



Smithtown Fire District Capital Project

Report of Examination

Period Covered:

January 1, 2013 — June 30, 2014

2014M-231



Thomas P. DiNapoli

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State of New York Office of the State Comptroller

Division of Local Government and School Accountability

October 2014

Dear Fire 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 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 Smithtown Fire District, entitled Capital Project. 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 New York State 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 Smithtown Fire District (District) is a district corporation of the State, distinct and separate from the Town of Smithtown and Suffolk County in which it is located. The District covers nearly 18 square miles and services approximately 50,000 residents with seven fire companies and one emergency services squad. The District has approximately 196 volunteer members, 16 full-time employees and 24 part-time employees.

An elected five-member Board of Fire Commissioners (Board) governs the District and is responsible for the District's overall financial management. The Board's responsibilities include approving the annual operating budget, adopting District policies, auditing District claims and ordering the Treasurer to pay claims. The District's 2014 adopted general fund budget was about \$4.23 million, which was funded primarily with real property taxes.

The District Treasurer is the District's chief fiscal officer, appointed by the Board, and is responsible for the receipt, custody and disbursement of District funds. The District Secretary is responsible for recording Board proceedings and retaining the District's key administrative records. The District Supervisor oversees maintenance staff and day-to-day firehouse operations.

Objective

The objective of our audit was to examine the District's internal controls over capital asset spending. Our audit addressed the following related question:

- Did the Board comply with capital reserve fund requirements when they authorized the Substation 1 reconstruction capital project?

Scope and Methodology

We examined the capital project records and the internal controls over the District's Substation 1 reconstruction project for the period January 1, 2013 through June 30, 2014. We expanded our scope back to January 1, 2012 to review pertinent capital project documents and Board minutes.

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

**Comments of
Local 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. District officials generally agreed with our recommendations and indicated they planned to initiate corrective action.

The Board has the responsibility to initiate corrective action. Pursuant to Section 181-b of the New York State Town Law, a written corrective action plan (CAP) that addresses the findings and recommendations in this report must be prepared and forwarded to our office within 90 days. To the extent practicable, implementation of the CAP must begin by the end of the next fiscal year. 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. The Board should make the CAP available for public review in the District Secretary's office.

Substation 1 Reconstruction

Capital projects are complex undertakings that require adequate advanced planning to ensure compliance with applicable laws and regulations. In accordance with New York State General Municipal Law (GML), the Board is responsible for publicly disclosing the estimated cost of proposed capital projects, so taxpayers can make informed decisions when voting on or voicing objections to such plans. GML also stipulates that capital project expenditures are subject to a permissive referendum and certain public notice requirements.¹

The best way to establish a well-thought-out capital project roadmap is to formalize a written capital asset policy. The policy should spell out the procedures to be followed when reviewing and approving a capital project spending plan and should address change orders, recordkeeping procedures and asset disposal. A district's capital asset policy should also include a written capital spending program which spells out the estimated capital spending activity by major categories, as well as the way district officials plan to finance these expenditures.

The Board established a "type" capital reserve² to finance the cost of acquiring, refurbishing, constructing and reconstructing District owned buildings and grounds in accordance with GML. The Board funded its capital reserve through annual budget appropriations and by transferring operating surplus from the general fund.

The Board approved the Substation 1 facility reconstruction capital project, which was funded with about \$2.8 million from the capital reserve fund, without complying with the permissive referendum requirements. Because District officials failed to publish and post a legal notice on the project prior to approval, the Board had to petition the County Legislature to legalize and validate its actions. In addition, the Board did not approve change orders totaling more than \$50,000 before the work began. These discrepancies occurred because the

¹ Actions subject to permissive referendum require fire district officials to publish and post a legal notice informing taxpayers about the board's plans. GML provides that the resolution authorizing the expenditure of money from a capital reserve does not take effect until 30 days after its adoption. However, if a petition signed by a sufficient portion of qualified voters is filed with the fire district secretary within 30 days after the board adopts the resolution, approval is subject to mandatory referendum, or by a majority of district voters.

² A "type" capital improvement reserve is a reserve that may be authorized for a general category, or type, of capital improvement, such as land, buildings or building alterations. For more information, see our publication entitled *Reserve Funds* available at: <http://www.osc.state.ny.us/localgov/pubs/lmgm/reservefunds.pdf>

District did not have a written capital asset policy outlining the procedures to follow when constructing capital assets.

In June 2012, the Board authorized the reconstruction of its Substation 1 facility to be funded with capital reserve funds totaling more than \$2.8 million.³ Although the Board resolution contained some required legal elements, including the maximum project cost, it did not state that the reconstruction project was subject to permissive referendum requirements. Because the District did not have a capital asset policy and procedures to be followed for constructing and reconstructing capital assets, District officials did not submit this resolution for a permissive referendum, as required by GML.

In February 2013, District officials informed us that they unintentionally failed to submit the resolution for a permissive referendum. Subsequently, to correct this oversight, the Board petitioned the Suffolk County Legislature's Ways and Means Committee in April 2014, seeking relief and action⁴ to legalize and validate the District's failure to submit the Substation 1 reconstruction project for permissive referendum. Pursuant to the authority granted by New York State County Law, the Suffolk County Legislature adopted a resolution in June 2014 that legalized and validated the District's actions with respect to the Substation 1 facility reconstruction.

We reviewed the District's construction work-in-progress activity for the Substation 1 capital project to determine if project costs were within the amounts authorized and if the Board approved change orders before the extra work began. As of the end of our fieldwork, District officials had expended or committed to expend approximately \$2.98 million for Substation 1 reconstruction, or approximately \$9,000 less than the total amount authorized. However, we found five change orders totaling \$51,000 for work that was completed without the Board's prior approval. District officials are also disputing the general contractor's final net change order totaling \$48,000. Officials indicated that they are withholding final payment of \$184,000 until all the disputed changes are resolved to District officials' satisfaction.

Without the appropriate guidance from a written capital asset policy and procedures in place for constructing capital assets, there is an increased risk of noncompliance with regulatory requirements. In

³ In January 2014, the Board increased the project's reconstruction costs by \$178,200, also funded with capital reserve money. This additional funding, which was submitted for permissive referendum, increased the Substation 1 capital project's maximum cost to \$2.98 million.

⁴ Pursuant to County Law, Section 227, the Suffolk County Legislature is authorized to legalize and validate any act of any municipality within the County, taken in connection with a lawful municipal purpose or object.

addition, project expenditures may be inaccurately recorded and not detected and corrected and there is a higher likelihood of contractor disputes occurring when the Board does not review and approve change orders before the work begins.

Recommendations

The Board should:

1. Ensure that permissive referendums for capital projects financed with the capital reserve follow all legal requirements.
2. Adopt a written capital asset policy containing the procedures to be followed when authorizing capital asset construction.

APPENDIX A

RESPONSE FROM LOCAL OFFICIALS

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

BOARD OF FIRE COMMISSIONERS

Smithtown Fire District

THOMAS A. BUFFA, *Chairman*
PADRAIG P. O'BRIEN
ROBERT E. REGULINSKI
THOMAS F. DUCKHAM
MICHAEL FELICE

Organized 1928

THOMAS A. BUFFA, *Secretary*
ANTHONY A. MINERVA, *Treasurer*
MATTHEW D. CURTIS, *District Manager*

October 6, 2014

Ira McCracken
Hauppauge Regional Office
NYS Office Building, Room 3A10
Veterans Memorial Highway
Hauppauge, New York 11788-5533

Re: Smithtown Fire District

Gentlemen:

This communication will serve as the Smithtown Fire District's response to the preliminary draft of your office's Report of Examination of the Fire District's Capital Project January 1, 2013 to June 30, 2014 (2014M-231)

Initially the Board of Fire Commissioners wants to commend the examiners from your agency for the professionalism and competence that they exhibited during the course of the audit.

The Board agrees with the audit results and accepts the recommendations set forth in the report, and respond as follows:

Finding #1: "The Board approved the Substation 1 facility reconstruction capital project, which was funded with about \$2.8 million from the capital reserve fund, without complying with the permissive referendum requirements".

Recommendation: "Ensure that permissive referendum for capital projects financed with the capital reserve follow all legal requirements".

Response: The Board agrees with the Finding and Recommendation. The Board thanks your office for calling to its attention its expenditure from a capital reserve fund without complying with the permissive referendum requirements, It has taken corrective action as set forth in the report. The Board is in the process of developing a Capital Reserve Expenditure Procedure to assure that all legal requirements are followed upon the adoption of the Resolution and the subsequent expenditure of the funds authorized. A copy of the Procedure will be filed with your office within the ninety (90) day period.

BOARD OF FIRE COMMISSIONERS

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ANTHONY A. MINERVA, *Treasurer*
MATTHEW D. CURTIS, *District Manager*

Finding #2: "During construction the Board did not approve change orders totaling more than \$50,000 before the work began."

Recommendation: "Adopt a written capital asset policy containing the procedures to be followed when authorizing capital asset construction."

Response: The Board agrees with the Findings and Recommendation. It will develop and adopt a written capital asset policy containing the procedures to be followed when authorizing capital expense construction. A copy of the written Capital Asset Policy will be filed with your office within the ninety (90) day period.

Very truly yours,

Thomas A. Buffa
Chairman of the Board
Smithtown Fire District

APPENDIX B

AUDIT METHODOLOGY AND STANDARDS

We interviewed District officials to obtain an understanding of the organization and the accounting system and reviewed pertinent documents, such as District policies and procedure manuals, Board minutes and financial records and reports. In addition, we reviewed the District's internal controls and procedures over its computerized financial system to help ensure that the information produced by this system was reliable.

After reviewing the information gathered during our initial assessment, we evaluated the District's internal controls for the risk of potential fraud, theft and professional misconduct. We then decided on the reported objective and scope by selecting for audit those areas most at risk. We selected the Substation 1 reconstruction capital project for further audit testing.

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

- We reviewed the Board minutes to determine the District's capital project maximum spending levels and review the related permissive referendum.
- We interviewed Board members and District employees and reviewed the District's capital projects and spending policies to gain an understanding of internal controls over capital project spending.
- We reviewed Board policies and practices, bidding procedures, vendor invoices, change orders, general ledgers and audited financial statements to assess the internal controls' design and effectiveness for preventing and detecting misuse and abuse.
- We analyzed capital project change orders for validity and proper authorization.
- We reviewed the June 3, 2014 resolution adopted by the Suffolk County Legislature to legalize and validate District official' actions with respect to the Substation 1 facility reconstruction.

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

APPENDIX C

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