



# Village of Middleville

## Internal Controls Over Financial Operations

### Report of Examination

Period Covered:

June 1, 2004 — May 31, 2008

2009M-201



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**

February 2010

Dear Village 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 Village 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 Village of Middleville, entitled Internal Controls Over 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 Village of Middleville (Village) is located in the Towns of Newport and Fairfield in Herkimer County, and serves approximately 535 residents. The Village is governed by an elected Board of Trustees (Board) which is comprised of a Mayor and two Trustees, all of whom are elected for two-year terms.

The Board is responsible for the general oversight of the Village's operations. The Mayor, who is a member of the Board, is the chief executive officer and the Village Treasurer is the chief fiscal officer. As the chief fiscal officer, the Treasurer is responsible for the custody of Village moneys, maintaining appropriate accounting records, and preparing monthly and annual financial reports. Although the Board is primarily responsible for the effectiveness and proper functioning of the Village's internal controls, the Mayor and Treasurer also share the responsibility for ensuring that internal controls are adequate and working properly.

The Village's 2007-08 general fund budget was approximately \$255,000 and was funded primarily by real property taxes, revenues from fire protection contracts, and sales tax. The water fund budget of \$64,340 was funded primarily by water rents.

### **Scope and Objective**

The objective of our audit was to review the Village's internal controls over financial operations for the period of June 1, 2004 to May 31, 2008. The Village was unable to locate water meter records for the period June 1, 2004 to June 30, 2006. As a result, we were unable to test water billings for this period. Our audit addressed the following related questions:

- Did the Board provide adequate oversight of the financial operations of the Village?
- Did the Treasurer establish internal controls to help ensure that the cash receipts and disbursements were adequately safeguarded, and that financial activity was properly supported and accurately recorded and reported on a timely basis?

### **Audit Results**

The Board did not provide adequate oversight of the Village's financial operations and the Treasurer did not establish internal controls to ensure cash receipts and disbursements were safeguarded, and financial activity was properly supported and accurately recorded. As a result, there is an increased risk for unauthorized or improper transactions to occur and go undetected.

The Board did not segregate the Treasurer's duties or institute compensating controls where necessary and it did not annually audit the Treasurer's records and reports. In addition, the Board did not establish controls to ensure that it audited all claims and that claims were supported by adequate documentation and complied with the Village's procurement policy.

Our tests of 135 disbursements totaling \$57,566 disclosed 12 payments to a contractor totaling about \$10,800 that were not supported by written contracts or other documentation indicating that the Board approved the work ahead of time or established the amount the contractor would be paid. We also found that 30 payments totaling \$6,817 were not supported by original invoices or receipts and 20 payments totaling \$6,497 did not contain documentation showing that the Board audited and approved the payment. In addition, 20 payments totaling \$3,888 were not supported by any documentation and six petty cash and expense reimbursements totaling \$1,200 were not supported by receipts or other documentation. As a result, Village officials do not have sufficient assurance that these payments were for legitimate Village expenditures.

Although the Board has adopted a procurement policy to help guide the Village's purchasing activities, the Board did not properly oversee and monitor purchases to ensure that the policy was followed. There was no documentation indicating that quotes or proposals were obtained for any of the 11 purchases we tested totaling \$14,402. The failure to abide by and monitor compliance with the Village's procurement policy increases the risk that goods or services will not be obtained at the lowest possible price and that public moneys will not be used in the best interests of the taxpayers.

The Board also did not ensure that timesheets containing supervisory approval were always prepared and kept on file to support payroll payments to hourly workers. For the fiscal year ended May 31, 2008, salaries, wages and employee benefits amounted to about \$70,000, or 21 percent of the Village's expenditures. We tested 16 payroll payments totaling \$6,265 made to four employees during the audit period. Timesheets supporting three payments totaling \$916 could not be located by Village officials and the time record for one payment for \$438 was not complete. Because of the insufficient controls over timesheets, the Village is at increased risk of compensating employees for hours they did not actually work.

Two individuals served as Treasurer during our audit period. The computerized accounting systems used by the Village allowed the Treasurers to change previously entered information without the system tracking the change. In addition, the Treasurers did not regularly document monthly bank reconciliations, and one Treasurer did not adequately support journal entries that adjusted recorded cash balances. These entries increased cash balances by about \$88,000 and decreased cash balances by about \$34,000 during the 2005-06 and 2006-07 fiscal years. Lastly, we found no indication that either Treasurer maintained chronological cash receipts records or receivable control accounts for real property taxes and water rents and monthly and annual financial reports were not filed in a timely manner. As a result of these weaknesses, there is an increased risk that cash is not adequately safeguarded and improper cash transactions could occur and go undetected.

### **Comments of Local Officials**

The results of our audit and recommendations have been discussed with Village officials and their comments, which appear in Appendix A, have been considered in preparing this report. Village officials generally agreed with our recommendations and indicated they have initiated corrective action.

# Introduction

## Background

The Village of Middleville (Village) is located in the Towns of Newport and Fairfield in Herkimer County, and serves approximately 535 residents. The Village is governed by an elected Board of Trustees (Board) which is comprised of a Mayor and two Trustees, all of whom are elected for two-year terms.

The Board is responsible for the general oversight of the Village's operations. The Mayor, who is a member of the Board, is the chief executive officer and the Village Treasurer is the chief fiscal officer. As the chief fiscal officer, the Treasurer is responsible for the custody of Village moneys, maintaining appropriate accounting records and preparing monthly and annual financial reports. Although the Board is primarily responsible for the effectiveness and proper functioning of the Village's internal controls, the Mayor and Treasurer also share the responsibility for ensuring that internal controls are adequate and working properly.

The Village provides fire protection to its residents, and by contract to the Towns of Newport and Fairfield. In addition, the Village provides a variety of other services to the community including water services, sidewalk snow removal, parks maintenance, and a summer recreation program.

The Village's 2007-08 general fund budget was approximately \$255,000 and was funded primarily by real property taxes, revenues from fire protection contracts, and sales tax. The water fund budget of \$64,340 was funded primarily by water rents.

The current Mayor and Trustees took office in April 2007.<sup>1</sup> They requested an audit by the Office of the State Comptroller due to missing bank records, unsupported entries in the accounting records, questionable payments and various other concerns related to the Village's financial operations prior to April 2007.<sup>2</sup> Upon taking office, the Mayor also suspended the use of the Village's Revolving Loan Fund (RLF) and requested a review of the RLF financial activity by the U.S. Department of Housing and Urban Development (HUD) due to potential financial improprieties.<sup>3</sup> HUD completed

<sup>1</sup> The current Mayor served as a Trustee from April 2006 until April 2007.

<sup>2</sup> The Mayor was able to obtain the missing bank statements and cancelled checks from the bank prior to our audit.

<sup>3</sup> The Village was awarded a HUD-administered Small Cities Community Development Block Grant (CDBG) grant in 1987. As a component of the grant, \$290,759 was allocated to provide low interest loans to homeowners for the purpose of addressing sub-standard residential conditions. The RLF was established to generate future loans to additional homeowners using loan repayments.

a review and issued a report in May 2008 that identified major violations of the Small Cities Community Development Block Grant (CDBG) program regulations, including a failure to maintain adequate financial controls and accounting systems, questionable costs of approximately \$50,000, failure to follow conflict of interest regulations, and inadequate files and records to support that program funds were used for eligible activities. The RLF had a balance of about \$30,500 at the time of HUD's review.

## **Objective**

The objective of our audit was to review the Village's internal controls over its financial operations. Our audit addressed the following related questions:

- Did the Board provide adequate oversight of the financial operations of the Village?
- Did the Treasurer establish internal controls to help ensure that the Village's cash receipts and disbursements were adequately safeguarded, and that financial activity was properly supported and accurately recorded and reported on a timely basis?

## **Scope and Methodology**

We interviewed Village officials and examined the Village's financial records for the period June 1, 2004 to May 31, 2008. The Village was unable to locate water meter records for the period June 1, 2004 to June 30, 2006. As a result, we were unable to test water billings for this period. Because HUD recently examined activity in the RLF, we did not review the RLF as part of our 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 are included in Appendix B of this report.

## **Comments of Local Officials and Corrective Action**

The results of our audit and recommendations have been discussed with Village officials and their comments, which appear in Appendix A, have been considered in preparing this report. Village officials generally agreed with our recommendations and indicated they have initiated corrective action.

The Board has the responsibility to initiate corrective action. A written corrective action plan (CAP) that addresses the findings and recommendations in this report should be prepared and forwarded to our office within 90 days, pursuant to Section 35 of the General Municipal Law. For more information on preparing and filing your CAP, please refer to our brochure, *Responding to an OSC Audit*

*Report*, which you received with the draft audit report. We encourage the Board to make this plan available for public review in the Clerk's office.

## Board Responsibilities

The Board is responsible for the oversight of the Village's financial operations and making sure that procedures are in place to safeguard the Village's financial resources. The Board fulfills this responsibility in part by instituting appropriate internal controls over the duties of the Treasurer to ensure that financial transactions are properly authorized, recorded, and reported and by annually auditing the Treasurer's records and reports. A major component of such internal controls is the segregation of the Treasurer's duties so that the Treasurer is not able to control substantially all phases of an accounting transaction. The Board is also responsible for ensuring that claims are audited prior to payment, purchases are made in compliance with procurement policies and timesheets are properly authorized to support payroll payments.

The Board did not provide adequate oversight of the Village's financial operations. The Board did not segregate the Treasurer's duties or institute compensating controls where necessary and it did not annually audit the Treasurer's records and reports. In addition, the Board did not establish controls to ensure that it audited all claims and that all claims were supported by adequate documentation and were in compliance with the Village's procurement policy. Lastly, the Board did not ensure that timesheets containing supervisory approval were prepared and kept on file to support payroll payments to hourly workers.

### Segregation of Duties

A basic principle of any internal control system is the requirement that there be an appropriate system of checks and balances in operations so no one individual can control all aspects of individual financial transactions. In order to help safeguard cash, the same individual should not receive and deposit cash, prepare and disburse checks, record transactions in the accounting records, and perform monthly bank reconciliations. If it is not practical to adequately segregate the financial duties, the Board should then exercise sufficient oversight to help ensure that transactions are properly recorded and reported, and that moneys are accounted for properly. For example, the Mayor or another member of the Board or a committee could review monthly cash reconciliations to verify that bank accounts are being reconciled correctly; review other banking documents to see if payments and withdrawals were authorized and accounted for properly; periodically determine that proper accounting records are being maintained on a current basis and ensure that appropriate financial reports are being prepared.

The Treasurer performed all aspects of the Village's financial and recordkeeping duties including receiving and disbursing monies, processing payrolls, billing and recording water rents, and maintaining the Village's accounting records. There was no segregation of key financial duties or other compensating controls in place. Because of the Village's small size, we recognize that it may be impractical to segregate the Treasurer's duties. However, in these circumstances, it is imperative that the Board provide sufficient oversight and compensating controls over the Treasurer's financial duties.

Concentrating key duties (e.g., receiving and depositing cash, recordkeeping, reconciling cash and preparing checks) with one individual weakens internal controls and significantly increases the risk that cash could be received and not deposited or improper checks could be written and be concealed with a journal entry and not be detected.

### **Annual Audit**

An annual audit of the Treasurer's records and reports serves as an important internal control over cash receipts and disbursements by providing independent verification that transactions have been properly recorded and reported and that cash has been properly accounted for. It also provides Board members with added assurance that the Treasurer's financial records and reports contain reliable information on which to base management decisions. An annual audit is especially important when there is limited segregation of duties.

The Board did not audit or contract with an independent auditor to audit the financial records and reports of the Treasurer for the fiscal years ending May 31, 2006 through May 31, 2008, as required by law. This lack of oversight diminishes the Board's ability to monitor financial operations and could result in the Board's failure to detect cash receipt or disbursement transactions that were not properly recorded or reported by the Treasurer.

### **Claims Processing**

With limited exceptions, the Board must audit and approve claims prior to payment. The audit of each claim by the Board is intended to determine whether the proposed payment is proper and complies with Village policies. The audit process verifies that the claim is sufficiently itemized and supported to indicate the nature of the purchase; that the purchase is for a valid and legal purpose and was properly authorized and approved; that the goods or services were in fact received; and that the claim complies with contract provisions or other Board authorizations, when applicable.

To document the approval of claims, individual Board members should either sign or initial each claim, or the Clerk should sign an abstract listing those claims that have been audited and approved

by the Board for payment. The approval of claims should also be documented by entries in the minutes of the Board, and claims should be retained on file so they are readily available for review and audit purposes.

As part of our audit, we reviewed cancelled checks and selected 135 checks totaling \$57,566 that in our judgment indicated a greater potential for improprieties. Our testing of the related claims disclosed claims that were not sufficiently supported, claims that lacked Board approval, and claims that were unavailable for audit.<sup>4</sup>

- From March 2005 to May 2006, the Village paid 12 claims to a contractor totaling about \$10,800 for various services, including repairs and renovations to the firehouse and other Village property. The claims included \$1,500 for firehouse renovations; \$2,265 for staining and painting the firehouse and installing soffits and trim; and \$2,400 for work done on the firehouse storage room. The Board minutes do not indicate that the Board approved the work ahead of time or established the amount the contractor would be paid, and no written contracts were on file. Failure to properly authorize service procurements or enter into written agreements with contractors that stipulate the services to be provided at an agreed upon compensation puts public moneys at risk of loss or abuse. Furthermore, we noted that Village officials did not obtain quotes for many of the services provided by this contractor, as required by the Village's procurement policy.
- Thirty claims totaling \$6,817 were paid based on statements that were not supported by original invoices or receipts. These claims were primarily paid to a home improvements store (\$2,633) and a gas station that the Village used to fuel its vehicles (\$3,124). When the Village pays claims based only on monthly statements that are not supported by actual invoices or receipts submitted by the employee who made the purchases, it increases the risk that the Village will pay for items or commodities that were not actually received. Furthermore, paying claims based upon other than original invoices or receipts increases the risk of duplicate payments. We found that three of these claims resulted in \$1,068 in duplicate payments by the Village. In these three cases, the vendors identified the overpayments and provided refunds.
- Twenty claims totaling \$6,497 were paid between July 2005 and January 2007 and did not contain documentation

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<sup>4</sup> Some claims had more than one deficiency.

indicating that the Board audited and approved the claims for payment. These claims had either one Board member's signature on the claim package or the claim package was not signed by any Board member. Although there were abstracts on file for some of these payments, the abstracts were not signed by the Clerk to certify that the Board had approved the claims. The lack of a thorough and deliberate audit of claims by the Board increases the risk that inappropriate and/or unauthorized payments could be made.

- Twenty check payments totaling \$3,888, issued between January and November 2006, were not supported by a claim on file. Nine of these checks totaling \$1,917 were written to the former Mayor's son who held various positions in the Village during this time, including Fire Chief, Codes Enforcement Officer and Department of Public Works (DPW) employee. One check for \$122 was also written to the former Mayor. Because these claims are not available for examination, Village officials have no assurance that these payments were for legitimate Village expenditures.
- From March 2006 to September 2006, three checks were written to the Village of Middleville for \$150 each (\$450 in total). The endorsement on the back of each check indicates they were deposited into bank accounts of another municipality where the former Treasurer also worked as the chief fiscal officer. The former Treasurer told us that these checks were cashed using funds on hand at the other municipality in order to replenish the Village's petty cash fund. The check from the Village was then deposited into the other municipality's bank account for reimbursement. However, there were no claims with supporting receipts on file to show what the petty cash funds of the Village were used for. Therefore, Village officials are unable to determine the propriety of these transactions.
- In 2004 and 2005, the fire chief was reimbursed \$300 each year for expenses and the second assistant fire chief was reimbursed \$150 for expenses in 2004. These claims were not supported by receipts or other documentation to explain the types of expenses incurred by the chief and the second assistant chief. The Village may reimburse the fire chief and assistant fire chiefs for the actual and necessary expenses they incur in the performance of their official duties, or it may provide a reasonable mileage allowance when they use their own automobile on official business; however, there is no authority for the Village to pay these officials an annual lump sum amount for these expenses.

## Procurement Policy

An important part of the Board's responsibility is to establish, implement, and monitor procurement policies and procedures to help ensure that the Village obtains goods and services of the required quantity and quality at competitive prices, and to protect against favoritism, extravagance, fraud, and corruption. General Municipal Law (GML) requires competitive bidding for purchase contracts over \$10,000 and public works contracts over \$20,000.<sup>5</sup> Additionally, GML requires municipalities to adopt written procurement policies for purchases and public works contracts below the competitive bidding thresholds.

Although the Board has adopted a procurement policy to help guide the Village's purchasing activities, the Board did not properly oversee and monitor purchases in all instances to ensure that the policy was followed. The policy requires Village personnel to obtain verbal or written quotes or to use a request for proposal (RFP) process for procurements within certain dollar limits. However, we reviewed 11 claims totaling \$14,402<sup>6</sup> and found no documentation indicating that quotes or proposals were obtained for any of the goods or services as required by the policy. These procurements included various renovations and repairs to the firehouse and other Village property (\$10,065), a fan (\$1,359), pressure treated wood (\$1,062), an inverter generator (\$960) and parking lot sealing (\$956).

The failure to abide by and monitor compliance with the Village's procurement policy increases the risk that goods or services will not be obtained at the lowest possible price and that public moneys will not be used in the best interests of the taxpayers.

## Timesheets

Timesheets are essential for accurate payroll processing and should be used by individual employees to record the hours they work, including starting and ending work times and overtime, if applicable. Without adequate timesheets, and an appropriate level of supervisory oversight, it may be impossible to verify if payroll payments are accurate. It also increases the risk for errors, irregularities and misinterpretations to occur and remain undetected and uncorrected.

The Board did not establish adequate controls over payroll. For the fiscal year ended May 31, 2008, salaries, wages and employee benefits amounted to about \$70,000, or 21 percent of the Village's expenditures. There was no supervisory approval documented on the timesheets and certain timesheets were either incomplete or missing. We tested 16 payroll payments totaling \$6,265 made to

<sup>5</sup> Effective November 12, 2009, the bidding threshold for public works contracts was increased from \$20,000 to \$35,000.

<sup>6</sup> Although the Village's purchasing policy requires officials/employees to obtain verbal quotes for purchase contracts under \$250, we only tested procurements of \$700 or more.

four employees during the audit period. Timesheets supporting three payments totaling \$916 (89 hours worked) could not be located by Village officials. In addition, the support for one payment for \$438 consisted of information written on the back of an envelope that lacked the name of the employee as well as the dates worked. Because of the insufficient controls over timesheets, the Village is at increased risk of compensating employees for hours to which they are not entitled.

## **Recommendations**

1. The Board should review the duties performed by the Treasurer and establish controls to compensate for the lack of segregation of duties.
2. The Board should annually audit the Treasurer's accounting records and reports or engage the services of an independent auditor to do so.
3. The Board should authorize service procurements and enter into written agreements with contractors that stipulate the services to be provided and the agreed upon compensation.
4. The Board should ensure that all claims for goods and services are supported by proper documentation and it should thoroughly and deliberately audit the claims before the Treasurer pays them.
5. The Board should ensure its audit and approval of claims is clearly documented by signing or initialing each claim or using a certified abstract that lists the approved claims. The Board's approval of claims should also be documented in the Board minutes.
6. The Board should ensure that claims are retained on file to support the propriety of each payment.
7. The Board should monitor and enforce compliance with its procurement policy relating to obtaining written/verbal quotes and proposals.
8. The Board should establish an adequate system of internal controls to ensure that appropriate timesheets are maintained by Village employees and that the timesheets contain supervisory approval and are retained on file.

## Treasurer's Responsibilities

Various provisions of Village Law set forth the powers and duties of the Treasurer. The Treasurer, as chief fiscal officer, should maintain an appropriate and complete set of accounting records for all funds to ensure that cash receipts and disbursements are adequately safeguarded. The Village's financial records and reports must be complete, accurate, and current to be relevant and useful for the Board and other Village officials to manage Village operations properly. The Treasurer should also routinely reconcile net bank balances with book balances.

Two individuals served as Treasurer during our audit period. Treasurer A was in office from the beginning of our audit period until April 2005 and again from April 2007 through the end of our audit period. Treasurer B was in office from April 2005 until April 2007. We found that controls were not established to ensure cash receipts and disbursements were adequately safeguarded, and that financial activity was properly supported and accurately recorded and reported on a timely basis. The Village's computerized accounting systems allowed the Treasurers to change previously entered information without the systems tracking the change. In addition, the Treasurers did not regularly document monthly bank reconciliations, and Treasurer B did not adequately support journal entries that adjusted recorded cash balances. Lastly, we found no indication that either Treasurer maintained chronological cash receipts records or receivable control accounts for real property taxes and water rents, and monthly and annual financial reports were not filed in a timely manner. As a result of these weaknesses, there is an increased risk that errors or irregularities could occur and go undetected.

### Accounting Records

The Treasurer must maintain complete and accurate records. Journal entries used to enter certain financial transactions or adjustments into the accounting system must be adequately supported and documented to explain the purpose of the entries.

The reconciliation of bank balances to ledger cash balances is also essential to ensure that Village records reflect correct cash balances and that cash is safeguarded. Accurate and complete bank reconciliations should be documented and should include the timely identification and investigation of any differences.

Internal controls over computer-processed data are necessary to ensure the integrity of the data and to prevent its manipulation for purposes of concealing improper transactions. It is important

that the Village's computerized financial system is capable of generating reports that show all changes made during the year to posted transactions. These reports help provide the Village with a mechanism for overseeing financial activity, determining individual accountability, reconstructing events, and problem monitoring.

For the fiscal year ended May 31, 2008, real property taxes and water rent revenues totaled about \$104,500 and \$57,800, respectively. Accurate financial records are necessary to properly account for the collection of real property taxes and water rents. The Treasurer should maintain detailed chronological cash receipts records for real property taxes and water rents that show the payer, property ID or account number, and the date and amount of the receipt. There should be a clear audit trail from the cash receipt records to the related deposits so the individual receipts that make up each deposit can be easily identified.

In addition, a receivable control account balance should be maintained and should equal the total of all balances in the related individual customer billing accounts. To help ensure that it does agree, a receivable control account's balance should be compared and reconciled periodically with the total of all the balances recorded in related individual customer billing accounts. Ideally, this reconciliation should be performed by someone independent of the cash handling and recordkeeping process.

Bank Reconciliations – The Treasurers did not regularly document their bank reconciliations. Treasurer A told us that she reconciled Village bank accounts each month; however, the only documentation available to show that reconciliations were performed were outstanding check lists, which are only one component of a complete bank reconciliation. The only bank reconciliations found on file for Treasurer B's term of office were for the month of May 2005. Furthermore, the Village did not receive bank statements and cancelled checks for the payroll bank account from July 2005 to January 2007, so Treasurer B could not have reconciled the payroll account during this time period.

The Treasurers' failure to reconcile bank balances to accounting records or to document their reconciliations prevents the Board from having reasonable assurance that all financial information is properly recorded in the accounting records and reported in financial reports and increases the risk that improper cash transactions could occur and go undetected and uncorrected.

Computerized Accounting System – The accounting systems used during the audit period allowed the Treasurers to change previously

entered information (i.e., the check payee) without the systems tracking the change. The software used by the Village in the 2005-06 and 2006-07 fiscal years was not capable of producing audit trail reports that show data changes made in the system. The software the Village began using in June 2007 had the capability to generate audit trail reports that show additions, deletions or modifications made to transactions in the data files, but no one was familiar with this option and the reports were not generated. Furthermore, the system allows the computer user to “clean up” the data files, which removes all audit trail tracking information. This severely diminishes the effectiveness of the audit trail function as an internal control and increases the risk that Village officials would not detect errors or inappropriate changes to transactions.

Journal Entries – There was no support available showing how journal entry amounts were determined and the purpose of the entries made by Treasurer B. These entries were made to increase and decrease cash accounts during the 2005-06 and 2006-07 fiscal years. Specifically, there was no supporting documentation or explanation for eight adjustments totaling \$64,793 that increased cash and one entry for \$25,426 that decreased cash in May 2006. Similarly, there was no support for 10 adjustments that increased cash a total of \$23,455 and one entry that decreased cash \$8,411 in February and March 2007, respectively.

When entries in the accounting records are not supported by adequate documentation, there is an increased risk that the records contain errors or irregularities that have not been fully identified and corrected or that the adjustments could be made to cover up fraudulent transactions.

Real Property Taxes and Water Rents – Treasurer A did not maintain chronological cash receipts records for real property taxes or water rents and no records were available indicating that Treasurer B maintained such records either. Receipts for taxes were hand-written on the tax roll which was in alphabetical order by property owner. The computerized records used to record water rent billings and receipts produced billing registers that reflect receipts from the previous quarter and some receipt registers were only on file for parts or our audit period; however, these records are in account number order and not by the date of receipt. The Treasurers recorded receipts in the central accounting records in lump sum amounts by bank deposit date, so there was no clear audit trail showing the individual taxpayer or customer payments that made up each deposit. In addition, the Treasurers did not maintain receivable control accounts for real property taxes or water rents.

When proper cash receipt records are not maintained, there is an increased risk that moneys will be received and not be deposited. Additionally, the failure to reconcile control accounts with the detail records could allow errors and/or irregularities related to the billing and collection of revenues to occur and go undetected.

During our audit, we performed tests of the Village's cash receipts (including taxes and water rents) and water billings. These tests were meant to determine whether receipts were deposited in Village bank accounts and whether water charges were properly billed, collected and enforced.<sup>7</sup> While our audit testing did not reveal any significant discrepancies, this does not diminish the need for the Treasurer to maintain proper cash receipts records and receivable control accounts.

## **Financial Reports**

Good management practices require the Treasurer to prepare monthly financial reports for the Board. These monthly reports should not only detail amounts received and disbursed, but they should also include cash balances and comparisons of actual revenues and expenditures to amounts estimated in annual budgets. The Mayor and the Board need this financial information to make informed decisions on the Village's financial operations. Furthermore, the Treasurer must provide annual financial reports to the Board and the State Comptroller within 60 days following the close of each fiscal year, as required by Law. The annual financial report is an important document which allows management and the general public to assess the Village's financial operations and financial condition.

The Treasurers in office during our audit period did not provide complete financial reports to the Board. According to the Mayor, who served as a Board Trustee from April 2006 until becoming Mayor in April 2007, Treasurer B did not provide any monthly financial reports to the Board during this time. When Treasurer A resumed office in April 2007, she provided the Board with monthly budget versus actual reports, abstracts, and a list of bank account balances; however, she did not provide reports of receipts. Treasurer A has also not completed the Village's annual financial report for the fiscal year ended May 31, 2007. Village officials indicated that the report was not filed due to problems found in the 2006-07 accounting records maintained by Treasurer B. In addition, Treasurer A did not file the annual financial report for the fiscal year ended May 31, 2008 with the State Comptroller until February 5, 2009, more than six months late. However, the current Treasurer who took office in May 2009 (after our audit period), filed the Village's 2008-09 annual report on time.

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<sup>7</sup> For a detailed description of our test procedures, see Appendix B, Audit Methodology and Standards.

The lack of monthly and timely annual financial reports diminishes the Board's ability to monitor and manage the Village's financial resources properly. In addition, the public is precluded from reviewing the Village's financial operations and financial condition when reports are not completed timely.

## **Recommendations**

9. The Treasurer should reconcile all general ledger cash balances to bank balances monthly and keep written documentation of the reconciliations.
10. The Board should periodically review audit trail reports and ensure that the Treasurer does not remove the audit trail tracking information.
11. The Treasurer should establish and implement procedures for maintaining proper documentation to support journal entries.
12. The Treasurer should maintain detailed chronological cash receipts records for real property taxes and water rents and clearly show what receipts make up each deposit.
13. The Treasurer should establish and maintain receivable control accounts for real property taxes and water rents and preferably someone other than the Treasurer should periodically reconcile these accounts with the individual taxpayer/customer detail records.
14. The Board should ensure that the Treasurer prepares and files required annual financial reports in a timely manner and also routinely prepares and files appropriate monthly financial reports with the Board.

## **APPENDIX A**

### **RESPONSE FROM LOCAL OFFICIALS**

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

## **Village of Middleville**

Mayor Elizabeth Schrader  
P.O. Box 425  
3 South Main Street  
Middleville, NY 13406

(315) 891-7645 phone    (315) 891-3600 fax

February 16, 2010

To the Office of the State Comptroller:

Thank you for your dedicated time to the audit of the Village of Middleville that was requested by our Village Officials. The following is our response to your findings.

As current Mayor of the Village of Middleville, I would like to begin my commentary to your audit findings as follows: The current Village Board, consisting of myself as Mayor and two Village Trustees, have worked diligently on rectifying problems in our community that were left behind from the previous administration. Upon taking office and noticing these problems, we immediately contacted your office, along with the US Department of Housing and Urban Development (HUD) and requested audits and assistance due to discrepancies and irregularities found in the administration. Unfortunately it was quite some time after our request to you to the time when the audits were actually performed and as you are aware, it was a very lengthy process for your completion of our audit. I would like to state that the Village Board, myself again included, were completely new to the political realm. We had no experience with politics, nor were we completely familiar with the exact procedures required. However, I will state that we conducted ourselves with honesty, integrity and fairness. We contacted agencies such as NYCOM (New York Conference of Mayors), our State Senator and Assemblyman, along with many other resources such as these, and asked for assistance and guidance. We developed policies and implemented all required procedures as we became aware of their necessity. Two examples of many such policies we developed were the code of ethics and procurement policy, both of which were not distributed or followed previously. I also would like to state that when we walked into office, many of the past records were gone. They had been removed, lost, or destroyed which only made our positions even more difficult, including such water meter books referred to in your report.

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With this in mind, I would also like to state that I worked closely with your auditors and learned much from these individuals. They were very helpful in immediately implementing corrective measures to the short fallings that were discovered. They also gave us resources for help in the future. They discussed each matter with our Board and gave full explanations to the requirements. I will now address each of your recommendations individually:

1. The Board should review the duties performed by the Treasurer and establish controls to compensate for the lack of segregation of duties:

Response: As noted in your report, segregation of duties becomes difficult when dealing with a small municipality with only a few key employees. To rectify the problem with the segregation of duties, the Village Board immediately instructed the Treasurer to complete a list of different procedures to compensate for this concern. Complete original bank reconciliations are required at the Board meetings for all accounts, and complete cash records and receipts were required to be submitted as well by all individual department heads. Spot checks in the Treasurer's Office also are made by each Village Official to verify all submitted information.

We also would like to state that we understand the importance of this item, as when we first took oath of office, the bank statements for several accounts were not sent to the Village Office, as the treasurer during that period had instructed the Bank to hold statements instead of mailing them. We also were unaware of several accounts that were opened using the Village Taxpayer ID number until a complete check of banks throughout a 60 mile radius was requested by our Board. We understand where this could become a problem if only one designated person is aware of the finances.

2. The Village Board should annually audit the Treasurer's accounting records and reports or engage in the services of an independent auditor to do so.

Response: The Village Board is now aware of the responsibility it has to audit annually the Treasurer's Records. The Treasurer who took office in 2007 was not able to perform an annual report because of so many discrepancies and adjustments to cash accounts that

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were not traceable and made by the Treasurer of the previous administration. Because we were not able to file the annual report for that period, we were unable to audit such report. Upon acknowledgement from your department that we were in fact unable to produce such report, we then filed our next year annual report based on true bank balances and full records that our administration had. Our Village Board has audited and reviewed such report and all records affiliated with such filing. We will continue to do so annually.

3. The Board should authorize service procurements and enter into written agreements with contractors that stipulate the services to be provided and the agreed upon compensation.

Response: The Board not only has implemented a procurement policy which is renewed annually, but we follow such policy in strict accordance. We also require contracts, insurance certificates and all necessary tax paperwork prior to commencement of work.

4. The Board should ensure that all claims for good and services are supported by proper documentation and it should thoroughly and deliberately audit the claims before the Treasurer pays them.

5. The Board should ensure its audit and approval of claims is clearly documented by signing or initialing each claim or using a certified abstract that lists the approved claims. The Board's approval of claims should also be documented in the Boards Minutes.

6. The Board should ensure that claims are retained on file to support the propriety of each payment.

7. The Board should monitor and enforce compliance with its procurement policy relating to obtaining written/verbal quotes and proposals.

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Response to Items 4, 5, 6, and 7: The Board requires original contracts or proposals according to the bid award or purchase relating to the procurement policy attached to such payment for claim submission. The Board requires original signatures on all submitted vouchers certifying work complete or purchase received, and requires full invoices with complete breakdown of purchase and item costs to be attached as well. The Board completely audits the claims and verifies completion of said work, or proof of said purchase. Only then is written signature authorization to the voucher approved and permission to the Treasurer given to pay the claim. A new complete filing system has been put into place for retainment of such claims and all proposals, estimates and payments relating to such item.

8. The Board should establish an adequate system of internal controls to ensure that appropriate timesheets are maintained by Village employees and that the timesheets contain supervisory approval and are retained on file.

Response: The current Mayor has always reviewed and approved the time sheets prior to the treasurer issuing payment, however no written signature was placed on the time card showing such approval. We now are aware of this requirement and are in fact complying with such requirement. We are 100% confident that paychecks have in fact been paid for actual time worked during our administration. We also would like to state that we were able to recover some funds from a past employee for the time period of 2004-2006 for falsification of time sheets that were submitted and wrongfully paid. The ex-employee was arrested and charged with falsification of business records and larceny. The ex-employee submitted time sheets that duplicated hours that were worked and submitted for payment to a nearby school district. We were only unable to recover the stipulated amount based on records we had, as many of the time sheets were removed prior to our administration taking over.

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9. The Treasurer should reconcile all general ledger cash balances to bank balances monthly and keep written documentation of the reconciliations.

Response: The Treasurer is currently doing so and all reconciliations are reviewed at the monthly Board Meeting.

10. The Board should periodically review audit trail reports and ensure that the Treasurer does not remove the audit trail tracking information.

Response: The Board is currently requiring written reports *at least every week*, usually more often, and verifies that all information remains consistent.

11. The Treasurer should establish and implement procedures for maintaining proper documentation to support journal entries.

Response: The Treasurer is doing so and is required to continue doing such.

12. The Treasurer should maintain detailed chronological cash receipts records for real property taxes and water rents and clearly show what receipts make up each deposit.

Response: The Village Board has implemented a process that is required of the Treasurer for such information to be kept as requested. All receipts are documented and maintained in a chronological order, not only within the computer system, but also with a written audit trail to verify. Deposit slips are now detailed with customer number, name and amount of receipt.

13. The Treasurer should establish and maintain receivable control accounts for real property taxes and water rents and preferably someone other than the Treasurer should periodically reconcile these accounts with the individual taxpayer / customer detail records.

Response: Controls have been set in place in which the Village Board reconciles the accounts to verify reports submitted by the Treasurer. Analysis are done repeatedly to verify amounts billed, received and reported for all accounts including real property taxes and water rents. Any variances or adjustments must be made by the Village

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Board, prior to any issuance, and verifications are again made after an adjustment was decided.

14. The Board should ensure that the Treasurer prepares and files required annual financial reports in a timely manner and also routinely prepares and files appropriate monthly financial reports with the Board.

Response: The Village Board now requires the following reports at its' monthly Board Meetings: Trial Balance, Accounts Receivable Report for Water Rents, Bank Reconciliations, Cash Receipts Report Certifications by each department head, Cash Disbursements Report and Permits issued. The annual report was in fact filed on time last year, and we can assure it will continue to be filed on time as long as we are in office.

In closing I would like to state that the Mayor and Village Board took appropriate action to correct procedures when findings were disclosed. We implemented all recommended safeguards for protection to our Village Finances. I would like to state that when we all chose to run for election, we were limited in knowledge of procedures due to inexperience. Your office and auditors have provided valuable information, which was implemented, and we are confident that you would be satisfied with our current procedures in place.

If you should have any questions, please do not hesitate to contact me.

Sincerely,



Elizabeth A. Schrader, Mayor  
Village of Middleville

## APPENDIX B

### AUDIT METHODOLOGY AND STANDARDS

Our overall goal was to assess the adequacy of the internal controls put in place by officials to safeguard Village assets. In order to accomplish this, we performed an initial assessment of internal controls so that we could design our audit to focus on those areas most at risk. Our initial assessment included evaluations of the following areas: financial condition, cash receipts and disbursements, records and reports, claims processing, procurement, payroll, and information technology.

During the initial assessment, we interviewed Village officials, performed limited tests of transactions, and reviewed pertinent documents such as adopted policies and procedures, Board minutes, and financial records and reports. Further, we reviewed the Village's internal controls and procedures over financial databases to verify whether the financial records were reliable. After reviewing the information gathered during our initial assessment, we determined where weaknesses existed, and evaluated those weaknesses for inherent control risks. We then decided upon the reported objectives and scope by selecting for audit those areas most at risk. We selected Board oversight of financial operations and the Treasurer's internal controls over cash receipts and disbursements and financial activity for further audit testing.

To assess the Board's oversight of financial operations and the Treasurer's internal controls over cash receipts and disbursements and financial activity, we performed the following audit procedures:

- We interviewed Village officials and documented and evaluated internal controls over key aspects of the recordkeeping, and cash receipts and disbursements processes.
- We reviewed accounting records and reports for completeness and for unusual items.
- We verified that checks that cleared Village bank accounts during our audit period were available for our examination. We then selected 135 cancelled checks totaling \$57,566 with payees and/or amounts that in our judgment indicated a greater potential for improprieties. We viewed the related claims (if available) to determine if they were for proper Village purposes, itemized, adequately supported, and audited and approved by the Board.
- We tested compliance with the Village's procurement policy provision that requires the Village to obtain proposals or written/verbal quotes for certain purchases.
- We determined all major sources of revenues, (other than real property taxes and water rents) and requested payment information from the payee or reviewed related contracts stipulating payment amounts. We traced these receipts to bank statement deposits.
- We verified that real property tax receipts were deposited by comparing taxes deposited into Village bank accounts to the tax rolls for two tax collection periods (June to October 2006 and June to October 2007). In this analysis, we accounted for the amount of taxes that were sent to the county for re-levy and we used the receipt dates indicated on the tax roll in order to compute the interest and penalty amounts that were collected and deposited.

- We reviewed adjustments to water rent billings for two quarters to determine if the adjustments were justified and appropriate amounts were re-levied onto the real property taxes.
- We verified the completeness of water rent billings for two quarters by selecting 45 properties from the tax roll (including some properties owned by Village officials/employees) and tracing to the water meter books and the water billing registers. We recalculated the water bills for the properties tested.
- We tested checks written to the Village of Middleville to determine if they were deposited in other Village bank accounts.
- We tested 16 payroll payments totaling \$6,265 for support, proper calculation and supervisory approval.

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

## APPENDIX C

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Steven J. Hancox, Deputy Comptroller  
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