



Town of Pulteney

Financial Management and Information Technology

Report of Examination

Period Covered:

January 1, 2010 — May 30, 2012

2012M-177



Thomas P. DiNapoli

Table of Contents

	Page
AUTHORITY LETTER	2
EXECUTIVE SUMMARY	3
INTRODUCTION	5
Background	5
Objective	5
Scope and Methodology	5
Comments of Local Officials and Corrective Action	6
FINANCIAL MANAGEMENT	7
Budgeting Practices	8
Management Oversight	11
Annual Audit	12
Recommendations	13
INFORMATION TECHNOLOGY	14
Acceptable Use	14
Online Banking	15
Monitoring	16
Breach Notification	16
Disaster Recovery	17
Controls Over Computer Equipment	17
Recommendations	18
APPENDIX A Response From Local Officials	19
APPENDIX B Audit Methodology and Standards	23
APPENDIX C How to Obtain Additional Copies of the Report	25
APPENDIX D Local Regional Office Listing	26

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 Town 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 Pulteney, entitled Financial Management and Information Technology. 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 Pulteney (Town) is located in Steuben County and has a population of 1,285. The Town provides various services to its residents including water, street maintenance, and snow removal services and general government support. The Town's 2012 general, highway, and water district appropriations totaled approximately \$1.29 million, which were funded primarily by real property taxes, sales tax, State aid, fees, and water rents.

Scope and Objective

The objective of our audit was to review the Town's financial management and controls over information technology (IT) for the period January 1, 2010, through May 30, 2012. We expanded the scope back to 2007 and forward to December 31, 2012, to review the Town's fund balance levels and budgeting trends. Our audit addressed the following related questions:

- Does the Board adopt realistic budgets, routinely monitor financial operations, and take appropriate actions to maintain the Town's financial stability?
- Did the Town ensure that its computer hardware, software, and data were adequately safeguarded?

Audit Results

During the last two fiscal years, the Town's financial condition has improved. This improvement has been primarily the result of hiring a bookkeeper who has enhanced the development and monitoring of the annual budgets adopted by the Board by helping the Board overcome a lack of established budgetary guidance. In previous years, the Board adopted budgets which included inaccurate revenue and expenditure estimates and appropriated fund balance that was not available. As a result, the financial condition of the general, water district, and highway funds had declined significantly between 2007 and 2010, resulting in cash shortages.

The Board made improvements in its adopted budgets for the 2012 and 2013 fiscal years, including increasing water rates and reducing or eliminating the appropriation of fund balance, and achieved improved operating results for 2012. To help ensure these improvements can be sustained, even if personnel changes occur, the Board should adopt policies and procedures that give detailed guidance on budget development and monitoring. The Town's financial condition requires the Board to remain focused on adopting budgets based on accurate information and closely monitoring actual results against budget estimates. In addition, we found that the Board has not adopted formal policies, and

the Supervisor has not developed detailed procedures, for ensuring that financial duties are adequately segregated or that sufficient review and oversight procedures are in place. Furthermore, the Board did not perform an audit of the water department and did not maintain adequate documentation of its audit of the records and reports of the Supervisor, Town Clerk, or Town Justice.

The Town should institute appropriate policies and procedures to protect its computerized data resources from internal and external threats. The Board has not established policies and procedures related to acceptable use, online banking, breach notification, or disaster recovery. Additionally, there is no system in place for monitoring IT activity or changes in the system, maintaining a computer inventory, or sanitizing computer equipment before disposal. Therefore, IT assets are at risk for unauthorized, inappropriate, and wasteful use.

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 have begun to take corrective action.

Introduction

Background

The Town of Pulteney (Town) is located in Steuben County and has a population of 1,285.¹ The Town provides various services to its residents including water, street maintenance, and snow removal services and general government support. The Town's 2012 general, highway, and water district appropriations totaled approximately \$1.29 million, which were funded primarily by real property taxes, sales tax, State aid, fees, and water rents.

The Town is governed by an elected Town Board (Board), which comprises the Supervisor and four elected Board members. The Board is responsible for the general management and control of the Town's financial affairs. The Supervisor, who serves as the Town's chief financial officer, is responsible for the day-to-day management of the Town under the direction of the Board. The current Supervisor and two new Board members took office effective January 1, 2012.²

The Supervisor appointed a bookkeeper who performs all of the Town's financial recordkeeping.³ The Town purchases water from the Village of Penn Yan (Village) and has a water operator who is responsible for water billings and collections and overseeing general water operations.

The Town uses the services of an outside vendor for information technology (IT) technical assistance and troubleshooting as needed.

Objective

The objective of our audit was to review the Town's financial management and IT controls. Our audit addressed the following related questions:

- Does the Board adopt realistic budgets, routinely monitor financial operations, and take appropriate actions to maintain the Town's financial stability?
- Did the Town ensure that its computer hardware, software, and data were adequately safeguarded?

Scope and Methodology

We examined the Town's financial management and controls over IT for the period January 1, 2010, through May 30, 2012. We expanded the scope back to 2007 and forward to December 31, 2012, to review the Town's fund balance levels and budgeting trends.

¹ According to the 2010 Federal Census

² Board members are elected for rotating four-year terms, and the Supervisor is elected to a two-year term; thus, the Board's membership changes periodically, resulting in different individuals who share the Board's ongoing oversight responsibilities during different periods of time.

³ The current bookkeeper was appointed in February 2011.

Our audit disclosed additional areas in need of improvement concerning IT controls. Because of the sensitivity of some of this information, certain vulnerabilities are not discussed in this report, but have been communicated confidentially to Town officials in a separate letter so that 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 have begun 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 Town Clerk's office.

Financial Management

The Board is responsible for making sound financial decisions that are in the best interests of the Town and the taxpayers who fund its operations. This responsibility requires the Board to adopt structurally balanced budgets for all operating funds, which include sufficient revenues to finance recurring expenditures. It is important that the Board adopt policies and procedures for preparing the budget and periodically monitoring the annual budget. The appropriation of fund balance as a funding source, when appropriate, can help Town officials ensure that the amount of real property taxes raised is not greater than necessary. The Board's responsibilities to effectively manage the Town's finances include conducting an annual audit of departments that receive or disburse cash, ensuring that the Supervisor adequately segregates financial duties among Town employees, and ensuring that financial records are accurately and timely prepared and reviewed.

The Town's financial condition has improved during the past two fiscal years after declining between 2007 and 2010. Although the Board has improved its budgeting practices to help the Town to begin to recover financially, it has not adopted detailed policies and procedures for its budget process to ensure the continued development of the most accurate and realistic annual budgets possible. Lacking established budgetary guidance, the Board had adopted budgets early in our audit period that included inaccurate revenue and expenditure estimates and appropriated fund balance that was not available. As a result, the financial condition of the general, water district, and highway funds had declined significantly since 2007, resulting in cash shortages.

With the assistance of the new bookkeeper, the Board made improvements in its 2012 and 2013 adopted budgets – which included increasing water rates and either limiting or eliminating fund balance appropriation – and improved operating results for 2012. However, the lack of detailed policies and procedures creates the risk that these improvements will not continue if Town personnel changes again. In addition, we found that the Board has not adopted formal policies, and the Supervisor has not developed detailed procedures, for ensuring that financial duties are adequately segregated or that sufficient review and oversight procedures are in place. Furthermore the Board did not perform an audit of the water department and did not maintain adequate documentation of its audit of the records and reports of the Supervisor, Town Clerk, and Town Justice.

Budgeting Practices

The Board must ensure that budgets are prepared and adopted based on the resources that can be used to fund operations. It is essential that the Board establish policies and procedures that help ensure that it will have the information needed to adopt realistic and structurally balanced budgets. In addition to accurately estimating revenues and expenditures, the Board must develop a reasonable estimate of the amount of fund balance⁴ that will be available at the end of the current fiscal year that it can appropriate to offset the ensuing year's tax levy and/or retain as a financial safeguard.⁵ The Board also is responsible for ensuring that the Town has adequate unexpended surplus funds⁶ for the current year's operations. Operating deficits occur when total expenditures exceed total revenues. While local governments can plan for operating deficits, by appropriating surplus fund balance to reduce the tax levy and benefit taxpayers in the short term, it is important for local officials to avoid depleting the fund balance to the point that there is insufficient cash available for paying bills or managing unforeseen events.

The Board has not adopted detailed policies and procedures for accurately estimating revenues and expenditures and the amount of fund balance that will be available for appropriation, determining the appropriate level of unexpended surplus funds to maintain for unforeseen occurrences or cash flow issues, monitoring the adopted budget and comparing it against actual results of operations, and for amending the budget, as needed, throughout the year. Without budget policies and procedures for guidance, the Supervisor – until the appointment of a new bookkeeper in 2011 – did not accurately estimate revenues and expenditures based on prior years' operations and available information. The Supervisor also did not establish a system to reasonably estimate the amount of fund balance that would be available at year end and, consequently, did not provide the Board with projections of available fund balance. The Board was also not

⁴ Fund balance is the difference between revenues and expenditures accumulated over time, which can be appropriated as a funding source in the next year's budget to reduce the tax levy.

⁵ The Government Finance Officers Association (GFOA) recommends that municipalities retain a minimum of two months (approximately 17 percent) of regular revenues or expenditures as surplus funds at year end.

⁶ 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).

sufficiently familiar with the Town's operations or budget process and, as a result, it adopted budgets for the general, water district, and highway funds that often appropriated more fund balance than was actually available, which caused significant fund balance declines.

The inaccurate budgets adopted by the Board during the beginning of our audit period resulted in budgetary deficits in the general and highway funds and fund balance deficits in the water district fund. The fiscal stress experienced by the water district fund⁷ caused it to rely on interfund loans, which exacerbated the fiscal stress of the general fund. The Board found itself in a difficult fiscal situation because it had relied too heavily on the former Supervisor and bookkeeper and did not take its own steps to ensure it was approving budgets that were based on accurate and reasonable information. While the new bookkeeper guided the Supervisor and Board to adopt more realistic budgets for 2012 and 2013, it is vital that the Board continue to refine and monitor its budgeting procedures to ensure that the Town's financial condition continues to improve and remains stable. The following tables demonstrate the financial trends over five years from 2007 to 2011⁸ along with preliminary 2012⁹ operating results for updated perspective.

Table 1: General Fund – Operations and Fund Balance						
	2007	2008	2009	2010	2011	2012
Beginning Fund Balance	\$244,634	\$227,413	\$161,227	\$76,599	\$27,780 ^a	\$36,025
Operating Surplus (Deficit)	(\$17,221)	(\$66,186)	(\$84,628)	(\$43,227)	\$8,245	\$28,617
Ending Fund Balance	\$227,413	\$161,227	\$76,599	\$33,372	\$36,025	\$64,642
Appropriated in Ensuing Year's Budget	\$150,000	\$143,000	\$80,000	\$31,000	\$0	\$11,549
Unexpended Surplus Funds	\$77,413	\$18,227	(\$3,401)	\$2,372	\$36,025	\$53,093
Surplus Funds as a % of the Ensuing Year's Appropriations	19%	5%	(1%)	1%	9%	14%
^a The 2011 beginning fund balance includes a prior period adjustment (decrease) totaling \$5,592.						

As of December 31, 2011, the general fund balance consisted only of outstanding interfund loans (\$43,750) made to the water district fund, which were uncollectable, leaving the general fund with a \$1,937 deficit cash balance and potentially unable to meet its cash

⁷ When the water district was established in 2007, the Board underestimated start-up costs and signed a water supply contract that required the water district to pay for double the amount of water that Town residents actually used, which immediately placed the water district fund in a deficit position.

⁸ The Supervisor submitted the 2011 annual financial report to OSC in June 2012 after we completed our fieldwork. As a result, we included 2011 operating results in our tables and analysis but did not specifically audit the year-end results.

⁹ In January 2013, we received the Town's preliminary budget-to-actual reports as of December 31, 2012, which did not include potential closing entries or adjustments, such as accrued payroll at year-end.

flow needs. The Board adopted a more realistic budget for 2012 by eliminating the appropriation of fund balance and more closely monitoring results of operations. This achieved an operating surplus which increased fund balance to a less precarious level at the end of 2012.¹⁰

Table 2: Water District Fund – Operations and Fund Balance						
	2007	2008	2009	2010	2011	2012
Beginning Fund Balance	\$0	(\$92,131)	(\$93,468)	\$18,718	(\$13,430) ^a	(\$34,014)
Operating Surplus (Deficit)	(\$92,131)	(\$1,337)	\$112,186	(\$32,993)	(\$20,584)	(\$13,725)
Ending Fund Balance	(\$92,131)	(\$93,468)	\$18,718	(\$14,275) ^b	(\$34,014) ^b	(\$47,739)
Appropriated in Ensuing Year's Budget	\$0	\$20,000	\$25,000	\$2,000	\$0	\$0
Unexpended Surplus Funds	(\$92,131)	(\$113,468)	(\$6,282)	(\$16,275)	(\$34,014)	(\$47,739)
Surplus Funds as a % of the Ensuing Year's Appropriations	(50%)	(62%)	(3%)	(5%)	(9%)	(11%)
^a The 2011 beginning fund balance includes a prior period adjustment (decrease) totaling \$845.						
^b The 2010 and 2011 ending fund balances do not include the unrecorded liability owed to the Village; the 2011 fund balance deficit was actually more than \$117,000. Refer to footnote 12 for further information.						

For the water fund, the Board improved its 2012 and 2013 budgets by increasing water rates and not appropriating fund balance. Based on preliminary 2012 results, the water district fund had an operating surplus of approximately \$61,000 which would have generated a positive fund balance of \$27,000. However, when finalizing 2012 accounting records,¹¹ the bookkeeper properly recorded the liability for arrears owed to the Village for 2010 and 2011 unpaid water bills,¹² which decreased the water district's fund balance. Thus, while the fund balance deficit increased slightly¹³ as of December 31, 2012, this balance now reflects the true financial position of the water district, while the 2010 and 2011 balances did not. Additionally, in the 2013 budget, the Board increased water rent rates and estimated water revenues and increased estimated water expenditures to more accurate levels, which should generate another operating surplus and a positive water district fund balance at the end of 2013.

¹⁰ In addition, the Town decreased the unpaid advances to the water fund to \$15,285.

¹¹ In February 2013

¹² In 2010 and 2011, the former Supervisor paid only half of the contractual water operation costs to force the Village to negotiate a reduced minimum water purchase. The Town then negotiated a plan for the payment of past due amounts, which totaled \$83,471 as of December 30, 2011.

¹³ Due to the \$61,000 operating surplus in 2012, the water district's fund balance deficit increased only by approximately \$14,000 when the bookkeeper recorded the \$75,000 liability for arrears that was owed to the Village.

Table 3: Highway Fund – Operations and Fund Balance						
	2007	2008	2009	2010	2011	2012
Beginning Fund Balance	\$130,140	\$42,421	\$23,280	\$62,133	\$46,139 ^a	\$52,195
Operating Surplus (Deficit)	(\$87,719)	(\$19,141)	\$38,853	(\$11,117)	\$6,056	\$74,037
Ending Fund Balance	\$42,421	\$23,280	\$62,133	\$51,016	\$52,195	\$126,232
Repair Reserve	\$0	\$0	\$26,465	\$28,374	\$29,641	\$29,680
Appropriated in Ensuing Year's Budget	\$165,000	\$78,000	\$92,000	\$79,000	\$3,398	\$21,549
Unexpended Surplus Funds	(\$122,579)	(\$54,720)	(\$56,332)	(\$56,358)	\$19,156	\$75,003
Surplus Funds as a % of the Ensuing Year's Appropriations	(20%)	(10%)	(10%)	(11%)	4%	13%
^a The 2011 beginning fund balance includes a prior period adjustment (decrease) totaling \$4,877.						

The Board made improvements and appropriated very little fund balance in its 2012 budget and a more reasonable amount for 2013. The highway fund had an estimated \$74,000 operating surplus in 2012, increasing total fund balance to approximately \$126,000.

After hiring a new bookkeeper and after we met with the Supervisor and bookkeeper on May 30, 2012, and reviewed our findings with them, the Board has made significant improvements in its budgeting practices. The Town should continue to make appropriate changes to the Town's budgeting practices to avoid experiencing more significant cash flow shortages that could jeopardize Town operations and services provided to residents.

Management Oversight

The Board is responsible for the oversight of the Town's financial operations. It exercises this oversight through the adoption of policies that give guidance on how financial functions are to be performed and by exercising its responsibility to audit the books and records of Town officials. The Board also must provide sufficient oversight of those officers and employees involved in these processes and ensure that an adequate level of segregation of duties is maintained. The Supervisor, as chief financial officer, is responsible for the day-to-day financial operations of the Town. These responsibilities include establishing well-designed internal control procedures that provide reasonable assurance that Town assets are safeguarded.

The Board has not adopted any formal policies, nor has the Supervisor developed detailed procedures, for ensuring that financial duties are adequately segregated or that sufficient review and oversight procedures are in place. As a result, the Supervisor assigned incompatible duties to both the bookkeeper and water operator and did not provide sufficient oversight and review. With these incompatible duties, and limited oversight, there is increased opportunity for these individuals to misappropriate cash and conceal the shortage.

The Supervisor's bookkeeper handled nearly all aspects of the cash receipts, cash disbursements, and recordkeeping processes and prepared deposits and bank account reconciliations with little oversight or review of her work by the Supervisor. The only existing control was the Supervisor's signature on checks. The Supervisor can provide additional oversight personally, or by having someone who is not involved in the receipt or disbursement of cash reconcile bank accounts, make comparisons with the accounting records, and review journal entries.

In addition, the water operator is responsible for billing, collecting, and recording water rent receipts and has the ability to add or remove user accounts and make adjustments in the water billing software. Although the water operator turns collections over to the bookkeeper, who prepares and makes the deposit and records the total amount received in the financial software, this practice does not mitigate the water operator's incompatible financial duties because no one independently compares the received water rents with the amounts billed. Therefore, there is no assurance that the water operator is receiving appropriate amounts, or is turning over all receipts received to the bookkeeper.

We reviewed all cash disbursements totaling \$31,678 made during October 2011 to ensure that they had proper supporting documentation and were appropriate Town expenditures and for valid business purposes. We also reviewed all receipts for the general, highway, and water funds totaling \$951,484 received from January 2011 to March 2011 to ensure they were appropriately deposited. For payroll, we compared the gross salary for September 2011 with pay rates to determine if Town officials and employees were appropriately paid. We did not find any significant exceptions with the cash disbursements, receipts, and pay rates that we reviewed.

Although we did not find any significant exceptions during our review of the work performed by the water operator and bookkeeper, without properly segregating the water operator's and bookkeeper's duties, the Town has an increased risk that improper water billings or adjustments may occur, or that accounting errors and irregularities may occur and remain undetected and uncorrected.

Annual Audit

Each Town officer or employee who received or disbursed any moneys in the previous year must provide an accounting to the Board for these moneys and must produce all books, records, receipts, vouchers, and canceled checks for audit. The Board must then audit these records, or engage an independent public accountant to do so. After completing the audit, the Board should ensure that the completion and results of the audit are included in the minutes of its proceedings. Also, the

Board should ensure that documentation is filed with the minutes that provides an explanation of how the audit was performed and the records that the Board reviewed during the audit.

The Board did not perform an audit of the water department, which collects receipts for water rents. Also, the Board did not maintain adequate documentation of its audit of the records and reports of the Supervisor, Town Clerk, and Town Justice.

The Board's failure to perform an annual audit of the water department diminishes its ability to effectively monitor the water district's operations and could result in errors or irregularities that remain undetected and uncorrected. In addition, without documentation of the Board's audit steps, results, and required corrective action in the minutes of its proceedings, Town taxpayers do not have any assurance that the Board performed a thorough audit of the records and reports of the Supervisor, Town Clerk, and Town Justice and communicated its findings to them so that they could take corrective action, if necessary.

Recommendations

1. The Board should adopt and implement detailed policies and procedures for preparing realistic and structurally balanced budgets, using actual financial results from prior years and other relevant and available data.
2. The Board should continue to appropriate fund balance only in amounts that are actually available, after retaining a reasonable amount for the ensuing year.
3. The Board should continue to monitor and adjust water rates as necessary to raise sufficient revenues to cover current operations and cash flow needs and repay arrears to the Village and the interfund loan owed to the general fund.
4. The Board should adopt written policies and the Supervisor should establish procedures to ensure that financial duties are adequately segregated and/or supervisory oversight controls are in place.
5. The Board should conduct an annual audit of the records of the Town Clerk, Supervisor, Town Justice, and Water Department. The Board should ensure that documentation of the results of the audits is filed with the minutes of its proceedings.

Information Technology

The Town relies on its IT system to perform a variety of tasks, including word processing, email communication, Internet access, banking, bookkeeping, payroll, and reporting to State and Federal agencies. Large amounts of information and data related to finances, taxes, water rents, payroll and personnel are stored on the IT system. The Town's use of IT presents a number of risks, such as unauthorized access, which can increase the risk that computerized equipment could be damaged or manipulated, or that data could be altered, misused, lost or corrupted without being detected. Even small disruptions in the IT system can require extensive time and effort to evaluate and repair. Town officials are responsible for designing and implementing a comprehensive system of internal controls over IT to protect these assets from unauthorized, inappropriate, and wasteful use. Both administrative and information system controls should be part of any IT security system. This is especially important because of the increasing use of viruses, malware, and other malicious methods intended to harm data resources and gain unauthorized access to valuable data.

The Town should institute appropriate policies and procedures to protect its computerized data resources from internal and external threats. The Board has not established policies and procedures related to acceptable use, online banking, breach notification, or disaster recovery. Additionally, there is no system in place for monitoring IT activity or changes in the system, maintaining a computer inventory, or sanitizing computer equipment before disposal. Therefore, IT assets are at risk for unauthorized, inappropriate, and wasteful use.

Acceptable Use

Good internal controls over IT assets and computerized data include an acceptable use policy that informs users about proper use of Town computers and requires the monitoring of computer usage to ensure compliance. An acceptable use policy defines the Board's goals for the use of equipment and computing systems and the security measures used to protect the Town's resources and confidential information. The policy must address the acceptable use of email accounts and Internet access and the installation of software on Town computers. It is important that the policy include provisions for enforcement and that system users provide written acknowledgement that they are aware of and will abide by the policy.

The Board has not adopted an acceptable use policy that covers Town officials and employees and the outside vendor who uses the IT system. Further, Town officials do not monitor computer use to determine

whether staff is properly using the Town's computer resources. As a result, there is an increased risk that the IT system could be used for inappropriate or non-Town-related purposes.

While comprehensive computer use policies do not guarantee the safety of the Town's electronic information, the lack of such policies significantly increases the risk that hardware and software systems and the data they contain may be lost or damaged by inappropriate use. This leaves the Town vulnerable to risks associated with personal use, including computer viruses and spyware that could potentially be introduced by accessing non-work-related websites or downloading unauthorized programs.

Online Banking

Online banking allows the convenience of moving money between bank accounts and to external accounts, reviewing transaction histories, reconciling accounts in real time, and monitoring cash balances. Because connecting to the Internet is a necessary part of the online banking process, the Town's online bank accounts must be monitored on a regular basis for unauthorized or suspicious activity. Wire transfers must be strictly controlled and closely monitored. Effective controls over wire transfers include a written policy that identifies authorized online banking activities and electronic funds transactions and establishes who may initiate, approve, transmit/execute, record, and reconcile wire transfer transactions. At least two people should be involved in wire transfer transactions. The policy should segregate duties so that no one person is able to approve wire transfers and transmit or execute the transaction. Ideally, the recording function also should be delegated to someone who does not have approval or transmittal duties.

In addition, it is essential that the Town enter into a written agreement with its bank that provides online banking services and electronic funds transactions. This agreement must prescribe the manner in which electronic (wire) transfers of funds will be accomplished, identify the names and numbers of the bank accounts from which such transfers may be made, identify the individuals authorized to request the transfer of funds, and implement a security procedure which includes verifying that a payment order is that of the initiating entity (the Town). For example, a callback provision would require the bank to contact someone other than the person who initiated the transaction to confirm the transfer.

The Town has one bank with which it conducts online banking, including electronic transfers. However, the Town does not have policies or procedures in place for monitoring online banking functions and transactions. Although the Town has an agreement with the bank, it is inadequate because it does not include a requirement for the bank

to contact a Town official for verification of an electronic transfer. Without a callback process to confirm a payment order, there are no controls to decrease the likelihood of errors, unauthorized transfers, or misappropriation of Town funds. In addition, the Supervisor and bookkeeper have the ability to initiate and transmit electronic transfers between bank accounts at the same bank without formal prior approval, increasing the risk that Town moneys could be transferred into unauthorized bank accounts. Without formal monitoring of online banking activities and a specific, written agreement that is understood and followed by all personnel involved, there is a significant risk that Town funds could be stolen or misused.

Monitoring

It is essential that the computerized software systems generate reports that help monitor financial activity. Change reports maintain a record of activity by system or application process and should provide changes or deletions made to the financial application (for example, vendor or payroll changes, or the addition or deletion of general and subsidiary ledger accounts) or adjustments recorded to user accounts. Town officials should review these reports to monitor problems, user activity, and changes to the data; provide a mechanism for individual accountability; and to reconstruct events.

The financial software used for Town recordkeeping permits records to be changed or deleted without requiring approval or documentation of the reason. Accordingly, the bookkeeper, who is the only individual with access to the financial software, has the capability to make any changes or deletions within the system. Although the software has a feature to generate a change report, the report is not generated or independently reviewed. Additionally, the water operator is the sole user of the water billing software, and there is no independent review of adjustments made to the water system. Because the software permits deletions and changes without prior authorizations, and a log of changes, deletions, or adjustments is not reviewed, irregularities could occur and go undetected.

Breach Notification

An individual's private and/or financial information, along with confidential business information, could be severely affected if security is breached or data is improperly disclosed. New York State Technology Law requires cities, counties, towns, villages, and other local agencies to establish an information breach notification policy. The policy should detail how the Town would notify individuals whose private information was, or is reasonably believed to have been, acquired by a person without a valid authorization. The disclosure should be made in the most expedient time possible and without unreasonable delay and should be consistent with the legitimate needs of law enforcement or any measures necessary to determine the scope of the breach and restore the reasonable integrity of the data system.

The Board has not adopted a breach notification policy. By failing to adopt an information breach notification policy, in the event that private information is compromised, Town officials and employees may not understand or be prepared to fulfill their legal obligation to notify affected individuals quickly.

Disaster Recovery

A disaster recovery plan is intended to identify and describe how Town officials plan to deal with potential disasters. Such disasters may include any sudden, unplanned catastrophic event (e.g., fire, computer virus, or inadvertent employee action) that compromises the availability or integrity of the IT system and data. Contingency planning is used to avert or minimize the damage that disasters would cause to operations. Such planning consists of the precautions to be taken to minimize the effects of a disaster so that officials and responsible staff will be able to maintain or quickly resume day-to-day operations. Typically, disaster recovery planning involves an analysis of business processes and continuity needs and should include significant focus on disaster prevention. The plan should also address the roles of key individuals and be distributed to all responsible parties, periodically tested, and updated as needed.

The Board has not developed a disaster recovery plan to address potential disasters. Consequently, in the event of a disaster, Town personnel have no guidelines or plan to follow to help minimize or prevent the loss of equipment and data, or to appropriately recover data. Further, without a disaster recovery plan, the Town could lose important financial data and suffer a serious interruption in Town operations.

Controls Over Computer Equipment

It is essential that Town officials maintain inventory records for computers, IT related assets, and significant applications installed and ensure that these records are readily available. In addition, sensitive and confidential information and software must be safeguarded throughout its useful life and cleared from equipment prior to disposal.

Inventory Records — Entities should maintain detailed, up-to-date inventory records for all computer hardware, software, and data. The information maintained for each piece of computer equipment should include a description of the item, including the make, model, and serial number; the name of the employee to whom the equipment is assigned, if applicable; the physical location of the asset; and relevant purchase or lease information including the acquisition date.

The Town does not maintain a list of computer equipment and was unsure of what equipment that it owned. The lack of records of electronic equipment places the Town at risk of loss or theft without timely identification.

Disposal — Sensitive and confidential information and software must be cleared from computer hard drives, disks, thumb drives, and other equipment and media before those items are disposed of or transferred to another use. Organizations must have a plan that clearly describes the organization's security management program and the policies and procedures that support it, including procedures for the secure disposal of all equipment containing electronic information.

The Town has not adopted a policy or procedures for the disposal and sanitization of computer equipment. Additionally, Town officials did not have any procedures to clear sensitive information and software from computers before disposal. Although no recent computer equipment has been disposed of, if sensitive and confidential information is not fully removed, it may be recovered and inappropriately used or disclosed by individuals with access to the discarded equipment and media.

Recommendations

6. The Board should adopt an acceptable use policy relating to IT access and computer use by Town officials, employees, and vendors who access the system.
7. The Board should establish written policies and procedures that provide well-designed internal controls over online banking, including adequate segregation of duties and independent review and prior approval of transactions.
8. The Town should enter into a comprehensive agreement with the Town's bank that establishes the process to be followed for initiation, approval, and processing of electronic funds transfers and identifies the names and numbers of the bank accounts from which such transfers may be made.
9. The Board should review, or designate someone to review, adjustment reports from the water billing software and reports that describes deletions and changes made in the financial software used by the bookkeeper.
10. The Board should adopt an information breach notification policy.
11. The Board should develop and adopt a formal disaster recovery plan that documents steps to be taken in the event of an emergency.
12. The Board should require that an inventory of the Town's electronic equipment be completed and regularly updated.
13. The Board should establish a policy to ensure that hard drives and other electronic media are properly sanitized before they are disposed of.

APPENDIX A

RESPONSE FROM LOCAL OFFICIALS

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

Town of Pulteney

P.O. Box 214

Pulteney, NY 14874

State of New York Comptroller

Rochester Regional Office

Attn: Edward Grant

Letter of Response to Town of Pulteney Audit Report

Mr. Grant,

I will be replying to you by topic indicated in the audit.

BUDGET

Upon my election for a term that began in 2012 the budget was a primary concern. Beginning in the summer of 2012 the bookkeeper and I met with the head of every department to review their spending for the first half of the year 2012 and estimated spending for remainder of the year. We then evaluated the cost of running specific departments after identifying needs for 2013. We built each department budget from the ground up.

We evaluate every line item monthly at a minimum, identify line item changes and why changes are needed. For example, the highway superintendent has, in the early part of 2013 spent more time cutting brush and chipping than was budgeted for last year, therefore, we have already had to move money from another line item to brush to accommodate for this weather related expenditure.

When 2013 started there was a fund balance left for approximately two months of reserve. We will work towards the recommended 3 months of reserve for 2014 and ahead.

We are currently working on a written budgetary procedure to discuss with the board for their review and acceptance. Using the completed AUD is a valuable tool for the budget process.

WATER DEPARTMENT

The budget of 2012 had increased the water EDU rate to begin to accommodate the actual cost of the Town of Pulteney's indebtedness for the water system. The figure selected to do this was not an actual figure so the Town had to develop a plan to include a budget amount that would repay in full the Village of Penn Yan for water contracted prior to 2012. This amount has been collected in taxes and dispersed to the Village of Penn Yan. In addition, the correct amount of money has never been collected by the Town for water usage. After reviewing the water rates a rise per quarter was required and subsequently billed to water customers. It also was discovered that no late charges were ever added to the water bills. This was instituted before the last quarter of 2012 by board mandate.

A policy for instituting a quarterly review is being written and will be incorporated into the job description for a new Town Clerk who will begin a term on Jan. 1, 2014. This person will have the responsibility of learning the water department billing system and review of system.

IT

Immediately after the audit in 2012, our IT person was hired to separate the internet lines from those of the library which shares our building. We have a secured line that is entirely password protected.

We are currently working on setting up a policy for rotating passwords on all secure Town computers. An inventory of all Town computers has completed. We are currently establishing a schedule with our IT person to set up replacements for our equipment that can then be included in the budget. Each department is currently assessing its needs for the future as well.

Our IT person will be hired to develop an acceptable plan for disaster recovery to submit to the Board for review and acceptance.

Backups for [REDACTED] on the bookkeepers system are done each week and stored in our safe. The Town Clerk's system backs up each day and is stored on site as well. The bookkeeper will be investigating a more complete back up than [REDACTED] with our IT person.

BANKING

At the bank level, many levels of security are required. Our bookkeeper can only transfer funds between specific accounts. Any changes need to be handled between the bank and the Town Supervisor.

As a rule we do no wire transfers and there are procedures that will be written into policy that will be submitted to the Board for approval

On line transfers are all coded as to need and will be monitored on a monthly basis from April 2013 on by the Town Supervisor.

MONTHLY FINANCIAL MONITORING

The Board has established specific financial reviews every month and will develop a written policy for such. Each month beginning in January of 2012 the board reviews all vouchers for payment. No checks are written unless pre – authorized. The abstracts for every department are reviewed and any large items or selected items are discussed. The bookkeeper identifies transfers and why needed.

Beginning at the end of the first quarter of 2013, (April Board Meeting) all of the Board members did a quarterly audit of all departments and their funds. The clerk accounts will be reviewed for the first two quarters at the July Board Meeting. We will begin a monthly review of bank reconciliation statements for all accounts in April of 2013.

In summary, our Town's financial health is getting much better and our policies will be developed to continue this improvement forward.

Most Sincerely,

Jane Russell

Supervisor, Town of Pulteney.

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 Town 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, payroll, and information technology. During the initial assessment, we interviewed appropriate Town officials, performed limited tests of transactions, and reviewed pertinent documents, Board minutes, and financial records and reports.

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, or professional misconduct. We then decided on the reported objectives and scope by selecting for audit those areas most at risk. We selected the Town's financial management and IT system for further audit testing.

The objective of our audit was to review the Town's financial management and controls over information technology. To accomplish our objective, we reviewed financial management and IT controls for the period January 1, 2010, to May 30, 2012. We expanded the scope back to 2007 and forward to December 31, 2012, to review fund balance and budgeting trends. To achieve the objective of this audit and obtain valid audit evidence, we performed the following audit procedures:

- We interviewed appropriate Town officials to gain an understanding of Town processes and operations and to determine if internal controls were in place over financial management and IT.
- We reviewed the minutes of the Board meetings from January 1, 2010, through January 2012.
- We analyzed fund balance for the period 2007 through 2012.
- We compared budgeted revenues and expenditures to actual operating results for fiscal years 2007 through 2012.
- We reviewed total annual revenues and expenditures to determine the operating deficits or surpluses for each fund.
- We reviewed budgets for 2007 through 2013 to determine the amount of fund balance that was appropriated for each fund each year.
- We reviewed interfund receivable and liability (due to and due from) accounts for 2010 and 2011 to determine if interfund advances were authorized, appropriate, and repaid as necessary.
- We reviewed all Town bank statements for 2010 and 2011 to identify cash balances and evaluate cash flow.

- For a consecutive three-month period (January 2011 to March 2011) we traced all transfers and withdrawals from the bank statements to other Town accounts or supporting payment information.
- We reviewed all receipts for the general, highway, and water district funds totaling \$951,484 received from January 2011 to March 2011 and compared them to bank statement deposits and financial records to ensure they were appropriately deposited.
- We reviewed all cash disbursements totaling \$31,678 made during October 2011 and compared bank statements and canceled check images to financial records and abstracts to determine if payments were for valid Town purposes and if they corresponded with financial records.
- For payroll, we compared the gross salary for September 2011 with pay rates to determine if Town officials and employees were appropriately paid.
- Related to the water operator's duties, we compared the January 2012 quarterly water rent billing to the water receipts recorded from January 2012 to March 2012 by the water operator and bookkeeper, and to deposits made by the bookkeeper.
- We reviewed a quarterly water billing report for January 2012 to determine the amount of unpaid water rents for one quarter and the amount of potential revenue the Town could realize from charging a penalty for late payment. Also, we reviewed the list of unpaid water accounts re-levied on 2012 tax bills.

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.

APPENDIX C

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DIVISION OF LOCAL GOVERNMENT
AND SCHOOL ACCOUNTABILITY

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

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