



Town of East Fishkill Financial Condition

Report of Examination

Period Covered:

January 1, 2012 — December 19, 2013

2014M-139



Thomas P. DiNapoli

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State of New York Office of the State Comptroller

Division of Local Government and School Accountability

August 2014

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 East Fishkill, entitled Financial Condition. This audit was conducted pursuant to Article V, Section 1 of the State Constitution and the State Comptroller's authority as set forth in Article 3 of the General Municipal Law.

This audit's results and recommendations are resources for local government officials to use in effectively managing operations and in meeting the expectations of their constituents. If you have questions about this report, please feel free to contact the local regional office for your county, as listed at the end of this report.

Respectfully submitted,

*Office of the State Comptroller
Division of Local Government
and School Accountability*

Introduction

Background

The Town of East Fishkill (Town), located in Dutchess County, has approximately 29,000 residents. The Town Board (Board) is the legislative body responsible for overseeing Town operations, including establishing internal controls over financial operations and maintaining sound financial condition. The Town Supervisor (Supervisor) is a member of the Board and serves as the chief executive officer. The Supervisor is responsible for receiving, disbursing and maintaining custody of Town moneys; maintaining accounting records; and providing financial reports to the Board. The Board is responsible for the general management and control of the Town's financial affairs. The Board has the authority to levy taxes on real property located within the Town, set the rates for sewer user fees and issue debt. The Supervisor and department heads also share the responsibility for ensuring that internal controls over the Town's financial operations are adequate and working properly.

The Town Comptroller is responsible for maintaining the Town's accounting records on behalf of, and under the direction of, the Supervisor. The Town Tax Collector collects taxes, assessments and sewer rents payable to the Town.

The Town provides various services to its residents, including street maintenance, lighting, water, recreation, sewer and general government support. Expenditures incurred in providing these services are accounted for in the general, highway, water, sewer and lighting funds. For fiscal year 2013, total appropriations totaled \$19.3 million, including appropriations of \$1.56 million for three sewer districts. For fiscal year 2014, total budgeted appropriations totaled \$19.9 million, again including appropriations of \$1.56 million for the sewer districts. Expenditures are funded primarily by real property taxes, user charges and State aid.

The sewer fund primarily derives its revenue from real property taxes and sewer rents. The three sewer districts have real property taxes levied to fund the debt payments required for the corresponding fiscal year. The sewer rents charged are used to operate the districts.

Objective

The objective of our audit was to review the financial condition of the Town's sewer fund. Our audit addressed the following related question:

- Did Town officials adequately monitor the sewer fund's financial operations to ensure fiscal stability?

**Scope and
Methodology**

We examined the Town sewer fund's financial condition for the period January 1, 2012 through December 19, 2013. We extended our scope period to include fiscal year totals from 2009, 2010 and 2011 for trend analysis. In addition, we reviewed fiscal year 2013 financial information.

We conducted our audit in accordance with generally accepted government auditing standards (GAGAS). More information on such standards and the methodology used in performing this audit are included in Appendix C of this report.

**Comments of
Local Officials and
Corrective Action**

The results of our audit and recommendations have been discussed with Town officials and their comments, which appear in Appendix A, have been considered in preparing this report. Town officials took exception with some of the findings in our report. Appendix B includes our comments on 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

Financial condition may be defined as a local government's ability to balance recurring expenditure needs with recurring revenue sources, while providing desired services on a continuing basis. A local government in good financial condition generally maintains adequate service levels during fiscal downturns and develops resources to meet future needs. Conversely, a local government in fiscal stress may struggle to balance its budget, can suffer through disruptive service level declines, may have limited resources to finance future needs, and often has minimal cash available to pay current liabilities as they become due. Town officials have a responsibility to taxpayers to ensure that their tax burden is not greater than necessary. To fulfill this responsibility, it is essential that Town officials develop reasonable budgets and manage fund balance responsibly.

Town officials did not adopt realistic budgets based on historical or known trends for the Town's three sewer districts. In addition, the Board did not effectively monitor the budgets throughout the year and did not require the Town Comptroller to present accurate and reliable financial information on a regular basis. As a result, the sewer fund's financial condition has deteriorated in recent years. As of December 31, 2012, the sewer fund reported an accumulated deficit of \$160,150 and its accumulated deficit for 2013 was approximately \$249,000. As a result, the sewer fund has had to rely on the general fund to subsidize its operations, which causes a taxpayer inequity. As of December 31, 2013, the sewer fund owed the general fund \$406,579.

Fund Balance

A key measure of the Town's financial condition is its level of fund balance, which is the difference between revenues and expenditures accumulated over time. When maintained at reasonable levels, fund balance provides cash flow and can be used to help finance the next fiscal year's operations. The restricted portion of fund balance represents the amount that the Town may use only for specific purposes. The unrestricted portion of fund balance is the amount that may be appropriated to fund programs in the next year's budget. To assist in managing financial operations and ensuring the orderly operation of government, the Town should maintain a reasonable level of unexpended surplus funds¹ as a financial cushion for unanticipated

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

expenditures and revenue shortfalls. The Board should adopt budgets that are based on realistic estimates of revenues and expenditures so that the fund balance is maintained at healthy levels.

The Town’s sewer fund comprises three sewer districts: Hamlet, Sagamor and Four Corners. The Town consolidated the districts’ financial information for reporting purposes. The Town ended 2012 with a deficit fund balance for the consolidated sewer fund for the first time. However, as illustrated in Table 1, the Hamlet Sewer District had deficit fund balances from fiscal years 2010 through 2013. The Town acquired the Four Corners Sewer District in 2011 and this district ended 2012 and 2013 with a deficit fund balance. The Sagamor District, purchased by the Town in 2010, is the only district that has a positive level of unexpended surplus funds.

Fiscal Year	2009	2010	2011	2012	2013 ^b
Hamlet	\$6,802	(\$39,771)	(\$188,935)	(\$307,148)	(\$401,860)
Sagamor	-	\$102,634	\$220,218	\$174,381	\$184,911
Four Corners	-	-	\$24,998	(\$27,384)	(\$31,682)
Consolidated	\$6,802	\$62,863	\$56,281	(\$160,151)	(\$248,631)

^a Numbers in parentheses indicate negative values.
^b 2013 amounts are unaudited.

The decline in fund balance to negative amounts was caused by operating deficits, poor budgeting and inadequate user charges. In addition, the construction of the Hamlet District’s sewer plant at a cost of \$15.5 million and the initial lack of users after the 2010 plant opening further exacerbated the sewer fund’s financial condition. Because the sewer fund is not self-sustaining, it has relied on transfers from the general fund to subsidize its operations.

Budgeting

It is essential that the Board adopt structurally balanced budgets for all of the Town’s operating funds that provide recurring revenues to finance recurring expenditures and provide a reasonable fund balance to finance capital repairs and maintenance. Effective management includes monitoring budgets during the course of the year and making any needed budgetary amendments to address revenue shortfalls or costs that exceed appropriations. Recurring operating deficits usually indicate a failure to ensure that budgets are realistic and properly monitored.

Table 2: Sewer Fund - Operating Results

Fiscal Year	2009	2010	2011	2012	2013
Estimated Revenues	\$697,680	\$1,045,150	\$983,501	\$1,542,138	\$1,562,310
Actual Revenues	\$728,546	\$913,326	\$1,010,892	\$1,359,500	\$1,460,249
Over/(Under) Budget	\$30,866	(\$131,824)	\$27,391	(\$182,638)	(\$102,061)
Budgeted Appropriations	\$697,680	\$1,045,150	\$983,501	\$1,542,138	\$1,562,310
Actual Expenditures	\$719,962	\$856,409	\$981,714	\$1,575,932	\$1,548,728
(Over)/Under Budget	(\$22,282)	\$188,741	\$1,787	(\$33,794)	\$13,582
Operating Surplus/(Deficit)	\$8,584	\$56,917	\$29,178	(\$216,432)	(\$88,479)

The sewer fund's operating deficits occurred in fiscal years 2012 and 2013 primarily because Town officials overestimated revenues. The fund's two major revenue sources are property taxes levied to cover debt service costs and sewer rents. Town officials stated that they prepare the sewer fund budget by first determining necessary appropriations and calculating expected property tax revenue. They then balance the budget by calculating the remainder as sewer rents. This budgeting practice has resulted in the sewer fund's operating deficits because budgeted sewer rents were continually more than the actual rents billed and collected. For example, revenues from sewer rents collected were \$222,581 (50 percent) less than budgeted in 2012 and were \$121,270 (28 percent) less than budgeted in 2013.

Town officials were aware that their budgeted sewer rents revenues were unrealistic. Officials continued to use inflated revenue estimates in the budget because they were reluctant to raise sewer rates in anticipation that new users would be added each year due to ongoing projects. Town officials expect that additional revenues resulting from these new users will eventually eliminate the deficit with minimal rate increases. Town officials also project that sewer rents revenue will increase in 2014 and 2015 due to development projects that are in progress. These additional revenues will potentially reduce the deficit but not eliminate it. Town officials project that the Hamlet Sewer District will reach the breakeven point by 2016.

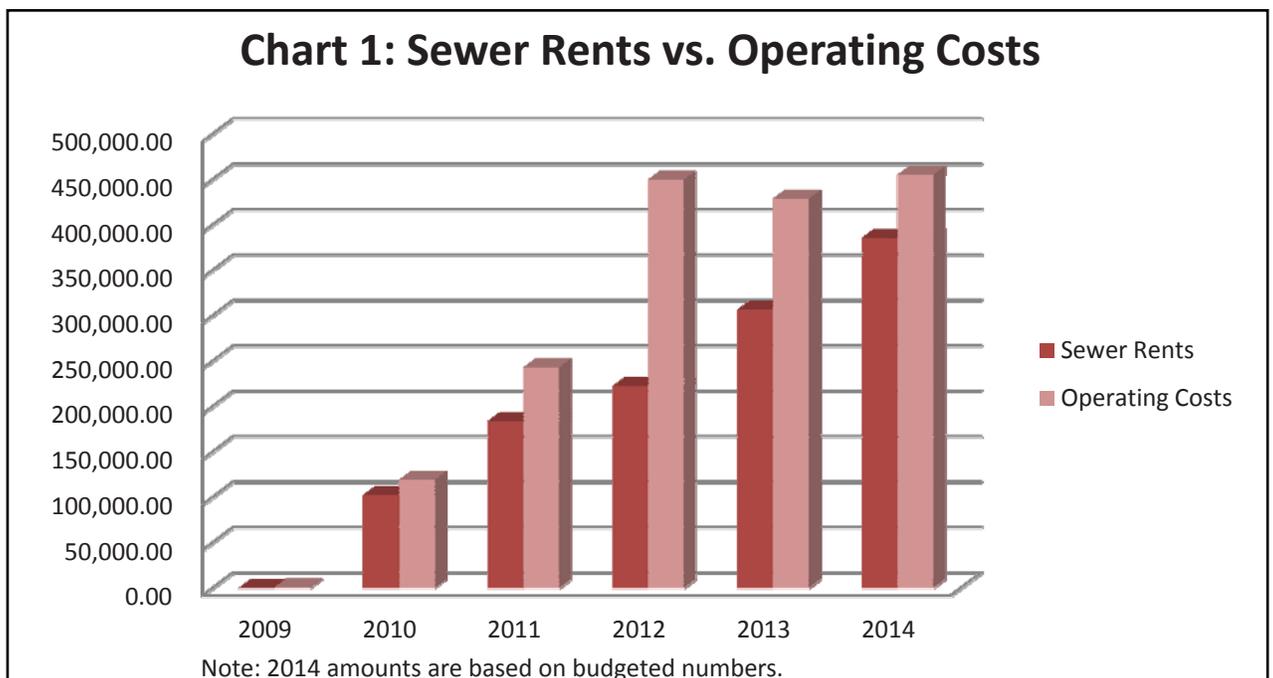
By adopting budgets that do not raise sufficient revenues to fund expenditures, the Board caused the sewer fund to incur operating and fund balance deficits. Unless the Board improves its budgeting practices by developing more realistic estimates, the sewer fund will continue to experience operating deficits and its financial condition will continue to deteriorate.

User Charges

Town officials are responsible for ensuring that sewer fund revenues are sufficient to finance operations. As such, Town officials should review sewer rent charges periodically to determine that revenues

are sufficient to cover the total cost of operation and maintenance of sewage treatment facilities. Based on that review, the Board should revise, if necessary, the sewer rent charges to generate sufficient revenue to pay the total operation and maintenance costs.

Town officials did not revise the sewer rent charges from 2009 through 2013 although two of the sewer districts had repeated operating deficits. According to Board members, the Town Comptroller was not required to regularly provide financial reports to the Board so that it could monitor results of operations. The Supervisor stated that the Board has been reluctant to raise the sewer rents all at once to the level appropriate to fully fund the sewer operations as the increases would have been large. Rather, Town officials feel that the increases should be gradual. The Board increased the 2014 sewer rents for the Hamlet Sewer District by 4.4 percent and Four Corners Sewer District by 2.8 percent. However, the rate increases are insufficient to cover the operating and maintenance costs of these districts, as shown on Chart 1.



Although the gap will be less than in prior years, we project that sewer rents will be approximately \$75,000 (17 percent) less than the operating costs in fiscal year 2014. As of our time of fieldwork, the sewer fund will likely have to rely on the general fund to subsidize its operations once again. Town officials have asserted that the operating deficits will continue to decrease and that the sewer fund should start seeing a surplus in operations by 2016 based on the Town’s most recent projections.

Interfund Advances

General Municipal Law (GML) allows municipalities to temporarily advance moneys from one fund to another with certain restrictions. When Town officials advance moneys between funds that have different tax bases, they must repay the loans, with comparable amounts of interest, by the end of the fiscal year in which the loans are made. In addition, financing recurring operating expenditures with non-recurring revenue sources, such as interfund loans, is indicative of poor budgeting and financial management, which often leads to poor financial condition.

The Town funded the sewer fund's deficits with interfund advances from the general fund, which has a different tax base from the sewer fund. As of the end of fiscal year 2013, the sewer fund owed the general fund \$406,579. Town officials stated that they were aware the sewer fund needed to repay the general fund but have not done so because the sewer fund does not have the funds. The general fund's subsidizing of the sewer fund creates a taxpayer inequity, as general fund taxpayers are paying for sewer services that they did not receive.

As a result of the Board's inadequate monitoring, the Town's sewer fund is not self-sustaining. Town officials were aware of the sewer fund's deficit fund balance and believed that future expansion will help to alleviate the operating deficits. However, Town officials' failure to align user rates and billings with budgeted revenues has caused the sewer fund's financial condition to deteriorate. As a result, the Town is at an increased risk of not having the funds necessary to provide sewer services at acceptable levels.

Recommendations

1. The Board should closely monitor the sewer fund's financial condition throughout the year.
2. The Board should develop reasonable and realistic sewer budget estimates.
3. The Board and Town officials should review sewer rent charges and revise them to generate sufficient revenues to pay the total costs needed to properly operate and maintain the facilities and sewer lines.
4. The Board should ensure that all interfund borrowing is repaid in accordance with the law.

APPENDIX A

RESPONSE FROM LOCAL OFFICIALS

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

The Town's response letter also contained additional attachments. Because the response letter generally describes the attachments' contents, we did not include them in Appendix A.



Town of East Fishkill

Dutchess County, New York

330 Route 376, Hopewell Junction, New York 12533
Telephone 845-226-2634

July 24, 2014

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

Re: Financial Condition Audit
Sewer Fund

On June 27th, officials from the Town of East Fishkill met with representatives from the Office of the State Comptroller to discuss a draft copy of the Sewer Fund's Financial Condition Report. In that meeting town officials pointed out numerous factual inaccuracies and misleading statements contained within the draft. OSC representatives conceded to a number of the changes requested and elected to keep others in the report, noting that the Town could address them its formal response or CAP. It was the Town's understanding that this revised draft copy would be provided to the Town so that a proper response could be created for inclusion in the final report.

See
Note 1
Page 15

The revised draft was never sent to the Town, however, a call was received on the afternoon of July 24th "reminding" the Town that a formal response was due by 5:00pm that day. It is unclear to Town officials how to respond to a draft report that has never been provided to them for review, so this response will be to the original, flawed draft.

See
Note 2
Page 15

1. The general thrust of the OSC Report is that the Sewer Fund does not have sufficient annual revenues to support its operating expenditures. This condition is acknowledged by the Town, with the basic explanation that a) it is the Hamlet Sewer District that has operating deficits, not all of the districts in the Sewer Fund; b) the Hamlet district was designed/built in the middle of a housing boom, but began operations at the beginning of the housing crash (which was not foreseen by either the Town officials at the time or the Office of the State Comptroller which reviewed the project and signed off on its feasibility); and c) we have steadily closed the deficit and have a plan to create an operating surplus within 1 -2 years.

See
Note 3
Page 15

In order to breakeven during the first several years of its operation, the Town would have had to charge users in Hamlet Sewer District exorbitant fees. Town officials chose not to place that extreme burden on the first users in the district knowing that the number of users would grow steadily and that the district deficit would be eliminated within a reasonable period of time.

See
Note 4
Page 15

2. Quote from the Report: "As a result, the sewer fund has had to rely on the general fund to subsidize its operations, which causes a taxpayer inequity. As of December 31, 2013, the sewer fund owed the general fund \$406,579 with no plans for repayment".

This is both misleading and inaccurate. The misleading part is that it is not a subsidy, but rather a loan. A subsidy implies that the General Fund gave/transferred monies to the Sewer Fund in order to cover its operating expenses. However, there is no taxpayer inequity because funds advanced by the General Fund to the Sewer Fund will be repaid by the end of 2015. The inaccurate part is to state there is no plan, when in fact there is a repayment plan in place and it was described to the OSC auditors during their examination. See page *attachment 1* for more details.

See
Note 5
Page 15

See
Note 6
Page 16

3. Quote from the Report: “and the lack of new users since the 2010 plant opening have further exacerbated the sewer fund’s financial condition”

This is factually inaccurate. There has been a steady increase in users within the Hamlet district. This was told to OSC during their field examination, this was emailed to OSC on February 26th, and this was explained in the initial draft meeting. See *attachments 1* and *2* for more details.

See
Note 7
Page 16

4. Quote from the Report: “Town officials project that the Hamlet Sewer District will reach the breakeven point by 2016”.

This is misleading. Town officials expressed the opinion that the Hamlet Sewer District will reach the breakeven point no later than 2016. Sufficient users to create an operating surplus will be on-line sometime in 2014 in the most likely scenario, meaning that 2015 will be the first full-year with an operating surplus.

5. Quote from the Report: “Town officials did not revise the sewer rent charge from 2009 through 2013 although two of the sewer districts had repeated operating deficits”.

This is factually inaccurate. According to OSC’s own numbers in the report, only one district (Hamlet) had repeated deficits. And as explained above, Town officials did not want to unfairly burden the initial district users with excessive user fees.

See
Note 8
Page 16

6. Quote from the Report: “According to Town officials, this amount [Due to General] includes costs associated with the construction of the Hamlet District’s sewer plant.”

See
Note 9
Page 16

This is false on two levels: 1) General Fund monies were not used to construct the sewer plant and 2) at no point did a Town official state or imply that such funds were used in this manner.

Respectfully submitted,

John L. Hickman, Jr.

Town Supervisor

Town of East Fishkill Hamlet Sewer Fiscal Plan

CREATE AN OPERATING SURPLUS

The goal for the Hamlet Sewer District is to move from a position of annual operating deficits to small annual operating surpluses. The function of the surpluses is to slowly build fund balance in the district to allow for significant "one-off" expenditures in future years without the need to borrow.

				Projected	Projected	Projected
	2011	2012	2013	2014	2015	2016
Benefit Units @ Q4	0	84.5	239.5	310	390	450
Quarterly Sewer Rents	\$ 108.91	\$ 108.91	\$ 108.91	\$ 113.75	\$ 118.75	\$ 123.75
Annual Operating Revenue (based on BU in Q4)	\$ -	\$ 36,812	\$ 104,336	\$ 141,050	\$ 185,250	\$ 222,750
Annual Operating Expenditures	\$ 131,441	\$ 137,028	\$ 192,838	\$ 152,500	\$ 175,000	\$ 200,000
Surplus/(Deficit)	\$ (131,441)	\$ (100,216)	\$ (88,502)	\$ (11,450)	\$ 10,250	\$ 22,750
Note: Operating Expenditures do not include debt payments. Operating Revenues do not include property tax receipts.						

REPAY DUE TO/DUE FROM

The Capital Project associated with the formation of the Hamlet Sewer District will be closed in 2014 with a cash balance of over \$404,000. This represents the almost identical amount of "Due Tos" in the Hamlet Sewer District. The Town can only use this money to pay down debt within the Hamlet Sewer District.

The Hamlet Sewer District property tax revenue is raised to the extent of debt payments (principal and interest) each year.

2014 Hamlet Sewer Property Taxes: \$981,185

2014 Hamlet Sewer Bond Principal Due: \$322,438

2014 Hamlet Sewer Bond Interest Due: \$658,742

2014 Total Hamlet Sewer Bond Payments: \$981,180

Therefore, if the excess debt monies are used to pay \$322,438 in principal in 2014 – that same amount in tax revenue will be freed up to clear the majority of the district's "Due Tos". Any amount not paid back in 2014, will then be paid back in 2015 using the same methodology.

[REDACTED]

From: [REDACTED]@eastfishkillny.org>
To: [REDACTED]@osc.state.ny.us>
Sent: Wednesday, February 26, 2014 3:55 PM
Subject: Re: Sewer Rates and Number of Units

We started billing for useage in mid-2012. At that time, there were 84.50 BU billed.

At the end of 2012, there were still 84.50 BU

At the end of 2013, there were 239.5 BU

I think by the end of 2014, there will be ~ 295 BU

And by the end of 2015, I think there realistically could be 315 - 390.

After that, growth will likely be slow -- but steady.

Thanks,
[REDACTED]

----- Original Message -----

From: [REDACTED]@osc.state.ny.us
To: [REDACTED]
Sent: Wednesday, February 26, 2014 11:41 AM
Subject: Re: Sewer Rates and Number of Units

Good morning, [REDACTED]

Just a follow up regarding the Hamlet sewer rent information.

Thank you for your time.

[REDACTED]
Senior Examiner
Office of the State Comptroller
33 Airport Center Drive, Suite 103
New Windsor, NY 12553

[REDACTED]@osc.state.ny.us

From: [REDACTED]
To: [REDACTED]
Date: 02/20/2014 03:28 PM
Subject: Re: Sewer Rates and Number of Units

APPENDIX B

OSC COMMENTS ON THE TOWN'S RESPONSE

Note 1

We held an exit discussion with Town officials on June 27, 2014 to clarify any misunderstandings in the report and ensure that the report was factually correct. During the discussion, Town officials expressed concern about how readers might interpret a few sentences in the report. We agreed to consider revising the sentences in question using the wording Town officials suggested to avoid possible misinterpretation. At no time during our discussion did we tell Town officials that a revised draft would be issued.

Note 2

We sent a draft report to Town officials on June 24, 2014 and held an exit discussion with Town officials on June 27, 2014. The Town's response to the draft report was due on July 24, 2014. We did not tell Town officials that we would reissue the draft report. We stated that we would consider the wording changes that they suggested. In a phone conversation held on July 25, 2014, Town officials told us that they assumed we would reissue the draft report.

Note 3

OSC's review of and sign-off on the Town's sewer district formation or establishment was based on project construction cost estimates that Town officials provided. This review and sign-off process does not include any assessment of future operating costs or operation performance.

Note 4

The Board should not place the burden on taxpayers who do not benefit from the sewer districts in question.

Note 5

General Municipal Law §9-a states that interfund advances must be repaid no later than the close of the fiscal year in which advance was made with interest if the advance was made from a fund with a different tax base. Based on information Town officials provided during our fieldwork, the general fund has advanced moneys to the sewer fund without repayment as required by law for at least three consecutive years. Therefore, the general fund is subsidizing the sewer fund.

Note 6

Town officials did not provide a formal repayment plan during our audit fieldwork. We amended the wording in the report based on the updated information Town officials provided with their email dated June 27, 2014, after our exit discussion.

Note 7

On June 27, 2014, Town officials provided us with a spreadsheet with amounts that showed improvement based on projected number of added users (they subsequently included this as part of their response). However, they did not provide any support to justify how they arrived at those projections. The information provided in the email dated February 26, 2014 is different from the information that was provided on June 27, 2014, after the exit discussion. In addition, Town officials used the best case scenario in calculating when an operating surplus would occur. Regardless of this projection, the sewer district is still in a deficit position and being subsidized by the general fund.

Note 8

As Table 1 in the report illustrates, the ending fund balances for both Hamlet and Four Corners decreased in 2012 and 2013, which resulted from operating deficits.

Note 9

Based on discussions with Town officials at the June 27, 2014 exit conference, we amended the report.

APPENDIX C

AUDIT METHODOLOGY AND STANDARDS

Our overall goal was to assess the Town's financial condition and identify areas where the Town could realize efficiencies and protect assets from loss or misuse. To accomplish this, our initial assessment included a comprehensive review of the Town's financial condition.

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

- We reviewed the Town's policies and procedures for developing and reporting information relevant to financial and budgeting activities. This included gaining information on Town officials' fiscal responsibilities.
- We interviewed Town officials to determine what processes were in place and gain an understanding of the Town's financial condition and budget.
- We reviewed and analyzed the Town's financial records and reports for the sewer fund, including balance sheets, budget reports, and statements of revenues and expenditures for fiscal years 2009 through 2013.

We conducted this performance audit in accordance with GAGAS. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

APPENDIX D

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