



# Locust Valley Water District

## Budgeting

### Report of Examination

Period Covered:

January 1, 2009 — December 31, 2012

2013M-179



Thomas P. DiNapoli

# Table of Contents

	<b>Page</b>
<b>AUTHORITY LETTER</b>	2
<b>INTRODUCTION</b>	3
Background	3
Objective	3
Scope and Methodology	3
Comments of Local Officials and Corrective Action	3
<b>BUDGETING</b>	4
Recommendations	7
<b>APPENDIX A</b> Response From Local Officials	8
<b>APPENDIX B</b> Audit Methodology and Standards	12
<b>APPENDIX C</b> How to Obtain Additional Copies of the Report	13
<b>APPENDIX D</b> Local Regional Office Listing	14

# State of New York Office of the State Comptroller

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## Division of Local Government and School Accountability

September 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 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 Locust Valley Water District, entitled Budgeting. 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 Locust Valley Water District (District) is located in the Town of Oyster Bay, in Nassau County. The District supplies drinking water to 7,500 customers in the Hamlet of Locust Valley, the Village of Lattintown, and sections of the Villages of Mill Neck and Matinecock. The District's total revenue for 2012 fiscal year was approximately \$2.2 million, primarily generated from metered water sales and real property taxes. The District's 2012 expenditures totaled more than \$2.4 million.

The District is governed by an elected three-member Board of Commissioners (Board) consisting of a Chairman, a Secretary, and a Treasurer. The Superintendent is responsible for the general management of the District's operations under the Board's direction. The Board, as a whole, is responsible for providing oversight of District finances including adopting the yearly budget.

## Objective

The objective of our audit was to assess the internal controls over the District's financial operations for the period January 1, 2009, through December 31, 2012. Our audit addressed the following related questions:

- Did the Board adopt budgets that reflected the District's operating needs?

## Scope and Methodology

We reviewed District budgets and operating results for fiscal years 2009 through 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 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 agreed with our recommendations and indicated they planned to take 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 Board Secretary's office.

## Budgeting

It is important that the Board adopt budgets based on actual financial operating results from prior years along with other relevant available data. The Board must adopt structurally balanced budgets based on realistic estimates of revenues and expenditures.

Fund balance<sup>1</sup> represents the accumulation of the District's prior years' results of operations (operating surpluses and deficits). Unrestricted fund balance can be appropriated in ensuing years' budgets and used as a source of revenue to either lower property taxes, compensate for anticipated revenue shortfalls or to help finance the construction of capital assets through budgeted transfers to a capital projects fund. Adopting a fund balance policy which defines the amount of unrestricted or unexpended surplus funds can help buffer the District's finances against uncertainties and unforeseen risks, and provide cash flow throughout the fiscal year to sustain normal operating needs. Fund balance levels and its use should be closely monitored to ensure that adequate amounts are maintained.

Additionally, the use of a multiyear Capital Plan<sup>2</sup> can help District officials identify projects, their timing, estimated costs and necessary revenue streams to pay them. If capital projects are financed through budget appropriations, only those amounts expected to be used in the current year should be included in the budget.

The Board frequently over-estimated budgeted expenditures for the 2009 through 2012 fiscal years, and also appropriated \$1 million in fund balance each year which was not fully needed to finance District operations. As a result, only a fraction of the appropriated fund balance was used to fund operations in three of the four years reviewed. None of the appropriated fund balance was used in the other year. The Board also appropriated more fund balance than available to balance three of the four ensuing years' budgets. Had the Board had a fund balance policy in place budget estimates could have been

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

<sup>2</sup> A multiyear capital plan encompasses three-to-five years and provides details on the scope, timing, and funding of capital projects.

more realistic, budgets would have been structurally balanced and the District’s financial condition would have been more transparent to residents.

Appropriated Fund Balance – Generally, planned operating deficits occur when the Board adopts a budget where the appropriations are greater than the expected revenues, with the difference being funded by unexpended surplus funds. The Board frequently over-estimated budget expenditures<sup>3</sup> and appropriated fund balance in excess of its operating needs. As a result, only a fraction of the appropriated fund balance was used to fund operations in three of the fiscal years reviewed, while in one year none of the amount appropriated was used.

The Board appropriated over \$1 million of fund balance in each of the adopted budgets, as shown in Table 1.

<b>Table 1 - Appropriated / Assigned Fund Balance vs. Results of Operations</b>				
	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>
Appropriated / Assigned fund balance	\$1,379,244	\$1,087,978	\$1,021,834	\$1,153,355
Actual Operating Surplus / (Deficit)	(\$305,635)	\$421,613	(\$123,493)	(\$194,775)
Appropriated Fund Balance Not Used	\$1,073,609	\$1,509,591	\$898,341	\$958,580

Additionally, the Board appropriated more fund balance than available to fund the ensuing years’ budgets for three of the four years, as shown in Table 2.

<b>Table 2 - Appropriated / Assigned Fund Balance vs. Available Fund Balance</b>				
<b>Unassigned Fund Balance</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>
Unrestricted Fund Balance Available at December 31 <sup>a</sup>	\$804,706	\$696,205	\$1,216,009	\$1,015,419
Fund Balance Assigned for Ensuing Year's Budget	\$1,087,978	\$1,021,834	\$1,153,355	\$1,236,180
Unassigned (over-appropriated)	(\$283,272)	(\$325,629)	\$62,654	(\$220,761)

<sup>a</sup> Does not include encumbrances

This budgeting practice is imprudent because it gives the impression that the Board appropriated unexpended surplus funds in adopted budgets to reduce the real property tax levies or to avoid raising revenues through increased water rates. In reality, the Board inflated budgeted expenditures which largely offset the amount of fund balance appropriated, so that very little of fund balance is actually used to fund operations.

<sup>3</sup> See “Over-estimated Expenditures” section

Finally, the Board has not adopted a fund balance policy to define the amount of unrestricted fund balance to be retained or used during emergencies and to provide cash flow to sustain operations throughout the fiscal year.

Over-estimated Expenditures – The Board consistently adopted budgets that estimated expenditures in excess of the District’s operating needs. This occurred because the Board did not use prior years’ actual expenditure trends and other financial information such as multiyear capital planning when preparing annual budgets. As a result, only a fraction of fund balance appropriated to fund District operations was actually needed in three of the four years reviewed.

We compared budget to actual expenditures to determine whether the District budget estimates realistically reflected the District’s operating needs. For the 2009 through 2012 fiscal years, the District reported 166 positive expenditure variances totaling \$4.8 million out of 196 expenditure line items.

On average, District officials included 13 appropriations in the annual budget, aggregating more than \$1.9 million over four years, which were never used and 29 other appropriations, aggregating \$2.9 million, which exceeded operating needs by a total of \$4.8 million.

For example, as shown on Table 3, almost \$2.4 million has been budgeted over four years for capital improvements. However, the list of planned capital projects provided to us is comparable to a multiyear capital plan rather than a list of projects intended to be financed and completed during current budget cycles. As a result, the District reported substantial positive variances, which over four years aggregated almost \$1.7 million.

	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>	<b>Total</b>
Budget	\$800,000	\$550,000	\$475,000	\$545,000	\$2,370,000
Actual	\$148,071	\$103,127	\$66,091	\$358,839	\$676,128
Variance	\$651,929	\$446,873	\$408,909	\$186,161	\$1,693,872

As a further example, District officials appropriated funds for compensated absences that was never used. Over the four years, this aggregated to \$385,000. District officials indicated that they did not survey employees of retirement age when they prepared the budget. Nevertheless, the Board continued to estimate and include appropriations in adopted budgets even though no one retired during the four-year period.

## **Recommendations**

1. The Board should adopt budgets that realistically reflect the District's operating needs.
2. The Board should appropriate only available fund balance to finance operations in succeeding years' budgets.
3. The Board should adopt a fund balance retention policy identifying the portion of fund balance to be retained for contingencies and to provide cash flow throughout the fiscal year.
4. The Board should provide an appropriation in adopted budgets to fund only the capital projects it intends to complete during the budget cycle.
5. District officials should correctly identify the appropriation for compensated absences that is included in the budget.



**APPENDIX A**  
**RESPONSE FROM LOCAL OFFICIALS**

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

# LOCUST VALLEY WATER DISTRICT

226 Buckram Road, P.O. Box 531  
Locust Valley, New York 11560  
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Anker Johansen  
Chairman  
Louis P. Savinetti  
Treasurer  
Pasquale J. Eliseo  
Secretary  
Charles A. Savinetti, Jr.  
Superintendent

August 28, 2013

Mr. Ira McCracken  
Chief Examiner  
Office of the State Comptroller  
NYS Office Bldg, Room 3A10  
250 Veterans Memorial Highway  
Hauppauge, N.Y. 11788-5533

**Re: Locust Valley Water District  
Budgeting - Report of Examination  
January 1, 2009 – December 31, 2012  
2013M-179**

Dear Mr. McCracken:

The Board of Commissioners of the Locust Valley Water District appreciates the recommendations made during your audit and trust that they will help us provide clearer accountability for the public funds spent in our District. Please consider this letter our Audit Response and Corrective Action Plan.

## **Audit Response**

The Board agrees with the findings and the five recommendations made in your report and appreciate the benefits of this process. We will endeavor to implement the following Corrective Action Plan that will address your recommendations.

## Corrective Action Plan

The following sets forth the Board's plans to implement a Corrective Action Plan:

### Audit Recommendation:

1. The Board should adopt budgets that realistically reflect the District's operating needs.

#### **Implementation Plan of Action:**

The Board intends to submit its 2014 budget that better estimates our annual operating needs.

#### **Implementation date:**

Immediately

#### **Person Responsible for Implementation:**

Board of Commissioners

### Audit Recommendation:

2. The Board should appropriate only available fund balance to finance operations in succeeding years' budgets.

#### **Implementation Plan of Action:**

The Board intends to submit its 2014 budget using only the available fund balance.

#### **Implementation date:**

Immediately

#### **Person Responsible for Implementation:**

Board of Commissioners

### Audit Recommendation:

3. The Board should adopt a fund balance retention policy identifying the portion of fund balance to be retained for contingencies and to provide cash flow throughout the fiscal year.

#### **Implementation Plan of Action:**

The Board will adopt a fund balance retention policy that recommends maintaining a maximum unassigned fund balance of 25% of the General Fund operating budget.

#### **Implementation date:**

Immediately

#### **Person Responsible for Implementation:**

Board of Commissioners

### Audit Recommendation:

4. The Board should provide an appropriation in adopted budgets to fund only the capital projects it intends to complete during the budget cycle.

#### **Implementation Plan of Action:**

The Board intends to submit its 2014 budget that only provides for capital projects it intends to complete during the budget cycle.

#### **Implementation date:**

Immediately

#### **Person Responsible for Implementation:**

Board of Commissioners

**Audit Recommendation:**

5. District officials should correctly identify the appropriation for compensated absences that is included in the budget.

**Implementation Plan of Action:**

The Board intends to submit its 2014 budget that correctly identifies the appropriation for compensated absences.

**Implementation date:**

Immediately

**Person Responsible for Implementation:**

Board of Commissioners

The District wishes to thank your office and employees for their patience and education. Should you have any questions concerning our Corrective Action Plan, please do not hesitate to immediately contact this Board directly.

Very truly yours,

Anker Johansen, Chairman  
Board of Water Commissioners

## 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 District assets. 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 oversight, cash receipts and disbursements, purchasing, and information technology.

During the initial assessment, we interviewed appropriate District officials, performed limited tests of transactions and requested pertinent documents, such as District policies and procedures manuals. We reviewed Board minutes, financial records, and reports. In addition, we reviewed the District's internal controls.

After reviewing the information gathered during our initial assessment, we determined where weaknesses existed, and decided upon the reported objective and scope by selecting for audit those areas most at risk. We selected budgeting practices for further review. Specific data and testing that was done to accomplish the objective:

- We interviewed District officials to gain an understanding of the financial operations of the District.
- We reviewed the District budgets and actual results for the fiscal years 2009 through 2012.
- We reviewed audited reports prepared by outside accountants.
- We reviewed State Comptroller's Office publications and guidance on financial condition and management.

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.

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**AND SCHOOL ACCOUNTABILITY**

Andrew A. SanFilippo, Executive Deputy Comptroller  
Nathalie N. Carey, Assistant Comptroller

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