



# Town of Oyster Bay

## Financial Condition and Selected Financial Operations

Report of Examination

Period Covered:

January 1, 2010 — October 31, 2011

2013M-54



Thomas P. DiNapoli

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# **State of New York**

## **Office of the State Comptroller**

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### **Division of Local Government and School Accountability**

December 2013

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 Oyster Bay, entitled Financial Condition and 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

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## EXECUTIVE SUMMARY

The Town of Oyster Bay (Town) is located in Nassau County, covers an area of about 115 square miles and serves approximately 293,000 residents. The Town is governed by the Town Board (Board) which comprises the Town Supervisor and six Board members. The Board is responsible for the general management and control of the Town's financial affairs. The Town Supervisor, who serves as the chief executive officer, is responsible, along with other administrative staff, for the day-to-day management of the Town.

The Town provides various services to its residents, including community services, culture and recreation, highway, public safety and general government support. The majority of the Town's funding comes from real property taxes, fees and State aid. The cost of Town activities in 2011 and 2012 was approximately \$282 million and \$313 million, respectively.

### **Scope and Objective**

The objective of our audit was to examine internal controls over selected financial operations for the period January 1, 2010 through October 31, 2011. We also reviewed selected budget-related activities, financial condition and contracts prior to January 1, 2010 and throughout 2012, because we considered it relevant to this audit. Our audit addressed the following related questions:

- What is the financial condition of the Town's major operating funds?
- Are internal controls over change orders and contracts appropriately designed and operating effectively?
- Are internal controls over information technology (IT) appropriately designed and operating effectively?

### **Audit Results**

The Town's deteriorated financial condition has placed it in fiscal stress. The general fund's total unreserved balance has declined by \$25 million, from \$14.7 million at the end of fiscal year 2007 to a deficit of \$10.3 million at the end of 2012. The town-outside-village (TOV) fund's unreserved balance decreased from a surplus of \$2.5 million at the end of fiscal year 2007 to a deficit of \$4.5 million at the end of 2012. The Solid Waste Disposal District's (SWDD) unreserved fund balance went from a surplus of \$2.6 million at the beginning of 2010<sup>1</sup> to a deficit of \$11.9 million in 2012. Although the

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<sup>1</sup> Starting in 2010, the SWDD fund was presented as a separate major fund.

Garbage Collection Districts fund reported a surplus of \$7 million in 2011, it sustained a \$17.3 million operating deficit in 2012, thus decreasing fund balance to a deficit of \$10.3 million at the end of 2012. The Town's current state of fiscal stress resulted from poor budgeting practices, specifically the continued overestimation of revenues and the use of fund balance to fund ongoing operations.

Town officials took a number of steps to address their financial problems during 2012. The Board authorized spending reductions in the 2012 overall budget of \$10.5 million, lowered revenue estimates, curtailed all non-contractual and non-emergency overtime and reduced discretionary spending by 20 percent. The Board also implemented an early retirement incentive program<sup>2</sup> that Town officials believe will save approximately \$10 million annually. In addition, the State Legislature granted special authority<sup>3</sup> to the Town to issue long-term debt to pay for termination payments related to the early retirement incentive program for Town employees, for which appropriations had not been provided in the adopted budget. Accordingly, in 2012, the Town issued \$7.5 million in long-term debt to pay for such termination payments. Because of that special authority, the Town's combined results of operations for 2012 were \$7.5 million better than planned. Despite these efforts, except for the TOV fund, the Town sustained significant operating deficits in 2012 resulting in higher fund deficits.

The Town first began experiencing signs of fiscal stress in 2008, when the Board started appropriating fund balance it did not have to fund ensuing years' budgets. Such reliance on appropriated fund balance to finance operating budgets, whether or not sufficient surplus funds were actually available, contributed to its fiscal stress, resulted in cash-flow shortages and required the issuance of short-term borrowings to fund operations. The Town's fiscal health deteriorated in 2012 because the 2012 budget was not structurally balanced.

We also found that the Town needs to improve controls over construction projects and contracts for goods and services. The Town does not have a formal change order policy that establishes procedures to be followed when change orders are necessary. Change orders are generally negotiated between the contractors, a Town consultant and/or Town officials before they are submitted to the Board for review and approval. As a result, change orders ranging from a reduction in contracts of \$38,511 to an increase of almost \$2 million were approved by the Board between seven and 181 days after the work had been started or completed. In addition, one change order, related to the construction of a synthetic turf field at John J. Burns Park, altered the essential identity or main purpose of the original contract such that it may have constituted a new undertaking requiring that either new bids be requested and the contract awarded to the lowest responsible bidder or the contract be let in accordance with provisions of the Town procurement policy. Instead of requesting new public bids or issuing a request for proposals, the Town negotiated a change order with the existing contractor for the removal and disposal of contaminated material for \$1.2 million. This change order and other incidental changes to the original contract of about \$300,000 increased the cost of the project to \$2.7 million or by 124 percent.

Finally, the Board has not adopted IT policies and procedures regarding remote access, data backup, breach notification and disaster recovery. The lack of such policies and procedures increases the risk that computerized equipment and data could be subject to unauthorized access and potential loss of

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<sup>2</sup> Ninety-two employees took advantage of the early retirement incentive program.

<sup>3</sup> Chapter 178 of the Laws of 2012 authorized the Town of Oyster Bay to issue serial bonds to pay employees upon separation of service from the Town and amortize those costs over 10 years. Proceeds of long-term debt are recognized as other financing sources or revenue in the fund in which the related expenditure has been incurred.

data in the event of an emergency. In addition, the Town does not have a plan in place to notify those who may be affected by a potential breach of their personal information and the Town would likely not be able to maintain or quickly resume critical functions in the event of a disaster.

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

# Introduction

## Background

The Town of Oyster Bay (Town) is located in Nassau County. The Town, which covers approximately 115 square miles, includes 18 incorporated villages and has a population of approximately 293,000. The Town is governed by the Town Board (Board) which comprises seven elected members including the Town Supervisor. The Board is responsible for the general management and control of the Town's financial affairs. The Town Supervisor is the Town's chief executive officer and is responsible for the Town's daily operations. The Town Comptroller is the chief accounting officer and is responsible for the administration and management of the Town's finances, including budget control, accounts receivable, accounts payable, payroll, debt administration and information services.

The Town provides various services to its residents, including community services, culture and recreation, highway, public safety and general government support. The majority of the Town's funding comes from real property taxes, departmental income and State aid. The cost of Town activities in 2011 and 2012 was approximately \$282 million and \$313 million, respectively.

## Objective

The objective of our audit was to examine internal controls over selected financial operations. Our audit addressed the following related questions:

- What is the financial condition of the Town's major operating funds?
- Are internal controls over change orders and contracts appropriately designed and operating effectively?
- Are internal controls over information technology (IT) appropriately designed and operating effectively?

## Scope and Methodology

We examined internal controls relating to selected financial operations of the Town for the period January 1, 2010 to October 31, 2011. We also reviewed selected budget-related activities, financial condition and contracts dating prior to January 1, 2010 and throughout 2012, because we considered it necessary and relevant to this audit.

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 is 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 they planned to take 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 Board to make this plan available for public review in the Town Clerk's office.

## Financial Condition

The Board and Town officials are responsible for making sound financial decisions that are in the best interest of the Town and taxpayers and for performing management activities necessary to help maintain the Town's sound financial condition. The Board must adopt fiscally sound budgets, monitor those budgets during the year and make budgetary adjustments if necessary. Estimating fund balance is an integral part of the budget process. Town officials should maintain reasonable levels of fund balance to provide cash flow and should only appropriate fund balance for ensuing years if it is actually available.

The Town is experiencing fiscal stress due to a deteriorating financial condition. The general fund's total unreserved fund balance has declined by \$25 million, from \$14.7 million at the end of fiscal year 2007 to a fund deficit of \$10.3 million at the end of 2012. The town-outside-village's (TOV) total unreserved fund balance decreased from a surplus of \$2.5 million at the end of fiscal year 2007 to a fund deficit of \$7.4 million at the end of 2011. The TOV fund deficit decreased to \$4.5 million at the end of 2012. The Solid Waste Disposal District's (SWDD) unreserved fund balance went from a \$2.6 million surplus at the beginning of 2010<sup>4</sup> to a \$7.9 million deficit at the end of 2011. The SWDD fund deficit increased to \$11.9 million in 2012. Finally, the Garbage Collection Districts (GCD) fund sustained a \$17.3 million operating deficit in 2012, thus decreasing fund balance from a surplus of \$7 million to a deficit of \$10.3 million at the end of 2012. Collectively, these four funds reported net operating deficits of \$24.2 million (operating deficits of \$27.1 million and operating surplus of \$2.9 million) and their operations accounted for more than 70 percent of the Town's 2012 budget expenditures.

The Town first began experiencing fiscal stress in 2008, when the Board started appropriating fund balance it did not have to fund ensuing years' budgets. Such reliance on appropriated fund balance to finance operating budgets, whether or not sufficient surplus funds were actually available, contributed to its fiscal stress, resulted in cash-flow shortages and required the issuance of short-term borrowings to fund operations. Poor budgeting practices, such as inflated revenue estimates, further contributed to the deterioration of the Town's fiscal health.

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<sup>4</sup> Starting in 2010, the SWDD fund was presented as a separate major fund.

## Fiscal Stress

A local government is in sound financial health when it can consistently generate sufficient revenues to finance anticipated expenditures, maintain service levels and retain sufficient cash flow to pay bills and obligations when due without relying on short-term borrowings. Conversely, local governments in poor financial condition often experience unplanned operating deficits<sup>5</sup> and are unable to maintain current service levels without relying on short-term borrowing. Although operating deficits can sometimes be planned by prudently using surplus fund balances to finance operations, persistent and recurring operating deficits are usually indicative of structurally imbalanced budgets and an early indicator of financial stress. Local governments must adopt budgets that are structurally balanced, with reasonable estimates of revenues and appropriations, and continually monitor the budget and fund balance levels.

The Town's financial condition has deteriorated significantly since 2008 and the Town is currently in fiscal stress. Since 2007, the general fund unassigned fund balance decreased by \$20.1 million, from a surplus of \$14.7 million to a deficit of \$5.4 million at December 31, 2011. At December 31, 2011, the TOV fund had an unassigned fund deficit of \$7.4 million, which represents 60 percent of its 2012 budget, and the SWDD fund had a deficit of \$7.9 million which represents 24 percent of its 2012 adopted budget.

These funds' fiscal decline is largely attributable to poor budgeting practices, specifically the inclusion of unrealistic revenue estimates in adopted budgets. In addition, the appropriation of non-existing fund balance contributed to the Town's fiscal stress. As a result, the Town experienced cash-flow problems that required the issuance of \$12.5 million in revenue anticipation notes (RAN) in each of the 2010 and 2011 fiscal years and \$16.8 million in 2012. The continued and increasing reliance on RANs for cash flow needs is indicative of increasing fiscal stress.

In addition to issuing RANs in 2012, the Town also issued \$13 million in revenue deficiency notes (RDN).<sup>6</sup> RDNs are used to finance deficiencies arising from revenues being less than the amount estimated in the budget. They mature within one year from date of issuance and generally are repaid by including an appropriation in the

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<sup>5</sup> Unplanned operating deficits occur when appropriations are over-expended, expected revenues are not received, or a combination of both. By contrast, planned operating deficits occur when Boards knowingly adopt budgets where the appropriations are greater than the expected revenues, with the difference being funded by unexpended surplus funds.

<sup>6</sup> RDNs were issued to provide temporary budget relief for estimated revenues not expected to be realized in 2012 as follows: \$7 million in the general fund, \$1.7 million in the TOV fund, and \$4.3 million in the GCD fund.

next year's budget. Whereas RANs are secured and paid for by the collection of current revenues, RDNs generally must be repaid with new revenues in the following year. That means that fewer resources may be available to fund recurring operating expenditures.

Town officials could not provide us with a list of specific estimated revenues that would not be realized in 2012. The purpose of issuing RDNs is to finance a specific revenue deficiency or shortfall in the adopted budget, not to reduce or eliminate projected fund deficits, which may not necessarily result from revenue shortfalls. The Town then had additional fiscal challenges in 2013 because budget appropriations for the \$13 million RDNs were included in the 2013 adopted budget. With the continued decline of other revenue sources, current service levels provided to Town residents may be at risk.

Town officials took a number of steps to address their financial problems during 2012. The Board authorized spending reductions in the 2012 overall budget of \$10.5 million; they lowered revenue estimates, curtailed all non-contractual and non-emergency overtime and reduced discretionary spending by 20 percent. The Board also implemented an early retirement incentive program<sup>7</sup> that Town officials believe will save approximately \$10 million annually. In addition, the State Legislature granted special authority<sup>8</sup> to the Town to issue long-term debt to pay for termination payments related to an early retirement incentive program for Town employees, for which appropriations had not been provided in the adopted budget. Accordingly, in 2012, the Town issued \$7.5 million in long-term debt to pay for such termination payments. Because of that special authority, the Town's combined results of operations for 2012 were \$7.5 million better than planned. Despite these efforts, fund deficits (other than the TOV fund) increased in 2012 as shown in Table 1.

**Table 1: 2011 and 2012 Fund Surplus (Deficit)**

Fund	2011 Fund Surplus/(Deficit) (in Millions)	2012 Fund Surplus/(Deficit) (in Millions)	Change in Fund Balance (in Millions)
<b>General</b>	(\$5.40)	(\$10.30)	(\$4.90)
<b>TOV</b>	(\$7.40)	(\$4.50)	\$2.90
<b>SWDD</b>	(\$7.90)	(\$11.90)	(\$4.0)
<b>GCD</b>	\$7.00	(\$10.30)	(\$17.30)

<sup>7</sup> Ninety-two employees took advantage of the early retirement incentive program.

<sup>8</sup> Chapter 178 of the Laws of 2012 authorized the Town to issue serial bonds to pay employees upon separation of service from the Town and amortize those costs over a ten year period. Proceeds of long-term debt are recognized as other financing sources or revenue in the fund in which the related expenditure has been incurred.

The Town's audited 2012 financial statements reported an operating deficit for the general fund of approximately \$5.8 million, thus increasing the general fund deficit to \$10.3 million in 2012. The TOV fund realized an operating surplus of \$2.9 million, causing this fund's unassigned fund deficit to decrease from a deficit of \$7.4 million to a deficit of \$4.5 million at the end of 2012. Results of operations for the SWDD show an operating deficit of \$4 million for 2012, causing the unassigned fund deficit to increase to \$11.9 million at the end of 2012. Finally, the GCD fund had a \$17.3 million operating deficit in 2012, thus decreasing fund balance from a surplus of \$7 million to a deficit of \$10.3 million at the end of 2012.

We reviewed certain revenue estimates included in the 2013 adopted budget to determine whether the Board took actions to address the Town's financial condition. Although some revenues that were overestimated in prior years were more accurately estimated based on historical trends, the Board has not taken sufficient actions to address the Town's financial condition. While the 2013 general fund tax levy of \$37.7 million remained unchanged from the prior year, the Town budget was balanced with speculative revenue of \$17.5 million, derived from the planned sale of surplus land. Town officials indicated that they are actively negotiating the sale with two prospective buyers and expected the sale to be consummated in the second quarter of 2013. Regardless, it is imprudent for Town officials to fund recurring operating expenditures with "one shot" revenues, especially when the attainability of those revenues is inherently uncertain and contingent on a transaction that may or may not happen.<sup>9</sup>

We also noted that Town officials did not include recurring revenue of about \$14.8 million, originating from the Nassau County Local Government Assistance Program, in the 2013 general fund adopted budget, although it had been included in prior budgets. Instead, \$13.8 million of this revenue was budgeted in the GCD and \$1 million in the SWDD. Replacing recurring revenue with speculative one-time revenue to fund recurring expenditures is ill-considered because it creates a structural imbalance in the adopted budget and may lead to operating deficits.

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<sup>9</sup> On May 21, 2013, the Board authorized the sale of certain property for \$32.5 million. However, the sale was delayed because a Mandatory Referendum, held on August 20, 2013, was required to authorize the sale. The sale was further delayed by a court challenge, which was adjudicated in the Town's favor on October 9, 2013. It is uncertain at this time whether this case will be further appealed. Nonetheless, the Town signed the contract for the sale of this property on August 27, 2013 and received \$30 million on September 4, 2013. The balance of \$2.5 million will be paid to the Town at the closing date, which Town officials indicated will be within five years.

## Budgeting Practices

In preparing the budget, the Board is responsible for estimating Town revenues and other financing sources, as well as determining whether the Town will have surplus funds available to help fund the ensuing year's operations. The Board is also responsible for assessing the Town's financial condition and taking action to address operating deficits and declining fund balances that occur as a result of operations.

The annual Board resolution adopting the budget was not complete. While the resolution included total appropriations for each of the 11 major Town and special district funds, it did not include the appropriations for three other funds, characterized as internal service funds, referred to as the "M funds." The M funds are used to account for the financial activities for health insurance, liability and property loss insurance, and workers compensation. Town officials included separate budgets of estimated revenues and appropriations for each of the three M funds in the overall adopted budget and accounted for their activities separately in the Town accounting records. At year end, the Town allocated and reported the M funds' financial activities within the general fund and other operating funds based on actual cost incurred for each participating fund.

The Town appropriated more fund balance<sup>10</sup> than was available to fund ensuing years' budgets. Had detailed information about estimated fund balance been available at year end and provided to the Board before budgets were adopted, it would have been evident to the Board that it had appropriated non-existent fund balance ranging from \$725,570 to fund the 2009 general fund budget to \$6.3 million to fund the 2012 general fund budget. Table 2 shows the fund balance trends for the general fund, the amounts appropriated to fund the ensuing years' budgets from the 2007 through 2012 fiscal years (including fund balance appropriated in the M funds), and results of operations for those fiscal years.

The Board resolution adopting the 2009 general fund budget reflects an appropriated fund balance of \$8.8 million, although the actual amount appropriated was \$12.4 million. This occurred because the fund balance amounts appropriated to fund the budgets of the M funds aggregating \$3.6 million, were not included in the resolution

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<sup>10</sup> The Governmental Accounting 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 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).

as additional fund balance appropriated from the general fund. The over-appropriation of fund balance continued in each succeeding year. As a result, adopted budgets were under-funded because the Board appropriated non-existent fund balance of \$4.1 million in 2010, \$1.3 million in 2011 and \$6.3 million<sup>11</sup> in 2012 to balance those budgets. However, because the general fund had an unexpended fund deficit of \$5.4 million in 2011, the appropriation of an additional \$6.3 million to fund the 2012 budget is a form of planned deficit spending, which represents a planned increase in the general fund deficit.

**Table 2: General Fund**

General Fund - Detail of Appropriated Fund Balance						
	2007	2008	2009	2010	2011	2012
<b>Total Unrestricted Fund Balance (Deficit)</b>	\$14,671,147	\$11,645,425	\$6,279,485	\$374,746	(\$5,422,383)	(\$10,299,540)
<b>Less: Amounts Appropriated to Fund Ensuing Years' Budgets</b>						
General Fund	\$9,010,733	\$8,793,668	\$5,211,437	\$399,331	(\$819)	\$0
MM Fund (Health Insurance)	\$651,339	\$1,136,625	\$2,356,625	\$32,535	\$5,419,968	\$0
MS Fund (Workers' Compensation)	\$2,915,155	\$2,000,336	\$2,029,515	\$1,193,501	\$345,576	\$0
MW Fund (Unallocated Insurance)	\$325,181	\$440,366	\$740,366	\$42,848	\$511,283	\$32,735
<b>Total Appropriated to Fund Ensuing Years' Budgets</b>	<b>\$12,902,408</b>	<b>\$12,370,995</b>	<b>\$10,337,943</b>	<b>\$1,668,215</b>	<b>\$6,276,008</b>	<b>\$32,735</b>
Available Fund Balance/ (Deficiency) at Year End	\$1,768,739	(\$725,570)	(\$4,058,458)	(\$1,293,469)	(\$11,698,391)	(\$10,332,275)
Operating Surplus/(Deficit)	(\$5,043,784)	(\$2,970,169)	(\$5,147,110)	(\$6,115,568)	(\$3,213,457)	(\$5,781,843)

By appropriating more fund balance than available, the Board adopted budgets that were not structurally sound because expected resources were not available to fund operating expenditures, resulting in the operating deficits shown in Table 2, which in turn increased fund deficits. Had the Town estimated year end fund balance and information been made readily available to the Board before adopting the annual budget, the Town's early indication of fiscal stress would have been apparent in 2008. Since the level of fiscal stress became more significant from year to year, the Board could have taken remediating actions sooner, possibly averting the actions it had to take in 2012 to address the \$6.3 million budget gap, caused by appropriating fund balance that the Town did not have. Despite the Board taking those actions, the 2012 operating deficit was \$5.8 million and the general fund deficit increased from \$5.4 million to \$10.3 million as of December 31, 2012. The general fund's results of

<sup>11</sup> When fund balance is appropriated in ensuing years' budgets in a fund having unexpended fund deficits, such appropriation represents a planned increase in the deficit.

operations for 2012 were \$3.6 million<sup>12</sup> better than planned because the State Legislature granted special authority to the Town to issue bonds for unplanned termination payments.

The Board also appropriated non-existent fund balance to fund the adopted budgets of the TOV fund and the SWDD fund. The Board appropriated more fund balance than was available to fund the TOV fund's 2008 through 2010 budgets, causing the unexpended fund deficit to increase from \$475,469 in 2008 to \$5.6 million in 2010. The unexpended fund deficit increased to about \$7.4 million by the end of 2011. In an effort to reverse the declining fund balance trend and reduce the 2011 fund deficit of \$7.4 million, the Town appropriated a negative fund balance of \$3.8 million in the 2012 budget to provide funds in excess of the amount needed to fund operations. Although this action represents a planned deficit reduction of \$3.8 million in the TOV fund, there is no provision in the law<sup>13</sup> that allows a municipality to appropriate a negative fund balance in adopted budgets to fund prior years' fund deficits. However, results of operation reduced the deficit by only \$2.9 million which included \$500,000 of the \$7.5 million of long-term debt to pay for unplanned termination payments.

The unrestricted fund balance of the SWDD fund decreased by \$10.5 million, from a \$2.6 million surplus at the beginning of 2010<sup>14</sup> to a \$7.9 million deficit at the end of 2011. Most of this deficit resulted from the Town appropriating \$6 million of fund balance it did not have to fund the 2011 SWDD budget, as the unrestricted fund balance at the end of 2010 was a reported deficit of \$36,082. The SWDD fund reported an operating deficit of \$4 million in 2012, further increasing the deficit to \$11.9 million at that date.

It is imperative that Town officials diligently analyze and project revenues and expenditures to accurately estimate unrestricted fund balance at year end that may be appropriated to fund the subsequent year's budget. If the estimated fund balance is grossly overestimated or inaccurate, then the Town runs the risk of adopting budgets that are not structurally sound, which will ultimately result in fiscal stress.

## Overestimation of Revenues

The Board must ensure that there is a process to prepare, adopt and amend budgets based on reasonably accurate assessments of revenue sources that fund budget appropriations. When estimating revenues in the annual budget, the Board must have current and accurate

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<sup>12</sup> The \$3.6 million is the general fund's share of the \$7.5 million bond issued to pay for the cost of unplanned terminations.

<sup>13</sup> Deficit financing authority can only be granted by the State Legislature.

<sup>14</sup> Prior to 2010, the activities for this fund were reported under the Refuse and Garbage District. Starting in 2010, the SWDD fund is being presented as a separate major fund.

information and must use historical data to guide it in determining the reasonableness of revenue estimates.

The Town has a history of poor budgeting relating to estimates of certain significant revenues. These revenues have often been significantly overestimated and do not appear reasonable or justifiable based on past trends or other information. As a result, the general, TOV and SWDD funds have sustained operating deficits which led to a decline in their respective funds' surpluses and to a deteriorating financial condition.

General Fund – The general fund is the Town's main operating fund and accounts for transactions that are not legally required to be accounted for in other funds. Certain general fund revenues have been decreasing in recent years. Despite these trends, Town officials continued to include unrealistic revenue estimates in adopted budgets for mortgage taxes, interest earnings and local government assistance,<sup>15</sup> which contributed to the fund's operating deficits and declining fund balance.

**Table 3: General Fund Selected Revenue Budget Variances**

	2008	2009	2010	2011	2012
<b>Mortgage Tax</b>					
Adopted Budget	\$17,400,000	\$15,000,000	\$12,000,000	\$11,000,000	\$11,000,000 <sup>a</sup>
Actual	\$11,800,310	\$9,967,443	\$9,046,023	\$8,519,298	\$9,502,116
Variance/(Negative)	(\$5,599,690)	(\$5,032,557)	(\$2,953,977)	(\$2,480,702)	(\$1,497,884)
<b>Interest Earnings</b>					
Adopted Budget	\$1,900,000	\$2,100,000	\$2,000,000	\$300,000	\$200,000
Actual	\$1,241,962	\$231,306	\$116,012	\$100,709	\$106
Variance/(Negative)	(\$658,038)	(\$1,868,694)	(\$1,883,988)	(\$199,291)	(\$199,894)
<b>Local Government Assistance</b>					
Adopted Budget	\$10,000,000	\$13,945,000	\$14,000,000	\$15,000,000	\$15,000,000 <sup>b</sup>
Actual	\$10,701,505	\$12,375,099	\$13,331,035	\$13,144,675	\$13,733,876
Variance/(Negative)	\$701,505	(\$1,569,901)	(\$668,965)	(\$1,855,325)	(\$1,266,124)

<sup>a</sup> The original adopted budget revenue estimate was revised to \$9,749,126.  
<sup>b</sup> The original adopted budget revenue estimate was revised to \$13,169,000.

<sup>15</sup> The annual Town share of sales tax revenue as allocated in the County of Nassau adopted budget

As shown in Table 3, between 2007 and 2011, the general fund has incurred annual operating deficits which caused available fund balance to decrease by approximately \$20 million, from a surplus of \$14.7 million to a deficit of \$5.4 million. The Town also sustained a general fund operating deficit of \$5.8 million for the 2012 fiscal year, further increasing the accumulated unassigned deficit to \$10.3 million.

General fund operating deficits were caused in part by including estimated revenues that were overly optimistic and by appropriating significant amounts of fund balance in adopted budgets, whether it existed or not. Because the Board has allowed these imprudent budgeting practices to continue, the general fund financial condition has deteriorated and is currently in a state of fiscal stress.

TOV Fund – The TOV fund experienced cumulative operating deficits of \$8.3 million between the years 2009 through 2011. Poor budgeting practices were the major contributor to this deficit, as the Town continuously over-budgeted estimated revenues for building fees. The negative trend in this revenue began in 2009, when \$1.8 million or 32 percent of the estimated revenue from building fees for that year was not realized. Town officials continued to overestimate this revenue in the 2010 and 2011 adopted budgets. Despite the negative trend in collection of this revenue, Town officials increased this revenue estimate in the 2012 adopted budget to \$6.5 million while only realizing \$4.3 million, or \$2.2 million less than estimated.

The continued overestimation of revenue from building fees in adopted budgets has negatively impacted the financial condition of the TOV's fund, and with a 2011 fund deficit of 60 percent of the 2012 budget, the TOV fund was in fiscal stress. The deficit at the end of 2012 was reported at \$4.5 million.

SWDD Fund – Starting with the 2010 fiscal year, the Town accounted for and reported the financial activities of the SWDD fund separately as a special revenue fund. Prior to the 2010 fiscal years, the Town combined and reported this fund's activities within the Refuse and Garbage Districts fund. The restated fund balance of the SWDD fund at January 1, 2010 was a surplus of \$2.6 million, of which \$1.2 million was appropriated to fund the 2010 budget. However, the operating deficit for 2010 was over \$2.6 million. As result, a fund deficit of \$36,082 was reported for the year. The additional unplanned operating deficit of \$1.4 million resulted from a revenue shortfall of \$4.9 million, which mostly resulted from the overestimation of refuse and garbage charges.

For 2011, the Town adopted a budget of \$34.6 million that was not balanced because it was partially funded with \$6 million of appropriated fund balance that did not exist. Town officials indicated that the appropriation of non-existent fund balance was not intentional but was due to an error because the fund surplus of the GCD fund of more than \$6 million at December 31, 2010 was mistakenly applied to fund the SWDD budget. However, despite appropriating the fund balance of the wrong fund, records show that \$2.4 million of the \$6 million had already been appropriated to fund the 2011 GCD fund's budget, leaving only \$3.6 million available to appropriate. As a result, the Town Board adopted the 2011 budget with a built-in budget shortfall of \$6 million.

The actual SWDD 2011 operating deficit was \$7.9 million, which was caused mainly by the \$6 million appropriation of non-existent fund balance and an unplanned deficit of about \$1.8 million. The SWDD fund's fiscal problems were further exacerbated when the Board adopted a 2012 budget that included more than \$4 million in estimated revenues from litigation recovery. Due to the nature, timing and uncertainties surrounding any litigation proceedings, the Board should not have included this uncertain, one-time revenue in the adopted budget since it was intended to pay for recurring operating costs. Unless a judgment has been rendered and it is probable that the revenue will be received, we generally caution local governments against including such revenues in adopted budgets. Also, because it is not a recurring revenue, it should generally not be used to fund operating expenditures. Town officials informed us that this revenue was not received in 2012. As a result, the SWDD fund deficit increased from \$7.9 million to more than \$11.9 million at the end of 2012.

GCD Fund – The GCD fund had a positive fund balance of approximately \$7 million at December 31, 2011. However, the Board appropriated almost \$8.4 million of fund balance, or \$1.4 million more than available, to balance the 2012 budget. The Board also included estimated revenues from litigation recovery in the 2012 adopted budget of approximately \$8.4 million, which were not realized. Due to the uncertain timing and nature of this one-time revenue, the Board should not have included it in the adopted budget to pay for recurring operating costs. As a result of these poor budgeting practices, the GCD sustained an operating deficit of \$17.3 million in 2012, wiping out its previous surplus and leaving a fund deficit of \$10.3 million at December 31, 2012.

Town officials' approach to budgeting has not been sound or prudent. When the Board adopts unrealistic budgets which consistently overestimate revenues, that include revenues which are contingent on future events and on specific litigation outcomes, or that rely on fund

balance that does not exist, it creates a structural imbalance that leads to fiscal stress, cash-flow problems and an increased risk that current service levels may not be sustainable.

## **Recommendations**

1. The Board should develop a long-range financial plan that addresses the negative impact of its recurring operating deficits and eliminates deficit fund balances.
2. The Board must adopt budgets that are structurally balanced. Recurring revenues should be reasonably estimated and attainable, and sufficient to cover the cost of recurring services.
3. Town officials should refrain from balancing operating budgets with non-recurring revenues or revenues that are speculative or contingent on future events, such as proceeds from litigation or land sales. Such revenues should generally be used to fund non-operating expenditures.
4. The Board should ensure that all funds are included in the budget adoption resolution and that each fund's total appropriation agrees with the amounts included in the detail budget document.
5. Town officials should improve the methods used to project fund balances at year end so that, when adopting the budget, the Board does not appropriate excessive or non-existent fund balances.
6. The Board should ensure that the budget is continuously monitored and require that immediate action be taken to mitigate the negative impact of any significant revenue deficiency or any other significant budget shortfall.

## Change Orders and Contracts

Town officials are responsible for designing internal controls to help ensure that goods and services of the best quality are obtained at the lowest possible price and in compliance with Town policies and legal requirements. This helps to ensure that taxpayer dollars are expended in the most efficient manner. The Town should have a formal policy for construction contracts which establishes the protocols to be followed when change orders are necessary or required. Bid specifications should convey in precise terms the basis on which contracts will be awarded, state the nature of the goods or services as definitely as practicable and contain all information necessary to enable prospective bidders to prepare and submit reasonable bid proposals.

The Town does not have a formal change order policy that establishes procedures to be followed when change orders are necessary. Change orders are generally negotiated between the contractors, a Town consultant and/or Town officials before they are submitted to the Board for review and approval. As a result, Town officials negotiated and signed off on completed contractual change orders before the Board had the opportunity to review and approve them. In addition, bid specification for certain contracts were often vague or indefinite and did not provide sufficient information for bidders to draw intelligent bids or were so vague that too much was left to the discretion of the awarding official.

### Change Orders

Capital projects are complex undertakings that require good planning to ensure they are completed within the original cost and scope. A change order is a formal modification of a construction contract, agreed upon by both the Town and contractor, to authorize a change in the work or certain other contractual changes. When the change relates to details or relatively minor particulars and is incidental to the original contract, a change order may be issued without competitive bidding.<sup>16</sup> However, no important general change may be made, without competitive bidding, which so varies from the original plan or so alters the essential identity or main purpose of the contract as to constitute a new undertaking.

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<sup>16</sup> General Municipal Law requires competitive bidding on all purchase contracts involving an expenditure of more than \$20,000 for 12 months for materials, supplies and equipment and on expenditures of more than \$35,000 for public work contracts. Prior to June 22, 2010, the bidding threshold for purchase contracts was \$10,000. Prior to November 2, 2009, the bidding threshold for public work contracts was \$20,000.

A change order policy is necessary to provide guidance in analyzing, processing and authorizing change orders. Because change order work is often negotiated with existing contractors to minimize delays and therefore can be more costly than work awarded through competition, it is important that Town officials plan capital projects in such a way as to minimize the need for change orders. While some amount of change orders can be expected, certain conditions can lead to a higher number of change orders which usually result in additional project costs.

The Town does not have a formal change order policy that establishes the procedures to be followed when change orders are necessary or required. Change orders are generally negotiated between the contractors, a Town consultant and/or Town officials in accordance with individual contract provisions, before they are submitted to the Board for review and approval.

We judgmentally selected 10 capital projects with change orders totaling \$9.7 million, awarded to 10 separate contractors covering the period January 1, 2010 through October 31, 2011. The initial contracts for the 10 capital projects were awarded by the Board between June 2008 and May 2011 and totaled \$40.6 million. The Board approved change orders ranging from a reduction in contracts of \$38,511 to an increase of almost \$2 million, between seven and 181 days after the work had been started or completed.

**Table 4: Schedule of Capital Projects with Change Orders**

Name of Capital Project	Bid Amount	Change Orders	Late Approval by the Board (in Days)
<b>Construction of storm drain &amp; highway</b>	\$1,736,260	\$15,837	84
<b>Storm water drainage and road improvement</b>	\$1,998,330	\$35,400	181
<b>Traffic signal Improvement to the Oyster Bay Triangle</b>	\$180,551	(\$38,511)	29
<b>Tobay Beach Pavilion Improvement</b>	\$361,220	\$147,173	46
<b>Replacement of waste oil tanks</b>	\$147,800	\$40,935	50
<b>Outstrukction Foundation - The Farm</b>	\$340,160	\$117,151	39
<b>John J. Burns Park - Synthetic Turf Field</b>	\$1,209,094	\$1,498,410	28
<b>Hicksville Parking Facility</b>	\$33,083,000	\$1,908,023	22 <sup>a</sup>
<b>Contract for electrical materials and services</b>	\$24,711	\$2,125,289	None <sup>b</sup>
<b>Contract for fencing materials and services</b>	\$1,489,964	\$3,810,036	None <sup>b</sup>
<b>Total / Average</b>	\$40,571,090	\$9,659,743	60

<sup>a</sup> Represents the average of three change orders approved by the Board between seven and 40 days after they were signed  
<sup>b</sup> The Board periodically increased the amount authorized to be spent under these contracts by resolution.

Town officials indicated that, although the additional work was started or completed before the change orders were approved by the Board, contractors are not paid until the changes are formally approved. Nevertheless, only the Board has the authority to approve or disapprove change orders, and change orders affecting the cost of the original project may not be executed unless such changes and any additional financing are approved by the Board in advance of starting or completing the work.

After requesting public bids, the Board awarded a contract for the construction of a synthetic turf field at the John J. Burns Park for approximately \$1.2 million. According to documents obtained from one of the Town's engineers, the field may have been known to be a dumping ground for a construction company. Consequently, the Town consulting engineer conducted an investigation using remote sensing ground penetrating radar (GPR) technology over the suspected contaminated area. The report disclosed that large anomalies were detected in five locations, but the GPR was unable to determine the exact size of those anomalies. No provisions were made in the bid specifications to provide for the potential detection and removal of contaminated materials.

Approximately within two weeks of construction, several parcels of the land were found to be contaminated. Instead of requesting new public bids for the excavation and removal of the contaminated materials, the Town negotiated a change order with the existing contractor for the removal and disposal of the contaminated material for approximately \$1.2 million. This change order and other incidental changes to the original contract of about \$300,000 increased the cost of the project to \$2.7 million.

Because the change order may have substantially varied from the original contract, it may have altered the essential identity or main purpose of the contract and, hence, constitutes a new undertaking which required competitive bidding. Even if it did not, however, the Town should have been more careful in planning the project and ensuring that all reasonably foreseeable work necessary to efficiently complete the project was included in the project scope. This serves to ensure that all bidders on the initial project have an opportunity to bid on the full scope of the project.<sup>17</sup>

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<sup>17</sup> Note that the removal of contaminated soil also may constitute a professional service, which is exempt from competitive bidding. However, if the Town applied this exception, the Town would have had to comply with its procurement policies and procedures in letting the soil removal work.

## **Contracts for Goods and Services**

As a general proposition, bid specifications should be drafted to allow vendors supplying reasonably equivalent items to compete on an equal basis. Specifications should convey in precise terms the basis on which the contract will be awarded, state the nature of the goods or services as definitely as practicable and contain information necessary to enable prospective bidders to prepare and submit reasonable bids. When a local government is unable to provide precise quantity requirements, bid specifications generally may call for bids on a unit basis. However, the specifications generally should also set forth estimated quantities, based on historical data or other reasonable basis, so that bidders have sufficient and uniform information to intelligently calculate their bids. Specification should not be so indefinite that bidders do not have sufficient information to draw intelligent bids or so equivocal that too much is left to the discretion of the awarding official or body.

The Town awarded an electrical contract and a fence contract to two vendors after requesting public bids. The Town paid \$1.2 million under the electrical contract during our audit period and \$4.7 million under the fence contract from the contract's inception through April 2012. The bid specifications for these contracts did not provide reasonable estimated quantities. Moreover, because there was no estimated quantity for labor and work order provisions, the bid specifications did not provide an indication of what percentage of the total contract cost these particular items represent. Because the specifications were indefinite, prospective bidders may not have had sufficient information to draw intelligent bids which may have resulted in Town officials having too much discretion when awarding the contracts. As a result, there is a higher risk that the Town may not be receiving the most competitive prices or most economical services.

Electrical Contract –The Town awarded an electrical contract to a vendor after requesting public bids. During our audit period, the Town paid the vendor a total of \$1.2 million. The bid specifications included 96 items, primarily involving the furnishing and installation of electrical parts. The Town awarded the contract to the lower of two bidders based on an average of the 96 items which totaled \$24,711 and authorized an initial amount to be spent under this contract from bond proceeds of \$500,000. An additional \$1,000,000 was authorized during the audit period for a total of \$1,500,000.<sup>18</sup> The estimated quantity set forth in the bid specifications for each of the 96 items, however, was set at one. Therefore, bidders may not have had sufficient information to intelligently calculate their bid proposals for this contract.

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<sup>18</sup> An additional \$650,000 was authorized on January 3, 2012, bringing the total authorization to \$2,150,000.

We also found that certain categories listed in the bid specifications had set prices for that particular item. For example, the Town set a fixed price of \$90 per hour for an item referred to as “Labor not Included in this Contract” (Labor). According to the description in the bid specifications, this item “include[d] any labor that is not already included in the items of work of this Contract.”<sup>19</sup> The specifications also limited the dollar amount for an item characterized as “Force Account Work per Work Order” (Force Account Work) at \$10,000.<sup>20</sup> According to the bid specifications, the “force account” work item was used “[w]here there is no applicable contract unit price item in the contract for work required or requested by the Town.” Because the Town had a fixed price for each of the two items, the Town may have undermined the purpose of competitive bidding by excluding them from the competitive process.<sup>21</sup>

We judgmentally selected 10 claims totaling \$531,688 paid under this contract for services rendered during our audit period. For the 10 claims tested, only 20 of the 96 bid item categories were used outside of the Labor and Force Account Work items. In addition, work done under the Labor and Force Account Work items did not fully describe the extent of the work performed. The only information provided was the location where the work was performed, the quantities of materials used,<sup>22</sup> a lump sum of the number of labor hours used, the type and cost for equipment used and a profit factor of 15 percent on items not included in the bid. Because the contract did not have estimated number of units for each item, it is unclear whether the Town relied on the Labor and Force Account Work categories within the contract to complete certain electrical projects instead of using the listed items in the bid specification, which in many cases included a furnish and install provision as part of the item.

This type of contract can be an appropriate competitive means of procuring certain good or services when a local government is unable to provide precise quantities because of fluctuating or indefinite needs. The Town, however, should have included reasonable estimated quantities of the items requested so bidders had sufficient and uniform information to calculate their bids intelligently. Moreover, because

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<sup>19</sup> Town officials indicated that the fixed price of \$90 per hour was based on the prevailing wage rate, benefits, payroll taxes and “reasonable profit.”

<sup>20</sup> Town officials indicated that this item is used for larger projects requiring extra work and the use of parts not included in the bid specifications. The \$90 per hour labor charge is used in conjunction with this extra work. The specification also provided, under certain circumstances, that the vendor could include a certain percentage for profit and overhead to be added to these charges.

<sup>21</sup> The Town would still be subject to the prevailing wage requirements of the Labor Law.

<sup>22</sup> The claims listed both the materials as quoted in the bid contract and other materials not included in the bid.

there was no estimated quantity for the “Labor and Work Order” provision, the bid specifications do not provide an indication of what percentage of the total contract’s cost this particular item represents. Because the specifications were indefinite, prospective bidders may not have had sufficient information to draw intelligent bids and Town officials may have had too much discretion when awarding the contracts.

Fencing Contract – We found that certain categories listed in the bid specifications had set prices for that particular item. For example, the Town set a fixed price of \$85 per hour for “Labor not Included in the Contract”(Labor) and limited the dollar amount for an item characterized as “Force Account Work per Work Order” at \$10,000.<sup>23</sup> Because the Town had a fixed price for each of these items, the Town may have undermined the purpose of competitive bidding by excluding them from the competitive process.<sup>24</sup> In addition, we found that the estimated quantities in the bid specifications appeared to be significantly less than the amount used by the Town during the course of the contract. This may have resulted in prospective bidders not having sufficient information to draw intelligent bids when submitting bid proposals for the contract.

In May 2008, the Board awarded the fence contract to the low bidder for \$1,489,964. According to the bid specifications, the contract was for a one-year term with the option of two additional one-year extensions. The specifications also indicated that the Town would budget an annual amount of \$400,000 for this contract. However, the amount authorized to be spent in the first year of the contract was later more than doubled to \$900,000. The contract was extended for two additional one-year terms for amounts not to exceed \$1.2 million in the second year and \$3.2 million in the third year, for a total of up to \$5.3 million<sup>25</sup> over the three-year period. This appears to represent a significant increase over what was projected in the specifications, which suggested that \$400,000 would be spent each year on the contract (i.e., \$1.2 million over the three-year contract period). Not having accurate estimated quantities in the specification could mean that prospective bidders did not have sufficient information to make intelligent bid proposals for the contract. This in turn could result in the Town not obtaining vendor quantity discounts and potentially paying higher costs.

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<sup>23</sup> We were informed that this item is used for larger projects requiring extra work and the use of parts not included in the bid specifications. The specification also provided, in certain circumstances, that the vendor could include a certain percentage for profit and overhead to be added to these charges.

<sup>24</sup> We note that the Town would still be subject to the prevailing wage requirements of the Labor Law.

<sup>25</sup> Funded with proceeds of general obligation bonds

Moreover, from May 2008, the inception of the contract, through April 2012, the Town paid this vendor more than \$4.7 million. We selected 10 claims paid under the contract totaling \$1,186,000, including payments for furnishing and installing various quantities of 38 bid items and payments made under the Work Order and Labor items totaling \$351,000 (\$293,000 and \$56,820) and \$23,000 for traffic control. The actual quantities used for 27 of the 38 different bid items ranged from 30 percent to 2,731 percent of the estimated quantities included in the bid specifications. Our test results suggest the estimated quantities in the bid specifications were often not accurate, and in some circumstances resulted in significant underestimated amounts for particular items.

In addition, certain claim vouchers were not sufficiently itemized to show whether the Town was properly billed for separate labor changes. For example, a claim totaling \$184,790, included 96 hours for work provided under Work Order for \$7,462 and 96 hours for work done under Labor for \$8,160. The \$7,462 labor charge under the Work Order was segregated and calculated based on total time spent by each title of employee who performed the extra work. However, the \$8,160 labor charge under Labor was not attributed to any other work since the remainder of the payments related to the installation of bid items, which already included labor costs. Town officials could not provide us with detailed information to show whether the Town was properly billed for these labor changes.

Had the Town prepared bid specifications that allowed prospective bidders to provide bid offers based on more precise estimated quantities that reflected the Town's actual projected needs or requirements over the life of the contract, and that did not include fixed price amounts for certain bid items, the Town may have had an opportunity to secure a more cost effective contract than the \$5.3 million authorized over the contract period.

## **Recommendations**

7. The Board should adopt a formal change-order policy to provide guidance in analyzing, processing and authorizing change orders.
8. The Board should ensure that effort is made to minimize the need for change orders through effective capital planning so that all reasonably foreseeable work necessary to efficiently complete each project is included in the project scope and should ensure that all bidders on the initial project have an opportunity to bid on the full scope of the project.
9. Town officials and the Board should ensure, when change orders are significant in relation to the original cost of a project, are so varied from the original plan or alter the essential identity or main

purpose of the contract as it may constitute a new undertaking, that either new bids be requested and the contract awarded to the lowest responsible bidder or the contract be let in accordance with provisions of the Town's procurement policy.

10. All change orders should be reviewed and approved by the Board to ensure that the changes are necessary before any work is performed.
11. Town officials should ensure that bid specifications for contracts include reasonably estimated quantities for goods and services required to complete the project and that the contracts be awarded based on the total cost of the projects.
12. Town officials should make every effort to ensure that estimated quantities included in bid specifications are realistic so that bids reflect the true value of each contract over the contract's terms.
13. Claim vouchers should be sufficiently itemized to permit a proper audit of the charges.

## Information Technology

The Town uses information technology to initiate, process, record and report transactions. It also relies on its IT system to transmit information, store data, process payroll, maintain financial records, communicate by electronic mail (email) as well as access the Internet. If the IT system fails, the results could range from inconvenient to catastrophic. Even small disruptions in processing can require extensive effort to evaluate and repair. Accordingly, Town officials are responsible for establishing internal controls over IT to protect these assets against the risk of loss, misuse or improper disclosure of sensitive data.

The Board is responsible for adopting policies and procedures for all aspects of the Town's computerized data. Such policies should include, but not be limited to, remote access controls, data backup, breach notification and disaster recovery. Effective technology policies and procedures should be regularly reviewed and updated to reflect changes in the Town's technology environment.

The Board has not adopted policies and procedures regarding remote access, data backup, breach notification and disaster recovery. The lack of such policies and procedures increases the risk that computerized equipment and data could be subject to unauthorized access and potential loss of data in the event of an emergency. In addition, the Town does not have a plan in place to notify those who may be affected by a potential breach of their personal information and the Town would likely not be able to maintain or quickly resume critical functions in the event of a disaster.

Remote Access – Remote access is the ability to access the computer network from the Internet or other external source. An important component of internal controls ensures that remote computer access is controlled, monitored and tracked so that only authorized individuals may enter or retrieve data. Policies and procedures should address how remote access is granted, who is given remote access and how it will be tracked, monitored and controlled.

The Board has not adopted a remote access policy and procedures. The Town provides remote access to the support technicians, vendors, administrators and staff. However, the Town has not established or implemented policies and procedures governing remote access which include ensuring that remote access systems are secure. Also, there are no written agreements between the Town and the vendors, administrators and staff outlining acceptable use of the Town's system, and remote access is not monitored.

Without a remote access agreement, there is a greater risk that the Town's IT resources could be compromised and/or inappropriate transactions could be initiated and not detected by Town officials.

Data Backups – It is important for the Town to ensure that data stored on computers and servers is backed up (i.e., a duplicate copy of information made) routinely to enable restoration in the event of a loss. Effective written backup procedures include provisions for maintaining backup copies and storing them in a secure location. Periodic testing and restoration of backups helps ensure the viability of data.

Although we were told that backups are routinely performed, there are no written procedures outlining backup procedures or to ensure server backups are successful or that the data on the backups can be successfully restored.

By not developing written procedures, Town officials have not sufficiently addressed the Town's IT risks or developed written policies and procedures for data backup and restoration. If Town systems were compromised, the Town could lose essential information which may not be recoverable or could incur expenses for restoration of systems or for repair or replacement of equipment.

Breach Notification – An individual's private and/or financial information, along with confidential business information, could be severely impacted if the Town's computer security is breached or data is improperly disclosed. State Technology Law requires the Town to establish an information breach notification policy. Such a 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. It is important for the disclosure to 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. Safeguarding information is challenging when personal and business information is stored on laptop computers or portable media. Town residents, officials, employers and vendors have a right to expect that the Town will protect their personal, private or sensitive information.

The Board has not adopted a breach notification policy detailing how employees would notify individuals whose private information was, or is reasonably believed to have been, acquired by a person(s) without a valid authorization. Without an information breach notification policy, in the event that private information has been compromised,

Town officials and employees may not be prepared to notify affected individuals.

Disaster Recovery Plan – 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, catastrophic event (e.g., fire, computer virus or deliberate or inadvertent employee action) that compromises the availability or integrity of the IT system and data. Contingency planning to prevent loss of computer equipment and data, including the procedures for recovery in the event of an actual loss, is crucial to an organization. The plan needs to address the roles of key individuals and include 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. Disaster recovery planning also involves an analysis of continuity needs and threats to business processes and may include significant focus on disaster prevention.

Town officials have not prepared and tested a disaster recovery plan for the Town's financial system or its network system. In the event of a disaster, Town personnel have no guidelines or plan to follow to resume orderly operations as soon as possible, to help minimize or prevent the loss of equipment and data, or to provide guidance for implementing data recovery procedures. As a result of these control weaknesses, the Town's IT assets are at an increased risk of loss or damage, and there could be potentially costly disruptions to its critical operations.

## **Recommendations**

14. The Board should adopt a remote access policy which addresses the terms of use for both employees and non-employees. Town officials should also secure agreements with vendors regarding expectations and consequences of computer usage and should institute procedures for monitoring remote access.
15. The Board should adopt comprehensive policies and procedures addressing the safeguarding of computerized data and assets, including procedures to periodically test and restore back-up data to ensure that it is complete, accurate and useable.
16. The Board should establish and adopt a comprehensive information breach policy that details specific guidelines for informing individuals whose information may have been or has reasonably believed to have been compromised.
17. Town officials should develop and implement a formal disaster recovery plan, identifying potential risks and detailing the

responses to be taken. Town officials should distribute the plan to all responsible parties, periodically test the plan and update the plan as needed.

## **APPENDIX A**

### **RESPONSE FROM LOCAL OFFICIALS**

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



## Office of the Comptroller Town of Oyster Bay

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Comptroller

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October 31, 2013

Ira McCracken, Chief Examiner  
Office of the State Comptroller  
NYS Office Building, Room 3A10  
250 Veterans Memorial Highway  
Hauppauge, New York 11788-5533

Dear Mr. McCracken,

We have reviewed the draft report of examination on the Town of Oyster Bay's Financial Condition and Selected Financial Operations. Some of the recommendations have already been implemented, and those that remain will be taken under advisement by the Town Board and its officials. We appreciate the opportunity to reply to the recommendations listed in the draft report.

1. *The Board should develop a long-range financial plan that addresses the negative impact of its recurring operating deficits and eliminates deficit fund balances.*

The Town agrees with this recommendation and is in the process of developing a long range financial plan that will reverse the current trends.

2. *The Board must adopt budgets that are structurally balanced. Recurring revenues should be reasonably estimated and attainable, and sufficient to cover the cost of recurring services.*

The Town agrees with the recommendation and will produce a 2014 budget with reasonable estimates of recurring revenues that are sufficient to cover the costs of recurring expenses.

3. *Town officials should refrain from balancing operating budgets with non-recurring revenues or revenues that are speculative or contingent on future events, such as proceeds from litigation or land sales. Such revenues should generally be used to fund non-operating expenditures.*

When recurring revenues declined due to economic conditions, the Town utilized surplus and non-recurring revenue to balance these shortfalls. Going forward, the Town will be less dependent on non-recurring revenue sources.

4. *The Board should ensure that all funds are included in the budget adoption resolution and that each fund's total appropriation agrees with the amounts included in the detail budget document.*

Although the Town of Oyster Bay did not separately identify the Risk Retention Funds in the fund summary in the annual resolution for the budget, the Town did, in that same resolution include the Annual Budget Document, which included all of the Town's funds, inclusive of the Risk Retention Funds.

5. *Town officials should improve the methods used to project fund balances at year end so that, when adopting the budget, the Board does not appropriate excessive or non-existent fund balances.*

The Town agrees with this recommendation and will look to show improvement in this area when preparing future budgets.

6. *Town officials should ensure that all components of fund balance are reported or disclosed on financial statements for each fund, so that the full amount of fund balance appropriated to fund the ensuing year budget is shown.*

The Town's financial statements were presented in accordance with Generally Accepted Accounting Principles (GAAP), and therefore the presentation of the components of fund balance (in accordance with GASB No. 54) were correct in the Town's financial statements for the years ended 2008 through 2011. The State's restated fund balance presentation in Table 2 would not be proper presentation under GAAP. As stated in Governmental Accounting Standards Board Statement No. 54 – Fund Balance Reporting and Governmental Fund Type Definitions (GASB 54), paragraph 15 and 19, "governments should not report an assignment of fund balance for an amount to a specific purpose if the assignment would result in a deficit in unassigned fund balance...amounts assigned to other purposes in that fund should be reduced to eliminate the deficit." Under GASB 54, an appropriation of fund balance to fund the ensuing year's budget is classified as an assignment of fund balance. If the Town appropriated fund balance for the ensuing year's budget in excess of the fund balance available, the Town can only present the portion of the appropriated fund balance that is available as appropriated or assigned. The State's proposed restatement in Table 2, which presents a positive assigned fund balance with a negative unassigned fund balance, would not be proper presentation under GAAP reporting.

See  
Note 1  
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Additionally, under GAAP reporting and in accordance with GASB Codification Section 2300.106n, the Town is only required to disclose deficits in relation to non-major funds in the notes to the financial statements. Each year the Town details the reasons for all fund deficits in the notes to the financial statements, including, if applicable, fund deficits that were the result of budgetary planning.

The State implies that the Town did not present components of fund balance properly in accordance with GASB 54 and prior to implementation of GASB 54 when presenting assigned fund balance (designated fund balance prior to GASB 54). The State is of the opinion that there can be a deficit unassigned fund balance while still presenting positive components of assigned fund balance, but only for the general fund. Our interpretation of GASB 54 and prior guidance is that before presenting a deficit unassigned fund balance in any government fund, that the assigned components be reduced first. A government cannot assign resources it does not have. The Town's contract accountants, AVZ are of the opinion that before there can be a deficit in unassigned fund balance the assigned fund balance must be reduced to zero. AVZ advised the Town on this matter and it was further supported by the Town's auditors. In addition, the Town has had this issue in the past on other CAFR reports submitted to the GFOA and we have received comments when presenting a deficit in the unassigned fund balance component (or unreserved undesignated) while presenting positive components of assigned fund balance (undesignated fund balance).

See  
Note 2  
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We believe the Town financial statements are presented correctly and that the Town's fiscal condition was described adequately in the notes to the financial statements.

7. *The Board should ensure that the budget is continuously monitored and require that immediate action be taken to mitigate the negative impact of any significant revenue deficiency or any other significant budget shortfall.*

The Town agrees with this recommendation. State of the art accounting software is being tested now and will be implemented on January 1, 2014 allowing officials real time access to budgetary information.

8. *The Board should adopt a formal change-order policy to provide guidance in analyzing, processing, and authorizing change orders.*

The Town does have such a formal policy, which is incorporated as Articles 32 and 33 (and, when appropriate, Article 32(A)) of the Town's standard contract provisions in all of its Agreements for the procurement of construction services. The Town's formal change order policy as contained in these provisions: (1) requires both the prior recommendation of the appropriate Commissioner and the prior approval of the Town Board as a condition for payment of any change order; and (2) also contains detailed provisions for the pricing of such change orders. Where applicable, the Town's standard contracts also include provisions for the recognition of and payment for Differing Site Conditions (Article 32(A)). The Town's standard change order provisions are typical of such provisions in equivalent municipal construction contracts, and are well crafted for the purpose of controlling the use of change orders in order to insure that there is a legitimate reason for the change in the scope of the contract work and for the pricing of the resulting additional (or deleted) work.

See  
Note 3  
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9. *The Board should ensure that effort is made to minimize the need for change orders through effective capital planning so that all reasonably foreseeable work necessary to efficiently complete each project is included in the project scope, and ensuring that all bidders on the initial project have an opportunity to bid on the full scope of the project.*

In general, change orders are best minimized by adequate pre-bid site and subsurface investigation and by careful and thorough design. Most change orders originate from encountering either unknown or unanticipated subsurface or other site conditions, or from unintentional omissions in the original design drawings and specifications, and not from deliberate decisions by the project owners to add or expand beyond the original contemplated contract scope. In general, the design and execution of the site and subsurface investigation, and the preparation of the project drawings and specifications, are performed by the Town's independent outside consultants, not by the Town itself. Thus, as a practical matter, the primary input by the Town into the adequacy of the site investigation and preparation of the project plans and specifications is in its selection of the appropriate outside consultant to perform the technical engineering work. Historically, the professional consultants retained by the Town to perform these expert functions are well known and fully qualified in their respective fields to perform such services.

10. *Town officials and the Board should ensure that when change orders are significant in relation to the original cost of a project, are so varied from the original plan or alter the essential identity or main purpose of the contract as it may constitute a new undertaking, that either new bids be requested and the contract awarded to the lowest responsible bidder or the contract be let in accordance with provisions of the Town procurement policy.*

As a general principle, we agree with this recommendation.

However, when a major changed subsurface condition or omission in the project plans or specifications is discovered after an award is made, and especially once the project has commenced, whether to suspend or terminate a project and rebid is always a matter of judgment. Such judgment must take into account many factors, including often most critically the time impact of proceeding in that manner rather than by allowing the ongoing work to proceed via a change order to the contractor already in place on the job. It takes time (and substantial additional cost) to suspend or terminate a project and rebid the project. The potential loss of time is especially critical when dealing with public recreational facilities such as parks, where a whole season can be threatened by even a slight delay in completing a project, negatively impacting hundreds of youthful Town residents.

11. *All change orders should be reviewed and approved by the Board to ensure that the changes are necessary before any work is performed.*

As previously stated, the Town's change order policy, as embodied in Article 32 of the Town's standard construction contract terms and provisions, already provides that change orders, to be valid, must be approved in advance by the Town Board, on the recommendation of the Commissioner. However, in practice, strict adherence to this

requirement would result in unacceptable delays to the progress of projects and, in many cases, result in additional costs as a consequence of said delays. It is often simply not possible to interrupt or suspend a job for weeks at a time until the full Town Board can be convened to act on a change order. For projects that are time-sensitive, or which involve multiple contractors (such as any job awarded under the Wicks Law), any delay in allowing the work to proceed once the need for a change order has been identified can threaten both timely completion of the project, and result in claims for delay by the contractor involved, or other contractors, that can add substantially to the ultimate cost of the project. In addition, it is worth noting that it is the contractor that proceeds with the change order work prior to Town Board approval that is financially at risk.

12. *Town officials should ensure that bid specifications for contracts include reasonable estimated quantities for goods and services required to complete the project and that contract be awarded based on the total cost of the project.*
13. *Town officials should make every effort to ensure that estimated quantities included in bid specifications are realistic so that bids reflect the true value of the contract requirements over the contract term.*

We agree with recommendations numbered 12 and 13.

With regard to requirements contracts, under current Town practice (extending back to such contracts awarded over the last several years); most requirement-type contracts have been bid using estimated quantities based upon historical usage. The Electrical Requirements contract referred to in the draft Report was a special case, because it was the first such contract awarded, and therefore there was no Town historical experience upon which to base such estimated quantities. However, past historical usage is not always a safe guide to future usage, since actual usage of the types of work typically awarded via requirements contracts are quite variable, based on changes in Town priorities or as a result of weather events (e.g., Hurricane Sandy) and other natural causes.

14. *Claim vouchers should be sufficiently itemized to permit a proper audit of the charges.*

We agree with this recommendation.

15. *The Board should adopt a remote access policy which addresses the terms of use for both employees and non-employees. Town officials should also secure agreements with vendors regarding expectations and consequences of computer usage and institute procedures for monitoring remote access.*

The Town revised its IT Policy by resolution 1060-2012, dated 12/18/2012. This resolution included sections pertaining to remote access via VPN and the Town's wireless network. Town vendors have been provided with a computer usage agreement. The Town monitors remote access by maintaining a log of any user activity via VPN.

16. *The Board should adopt comprehensive policies and procedures addressing the safeguarding of computerized data and assets including procedures to periodically test and restore back-up data to ensure that it is complete, accurate, and useable.*

The Town's IT Department has undocumented procedures for backing up virtual, physical and database servers which are followed. The IT staff is aware of the procedures. The Town agrees that these procedures should be documented and a formal comprehensive policy is being drafted for inclusion in our updated IT policy.

17. *The Board should establish and adopt a comprehensive Information Breach Policy that details specific guidelines for informing individuals whose information may have been or has reasonable belief to have been compromised.*  
The Town agrees with this recommendation. A formal policy is being drafted for inclusion in our updated IT policy.
18. *Town officials should develop and implement a formal disaster recovery plan, identifying potential risks and detailing the responses to be taken. Town officials should distribute the plan to all responsible parties, periodically test the plan, and update the plan as needed.*

The Town agrees with this recommendation. The development of a comprehensive disaster recovery/business continuity plan is an approved project for 2013/2014. Preliminary discussions were held in early 2013; with phase 1 completed for the Department of Planning & Development. The development of the plan will be done in several phases; from design through implementation and follow up test schedule. Additionally, an application for funds under the Hazard Mitigation Grant Program has been submitted.

Once again, we appreciate the opportunity to respond to the recommendations and look forward to working with your office in the future.

\_\_\_\_\_  
Robert J. McEvoy  
Town Comptroller

RJM/hs

cc: Supervisor John Venditto  
Members of the Town Board

## **APPENDIX B**

### **OSC COMMENTS ON THE TOWN'S RESPONSE**

#### **Note 1**

We agree with the Town's interpretation of GASB 54's presentation of individual components of fund balance in financial statements and have revised our report accordingly.

#### **Note 2**

We agree with Town officials that the focal point of our finding is that "A government cannot assign resources it does not have." Therefore, we expect Town officials to follow their own interpretation of GASB 54 and prepare structurally-balanced budgets that rely on recurring and realizable revenues to fund recurring expenditures, without resorting to balancing the budget with fund balance it does not have or by including questionable revenue that may not be available to finance Town operations.

#### **Note 3**

We revised our report to indicate that change orders are generally negotiated between the contractors, a Town consultant and/or Town officials in accordance with individual contract provisions. However, before any work on the proposed change orders can be implemented, the change orders must be approved by the Board.

## **APPENDIX C**

### **AUDIT METHODOLOGY AND STANDARDS**

Our overall goal was to examine internal controls over the Town's financial operations. 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, 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 financial condition, limited purchasing activities and IT for further testing. To achieve our audit objective and obtain valid audit evidence, we performed the following procedures:

- We interviewed Town officials responsible for financial oversight and for maintaining accounting records to gain an understanding of the Town's budgeting practices and financial operations.
- We reviewed policies and procedures relevant to our audit objective.
- We analyzed operating funds having substantially deteriorating financial condition and those funds that had significant fund deficits during our audit period. These funds include the general fund, TOV fund and the SWDD fund.
- We obtained revenue and expenditure comparison reports for the fiscal years ending 2008 through 2011 and analyzed the budget-to-actual results for select funds.
- We reviewed estimates and year-to-date results of operation for the 2012 budget for select funds.
- We analyzed unexpended surplus funds and fund balances for select funds for the period 2008 through 2012.
- We performed trend analyses of select revenue items and fund balances for fiscal years 2008 through 2012.
- We reviewed the revenues for the 2012 adopted budget for the Garbage Collection Districts Fund.
- We reviewed certain estimated revenues included in the 2013 adopted budget.

- We selected 10 capital projects with change orders and compared the cost of each change order to the original contracts to determine whether the changes were approved in a timely manner by the Board and whether they were merely incidental to or significantly altered the nature of the original contract as to render them new undertakings that required competitive bidding.
- We judgmentally selected 10 of the highest paid claims totaling \$531,688 for electrical service and compared those items against those listed in the bid specifications.
- We selected 10 of the highest paid claims totaling \$1.2 million for the fencing contract and compared those items against those listed in the bid specifications.
- We interviewed local officials, employees and the Town's IT consultant to obtain an understanding of the organization's computer network.

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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# APPENDIX E

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