



Village of Maybrook

Water Operations

Report of Examination

Period Covered:

June 1, 2010 — September 25, 2012

2013M-121



Thomas P. DiNapoli

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State of New York Office of the State Comptroller

Division of Local Government and School Accountability

August 2013

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 Maybrook, entitled Water 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*

Introduction

Background

The Village of Maybrook (Village) is located in Orange County in the Town of Montgomery and has a population of approximately 3,000. The Village is governed by a five-member elected Board of Trustees (Board) and comprises a Mayor and four Trustees. The Board is the legislative body responsible for the general management and control of Village financial affairs.

The Village provides various services to its residents, including street maintenance, snow removal, street lighting, sewer services, and general government support. The Village also provides water services to over 900 residential and commercial customers. The water fund budgeted appropriations for the fiscal year ended May 31, 2012, were approximately \$262,000 and were financed by user fees.¹

The Mayor is the Village's chief executive officer. The Clerk-Treasurer is the chief fiscal officer, who along with the Deputy Treasurer is responsible for the Water Department's daily financial operation. The Board employs a water clerk who bills and collects water and sewer rents for residential and commercial customers.

Objective

The objective of our audit was to examine internal controls over the Village's water operations. Our audit addressed the following related question:

- Are internal controls over the Village's water operations appropriately designed and operating effectively?

Scope and Methodology

We examined internal controls over water operations for the period June 1, 2010, through September 25, 2012. We expanded the scope of our audit back to the 2008-09 fiscal year to assess the water fund's interfund advances and review pertinent 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 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 planned to take corrective action.

¹ The Village bills its water customers quarterly (in January, April, July, and October) based on usage.

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 of Trustees to make this plan available for public review in the Clerk-Treasurer's office.

Water Operations

The Board is responsible for establishing internal controls to provide reasonable assurance that Village resources are adequately safeguarded and accounted for, and that financial transactions are properly authorized. Village officials are responsible for implementing the Board's control directives by designing and documenting operating policies and procedures, and properly delineating employee responsibilities. Such policies and procedures should include providing adequate segregation of financial duties, and ensuring that water bills are accurately calculated and that billing adjustments are properly authorized and documented. The Board is also responsible for ensuring that interfund advances are approved and repaid in accordance with legal requirements and for establishing policies that provide proper cost allocations.

The Village's internal controls over water operations need to be improved. The water clerk's duties were inadequately segregated, interfund advances were not accurately accounted for, reconciled, or repaid as required and employee benefits costs were inaccurately allocated. As result of deficient internal controls, we detected errors in more than 17 percent of the water bills that we reviewed, and more than \$1,100 of customer account adjustments were made without documented prior approval. In addition, as of May 2012, the water fund owed the general fund approximately \$126,000. The water fund was also over-charged approximately \$74,000 for employee benefit costs. As a result, the Village is not collecting all the revenue it is entitled to and the water fund's financial condition is diminished.

Segregation of Duties

Proper segregation of duties can help ensure that no one individual controls all phases of a transaction and allows the work of individual employees to be verified by other employees in the course of their duties. If it is not feasible to segregate duties, Village officials should institute compensating controls, such as providing enhanced management oversight.

The water clerk was solely responsible for the billing and collection process. Her duties were performed with little oversight and included importing meter readings into the billing software application, preparing and printing bills, collecting payments, preparing deposits, entering receipts into the computer system, maintaining customer detail accounts, and making account adjustments. The water clerk was also able to create, delete, and amend customer accounts. Although

the Deputy Treasurer maintained the receivable control account,² compared collection reports with the amount of cash collected, and prepared the monthly bank reconciliations, the information used to perform these duties was based solely on reports and other information the water clerk provided. Further, the Clerk-Treasurer was unaware it was her responsibility to oversee the water clerk's job performance. Concentrating these key duties with water clerk (i.e., accounting records maintenance, cash custody, and reconciliations) with little or no oversight weakens internal controls and significantly increases the risk that errors and/or irregularities might occur and go undetected. For example, the water clerk could make changes to an individual's water bill by adjusting the rates used to calculate it, or make adjustments to that individual's water account without prior authorization or approval.

Billing Discrepancies

The Board and Village officials are responsible for ensuring that water user charges are properly billed, collected, and recorded in a timely manner. The water clerk and Deputy Treasurer are responsible for ensuring that the information contained in the Village's water readings and bills is accurate and complete. The water clerk downloads the water meter readings³ from the Water Department's software into the Village's accounting software, which automatically calculates the current bills (based on metered usage, rates, penalties, and unpaid amounts from prior bills). The water clerk then generates and prints the bills.

We calculated 69 customers' water bills⁴ to assess their accuracy and found billing errors in 12 of the 69 bills, or about 17 percent.

- Four customers were over-charged \$1,024 because the Board-approved rates were not used to calculate their bills.
- Four customers were under-charged \$115 because they were billed at the residential rate instead of the commercial rate.
- Two customers were assessed flat fees instead of Board-approved commercial rates.⁵

² A receivable control account is an accounting record used to record and summarize total water billing collections, account adjustments, and the outstanding balances for all customers' accounts, which, if properly maintained, allows Village officials to readily determine and reconcile this balance to all the outstanding individual customer account balances.

³ Water Department personnel read the water meters to determine customers' water usage.

⁴ These 69 accounts were billed a total of \$28,219 in July 2012 and represented 7.5 percent of all water accounts billed that quarter.

⁵ One customer was charged \$70 quarterly and another was charged \$400 quarterly.

- Two customers were under-charged because the Board-approved rates were not used to calculate their bills.⁶

Because there were errors in a significant number of water bills we reviewed, there is a risk that such errors exist with other customer's water bills. Therefore, the Village may not be collecting all the water fees that it is entitled to, and customers may not be accurately charged for water that is used.

Billing Account Adjustments

Billing adjustment procedures should, at a minimum, require that a designated official approves each adjustment and adequately documents the origination, justification, amount, and date it was approved. However, Village officials did not establish adequate procedures for the water clerk to follow when making billing adjustments. As a result, the water clerk made adjustments to customer accounts using her own discretion and without prior written authorization or limits.

We reviewed all 43 adjustments⁷ totaling \$1,163 that the water clerk made to customer water accounts during the 2011-12 fiscal year. The water clerk was unable to provide any documentation showing the reasons why these adjustments were made, that she was authorized to make such adjustments, or that a Village official approved any of them.

The water clerk told us that customer account adjustments were made only after the Clerk-Treasurer verbally approved them. Therefore, no written documentation authorizing such account adjustments was maintained. The failure to formally approve adjustments and adequately document the reasons they are made creates a risk that customers may receive water account adjustments to which they are not entitled.

Interfund Advances

The law allows temporary interfund advances from one Village fund to another; however, advances must be repaid as soon as moneys are available, but no later than the close of the fiscal year in which the moneys were advanced. The Board should approve all interfund advances and such advances should be reconciled at year-end.

Although the Board authorized the use of temporary interfund advances, the advances were not repaid by the end of the fiscal year, as required. Further, the Deputy Treasurer did not maintain adequate records to account for such advances and, as a result, was unable to perform the year-end reconciliation process (identifying which funds advanced money to other funds).

⁶ Two customers were each charged \$64, instead of \$69.

⁷ We reviewed 29 penalty adjustments totaling \$725 and 14 overpayment adjustments totaling \$438 that the water clerk made during the 2011-12 fiscal year.

Our analysis⁸ showed that, as of June 1, 2008, the water fund owed the general fund approximately \$132,000. The general fund advanced the water fund approximately \$88,000 more over the next four years bringing total outstanding advances to approximately \$220,000. Although the water fund repaid almost \$94,000 during this same time period, the water fund still owed the general fund approximately \$126,000 as of May 31, 2012.

The Board had not properly managed the water fund's finances which required general fund advances to sustain water operations. The Mayor informed us that the Village undertook several capital projects in the past to repair the Village's sewer system, and that water fund money was used to fund these projects. However, because interfund advances were not repaid, the general fund essentially subsidized the water fund's operations.

Cost Allocation

Cost allocation⁹ is the process of identifying and assigning administrative expenditures to the departments with which they are associated. Such allocations, when consistently applied from year-to-year, provide a useful tool to efficiently track the true departmental costs of Village operations. Cost allocation can provide a better way to manage Village resources, can help in preparing annual budgets, and can provide the Board with an accurate picture of departmental operating costs.

Because the Board did not adopt or implement a formal cost-allocation plan for assigning the water fund's portion of employee benefit expenditures and provided little oversight of this process, the Deputy Treasurer used unreasonable cost allocation percentages and applied them inconsistently from year-to-year. As a result, the water fund was over-charged approximately \$74,000 for employee benefits over a two-year period.

The Deputy Treasurer allocated water fund employee benefits costs¹⁰ at 99.3 percent of total Water Department salaries in the 2009-10 fiscal year and 148.7 percent of salaries in 2010-11. Calculation

⁸ We reviewed fiscal year-end financial reports from 2008-09 through 2011-12 and verified that the amounts agreed with those reported to Office of the State Comptroller (OSC).

⁹ Allocating expenditures that benefit a specific department's service area should reasonably be based on use or benefit. For example, employee benefit expenditures, which include insurance, Social Security, and retirement contributions, can be of such magnitude that, if not properly allocated, could materially understate a department's total expenditures.

¹⁰ Our recalculations showed that the actual Water Department's employee benefits paid were approximately \$43,900 and \$61,000 for the 2009-10 and 2010-11 fiscal years, respectively.

of the water fund's employee benefits allocation percentages based on the Water Department's actual employee salaries and benefits paid for these two years showed actual cost percentages of 36.8 and 35.8 percent, respectively. Therefore, the allocation percentages the Deputy Treasurer used were 62.5 and 112.9 percent more than these benefits actually cost the water fund for the two fiscal years.

Without a reasonable and consistently applied employee benefits cost-allocation plan, water fund expenditures cannot be properly allocated and, as a result, no one can be certain about the true cost of the Village's water operations. Further, because an accurate picture of water fund operations was not provided to the Board, it did not have the necessary information to prepare accurate future water fund budgets.

Recommendations

1. The Board should segregate incompatible duties within the water operation's accounting function or implement compensating controls.
2. The Board and Village officials should implement water billing procedures to ensure that water user charges are properly billed, collected, and recorded in a timely manner.
3. Village officials should investigate the water billing errors and adjust customer accounts for any amounts over- or under-billed.
4. Village officials should implement billing adjustment procedures that, at a minimum, require a designated official's approval for all adjustments and that require written documentation of the reasons for such adjustments.
5. The Board should ensure that all advances between funds are repaid no later than the close of the fiscal year in which they were made and that adequate records are maintained for all such advances.
6. The Board should implement a formal cost-allocation plan that assigns employee benefit costs to the water fund, ensuring that the allocations are reasonable and applied consistently.

APPENDIX A
RESPONSE FROM LOCAL OFFICIALS

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



VILLAGE OF MAYBROOK

111 Schipps Lane, Maybrook, New York 12543 • Telephone: (845) 427-2717

August 7, 2013

Tenneh Blamah

Chief Examiner of Local Government and School Accountability

Office of the State Comptroller

Division of Municipal Affairs

33 Airport Center Drive, Suite 103

New Windsor, NY 12553

Re: Village of Maybrook OSC Audit Report

Dear Tenneh Blamah:

Please be advised, I am in receipt of the report from your office pertaining to the above referenced matter. I appreciate your recommendations and wish to advise you and your office of the following in response to the findings and recommendations for Segregation of Duties of water operations:

- The Village has implemented a system of internal control with checks and balances regarding water operations including an independent review of billings based on the usage generated from the water meter readings. The bills generated in the water billing software will be compared to a separate calculation performed by an employee independent of the water billing function.
- The Village has implemented a system of internal control and checks and balances where an employee independent of collecting water payments reviews and provides oversight over creating the receipt, preparing the deposit, and entering the information on the system in a timely manner.
- The Village has implemented a system of internal control that an employee independent of water billing and collections maintain customer

Trustees

Kevin Greany
James R. Barnett
Robert Pritchard

Village Clerk

Treasurer
Valentina Johnson

Meetings 2nd
and 4th Mondays

Fax: (845) 427-2164

TDD: 1-800-662-1220

- The Village has implemented a system of internal control that an employee independent of the water and sewer billing function review a sample of the bills each billing by performing an independent calculation of bills based on the water meter readings.

In response to findings and recommendations for Billing Account Adjustments:

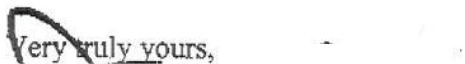
- The Village Board will have a Resolution to designate an official to review, approve, and sign-off on all billing adjustments prior to them being made on the system.

In response to findings and recommendations for Interfund Advances:

- The Village has implemented a system of internal control where interfund advances are periodically reviewed and paid back as funds become available.

In response to findings and recommendations for Cost Allocation:

- The Village will review and implement a new system to allocate expenses to the Water Fund to ensure the amounts allocated are reasonable.


Very truly yours,

Dennis K. Leahy

Mayor

APPENDIX B

AUDIT METHODOLOGY AND STANDARDS

Our overall goal was to assess the adequacy of internal controls over water operations. To accomplish our objective and obtain valid audit evidence, we interviewed appropriate Village officials, tested selected records, and examined pertinent documents for the period June 1, 2010, through September 30, 2012. Our procedures included the following:

- We interviewed Village officials to gain an understanding of water operations, determine if there were adopted policies and procedures over water rent billing, collection, and enforcement, and determine whether the accounting functions were adequately segregated.
- We reviewed Board minutes during our audit period for evidence of Board oversight over water operations.
- We recalculated 69 water¹¹ bills from July 2012 using the Board's established rates to determine if these bills were accurate.
- We reviewed daily water cash receipts to determine if adequate procedures and controls were in place. We also compared the water receivable control account with the cash receipt journals to determine if any unauthorized water account adjustments were made.
- We analyzed all penalty adjustments assessed on 29 overdue customer water accounts and all overpayment adjustments made to 14 customer account balances during the 2011-12 fiscal year.
- We reviewed water fund interfund advances for the 2007-08 through 2011-12 fiscal years, as reported on year-end trial balance reports, and verified that the amounts shown agreed with those reported on the Annual Update Documents supplied to OSC.
- We examined account records to determine if interfund advances were repaid at the end of the fiscal year in which they were made.
- We obtained fiscal year-end financial reports from 2008-09 through 2011-12 and verified that the amounts shown agreed with the amounts annually reported to OSC.
- We recalculated employee benefit allocations applied to the water fund for the 2009-10 and 2010-11 fiscal years to determine if they were reasonably allocated.

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.

¹¹ We judgmentally selected our sample from the 911 customers billed in July 2012 based on unusually high or low meter readings.

APPENDIX C

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