ensure the bookkeeper maintained accurate accounting records and reports on his behalf. Without accurate accounting records, Town officials do not have reliable information on which to base their financial decisions.

The Town should institute appropriate policies and procedures to protect its computerized data resources from internal and external threats. The Board has not established policies and procedures related to acceptable use, breach notification, or disaster recovery. Therefore, IT assets are at risk for unauthorized, inappropriate, and wasteful use.

Comments of Local Officials

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 findings and indicated they plan to initiate corrective action.

² Former Supervisors were in office for the following terms: January 1, 2010 – December 31, 2011, January 1, 2006 – December 31, 2009, and January 1, 2000 – December 31, 2005.

Introduction

Background

The Town of Hamlin (Town) is located in Monroe County and had a population of 9,045 as of the 2010 U.S. Census. The Town provides various services to its residents, including street maintenance, snow removal, sewer, lighting, and general government support. Budget appropriations for 2012 were approximately \$3.8 million, funded primarily by real property taxes, sales tax, planned use of fund balance, and State aid.

The Town is governed by the Town Board (Board), which comprises four elected members and an elected Town Supervisor (Supervisor).³ While Town Law gives the Board responsibility for the general management and control of Town finances, the Supervisor is the Town's chief executive officer and chief financial officer, and has overall responsibility for the Town's accounting records. The Town's bookkeeper maintains the accounting records and uses a computer to process and store financial and non-financial data. Although the Board primarily is responsible for the effectiveness and proper functioning of internal controls, the Supervisor and department heads share this responsibility. The Board is responsible for reviewing and approving payment for claims against the Town.

We performed an initial on-site risk assessment of the Town's internal controls and financial operations in June 2011 and identified significant deficiencies. Due to the identified deficiencies in the Board's and Supervisor's oversight over financial management and recordkeeping, we returned to the Town in November 2011 to perform an audit.

Objective

The objective of our audit was to determine if the Board and Supervisor provided adequate oversight over Town financial operations, accounting functions and information technology to properly account for and safeguard Town assets. Our audit addressed the following related questions:

- Has the Board provided adequate oversight over the Town's financial operations?
- Did the Supervisor maintain adequate, timely, and accurate accounting records and reports?

³ Board members are elected for rotating four-year terms, and the Supervisor is elected to a two-year term; thus, the Board's membership changes periodically, resulting in different individuals who share the Board's ongoing oversight responsibilities during different periods of time.

- Are controls over information technology (IT) adequately designed to ensure the Town's IT assets and computerized data are safeguarded?

**Scope and
Methodology**

We examined the Town's oversight of financial operations and internal controls over accounting records and information technology for the period January 1, 2010 to August 9, 2012.

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 findings 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 Town Board to make this plan available for public review in the Town Clerk's office.

Board Oversight of Financial Operations

The Board is responsible for the oversight of the Town's financial operations. It is essential that Board members understand the extent of oversight required to meet their responsibilities to Town taxpayers. This requires the Board to establish internal controls that enable Town officials to monitor financial activity and obtain information for making management decisions, preparing realistic budgets, filing required reports, and maintaining a healthy and stable financial position for the Town. In addition, the Board is required to audit the records and reports of the Supervisor, and other departments that receive or disburse Town moneys, on an annual basis to ensure that all Town moneys have been adequately accounted for. The Board also must audit and approve all claims before they are paid to ensure that claims are for appropriate Town purposes.

The Board did not provide the necessary guidance to the Supervisor and employees, and did not establish internal controls that ensured the Town's financial activity was accurately recorded and reported. The Board did not ensure that the Supervisor assigned accounting duties to properly trained personnel or that those duties were adequately segregated and performed. As a result, significant accounting deficiencies occurred and the Board did not have reliable information on which to base management decisions. In addition, the Board did not annually audit the records and reports of the Supervisor, or other departments which received or disbursed moneys on the Town's behalf, as required. Further, the Board did not audit all claims before they were paid, and had not established adequate controls over credit card use, which increased the risk that Town moneys could have been spent for inappropriate purposes.

Oversight of Accounting and Financial Reporting

At a minimum, Board members must provide sufficient oversight to ensure that the Town's financial records are complete and up-to-date, transactions are recorded properly, accurate bank reconciliations are prepared monthly, and required reports are completed and filed on a timely basis. It is essential that the Board adopt comprehensive policies and require the Supervisor to implement procedures to govern accounting and recordkeeping functions. These policies and procedures must adequately segregate duties, ensure staff are qualified and properly trained, and ensure the Town's financial activity is accurately recorded and reported on a timely basis. Written policies and procedures help to ensure that transactions are processed consistently and accurately, provide guidance for employees to understand the Town's objectives and each individual's role in the process, and can reduce the turmoil and training time needed during periods of staff turnover.

The Board has not adopted comprehensive policies, or required the Supervisor to implement detailed procedures, for many vital accounting, recordkeeping and financial reporting functions. For example, the Board did not address the lack of segregation of duties which resulted when the Supervisor assigned⁴ virtually all accounting duties to the bookkeeper, and did not ensure that the Supervisor or another person performed independent reviews of pertinent records such as bank reconciliations, journal entries, or bank transfers.

Although the Board received monthly budget to actual reports, it had not requested or received monthly trial balances, balance sheets, or reports on cash balances for each fund. In fact, when we requested the balance sheets for our audit, the bookkeeper said she was not sure how to generate them and that she has never used the balance sheet or other reports of asset and liability accounts, such as a trial balance. Without adequate and accurate supplemental financial reports, the Board lacked the information it needed to adequately monitor and manage the Town's fiscal condition.

Had Board members been receiving and reviewing balance sheets or trial balances from the financial system, they would have been in a position to identify significant errors in the accounting records, question why the records did not agree with the annual financial report, and address them with the Supervisor and bookkeeper to ensure timely correction. For example, the general fund⁵ balance sheet printed from the financial accounting system, for the year ended December 31, 2011, included an asset account — due from other funds — with a negative balance of \$909,665. An asset account with a negative balance would be highly unusual and should prompt immediate investigation by management.

The Town's current accounting records and available accounting reports are not adequate to assess the Town's present financial operations. The Board's failure to require that the Supervisor provide it with accurate and up-to-date financial information is a significant lack of oversight and could result in the deterioration of the Town's financial condition, or the failure to detect significant errors or irregularities.

The Board's failure to provide the necessary oversight contributed to the significant problems we found with the Town's financial records, as described in the finding entitled "Supervisor's Accounting Records and Reports."

⁴ Current Supervisor and several former Supervisors

⁵ The same errors also existed in the general ledgers and fund balances of the Town's other funds, but were not included in the annual financial report.

Annual Audit

Town Law⁶ provides that all Town officers and employees who receive or disburse moneys during the year must account for such transactions and present their books and records to the Board by January 20 of the following year. The Board must then audit these records or engage an independent public accountant to do so. Town officials should prepare and implement corrective action plans to address any weaknesses identified during the Board's audit, as well as all findings and recommendations identified by any other audits conducted of the Town.

We found no evidence in the minutes or elsewhere that the Board audited, or caused to be audited, the books and records of the Supervisor or other departments during our audit period (for the 2010 or 2011 fiscal years). However, the Town inaccurately stated on its 2010 and 2011 annual financial reports to OSC that its accounting records and financial reports had been independently audited.

We did find that the Town had hired an independent accounting firm to conduct internal control reviews; however, the last review conducted was for the 2008 fiscal year, and was for only the Town Clerk's office and Recreation Department. Town officials had not prepared corrective action plans to address weaknesses identified as a part of this review. The Supervisor's office's most recent internal control review was conducted for the 2002 fiscal year. This review contained multiple findings that were very similar to findings we addressed during our audit,⁷ which indicates that the Board has not taken corrective action to address significant internal control and accounting deficiencies communicated to it at least 10 years ago. We also found that a former Board member, who was a certified public accountant, had performed an annual audit, on the Board's behalf, of the Justice Court for the 2010 fiscal year.

The Board's failure to ensure that annual audits are performed diminishes its oversight of Town operations and could allow any errors and/or irregularities which may have occurred to remain undetected and uncorrected. In addition, the failure to take adequate and timely corrective action to address all audit report findings further demonstrates the Board's lack of commitment to sound management of financial operations and resources in the best interests of its taxpayers.

⁶ Town Law Section 123

⁷ The internal audit for the 2002 fiscal year included weaknesses in segregation of duties, accounting records and procedures, bank account reconciliations, and audit and review of claims.

Claims Audit

With few exceptions, Town Law requires the Board to audit and approve all claims before the Supervisor can disburse payment.⁸ The Board's approval must be accurately recorded in the Board's minutes. The audit of claims should be a deliberate and thorough process to determine whether proposed payments are proper, and whether the Town's purchasing procedures and applicable laws have been followed. All claims must be for valid Town expenditures, be written, itemized and accurate, include evidence of approval of the Town official responsible for the purchase, and include evidence that the goods or services have been received.

Audit Process — The Board did not conduct a deliberate and thorough audit of claims during the majority of our audit period. Prior to the new Supervisor taking office in January 2012, Board members generally only reviewed the abstract of claims and rarely reviewed the individual claims and supporting documentation before approving them for payment. In January 2012, when we discussed our claims audit concerns with the new Supervisor, he told us that he planned to implement corrective action immediately.

We judgmentally selected 20 claims paid in November 2011 (before the Board audited claims) totaling \$26,593 and 22 claims totaling \$37,455 paid in February 2012, after the Board began auditing claims. None of the November claims contained evidence of detailed Board audit. However, we found that the Board members had reviewed and initialed all of the February claims that we tested, prior to approving them for payment. Nonetheless, we found that three of the 22 February claims, which totaled \$3,824, did not have an adequate receipt or invoice to support the purchase. For example, the Board approved a \$2,110 claim for online dog licensing software and maintenance that was not supported by a vendor invoice. On our inquiry, Town officials obtained a faxed copy of the invoice to support the purchase; however, the Board should have required adequate support before approving the claim for payment. Furthermore, the claims generally did not include sufficient documentation of competitive quotes obtained to comply with the Town's procurement policy.

While the Board has made progress with auditing claims, the payment of claims without adequate supporting documentation increases the risk that the Town could pay for goods and services that are not Town-related.

Credit Card Purchases — An effective system of internal controls over credit card purchases requires the Board to implement and

⁸ The Board may, by resolution, authorize the payment in advance of its audit of claims for public utility services, postage, freight and express charges. All such claims should be presented at the next regular meeting for audit.

monitor a sound credit card policy that establishes the parameters for using the credit card and procedures for monitoring credit card usage.

During our initial risk assessment, the Board had not adopted a policy for credit card use, and did not audit or review any detail supporting credit card purchases. Credit card purchases were paid automatically through an electronic bank withdrawal directly from Town bank accounts. Based on our risk assessment discussions, the Board adopted a credit card policy in September 2011, which set forth the number and dollar limits of cards authorized for each department. However, Town officials did not make any improvements in ensuring that credit card purchases were approved before they were made, and that credit card statements and supporting receipts were audited and approved by the Board prior to the scheduled electronic payment.

During our audit, we found extensive and unmonitored use of bank credit cards. Eight bank credit cards were linked to the general fund checking account and two cards were linked to the highway fund checking account. Credit card purchases were not recorded on abstracts or reviewed by the Board prior to monthly automatic payments being deducted from the Town's accounts.

We discussed our concerns with the new Supervisor in February 2012, and he required the immediate return of all credit cards, except for those used by the Town Clerk and Highway Department. The Board approved an amended credit card policy which reflected this change. Although limiting the number of credit cards significantly improves control over credit card use, the Board should make additional control improvements. The Town continued to allow automatic bank withdrawals, was not putting credit card purchases on abstracts, and we found no indication that the charges were being audited or approved by the Board prior to payment. Allowing a bank to disburse Town moneys electronically, without prior Board review and approval of the disbursements, increases the risk that Town moneys could be lost, stolen, or mistakenly diverted to unauthorized individuals.

During 2011, the general and highway funds made credit card purchases totaling \$24,173 and \$4,055, respectively, that were never audited or approved. Due to the increased risk of improper purchases, we reviewed all 2011 credit card purchases made by the four Town departments⁹ with the largest number and dollar amount of credit card purchases. We identified only minor deficiencies which we discussed with Town officials. Although most purchases had adequate documentation, inadequate policies and procedures and the lack of audit and approval of credit card purchases increase the risk that errors and irregularities could occur and not be detected in a timely manner.

⁹ Recreation, Town Clerk, Highway and Building Inspector

Recommendations

1. The Board should adopt and implement comprehensive policies and ensure Town officials develop procedures to adequately segregate financial accounting and reporting duties.
2. The Board should monitor the Town's financial activity to ensure it is accurately recorded and reported on a timely basis.
3. The Board should insist that it receives the necessary financial reports from the Supervisor each month and use these reports as a tool to effectively manage the Town's financial operations.
4. The Board should properly conduct an annual audit of the records and reports of the Town Supervisor, and all other departments which receive and disburse cash (Town Clerk, Justices, and Recreation Department). The Board should maintain documentation of the outcome of the audit and corrective action taken.
5. The Board should continue to thoroughly audit and approve claims prior to payment, including all credit card purchases, to ensure they are adequately itemized, supported, approved, and in compliance with applicable Town policies.
6. The Board should amend its credit card policy to further restrict authorized use to specific and necessary purchases such as travel expenses or other purchases that cannot be made using the Town's voucher system.
7. The Board should not permit automatic bank deductions to pay credit card bills.
8. The Board should ensure that all credit card purchases are recorded on abstracts and document its review and approval of credit card purchases.

Supervisor's Accounting Records and Reports

The Supervisor, as the Town's chief fiscal officer, is responsible for the basic accounting functions, maintaining adequate records, and providing other Board members with the timely and accurate financial information they need to effectively manage Town operations. If the Supervisor assigns these duties to an assistant, the Supervisor should provide sufficient oversight to ensure that the assistant maintains suitable records and documents financial information accurately.¹⁰ It is the Supervisor's responsibility to provide the Board with reliable monthly¹¹ and annual financial reports. Accurate reports allow the Board to routinely monitor the Town's financial activity, control its expenditures and safeguard Town assets.

The Supervisor has traditionally designated a bookkeeper to assist with the accounting and recordkeeping functions. The same individual¹² has worked as bookkeeper under the last four Supervisors, including the current Supervisor who took office on January 1, 2012.¹³

The Town's accounting records and resultant financial reports were in considerable disarray. For example, the Town failed to accurately report the cash position of any Town fund in its annual report to the Office of the State Comptroller (OSC). Further, the Supervisor did not review the bank reconciliations prepared by the bookkeeper for completeness and accuracy. Due to the multitude of errors and unclear explanations in the accounting records, we were unable to determine with any certainty the amount by which the Town's accounts were over or under reported, individually or in total. These deficiencies occurred because the Supervisor did not adequately segregate accounting duties, and did not provide adequate oversight to ensure the bookkeeper maintained accurate accounting records and reports on his behalf. As a result, the Town has an increased risk of exposure to the possibility of fraud, abuse, and professional misconduct. Further, because the records were in such disarray, the Supervisor

¹⁰ This oversight can be provided personally or by having someone not involved in the receipt or disbursement of cash assets reconcile bank accounts, make comparisons with the accounting records and review journal entries.

¹¹ Town Law requires the Supervisor to submit a report to the Board at the end of each month of all moneys received and disbursed during the month. The reports should include detailed monthly and year-to-date budget and actual comparisons, and balance sheet accounts, including reconciled cash balances for each fund.

¹² The bookkeeper retired effective December 31, 2012, after the end of our fieldwork.

¹³ Former Supervisors were in office for the following terms: January 1, 2010 – December 31, 2011, January 1, 2006 – December 31, 2009, and January 1, 2000 – December 31, 2005.

was unable to provide the Board reasonable assurance that errors or irregularities had not occurred, or with accurate information needed to make informed financial decisions and adequately monitor the Town's fiscal health.

Accounting Records and Financial Reports

Adequate financial records include cash receipts and disbursement journals, revenue and expenditure classification ledgers, general ledgers, and investment records. The Supervisor must ensure that these records are maintained accurately and timely to generate, and provide the Board with, reliable monthly and annual financial reports. General Municipal Law (GML) requires the Supervisor to file an annual financial report, referred to as the annual update document (AUD), with OSC within 90 days after the close of the fiscal year. The AUD is a representation of the Town's financial position and results of operation. The usefulness of the AUD depends on its timeliness and accuracy.

We reviewed the Town's 2011 accounting records and AUD to assess their completeness and accuracy, and identified numerous significant deficiencies. Due to the multitude of errors and unclear explanations, we were unable to determine with any certainty the amount by which the Town's accounts were over or under reported, individually or in total. For example, multiple adjustments were made to the accounting records months after the original entries occurred. We found that reports printed months later, for the same time period, now showed entries that were not included on the original reports, and in many cases, the beginning balance no longer agreed with earlier printouts.

For example, a May 2011 general ledger report for the general fund cash account that was printed on June 30, 2011 showed a beginning balance of \$12,981. That same ledger report printed on January 19, 2012, and again on March 26, 2012, showed the beginning balance to be \$5,497 and \$6,049, respectively. The descriptions listed for changes made to the accounting records through journal entries were often insufficient. Journal entries included descriptions such as "correct wrong posting" or, in some cases, no explanation was given at all, and the records just showed an entry reversed. As a result, in multiple cases, the bookkeeper could not remember and explain to us why certain entries were made, even after attempting to research them. Because the bookkeeper did not maintain adequate accounting records, we found that account balances were significantly misstated. Specific examples are below.

- The bookkeeper incorrectly reported nearly every cash account on the Town's AUD. In some instances, cash accounts were not reported at all; in other cases, improper reconciliations or accounting resulted in incorrectly reported amounts. For

example, the general fund cash in time deposits account was reported at \$750,593 on the AUD, but only \$605,638 on the balance sheet printed from the accounting records. The bookkeeper could not explain the differences.

- The accounting records and AUD did not accurately reflect \$210,000 in bond proceeds or the related expenditures for a water district's capital costs. The bookkeeper recorded and paid for project costs from the general fund instead of the capital projects fund, as required. The bookkeeper credited the bond proceeds to the general fund to reimburse it for its cash outlay but did not record bond proceeds as revenue in any fund. As a result, the general fund expenditures were overstated in the accounting records (but not reported on the annual report). Further, the capital project fund revenues and expenditures, and general fund balance, were understated by \$210,000 in the accounting records and on the AUD. The bookkeeper believed her treatment resulted in a "wash" and a repayment of the liability, and that no other entries were required.
- The Town reported reserved cash for capital reserves, totaling \$520,462, in the general, highway, sewer and capital projects funds, but did not report corresponding reserve accounts in the fund equity section of the AUD for the general and highway funds. Additionally, the bookkeeper did not maintain general ledger accounts in the accounting records for any of the reserves, and could not provide support for the reported amounts. We also found that the amount reported as cash, special reserves, in the general fund included a reserve amount of \$26,477 that was reported a second time in the capital projects fund, which resulted in one of the lines being overstated.
- Although total interfund receivables should equal interfund payables, the accounting records, as of December 31, 2011, showed total receivables as a negative \$867,000 while payables totaled \$161,000. Out of eight general ledger accounts, only two had the type of balance appropriate for the account¹⁴ and none were reported on the AUD. Furthermore, the general and sewer fund balance sheets included accounts payable (liabilities) totaling \$63,719 and \$51,519, respectively, which were not included on the AUD.

¹⁴ Interfund receivables are asset accounts and should normally have a debit or "positive" balance, while interfund payables are liabilities and should have credit or "negative" balances.

The Town Supervisor also is responsible for submitting a separate annual report to OSC for the Hamlin-Kendall joint water district. The Town leased this joint water district to the County in 2006, but the Town still maintains funds and levies taxes to make annual debt service payments on the district's outstanding obligations. However, the Town does not hold the moneys belonging to this separately-reported entity in a separate bank account; instead, the Town comingles these funds with all other moneys in its money market account. The bookkeeper identified three of the sub-accounts on the money market reconciliation that are attributed to the joint water district totaling \$344,028. However, on the separate annual report for the joint water district, the Supervisor reported cash totaling \$336,674, a difference of \$7,354.

These discrepancies occurred and were not detected because the Supervisor did not adequately segregate accounting duties or implement compensating controls – such as reviewing or approving the bookkeeper's journal entries or bank transfers – to ensure records were up to date and moneys were properly accounted for. The bookkeeper handled nearly all aspects of the cash receipts, cash disbursements, and recordkeeping processes, and prepared bank account reconciliations, with little oversight or review of her work by the Supervisor. With these duties, and limited oversight, an individual could misappropriate cash, and conceal any shortage when preparing the bank reconciliation.

Further, the bookkeeper did not have proper training, particularly when a new computer system was introduced, and did not understand certain functions or the end result of certain transactions. Her lack of training and understanding were exacerbated by the fact that the Board and Supervisor had neither established detailed accounting procedures to help guide the bookkeeper, nor monitored her work. Significant problems with accounting records make reports to the Board inaccurate and insufficient upon which to base the Town's financial decisions. Consequently, Town officials have been relying on incomplete and inaccurate records and reports, and are not in a position to assess or monitor the true financial position of any of the Town's funds.

Bank Reconciliations

The reconciliation of bank account balances to general ledger cash balances is an essential control activity which verifies that all cash receipt and disbursement transactions are captured and correctly recorded. This process provides for the timely identification, correction, and documentation of differences between Town records and bank cash balances. Accurate and complete bank reconciliations should be performed and reviewed by an individual independent of the cash custody function to ensure that the accounting records are correct and that moneys are being accounted for properly.

The Supervisor did not prepare the bank reconciliations, or ensure that they were performed by an individual independent of the cash custody and recordkeeping functions. He also did not review the bank reconciliations prepared by the bookkeeper for completeness and accuracy as a compensating control. The lack of independent preparation or review of bank reconciliations increases the risk that improper payments could be initiated or cash could be diverted from deposits, and such transactions concealed.

The bookkeeper claimed that she properly reconciled the Town's bank accounts on a monthly basis. However, because the bookkeeper did not maintain accurate accounting records, these records could not be relied upon for reconciling to the bank records. We reviewed the bank account reconciliations prepared by the bookkeeper for the highway fund and payroll checking accounts, and the combined checking account used for the general, lighting, sewer, and Huntington Park funds.¹⁵ None of the bank accounts we reviewed were properly reconciled. We found multiple instances of improperly recorded outstanding and voided checks and journal entries, as well as transposition and calculation errors. In fact, prior to April 2011, the bookkeeper had only been including the general fund ledger balance in her reconciliation of the combined checking account – she did not include ledger balances for the sewer, lighting and park funds – yet still showed the statements to be reconciled. Although we explained proper reconciliation procedures and returned the reconciliations to the bookkeeper to recalculate, she could not successfully complete the process.

Because the records were in such disarray, we were concerned that fraud was occurring without Town officials' detection. To alleviate fraud concerns, we did a detailed analysis and found that the major reason the highway records did not reconcile was the incorrect recording of multiple credit card payments made on behalf of other funds. The bookkeeper told us she did not know how to properly record the interfund receivables and payables to account for these purchases; she instead only made adjustment notations on the bank statement reconciliations. These adjustment notations increased each month because the bookkeeper did not make the necessary reimbursements between funds. In addition, we found calculation errors and instances where she incorrectly noted which fund owed or was due payment. After identifying numerous errors, we were eventually able to assist the bookkeeper in reconciling the highway bank statements to the accounting records.

¹⁵ See Appendix B, Audit Methodology and Standards, for details on bank reconciliation testing.

Due to numerous errors in the accounting records and bank reconciliations, and unexplained changes to general ledger balances, we were unable to reconcile the combined bank account, and unable to rule out the possibility of fraud or significant errors in financial reporting. To address these significant risks, we conducted additional testing¹⁶ of individual receipts and canceled checks to ensure that receipts were properly deposited and accounted for, and disbursements were for legitimate purposes and in agreement with supporting claims, documentation and accounting records. While our testing did not identify fraudulent activity, the failure to monitor and ensure the proper maintenance of accounting records and independent reconciliation of cash balances resulted in inaccurate accounting records and reports and a lack of reasonable assurance that Town funds were properly accounted for.

Recommendations

9. The Supervisor should develop detailed accounting procedures and duty descriptions to provide clear guidance to finance department staff, and adequately segregate accounting duties to the extent possible.
10. The Supervisor should ensure that the individual he designates as bookkeeper has the skills and training to perform the requirements of the position.
11. The Supervisor should ensure independent reviews of pertinent records to mitigate instances where duties cannot be properly segregated.
12. The Supervisor should ensure that he and his staff maintain timely and accurate accounting records and reports and provide detailed, accurate information to the Board on a monthly basis.
13. The Supervisor should ensure that timely and accurate bank reconciliations are independently prepared and reviewed, and made available to the Board for review, to ensure that all discrepancies are investigated and corrected immediately.
14. The Board and Supervisor should consider acquiring the expertise necessary to resolve the accounting errors, establish the Town's financial condition, and institute proper controls and procedures to ensure records are properly maintained going forward.

¹⁶ See Appendix B, Audit Methodology and Standards, for details on our additional testing.

Information Technology

The Town relies on its information technology (IT) system to perform a variety of tasks, including word processing, email communication, internet access, banking, bookkeeping, payroll, and reporting to State and Federal agencies. Additionally, large amounts of information and data related to finances, taxes, payroll and personnel are stored on the IT system. The Town's use of IT presents a number of risks, such as unauthorized access, which can increase the risk that computerized equipment could be damaged or manipulated, or that data could be altered, misused, lost or corrupted without being detected. Even small disruptions in the IT system can require extensive time and effort to evaluate and repair. Town officials are responsible for designing and implementing a comprehensive system of internal controls over IT — including detailed policies and procedures — to protect these assets from unauthorized, inappropriate, and wasteful use.

The Town needs to institute appropriate policies and procedures to protect its computerized data resources from internal and external threats. The Board has not established adequate policies and procedures related to acceptable use, breach notification, or disaster recovery. Therefore, IT assets are at risk for unauthorized, inappropriate, and wasteful use.

Policies and Procedures

Good internal controls over IT assets and computerized data include adequate IT policies and procedures that inform users about proper use of Town computers, and require consistent monitoring of computer usage to ensure compliance. An acceptable use policy defines the Board's goals for the use of equipment and computing systems, and the security measures to protect the Town's resources and confidential information. The policy must address the acceptable use of email accounts, internet access, and the installation of software on Town computers, as well as guidance for required data backups, consistent virus protection, effective use of passwords and disposals of hardware and software. It is important that the policy include provisions for enforcement, and that system users provide written acknowledgement that they are aware of, and will abide by, the policy.

The Town has vague policies in place related to acceptable use of voice mail, email, computer files and the internet. However, system users are not required to provide a written acknowledgement that they are aware of and will abide by the policies, and Town officials do not monitor computer use to determine whether staff is properly using the Town's computer resources. In addition, the Town does not have policies that address other essential security measures such as

the backup of data, consistent installation of virus software, effective use of passwords, and disposals of hardware and software. As a result, there is an increased risk that the IT system could be used for inappropriate or non-Town-related purposes.

While comprehensive computer use policies do not guarantee the safety of the Town's electronic information, the lack of such policies significantly increases the risk that hardware and software systems and the data they contain may be lost or damaged by inappropriate use. This leaves the Town vulnerable to risks associated with personal use, including computer viruses and spyware that could potentially be introduced by accessing non-work-related websites or downloading unauthorized programs.

Breach Notification

An individual's private and/or financial information, along with confidential business information, could be severely impacted if security is breached or data is improperly disclosed. New York State Technology Law requires cities, counties, towns, villages and other local agencies to establish an information breach notification policy. The policy should detail how the Town would notify individuals whose private information was, or is reasonably believed to have been, acquired by a person without a valid authorization. The disclosure should be made in the most expedient time possible and without unreasonable delay, consistent with the legitimate needs of law enforcement or any measures necessary to determine the scope of the breach and restore the reasonable integrity of the data system.

The Board has not adopted a breach notification policy. By failing to adopt an information breach notification policy, in the event that private information is compromised, Town officials and employees may not understand or be prepared to fulfill their legal obligation to notify affected individuals quickly.

Disaster Recovery

A disaster recovery plan is intended to identify and describe how Town officials plan to deal with potential disasters. Such disasters may include any sudden, unplanned catastrophic event (e.g., fire, computer virus, or inadvertent employee action) that compromises the availability or integrity of the IT system and data. Contingency planning is used to avert or minimize the damage that disasters would cause to operations. Such planning consists of the precautions to be taken to minimize the effects of a disaster so officials and responsible staff will be able to maintain or quickly resume day-to-day operations. Typically, disaster recovery planning involves an analysis of business processes and continuity needs and should include significant focus on disaster prevention. The plan should also address the roles of key individuals, be distributed to all responsible parties, periodically tested, and updated as needed.

The Board has not developed a disaster recovery plan to address potential disasters. Consequently, in the event of a disaster, Town personnel have no guidelines or plan to follow to help minimize or prevent the loss of equipment and data or to appropriately recover data. Further, without a disaster recovery plan, the Town could lose important financial data and suffer a serious interruption in Town operations.

Recommendations

15. The Board should adopt adequate IT policies and procedures including acceptable use of email accounts, internet access, and the installation of software on Town computers, as well as guidance for required data backups, consistent virus protection, effective use of passwords, and equipment disposal.
16. The Board should adopt an information breach notification policy.
17. The Board should develop and adopt a formal disaster recovery plan that documents steps to be taken in the event of an emergency.

APPENDIX A
RESPONSE FROM LOCAL OFFICIALS

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



TOWN OF HAMLIN

Supervisor's Office

1658 Lake Road • P.O. Box 148 • Hamlin, New York 14464-0148 • Phone (585) 964-8981

February 26, 2013

The Hamlin Town Board ("The Board") agrees with the findings of the State Comptroller during this audit. The Board thanks the Comptroller's Office for their guidance and recommendations to strengthen our policies. During the audit process, the Board became aware of several issues which were quickly corrected and were awaiting the Comptroller's Audit recommendations prior to moving forward with specific corrections to more complicated issues.

After receiving the draft report, four members of the Board met separately with OSC representatives on February 11, 2013 and later that day the Board authorized an RFP (Request for Proposal) to conduct an annual audit of the Justice Court, Town Clerk and Town Supervisor's records. The Board's first step will be to resolve accounting errors establish the Town's financial condition and institute proper controls and procedures to ensure records are properly maintained going forward.

In addition, the Board has continued to thoroughly audit and approve claims prior to payment, per recommendation number five of the OSC report. Policies covering internet and computer use were approved on 8-13-12. The Board plans to review this policy and update if necessary to ensure that it meets all the criteria required by the OSC. A formal disaster recovery plan will also be adopted.

The Bookkeeper employed during the audit engagement retired 12-31-12. The new Bookkeeper has received training on the [REDACTED] program from [REDACTED] representatives. A networking system with peers in other municipalities has been established to assist with day to day questions and exchanges of information. The new Bookkeeper is enrolled in the OSC training scheduled in April 2013 in Arcade, New York. Additional training will be sought as it becomes available.

The new administration takes the results of the audit and recommendations of the OSC seriously and will present a Corrective Action Plan designed to remedy all problems



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identified and satisfy each recommendation made in the report. The Board plans to work with accounting professionals, the OSC and members of Town staff to put in place the policies and procedures required. The Town Board has set a goal of 12-31-13 to complete these corrections.

Once again, the Town Board thanks the OSC audit team for their recommendations and assistance in strengthening the policies and procedures used to safeguard Hamlin taxpayer funds.

Sincerely,

Thomas N. Breslawski
Hamlin 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. 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 appropriate 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 determined where weaknesses existed, and evaluated those weaknesses for the risk of potential fraud, theft and/or professional misconduct. We then decided upon the reported objectives and scope by selecting for audit the areas most at risk. We selected Board oversight, Supervisor's records and reports, and information technology for further testing. To achieve our audit objectives and obtain valid audit evidence, we performed the following audit procedures:

- We interviewed appropriate Town officials and reviewed pertinent documents, such as Town policies, Board minutes, and financial records and reports.
- We evaluated the Town's existing internal controls, including segregation of duties over cash receipts and disbursements and payroll, to determine their overall existence and effectiveness.
- We randomly selected 20 claims (using a random number generator) in each of two judgmentally selected months before and after the Town Board improved its claims audit procedures. We reviewed the selected claims for proper supporting documentation, appropriateness and compliance with the Town's procurement policy.
- We reviewed 2011 credit card purchases and statements by various departments, as well as the auto-payment process for credit cards. We judgmentally selected the departments according to the highest numbers and percentages of purchases, as follows: Recreation: 95 purchases comprising 36 percent of total credit card purchases; Town Clerk: 40 purchases comprising 25 percent of total credit card purchases; Highway: 27 purchases comprising 14 percent of total credit card purchases; Building Inspector: 32 purchases comprising 8 percent of total credit card purchases. Although the Building Inspector had a smaller percentage of purchases, it still made a larger number of purchases; therefore, we included these purchases in our sample selection.
- We reviewed the Town's bank reconciliations for Town Clerk, Highway, Payroll, and the combined checking accounts. When issues arose, we expanded our testing of bank reconciliations to determine if fraud was occurring and to offer technical assistance to Town employees. We reviewed all 2011 monthly bank statements and reconciliations for the highway fund (fewer transactions) to verify the sources of the most material errors. We reviewed payroll account reconciliations for October through December 2011, the last three months of the most recent fiscal year. For the combined bank account, we reviewed the April and May 2011 bank reconciliations, as these were the bookkeeper's first attempts to properly include the sewer, lighting and park fund ledger balances in the reconciliation.

- We traced all cash receipts in the bookkeeper's office from October 2011 through December 2011 from cash receipt book to bank deposit.
- We traced disbursements (all claims paid January 2011 through March 2011 for the general, highway, water, sewer, lighting and trust and agency funds) to and from canceled checks, abstracts and minutes. We also traced all highway fund canceled checks from the bank statement to abstracts for May 2011 and all payroll account checks for March 2011 from canceled checks to payroll. We followed up on voucher numbers that were not approved in the minutes.
- We compared the various components of cash deposited to and recorded in the Town's money market account to amounts reported on the Town's annual report to OSC. We also reconciled the Town's comingled money market account to the bank, and traced it to the accounting records.
- We compared account balances from the internal financial statements - which Town officials printed off the accounting system at our request - to the balances included on the annual financial report.
- We reviewed the Town's controls and policies in place over information technology and computer use, and observed the storage locations of the Town's computer data backups.

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 C

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