



Big Flats Fire District No. 2

Internal Controls Over Financial Operations

Report of Examination

Period Covered:

January 1, 2011 — June 21, 2012

2012M-155



Thomas P. DiNapoli

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State of New York Office of the State Comptroller

Division of Local Government and School Accountability

January 2013

Dear District 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 the Board of Fire Commissioners 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 Big Flats Fire District No. 2, 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

EXECUTIVE SUMMARY

The Big Flats Fire District No. 2 (District) is a district corporation of the State, distinct and separate from the Towns of Big Flats and Southport, located in Chemung County. The District's general fund budget totaled \$101,467 for the 2012 fiscal year. Included in the budget is \$30,000 for rent of the Golden Glow Volunteer Fire Company, Inc. (Company) firehouses.

The Board of Fire Commissioners (Board) consists of five elected members and is responsible for the District's overall financial management. The voters elect a Treasurer who acts as the District's chief fiscal officer. The Treasurer is responsible for receiving and maintaining custody of District funds, for disbursing and accounting for those funds, for preparing monthly and annual financial reports, and for meeting any other reporting requirements.

Scope and Objective

The objective of our audit was to examine selected District financial operations for the period January 1, 2011 through June 21, 2012. Our audit addressed the following related questions:

- Did the Board provide adequate oversight of the District's financial operations?
- Did the Board ensure that the terms of the building lease were in the best interest of District residents?

Audit Results

The Board does not provide adequate oversight of District financial activities. The Board has not established written policies and procedures for cash receipts and disbursements, claims processing or information technology. Although the Board has adopted a procurement policy and reviewed each claim prior to payment, it did not ensure that the necessary supporting quotes were available for certain claims. Therefore, it has no assurance that goods and services are procured in compliance with the policy or in the most economical manner. The Board has not adequately segregated the Treasurer's duties or implemented mitigating controls. Bank statements and evidence of canceled checks are delivered to the Treasurer who also writes the checks, maintains the financial records and reconciles the bank accounts. Finally, the Board has not performed an annual audit of the Treasurer's books.

We found that the District entered into a new three-year lease with the Company effective January 1, 2011 to pay rent of \$30,000 annually, which was double the \$15,000 amount paid in 2010, for the two existing firehouses. When the new firehouse construction is complete, the two existing firehouses

will be sold. However, the rent amount will remain at \$30,000 per year. The Board did not perform a cost-benefit analysis of this transaction or determine if the rental price was at fair market value. Given that the payment for at least the first two years of the lease doubled the cost for the same space, it is questionable that the District has been paying fair market value. Instead, it appears that the increase was intended to subsidize the construction of the new firehouse that will be privately held.¹

Furthermore, statutory budget constraints may limit the District's ability to absorb any future increases in the lease payment. If the Company fails to sell the two existing buildings at the appraised value and meet its fundraising requirements, the real property tax cap and the statutory spending limitation could make increasing the District's lease payment difficult without voter approval or cuts in other District spending.

Comments of District Officials

The results of our audit and recommendations have been discussed with District officials and their comments, which appear in Appendix A, have been considered in preparing this report. Except as specified in Appendix A, District officials generally agreed with our recommendations and indicated they have taken corrective action. Appendix B includes our comments on the issues raised in the District's response letter.

¹ Town Law also authorizes the District to acquire a firehouse, in which case the asset would be publicly held.

Introduction

Background

The Big Flats Fire District No. 2 (District) is a district corporation of the State, distinct and separate from the Towns of Big Flats and Southport, located in Chemung County. The District's general fund budget totaled \$101,467 for the 2012 fiscal year. Included in the budget is \$30,000 for rent of the Golden Glow Volunteer Fire Company, Inc. (Company) firehouses.

The Board of Fire Commissioners (Board) consists of five elected members and is responsible for the District's overall financial management. The voters elect a Treasurer who acts as the District's chief fiscal officer. The Treasurer is responsible for receiving and maintaining custody of District funds, for disbursing and accounting for those funds, for preparing monthly and annual financial reports, and for meeting any other reporting requirements.

Objective

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

- Did the Board provide adequate oversight of the District's financial operations?
- Did the Board ensure that the terms of the building lease were in the best interest of District residents?

Scope and Methodology

We examined the District's financial operations for the period January 1, 2011 to June 21, 2012.

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

Comments of District Officials and Corrective Action

The results of our audit and recommendations have been discussed with District officials and their comments, which appear in Appendix A, have been considered in preparing this report. Except as specified in Appendix A, District officials generally agreed with our recommendations and indicated they have taken corrective action. Appendix B includes our comments on the issues raised in the District's response letter.

The Board has the responsibility to initiate corrective action. We encourage the Board to prepare a plan of action that addresses the recommendations in this report and forward the plan to our office

within 90 days. 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 Secretary's office.

Board Oversight

The Board is responsible for overseeing the District's fiscal activities and safeguarding its resources. To fulfill this duty, it is essential that the Board establish a system of internal controls, which consists of policies and procedures that ensure transactions are authorized and properly recorded; that financial reports are accurate, reliable, and filed in a timely manner; and that the District complies with applicable laws, rules and regulations. Due to the lack of segregation of duties in districts of this size, the Board should ensure controls provide for an independent review of financial transactions including performing an annual audit of the Treasurer's books and records. In addition, the Board should also ensure that the District obtains goods and services of the required quantity and quality at competitive prices in accordance with the General Municipal Law (GML) and the District's purchasing policy.

The Board does not provide adequate oversight of District financial activities. The Board has not established written policies and procedures for cash receipts and disbursements, claims processing or information technology. Although the Board has adopted a procurement policy and reviewed each claim prior to payment, it did not ensure that the necessary supporting quotes were available for certain claims. Therefore, it has no assurance that goods and services are procured in compliance with the policy or in the most economical manner. Bank statements and evidence of canceled checks are delivered to the Treasurer who also writes the checks, maintains the financial records and reconciles the bank accounts. Finally, the Board has not performed an annual audit of the Treasurer's books.

Competitive Quotes — The Board-adopted procurement policy requires that District officials and employees obtain two verbal quotes for purchases between \$250 and \$2,999, and three verbal quotes for purchases between \$3,000 and \$4,999. For purchases between \$5,000 and \$9,999 three written quotes are required. The policy also requires that documentation is required for each action.

We reviewed all 66 claims for 2011, totaling \$93,974, to verify that claims were supported by adequate documentation and were for valid District purposes. We found minor exceptions, which we discussed with District officials. However, all the claims were for legitimate District purposes. We also reviewed the 2011 claims to determine if they were in compliance with the procurement policy requirements for quotes. We found that 10 claims, totaling \$11,873,² required either

² Nine claims totaling \$8,589 required verbal quotes and one claim for \$3,284 required written quotes.

written or oral quotes. However, the District could not provide any supporting documentation that the required quotes were obtained.

Segregation of Duties — In order to safeguard cash, the same individual should not prepare and disburse checks, record the transactions in the accounting records, and perform bank reconciliations. If it is not practical to segregate the Treasurer's duties, the Board should implement compensating controls to mitigate any risks.

The Treasurer writes the checks, maintains the financial records and reconciles the bank accounts. The Treasurer also directly receives the bank statements and evidence of canceled checks. Without appropriate segregation of duties or compensating controls, there is an increased risk that errors or irregularities could occur and go undetected and uncorrected. We reviewed all the cash disbursements, compensation paid and bank transfers for 2011 and found that all disbursements were for appropriate purposes.

Annual Audit — It is important for the Board to perform or contract for an annual audit of the Treasurer's books and records. An annual audit serves as an important control procedure because it gives the Board an opportunity to verify that cash has been accounted for and transactions have been properly recorded. It also provides Board members with an added measure of assurance that the Treasurer's financial records and reports contain reliable information upon which to base management decisions.

There was no indication that the Board had audited the Treasurer's books and records for 2011. This lack of oversight has diminished the Board's ability to properly monitor financial operations and increased the risk that errors or irregularities could occur and remain undetected and uncorrected.

Recommendations

1. The Board should take immediate action to strengthen the District's internal control environment and develop, adopt, and implement written policies and procedures for cash receipts and disbursements, claims processing and information technology to control and monitor District operations.
2. District officials should adhere to the District's procurement policy and retain documentation of the required quotes when making purchases.
3. The Board should segregate, when practical, the duties performed by the Treasurer. If that is not practical, the Board should take a more active role in oversight of the District's financial records and activities.

4. The Board should perform a proper annual audit of the Treasurer's records and reports to ensure that the records are complete and accurate.

Building Lease

The Board may only exercise those powers and duties expressly authorized by statute and those powers necessarily implied to accomplish these responsibilities.³ Among those powers is the authority to lease real property such as firehouses or to acquire real property such as a firehouse for District use. In addition to the real property tax cap,⁴ Town Law also imposes a spending limitation on the District that would require voter approval to exceed.⁵

The District has historically leased two firehouses from the Company. In 2010, the annual lease payment was \$15,000. The Company is currently in the process of building a new firehouse to accommodate the District's new, larger equipment and consolidate it into one location.⁶ It is anticipated that the new firehouse will be available for use by January 2013, and will replace the two existing firehouses. The District has entered into a three-year lease agreement with the Company effective January 1, 2011, to December 31, 2013 for the use of the existing two firehouses and subsequently, for the new fire house when it is completed.⁷ The lease doubles the amount of the payment to \$30,000 annually. The District has formally supported the construction of the new firehouse and anticipates continuing the current lease payment.

However, the District has not been involved with any financial planning for the costs of the new building. For example, District officials did not compare costs of the District building a new fire house instead of leasing it from the Company. In addition, the District did not prepare a financial plan to determine if the District could pay the increased rent and stay within the spending limit of the District.

The Board did not perform a cost-benefit analysis of this transaction or determine if the increased lease payment was at fair market value. Given that the payment for at least the first two years of the lease doubled the cost for the same space, it is questionable that the District is paying fair market value. Instead, it appears that the new lease

³ There is no expressed or implied authority to subsidize a private corporation or association, such as a fire company.

⁴ The real property tax cap, in general, limits the growth of the real property tax levy to 2 percent unless 60 percent of the Board votes to override.

⁵ Town Law Section 176 (18)

⁶ The new firehouse will still only have five bays for District equipment, but the bays are one and a half times larger than the five bays in the two existing firehouses.

⁷ Part of the Company's financing plan for the new firehouse includes the sale of the two existing firehouses within two years to payoff short-term obligations.

amount of \$30,000 was set to generally cover the projected debt service cost on the new firehouse of \$33,712.⁸

As part of our audit, we reviewed the District's statutory spending limit and found that the District's expenditures were nearing the amount where they could not be raised without voter approval. For 2012, the spending limit was \$100,967 and budgeted expenditures were \$100,960 leaving a margin of only \$7.

In our audit of the Company,⁹ we identified several reservations about the Company's financing plan for the new firehouse. For example, debt service for the building will be \$33,712, over the next two years. The repayment of this debt is based on certain contingencies. In addition, the timely sale of the existing fire stations for near-appraised value is central to the Company's plans to repay the \$135,000 loan and the Company is relying on fundraising in amounts that far exceed the amount of funds raised in the past.

Recommendation

5. The Board should protect the taxpayers of the District by not agreeing to any further lease increases without detailed justifications for the amounts paid and a rigorous exploration of alternatives.

⁸ Town Law authorizes the District to acquire a firehouse, in which case the asset would be publicly held.

⁹ *Golden Glow Volunteer Fire Company, Inc. Internal Controls Over Financial Operations, Report 2012M-170*, available at www.osc.state.ny.us.

APPENDIX A

RESPONSE FROM DISTRICT OFFICIALS

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

**BIG FLAT FIRE DISTRICT #2
214 HENDY CREEK RD. P.O. BOX 3045
PINE CITY, NY 14871**

Commissioners:
Raymond Dann, Chairman
Keith Stewart
Richard Stewart
Dennis Barnes
Myron Sozanski

Treasurer:
Mary Stewart

Secretary:
Evelyn Ziegenhagen

January 4, 2013

Edward V. Grant, Jr.
Chief Examiner
Rochester Regional Office
The Powers Building
16 West Main Street, Suite 522
Rochester, NY 14614-1608

Re: Examination of the Big Flats Fire District #2

Dear Sir:

This letter is in response to your preliminary draft findings report pertaining to the audit of Big Flats Fire Dist #2.

The Big Flats Fire District #2 Commissioners have all received and reviewed the "Report of Examination" covering the "Internal Controls over Financial Operations" for the period of January 1, 2011 – June 21, 2012. The Board appreciates the experience and dedication shown by your staff in conducting this audit.

An exit conference was held on December 12, 2012 with the auditors from the Office of the State Comptroller, Mary Stewart - Treasurer and myself. While reviewing the draft report we found a few items that we thought needed clarification.

The executive summary stated that "The Board has not segregated the Treasurers duties or implemented mitigating controls". In our opinion, due to the relatively small amount of business handled on a month to month basis, it is very easy for the board to oversee the treasurer's transactions. The board regularly reviews and signs copies of all bills and monthly bank statements. Additionally, each board member receives a copy of the monthly treasurer's report. We have also implemented a new report that shows our "actual expenditures vs. estimated budget" that will allow us to further control expenditures.

See
Note 1
Page 15

The executive summary also stated that the board did not perform a cost benefit analysis for the rental price on the new building. While the board did not go to the expense of paying an outside firm to do a detailed cost analysis, the decision was reached after many weeks of deliberation between the fire company, the commission and the commission's attorney. We did contact our attorney in the early stages of this process to discuss the project and for them to give us an opinion on "prevailing wage" and if the board was required to pay it or not. The opinion from the board's lawyer was that the board of Fire Commissioners (i.e., taxpayers), would have to pay the prevailing wage if it were to build the new station.

See
Note 2
Page 15

That fact meant that the cost of the building would be roughly three times more than paying standard wages. This played a large part in our decision for the board not to build/own the new fire station.

While the rental agreement is higher than previous years, there are many advantages to this new facility over the previous two structures. Not only do we have 1.5 times more storage space, improvements in physical location, climate control, security, storage and maintenance will also help protect the fire districts equipment.

See
Note 3
Page 15

With all of this in mind the board made the decision to lease the new building for a term of 3 years, each year we have the option to review the lease agreement and if adjustments are required the board can go into negotiations with the fire company.

Sincerely Yours,

Raymond Dann
Chairman

Cc: Mary Stewart
Keith Stewart
Richard Stewart
Dennis Barnes
Myron Sozanski
Evelyn Ziegenhagen

APPENDIX B

OSC COMMENTS ON THE DISTRICT OFFICIALS' RESPONSE

Note 1

As per discussions with the Treasurer and two Board members, the Board did not conduct a review of the canceled checks or bank statements. In addition, the bank statements contained no initials documenting such a review. Therefore, the Board has no assurance that bills were paid as approved or that the monthly Treasurer reports were accurate.

Note 2

Whether the Company is subject to prevailing wage law requirements is outside the scope of our audit. We have referred this issue to the New York State Labor Department for review.

Note 3

The District paid the increased annual rent of \$30,000 for 2011 and 2012 for the exact same space for which they previously only paid \$15,000. The new building was not completed until December 2012.

APPENDIX C

AUDIT METHODOLOGY AND STANDARDS

Our overall goal was to assess the adequacy of the internal controls put in place by District officials to safeguard assets and monitor financial activities. To accomplish this, we performed an initial assessment of the internal controls so that we could design our audit to focus on those areas most at risk. Our initial assessment included evaluations of the following areas: financial transactions, cash disbursements, claims auditing, control environment, purchasing and personal services.

During the initial assessment, we interviewed District officials, performed limited tests of transactions, and reviewed pertinent documents such as the meeting minutes, and financial records and reports for the period January 1, 2011 through April 29, 2012.

After reviewing the information gathered during our initial assessment, we determined where weaknesses existed, and evaluated those weaknesses for the risk of potential fraud, theft and/or professional misconduct. We then decided upon the reported objectives and scope by selecting for audit those areas most at risk. We selected Board oversight and the building lease for further review.

To accomplish our audit objective and obtain relevant audit evidence, our procedures included the following:

- We interviewed District officials to gain an understanding of the District's operations.
- We reviewed all District cash receipts and disbursements for 2011 to determine if they were supported and in compliance with the procurement policy.
- We reviewed Board meeting minutes to confirm the documentation of the annual audit of the Treasurer's records and reports.
- We reviewed the District's building lease agreement and lease payments made to the Golden Glow Fire Company, Inc.

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.

APPENDIX D

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