



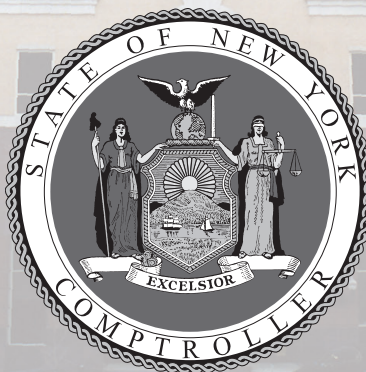
Town of Somerset Budgeting for Sales Tax

Report of Examination

Period Covered:

January 1, 2015 — November 18, 2016

2016M-419



Thomas P. DiNapoli

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State of New York Office of the State Comptroller

Division of Local Government and School Accountability

March 2017

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 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 Somerset, entitled Budgeting for Sales Tax. This audit was conducted pursuant to Article V, Section 1 of the State Constitution and the State Comptroller's authority as set forth in Article 3 of the New York State General Municipal Law.

This audit's results and recommendation 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 Town of Somerset (Town) is located in Niagara County (County) and has a population of approximately 2,600. The Town includes the Village of Barker (Village) within its borders. The Town is governed by an elected five-member Town Board (Board), which is composed of four Board members and the Town Supervisor (Supervisor). The Board is responsible for the general oversight and control of the Town's operations and finances. The Supervisor is responsible for the Town's day-to-day management. The Supervisor is also the Town's budget officer.

The Town provides various services to its residents, including highway maintenance, snow removal, water and sewer, street lighting, refuse collection and general government administration. Budgeted appropriations in the general and highway funds for 2016 totaled \$2 million and were funded primarily with sales tax, payments in lieu of taxes and real property taxes.

Objective

The objective of our audit was to review the Town's allocation of sales tax. Our audit addressed the following related question:

- Did the Town properly budget for sales tax distributions from the County?

Scope and Methodology

We examined the budgeting of sales tax revenue for the period January 1, 2015 through November 18, 2016. We extended our scope period back to January 1, 2012 to provide background and perspective with the Town's budgeting of sales tax revenue.

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

Comments of Town Officials and Corrective Action

The results of our audit and recommendation have been discussed with Town officials, and their comments, which appear in Appendix A, have been considered in preparing this report. Town officials disagreed with certain aspects of our findings and recommendation but indicated they planned to initiate corrective action. Appendix B includes our comments on issues raised in the Town's response.

The Board has the responsibility to initiate corrective action. A written corrective action plan (CAP) that addresses the finding and recommendation in this report should be prepared and forwarded to

our office within 90 days, pursuant to Section 35 of 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.

Budgeting for Sales Tax

Counties are authorized to voluntarily share some of their sales and use tax collections with towns. Generally, there are two ways a county may share these revenues with towns. One is by applying the money to reduce county real property taxes in the towns, and the other is by making cash distributions. When a county uses sales tax revenue to reduce county real property taxes, the towns have no transactions to budget for or record in the accounting records. When a county makes cash distributions to towns, the towns must properly budget and account for these transactions.

Based on a predetermined formula, Niagara County distributes a portion of its sales and use tax collections to the cities, towns and villages within the County. The Town and Village elected to receive their share of sales and use tax from the County in cash. Therefore, the Town must first use the sales and use tax received from the County to reduce real property taxes levied for town outside village (TOV) activities.

If the real property taxes levied for the TOV general and highway funds are reduced to zero, then the Town has several options available for the use of any remaining sales tax revenue. The Town may use the revenue to reduce general town taxes, decrease County taxes levied in the TOV areas, fund TOV activities or any combination thereof. In accordance with New York State Tax Law, eligible TOV activities for this purpose exclude special districts, such as water, sewer, lighting, refuse and fire protection districts (except a fire protection district that encompasses the entire TOV area).

Although Town officials consistently budgeted sales tax revenue in the TOV general and highway funds and reduced the real property tax levy in those funds to zero, they improperly budgeted sales tax revenue in the refuse district. Town officials were unaware that sales tax revenue could not be budgeted in the refuse district.

From 2012 through 2016, Town officials budgeted and recorded \$557,378 of sales tax revenue in the refuse district, which encompasses less than the entire TOV area. The 2016 refuse district budget included estimated revenues of \$137,692 from sales tax and \$19,308 from user fees¹ to fund appropriations totaling \$157,000 for refuse collection and disposal services provided by an independent contractor.

¹ In 2016, the Town assessed a user fee of \$21.57 upon 895 residential and commercial refuse customers located in the refuse district. If sales tax had not been budgeted in the refuse district, the user fee would likely have been approximately \$175.

For 2016, if Town officials allocated sales tax revenue to decrease the County real property taxes levied in the TOV area, the County tax rate per thousand of assessed valuation would have decreased from \$7.79 to \$6.65 (a reduction of 14.6 percent) for real property located in the TOV area. For example, the average assessed valuation of a single family residence in the Town is approximately \$150,000.² In 2016, the County tax bill on this property would have decreased by approximately \$170, from \$1,170 to \$1,000 if Town officials had applied sales tax revenue to reduce the County taxes, rather than allocating it to the refuse district.

The allocation of sales tax to the refuse district precluded residents from benefiting from sales tax revenue as provided for in statute. The Board is responsible for making sound financial decisions that are in the best interest of Town residents in accordance with statutory requirements.

Recommendation

1. The Board should allocate sales tax as allowed by statute.

² Based on the 2015-16 County real property tax statistics report prepared by the County real property tax services department

APPENDIX A

RESPONSE FROM TOWN OFFICIALS

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



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Supervisor

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February 3, 2017

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RE: Town of Somerset's Response to NYS Comptroller's Office Draft Report

To Whom It May Concern,

The Town of Somerset offers the following response to provide context and background to the Comptroller's draft report, which is to be issued soon.

First, it should be noted that the audit process occurred over an eight-month period and covered nearly every aspect of the Town's finances. The objective in the audit report infers that only the sales tax revenue issue was examined during the eight-month review period. However, over this extensive period, the examiner reviewed all records concerning Town disbursements, retirement accounts, Highway Department expenses, Water Department expenses, the tax collection office, and other various financial documents and business records of the Town. The Town is very pleased that after this full comprehensive review was concluded, the only issue found during the audit was the use of sales tax revenues, which is covered in detail below.

See
Note 1
Page 10

Because the Village of Barker is located within the Town of Somerset, the Town is required to operate a separate fund for services that are only provided to Town residents outside the Village, the so-called "part-town" or "B" fund. This makes sense because Village residents pay Village taxes for services in the Village similar to "part-town" services provided by the Town.

Niagara County distributes a portion of sales tax revenues to each city, town and village within the County based upon its population and these revenues are meant to off-set other costs borne by the taxpayers in the municipality. Consequently, the Village of Barker is allotted a certain amount of money based on population. The Town of Somerset is also allotted a sum of money based on population, excluding the Village population. It therefore makes sense that the Town's portion of sales tax revenue should be used to lower the costs borne to the Town residents outside the Village on "part-town" or "B fund" expenses since the Village residents are already getting their fair share through the Village's allotment.

However, there are further restrictions placed on how the Town can use its sales tax revenue that do not make sense. In the Town of Somerset, the Town Refuse District is comprised of the entire area of the Town outside the Village of Barker. In other words, the Refuse District covers the exact same area of the Town that the “part-town” or “B” fund would cover. However, for some reason, although the Town can use sales tax revenue to cover “part-town” or “B” fund expenses, it cannot use it to cover Refuse District expenses, even though the geographic boundary of the two are exactly the same.

The Town wishes to note that prior to allocating sales tax revenue to Refuse District expenses in 2012 it consulted a now retired expert examiner from the Office of the State Comptroller who was very familiar with the Town and who had previously conducted an audit of the Town. At that time, the Town was told it could use sales tax in any part-town function district, including the Refuse District because it is inclusive of all parcels outside the Village of Barker. It was based on this advice which it now appears was faulty, that the Town acted.

See
Note 2
Page 10

Upon receiving this recommendation, the Town made a decision that the most impactful and equitable manner by which to reduce the tax burden upon residents who live in the Town outside the Village was to apply the sales tax revenue to directly reduce the user fee for refuse and recycling collection services. In this manner, each resident in the district received an equal reduction in their tax bill, regardless of the assessed valuation of their parcel. So, rather than charging each resident approximately \$175.00 for refuse and recycling collection services, the Town allocated sales tax revenue to be able to reduce the user fee to approximately \$21.57, a savings of approximately \$153.00 from each resident’s tax bill.

The Town also wishes to correct an impression regarding Town residents’ tax burden contained in the Report. The draft report issued by the Office of the State Comptroller leaves the impression that shifting the County sales tax revenue from the Refuse District to offset the County property tax rate, as the draft report suggests the Town might do, will result in overall tax savings for Town of Somerset residents. In reality, doing so would only result in a shifting of taxes and fees, not a decrease. In fact, using sales tax revenue to reduce the County tax rate will result in savings for higher valued properties in the Town, while increasing costs to the lower valued properties. The same amount of money will be raised by taxes and fees in either scenario.

See
Note 3
Page 10

For example, a property valued at \$100,000.00 paid approximately \$779.00 in County property taxes, as well as a user fee of \$21.57 for the Town Refuse District under the current plan. Under the Office of the State Comptroller’s plan as outlined in the draft report, the same property would pay approximately \$665.00 in County taxes and a Town Refuse District user fee of approximately \$175.00. The net result is an increase of approximately \$39.43 in total costs to this resident. Meanwhile, a resident with a more valuable piece of property would realize an equivalent overall savings. These are not the results the Town hopes to achieve.

Regardless, whether or not it makes sense, State law dictates that the County sales tax revenue cannot be utilized in the Refuse District. Moving forward the Town will allocate the

sales tax money to the “part-town” or “B” fund, or as otherwise allowed by law, and will not allocate it to the Refuse District. As we believe this letter addresses all necessary aspects of a Corrective Action Plan, please allow it to also serve as the Town’s written Corrective Action Plan.

Sincerely,

Daniel M. Engert, Supervisor
Town of Somerset

APPENDIX B

OSC COMMENTS ON THE TOWN'S RESPONSE

Note 1

As we indicate in Appendix C, we conducted this performance audit in accordance with GAGAS. Those standards require that we adequately plan our audit, which was limited to the Town's allocation of sales tax. Before selecting our audit objective and scope, we conducted a risk assessment, not an audit, of various Town operations. We discussed observations noted during our risk assessment with Town officials.

Note 2

The Office of the State Comptroller was not a part of the conversation between Town officials and a retired examiner nor consulted on the matter.

Note 3

Our report does not indicate that the proper allocation of the sales tax will result in an overall savings for Town residents. As we indicate in our report, we used the average assessed valuation of a single family residence to demonstrate the impact of correctly allocating sales tax. However, the financial impact will vary depending on the assessed value of the property.

APPENDIX C

AUDIT METHODOLOGY AND STANDARDS

To achieve our audit objective and obtain valid evidence, we performed the following procedures:

- We reviewed the Town's annual adopted budgets and the results of operations as reported on the annual financial reports filed with the Office of the State Comptroller.
- We reviewed the most recent assessment roll, property tax records and reports, tax rates and refuse fees.
- We recalculated the County tax rate assuming that the Town applied sales tax to reduce the County levy in the TOV area.
- We discussed sales tax budgeting practices with Town officials.

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

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