



Town of Johnsburg

Management Oversight and Online Banking

Report of Examination

Period Covered:

January 1, 2011 — July 31, 2012

2013M-6



Thomas P. DiNapoli

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State of New York Office of the State Comptroller

Division of Local Government and School Accountability

April 2013

Dear Town 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 Town of Johnsbury, entitled Management Oversight and Online Banking. 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 Town of Johnsburg (Town) is located in Warren County and is governed by a Town Board (Board) which comprises an elected Town Supervisor (Supervisor) and four elected councilpersons. The Supervisor serves as the chief executive officer and chief fiscal officer. The Town provides various services to its residents that include road maintenance, snow plowing, and general government administration.

The 2012 budget for the general fund was \$1,162,537, and the highway fund budget was \$1,259,053. The Town's expenditures were funded primarily with revenues from real property taxes, sales tax, and State aid.

Scope and Objectives

The objectives of our audit were to evaluate the Town's oversight of financial activities and internal controls over online banking for the period January 1, 2011, to July 31, 2012. Our audit addressed the following related questions:

- Did the Board adequately design, implement, and monitor internal controls over the Town's financial activities?
- Did the Board adequately design and implement policies over online banking that ensure the protection of the Town's assets and data?

Audit Results

The Board did not adequately design, implement, or monitor internal controls over the Town's financial activities. The Supervisor did not provide effective oversight of the work performed by the bookkeeper to address her incompatible financial duties. Because the bookkeeper can initiate transactions, make accounting entries, and perform bank reconciliations without any supervision, there is a risk that she could initiate and conceal inappropriate transactions that could go undetected and uncorrected. Further, the Board did not conduct an annual audit of the records of officials and employees who receive and disburse cash. The Board's failure to perform an annual audit diminishes its ability to effectively monitor the Town's financial operations and could result in errors or irregularities that are undetected and uncorrected.

The Board did not design and implement policies over online banking that would have ensured the protection of the Town's assets and data. The Town did not establish a written policy for online banking that defined the Board's intentions. While the Town's bank has an "Internet User Agreement," Town officials were unaware of its provisions or that it existed. The bank's agreement did not address which Town officials were authorized to initiate online transfers or security procedures for authenticating transactions. Without a comprehensive online banking policy, it is possible that an unauthorized individual could initiate an online transfer and that it would remain undetected and uncorrected.

The Supervisor has not adequately segregated the bookkeeper's online banking duties. Also, the Supervisor had not reviewed or supervised the bookkeeper's online banking transactions totaling more than \$1.8 million made during the first six months of 2012. In addition, the Town has not established a confirmation process with its bank for online transfers of Town moneys. Although we did not find any discrepancies with the \$1.8 million in online transfers, because the bookkeeper's incompatible online banking duties are not adequately segregated, there is an increased risk that moneys may be transferred improperly, or that online transfers will not be properly recorded and documented.

Our audit also disclosed additional areas in need of improvement concerning IT controls, which, because of their confidential nature, we disclosed separately to Town officials.

Comments of Local Officials

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

Introduction

Background

The Town of Johnsbury (Town) is located in Warren County and has a population of about 2,400. The Town is governed by a Town Board (Board) that comprises a Town Supervisor (Supervisor) and four elected councilpersons. The Supervisor serves as the chief executive officer and chief fiscal officer. The Supervisor has a part-time bookkeeper who assists him with maintaining the Town's accounting records.

The offices at the Town Hall use a small number of desktop and laptop computers that function independently of one another (stand-alone) and are not connected through a network. The computers are of varying age and use different operating systems. They all have Internet access, but have varying levels of security protection (e.g., anti-virus software). The bookkeeper uses her computer to conduct online banking transactions.

The Town provides various services that include highway maintenance and snow removal, a public library, water services, and general government support. The Town's general fund budget for the 2012 fiscal year included appropriations totaling \$1,162,537, and appropriations for the highway fund totaled \$1,259,053. The Town's expenditures are funded primarily with revenues from real property taxes, sales tax, and State aid.

Objectives

The objectives of our audit were to evaluate the Town's oversight of financial activities and internal controls over online banking. Our audit addressed the following questions:

- Did the Board adequately design, implement, and monitor internal controls over the Town's financial activities?
- Did the Board adequately design and implement policies over online banking that ensure the protection of the Town's assets and data?

Scope and Methodology

We examined management oversight and online banking controls of the Town for the period January 1, 2011, to July 31, 2012. Our audit disclosed areas in need of improvement concerning information technology controls. Because of the sensitivity of this information, certain vulnerabilities are not discussed in this report but have been communicated to Town officials so they could take corrective action.

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 Town officials and their comments, which appear in Appendix A, have been considered in preparing this report. Town officials generally agreed with our recommendations and indicated they planned to initiate 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 Town Clerk's office.

Management Oversight

Part of the Board's responsibility for the general management and control of the Town's finances is providing proper and adequate oversight, including the development and implementation of control procedures for daily financial operations. These control procedures include, for example, segregation of incompatible duties or implementing mitigating controls through oversight. The Board can also accomplish this by conducting an annual audit of the books, records, and documents of officials and employees responsible for receiving and disbursing money.

The Board did not adequately design, implement, or monitor internal controls over the Town's financial activities. The Supervisor did not provide effective oversight of the work performed by the bookkeeper to address her incompatible financial duties. Further, the Board did not conduct an annual audit of the records of officials and employees who receive and disburse cash. The lack of adequate oversight of the financial activities places the Town at risk for errors and/or irregularities occurring and not being readily detected and corrected.

Lack of Compensating Controls

Proper segregation of duties ensures that no one person controls all phases of a transaction. When duties cannot be properly segregated, as is the case in many smaller localities like Johnsbury, the Supervisor should regularly review bank statements, canceled checks, cash receipt records, and bank reconciliations and compare them to the transactions recorded in the Town's accounting records to ensure that all Town monies are accurately recorded and deposited and disbursed only for proper Town purposes.

The Supervisor did not segregate the bookkeeper's incompatible financial duties or provide any oversight over the bookkeeper's work to reduce the risk associated with her inadequately segregated duties. The bookkeeper opens the mail, processes and records online banking transactions, prepares checks, maintains the check stock, processes the payroll, prepares bank reconciliations, and prepares the Supervisor's financial reports. She performs these duties without any oversight or review by the Supervisor.

We reviewed \$316,000 in revenues and \$343,000 in disbursements reported on the Supervisor's April and July 2012 cash reports to ensure they were accurately recorded and had adequate supporting documentation.¹ We also reviewed about \$1.3 million in general fund

¹ Refer to Appendix B for further information on our sample selections.

revenues, \$1.2 million in highway fund revenues, and about \$259,000 in disbursements reported on the Town's 2011 annual update document² for accuracy, source documentation, and approvals. Except for minor discrepancies that we discussed with officials, we found that the records were generally accurate and reliable and that disbursements were approved and contained sufficient documentation.

Although we did not find significant discrepancies, because the bookkeeper can initiate transactions, make accounting entries, and perform bank reconciliations without any supervision, there is a risk that she could initiate and conceal inappropriate transactions that could go undetected and uncorrected.

Annual Audit

The Board is required to annually audit, or cause to be audited, the books, records, and related documents of officials and employees who are responsible for receiving and disbursing money on behalf of the Town. This annual audit is particularly important in smaller governments which may not have an adequate system of controls because employees are required to perform duties that should otherwise be segregated. An annual audit not only helps to identify conditions that need improvement, but also enables Board members to learn more about financial operations so that they can effectively perform their fiscal oversight responsibilities.

During our audit period, the Board did not conduct an annual audit of the records of the Supervisor, Town Clerk/Tax Collector, Accounts Clerk, or Town Justice. Town officials did not provide us with any evidence, in the minutes of the Board's proceedings or other materials presented to us, that the Board had audited, or contracted with an independent auditor to audit, the financial records and reports of any Town officer or employee for the 2010, 2011, and 2012 fiscal years. The Board's failure to perform an annual audit diminishes its ability to effectively monitor the Town's financial operations and could result in errors or irregularities that are undetected and uncorrected.

Recommendations

1. The Supervisor should segregate the bookkeeper's incompatible financial duties or provide adequate oversight of the bookkeeper's work.
2. The Board should conduct, or contract for, an annual audit of the records and reports of all officers and employees who received or disbursed money during the previous fiscal year.

² General Municipal Law requires municipalities to file an annual update document with the Office of the State Comptroller within 60 days following the close of each fiscal year.

Online Banking

Online banking allows the convenience of moving money between bank accounts, reviewing transaction histories, reconciling accounts at any time, and closely monitoring cash balances. General Municipal Law allows local governments to disburse or transfer funds in their custody by means of electronic or wire transfers. A structured and effective internal control framework regulating online banking transfers is critical to safeguard Town moneys. The Board must adopt an online banking policy and establish controls that provide an adequate segregation of incompatible duties for those who will be initiating and authorizing online transfers and supervisory approval and bank confirmation of online transfers. The duties of authorizing, initiating, and recording online transfers must be performed by different individuals. Also, it is essential that online transfer confirmations are not performed by the same individual who initiates the transfers.

Online Banking Policy — Online wire or electronic transfers can disburse significant amounts of money, usually within minutes of being executed. Banks typically confirm the authenticity of online transfers with municipalities prior to disbursing the funds. To protect Town moneys from unauthorized online transfers, Town officials should have adequate controls in place over the authorization process for transfers and written agreements with the banks setting forth security procedures for authenticating transactions and identifying which officer(s) are authorized to disburse funds.

The Town did not establish a written policy for online banking that defined the Board's intentions. While the Town's bank has an "Internet User Agreement," Town officials were unaware of its provisions or that it existed. The bank's agreement did not address which Town officials were authorized to initiate online transfers or security procedures for authenticating transactions. Without a comprehensive online banking policy, it is possible that an unauthorized individual could initiate an online transfer and that it would remain undetected and uncorrected.

Online Transfers — The Town's bank allows Town officials to initiate, authorize, and transmit moneys electronically without outside assistance from bank personnel. To protect Town funds from unauthorized and improper online transfers, it is essential that Town officials review and authorize online transfers in a timely manner. Proper segregation of duties is critical for managing these types of transactions. Town officials should require at least two individuals

to be involved in each online transfer: one for authorization and one for transmittal. Also, it is essential that the bank contact an individual other than the one who initiates the online transfers to provide approval and confirmation of the transfers.

The Supervisor has not adequately segregated the bookkeeper's online banking duties or reviewed and supervised the bookkeeper's online banking transactions. Also, the Town has not established a confirmation process with its bank for online transfers of Town moneys. The bookkeeper authorizes, initiates, and records online transfers of Town moneys among accounts within the same bank without any supervisory review.

Before the current bookkeeper took office in January 2012, the Town did not perform online banking transfers. We reviewed all 47 online transfers that the bookkeeper made between six bank accounts totaling more than \$1.8 million made from February 2012 to July 31, 2012. We did not find any discrepancies or irregularities in these transfers.

Although we did not find any discrepancies, because the bookkeeper's incompatible online banking duties are not adequately segregated, there is an increased risk that moneys may be transferred improperly, or that online transfers will not be properly recorded and documented. Also, the bookkeeper's incompatible online banking duties increase the need for bank confirmation of all online transfers with the Supervisor.

Recommendations

3. The Board should adopt and communicate an online banking policy that outlines approved online banking activities and assigns responsibility for ensuring that the transactions are safely conducted and monitored.
4. The Board should ensure that the online banking agreement with its bank identifies who is authorized to initiate and approve online transfers and establishes security procedures for authenticating online transfers.
5. The Supervisor should authorize and approve all online transfers performed by the bookkeeper.

APPENDIX A

RESPONSE FROM LOCAL OFFICIALS

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



Town of Johnsburg

P.O.Box 7, North Creek, NY, 12853
Ph: 518-251-2421 Fax 518-251-9991

**Bakers Mills
Johnsburg
NorthCreek
North River
Riparius
Wevertown**

April 9, 2013

To: The NYS Office of the Comptroller

To Whom it May Concern,

In response to the draft of the Management Oversight and Online Banking report issued by your office in March 2013, first let me say that we welcome the constructive dialogue resulting from this study and are working to implement the changes in policies and procedures recommended in the draft report.

Town Supervisor
Ron Vanselow
(518) 251-2421

Regarding the Management Oversight portion of your report, the Town Supervisors office has already instituted some controls as far as the town's bookkeeper's duties, and the town board is now conducting physical examinations of all town records for town offices that receive or disburse monies. These policies will be formalized by resolutions of the town board in the near future.

Town Council
Gene Arsenaault
Arnold Stevens
Peter Olesheski, Jr.
Katie Nightingale

Regarding the Online Banking portion of your report, the first two recommendations are being addressed through dialogue with our banking institution and will also be formalized by board resolution in the near future. The third recommendation has already been addressed as the Town Supervisor is now authorizing and approving all online transfers done by the bookkeeper.

Highway Superintendent
Daniel B. Hitchcock
(518) 251-2113

We look forward to continuing to work with your office as we finalize these policies and procedures.

Town Clerk
William R. Rawson
(518) 251-3011

Sincerely,

Town Assessor
Ann P. Deppe
(518) 251-5559

Ron Vanselow
Supervisor,
Town of Johnsburg

APPENDIX B

AUDIT METHODOLOGY AND STANDARDS

The Town was selected for audit based on initial financial reviews. While reviewing the Town's accounting system, we found that the Town transitioned to new accounting software in the middle of its 2012 fiscal year.

The objectives of this audit were to evaluate the Town's oversight of financial activities and internal controls over online banking for the period January 1, 2011, to July 31, 2012. To achieve the objectives of this audit and obtain valid audit evidence, we performed the following steps:

- We interviewed officials to gain an understanding of the Town's budgeting process and accounting system.
- We reviewed the Supervisor's April 2012 cash report, which included summaries of cash receipts and disbursements. We judgmentally selected April 2012 because it was in the middle of the year within our scope period, and it was after the Town switched accounting systems. We traced about \$228,000 in general fund revenues and about \$33,000 in water rents from the report to source documentation. We traced about \$30,000 in general fund expenditures and about \$16,000 in highway fund expenditures from the report to the warrants.
- We reviewed the Supervisor's July 2012 cash reports, which included summaries of cash receipts and disbursements. We judgmentally selected July 2012 because it was the most recently completed month in our scope period. We judgmentally reviewed \$9,800 in general fund revenues, which was half of the total \$19,000 general fund revenues for July 2012, and \$45,000 in highway fund revenues, which was the total revenue received by the highway fund for July 2012. We traced these revenues from the report to source documentation. We traced \$257,000 disbursed from the highway fund and \$40,000 disbursed from the general fund from the Supervisor's July 2012 cash report to the warrants. These disbursements represented all of the disbursements from both funds during July 2012.
- We reviewed the Town's results of operations and compared its audited financial statements to its 2011 annual update document and general ledger.
- We compared the adopted budgets to the accounting records.
- We assessed the composition of significant balance sheet accounts.
- We reviewed the periodic reports prepared by the Supervisor and the Town Clerk.
- We analyzed inter-fund loans.
- We reviewed budget amendments, Board meeting minutes, and resolutions.
- We selected and reviewed samples of cash receipts and cash disbursements.

- We reviewed bank statements and bank reconciliations and compared them to the accounting records.
- We tested the reliability of the data maintained on the accounting system.
- We interviewed Town officials and reviewed documentation to determine existing policies related to the use of information technology and cyber-security awareness.
- We interviewed computer users and asked them to demonstrate their normal procedures for opening programs, accessing and browsing the Internet, and accessing email and online bank accounts. We also interviewed computer users to assess their general knowledge of cyber-security awareness.
- We reviewed the Town's written agreements with outside parties who provide information technology services.

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 objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

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