



Village of Brightwaters

Financial Operations, Conflict of Interest, and Information Technology

Report of Examination

Period Covered:

June 1, 2010 — February 29, 2012

2012M-190



Thomas P. DiNapoli

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State of New York Office of the State Comptroller

Division of Local Government and School Accountability

February 2013

Dear Village 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 Village 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 Village of Brightwaters, entitled Financial Operations, Conflict of Interest, 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 Village of Brightwaters (Village) is located in the Town of Islip in Suffolk County and has approximately 3,300 residents. The Village is governed by a Board of Trustees (Board) comprising four elected Trustees and an elected Mayor. The Board is responsible for the general management and control of the Village's financial affairs. The Clerk-Treasurer is the Village's chief financial officer and is responsible for maintaining custody of the Village's moneys, maintaining appropriate accounting records, disbursing Village funds, and preparing monthly and annual financial reports. In the Clerk-Treasurer's absence the Mayor may disburse funds.

Operating expenditures for the 2010-11 fiscal year were \$2,866,612. These expenditures were funded primarily with revenues from real property taxes and sanitation fees.

Scope and Objective

The objective of our audit was to review selected Village financial operations for the period June 1, 2010 through February 29, 2012. We expanded our audit scope for conflicts of interest to August 31, 2012 and for financial operations from June 1, 2009 to May 31, 2012. Our audit addressed the following related questions:

- Does the Board monitor financial operations and take appropriate actions to maintain financial stability?
- Did the Board establish procedures to ensure that Village officers and employees do not have a prohibited interest in Village contracts and that they are aware of their obligation to disclose interests in actual or proposed contracts?
- Are internal controls over information technology (IT) resources appropriately designed and operating effectively to adequately safeguard Village assets?

Audit Results

Due to a lack of policies and procedures in key financial areas, the Board did not effectively monitor financial operations, ensure that Village officers and employees disclose any interests in Village contracts, or implement sufficient controls to safeguard IT resources.

Over the 2009-10 through 2011-12 fiscal years, the Board underestimated expenditures by a total of more than \$416,000 despite historical indications that expenditures consistently exceeded the budget. These budgeting practices created operating deficits that have contributed to ongoing fund balance deficits in the general fund. During this period, the Village received over \$642,000 in non-recurring revenue without which the fund balance deficit would have been even greater. The Board's unrealistic budgeting practices, lack of budget monitoring, and reliance on one-time revenues places the Village's financial position at risk of continued decline.

The Board also failed to audit all claims as required by Village Law. For the fiscal year ended May 31, 2011, the Board reviewed and authorized only 12 abstracts with 573 claims out of 146 abstracts with a total of 1,031 claims. Further, many of the audited claims did not have proper approvals, authorizations for payment, and sufficient supporting documentation. The Board also did not segregate the Clerk-Treasurer's duties or institute compensating controls. For example, the Clerk-Treasurer had sole custody of the Restoration account¹ checkbook with the ability to write checks without oversight. The Board also did not require the Clerk-Treasurer to provide adequate financial reports for the Board to properly monitor the Village's financial condition. Additionally, the Clerk-Treasurer and Deputy Clerk-Treasurer used signature stamps to affix the signatures of the Mayor and Clerk-Treasurer to checks without their direct supervision. The Board's failure to properly audit claims and to segregate the Clerk-Treasurer's duties increases the risk that errors and irregularities could occur without being detected and corrected.

We also found that a Board member had a prohibited interest in a contract with the Village, and there was no process in place to ensure that Village employees and officials disclosed their interests in actual or proposed Village contracts. As a result, there could be an appearance of impropriety and/or increased opportunity for individuals to improperly benefit from Village contracts.

Finally, Village officials have not adopted comprehensive IT policies and procedures regarding standards for computer use, remote access, breach notification, data backup, and disaster recovery. Therefore, the Village may not be prepared to notify those who could be affected by a potential breach of their personal information, and would likely not be able to maintain or quickly resume critical functions in the event of a disaster. The lack of IT controls weakens the security of the Village's computer resources and increases the risk of unauthorized access, manipulation, and loss or destruction of critical and sensitive data.

Comments of Local Officials

The results of our audit and recommendations have been discussed with Village officials and their comments, which appear in Appendix A, have been considered in preparing this report. Except as indicated in Appendix A, Village officials generally agreed with our recommendations and indicated they have taken, or plan to take, corrective action. Appendix B contains our comments on issues raised in the Village's response letter

¹ The Village's Beautification Involvement Group Restoration account is used for Village beautification and outreach events.

Introduction

Background

The Village of Brightwaters (Village) is located in the Town of Islip in Suffolk County and has approximately 3,300 residents. The Village is governed by a Board of Trustees (Board) comprising four elected Trustees and an elected Mayor. The Board is responsible for the general management and control of the Village's financial affairs. The Clerk-Treasurer is the Village's chief financial officer and is responsible for maintaining custody of the Village's moneys, maintaining appropriate accounting records, disbursing Village funds, and preparing monthly and annual financial reports. In the Clerk-Treasurer's absence, the Mayor may disburse funds.

The Village offers a variety of services to its residents, including street maintenance, snow removal, public safety, garbage pick-up, a justice court, a four-week children's summer program, and general governmental support. Operating expenditures for the 2010-11 fiscal year were \$2,866,612. These expenditures were funded primarily with revenues from real property taxes and sanitation fees.

Objective

The objective of our audit was to review selected Village financial operations. Our audit addressed the following related questions:

- Does the Board monitor financial operations and take appropriate actions to maintain financial stability?
- Did the Board establish procedures to ensure that Village officers and employees do not have a prohibited interest in Village contracts and that they are aware of their obligation to disclose interests in actual or proposed contracts?
- Are internal controls over information technology (IT) resources appropriately designed and operating effectively to adequately safeguard Village assets?

Scope and Methodology

We examined Village financial operations for the period of June 1, 2010 to February 29, 2012. We expanded our audit scope for conflicts of interest to August 31, 2012 and for financial operations from June 1, 2009 to May 31, 2012. 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 Village 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 C of this report.

**Comments of
Local Officials and
Corrective Action**

The results of our audit and recommendations have been discussed with Village officials and their comments, which appear in Appendix A, have been considered in preparing this report. Except as indicated in Appendix A, Village officials generally agreed with our recommendations and indicated they have taken, or plan to take, corrective action. Appendix B contains our comments on issues raised in the Village's response letter.

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 of Trustees to make this plan available for public review in the Clerk-Treasurer's office.

Financial Operations

The Board is responsible for providing oversight of the Village's operations and ensuring that policies and procedures are in place so that cash and other resources are properly safeguarded, transactions are properly authorized and recorded, and financial reports are accurate, timely, and reliable. It is also important for the Board to adopt realistic budgets and monitor them against actual revenues and expenditures throughout the year. With few exceptions, Village Law requires the Board to audit and approve all claims before the Clerk-Treasurer can disburse payment. In addition, the Board must ensure that no one individual controls most or all aspects of financial transactions. If it is not practical to adequately segregate financial duties, the Board can implement compensating controls such as additional reviews.

The Board did not provide sufficient oversight of the Village's financial operations, and did not update or establish many policies required by law or sound business practices. Its budgeting practices resulted in operating deficits that contributed to a decline of fund balance in the general fund. Further, the Board does not audit and approve claims as required or certify all abstracts listing the claims to be reviewed. The Board generally relies on the Mayor, as chief executive officer, to oversee the Village's financial operations. Finally, the financial duties of the Clerk-Treasurer were not adequately segregated. As a result of these deficiencies, there is an increased risk that fraud or misappropriation could occur and not be detected or corrected.

Policies and Procedures

The Board is responsible for adopting, distributing, and monitoring compliance with written policies and procedures which, combined with job descriptions, help to ensure that transactions are processed consistently and accurately. Effective procedures provide guidance for employees and help ensure that financial duties are segregated so that no one individual controls most or all aspects of a financial transaction. General Municipal Law (GML) requires the Board to adopt a code of ethics and written policies relating to investments, and to procurements that are not subject to competitive bidding thresholds established by law. Village Law also requires the Board to thoroughly audit and approve each claim prior to payment. Finally, the Board must periodically review and update its policies and procedures to ensure they continue to meet the Village's needs and the requirements of law.

The Board did not establish written policies and procedures to provide guidance in critical financial operations including monthly financial reporting, claims audit, cash disbursements, check processing, online transfers, bank reconciliations, and payroll processing. Moreover, the Board has not reviewed or updated its purchasing policy and code of ethics since 1971, and had no investment policy. The Board's failure to develop and periodically review and revise formal policies and procedures contributed to the overall lack of segregation of duties that weakened the Village's internal controls. For example, the Board and Village officials did not require or review monthly financial reports to monitor the Village's financial position but repeatedly over-expended budgetary appropriations, resulting in operating deficits. Additionally, the lack of a defined claims audit process allowed numerous claims to be paid without proper Board approval and/or supporting documentation. As a result, there is an increased risk that unauthorized disbursements of Village funds may be made for inappropriate purposes.

Budgeting and Fund Balance

A key measure of financial condition is the level of fund balance, which represents resources remaining from prior fiscal years. When the annual budget is structurally balanced, recurring expenditures are financed with recurring revenues. A reasonable amount of fund balance should be maintained for cash flow purposes or to fund unexpected expenditures. Accordingly, it is important for the Board to adopt realistic budgets and monitor them against actual revenues and expenditures throughout the year. Operating deficits (when budgeted appropriations are over-expended, expected revenues are not received, or both) can indicate that budgets are not realistic and/or not properly monitored. Village Law, guidance from the State Comptroller's Office, and good budgetary controls require that financial commitments do not exceed budgeted appropriations. The Board may, by resolution, modify the budget to increase appropriations and provide additional moneys from other funding sources (e.g., by transferring an unexpended balance of another unexpended appropriation or allocating a cash surplus).

Over the past three years, the Board's budgeting practices have created operating deficits that contributed to the decline of fund balance in the general fund. The Board has no plan to address the structural deficits that depleted the fund balance. The Mayor does not believe that a deficit exists and therefore has no plans to address it. Further, the Clerk-Treasurer does not provide budget-to actual reports to the Board, and the Board does not request such reports, which are essential for budget monitoring.

Over the last three fiscal years, Village officials overestimated revenues and/or underestimated expenditures when preparing the budget because they did not consider historical revenue and expenditure data. These budgeting practices contributed to ongoing fund balance deficits, even with significant unbudgeted revenue that enabled the Village to end the 2010-11 fiscal year with an operating surplus.²

Table 1: General Fund – Fund Balance and Operating Results			
	FY 2009-10	FY 2010-11	FY 2011-12 ^a
Beginning Fund Balance	\$258,857	(\$395,104)	(\$84,267)
Revenue (Overestimated)/Underestimated	(\$252,830)	\$432,996	(\$87,476)
Expenditures (Underestimated)/Overestimated	(\$391,306)	(\$122,159)	\$97,372
Operating Surplus/(Deficit)	(\$644,136)	\$310,837	\$9,896
Prior Period Adjustments	(\$9,825)	\$0	\$0
Year-End Fund Balance	(\$395,104)	(\$84,267)	(\$74,371)
^a From unaudited financial statements			

While preliminary information for 2011-12 indicates that the Village has kept expenditures under budget, revenues were still overestimated and the fund balance remained in a deficit.

Expenditures – The Board underestimated expenditures by \$416,093 over the three-year period shown in Table 1. We examined certain expenditures from the last three fiscal years which Village officials continued to underestimate despite historical indications that these expenditures consistently exceeded budgetary estimates. For example, the Village budgeted \$123,618 for Code Enforcement personnel in 2009-10 but spent over \$145,000. The next year, the Village again appropriated \$123,618 but spent over \$159,000. In 2011-12, the Village increased the appropriation to \$138,618 but spent over \$174,000. Similarly, the Village appropriated \$15,281 for Highway vehicle repairs, parts, and maintenance in the 2009-10 budget. The Village actually spent over \$19,000. For the next year, the Village

² Notes to the 2009-10 audited financial statements stated the deficit year-end fund balance was primarily due to repair of roads damaged by the Suffolk County Water Authority (SCWA). Subsequent to May 31, 2010 (in the next fiscal year), SCWA reimbursed the Village \$436,429. In addition, the NYS Consolidated Local Street and Highway Improvement Program (CHIPS) provided approximately \$194,000 in grant money for road repairs, also subsequent to May 31, 2010. These reimbursements enabled the Village to end the 2010-11 fiscal year with significantly more revenue than estimated.

again appropriated \$15,281 but spent over \$36,000. In 2011-12, the Village kept the appropriation at \$15,281 and actually spent about \$19,000.

The Village does not have a process to verify whether appropriations are available before amounts are expended. As a result, during the 2011-12 fiscal year, the Village over-expended 82 appropriation accounts, totaling \$408,914. Even though 20 of these 82 accounts had no amounts appropriated in the budget, \$96,508 in expenditures were made on these budget lines without any budget transfers during the fiscal year to balance them. For example:

- No appropriations were budgeted for the Beautification Involvement Group (BIG) Restoration account,³ but the Village spent a total of \$13,565 during the 2011-12 fiscal year. Prior years' budget-to-actual reports show that expenditures have been consistently charged to this budget line. Further, these expenses are generally for pre-planned events that are repeated from year to year; therefore, past expenditures should be a reliable guide for budgeting.
- No appropriations were budgeted for the street maintenance contractual account in fiscal years 2009-10, 2010-11, and 2011-12, but the Village spent \$405,774 in 2009-10, \$33,276 in 2010-11, and \$10,000 in 2011-12.

If Village officials continue to allow expenditures to exceed available appropriations, moneys may not be available when required for necessary expenditures, which could jeopardize the Village's ability to provide services to its residents. Further, continued operating deficits deplete fund balance, leaving insufficient funds available at year end to retain for contingencies and unexpected events.

Revenues – For fiscal years 2009-10 through 2011-12, the Board overestimated revenues primarily for items such as interest and penalties on past due taxes, canal boat fees, interest and earnings on bank accounts, and mortgage taxes, and did not sufficiently amend the budget even though actual revenues have historically fallen short of budgetary expectations. For the three fiscal years 2009-10 through 2011-12, the Village incurred net revenue shortfalls of \$576,712 in these categories due to overestimated revenues:

³ The BIG Restoration account is used for Village beautification and community outreach events. This account is referred to as the Restoration account throughout this report.

Table 2: Overestimated Revenues									
	FY 2009-10			FY 2010-11			FY 2011-12		
	Budget	Actual	Variance	Budget	Actual	Variance	Budget	Actual	Variance
Mortgage Taxes	\$200,000	\$52,077	(\$147,923)	\$200,000	\$61,525	(\$138,475)	\$200,000	\$46,395	(\$153,605)
Canal Boat Fees	\$228,900	\$202,445	(\$26,455)	\$200,000	\$187,975	(\$12,025)	\$200,000	\$173,763	(\$26,237)
Interest & Earnings	\$23,000	\$2,922	(\$20,078)	\$23,000	\$1,271	(\$21,729)	\$23,000	\$291	(\$22,709)
Interest & Penalties on Taxes	\$6,500	\$10,409	\$3,909	\$11,500	\$7,432	(\$4,068)	\$11,500	\$4,183	(\$7,317)
Total Revenue Shortfall			(\$190,547)			(\$176,297)			(\$209,868)

Additionally, non-recurring revenues – namely Federal aid and “other compensation for loss” (insurance recoveries) – have resulted in a leveling of the gaps between revenues and expenditures. Some of these one-time revenues were received as reimbursements after the Village incurred expenses. Without these moneys, the fund deficits would have been even greater. In 2010-11 and 2011-12, the Village received a total of \$642,020 in non-recurring revenue from Federal aid and insurance recoveries.

If Village officials continue to rely on non-recurring revenues, as well as overestimating recurring revenues, the Village will not be able to address the deficit fund balance. Additionally, if the Village continues to budget expenditures without taking actual past expenditures into account, it will continue to face budgetary challenges that hamper efforts to maintain a positive fund balance.

Claims Processing

With few exceptions,⁴ Village law requires the Board to audit and approve all claims (bills or invoices submitted by vendors) before the Clerk-Treasurer can disburse payment unless the Board has established the position of village auditor. A proper claims audit should verify that each claim contains sufficient supporting documentation to determine compliance with policies and statutory requirements; that the amount claimed represents a legal obligation and proper charge against the Village; that the claim is itemized and supported with a detailed receipt for the goods and services purchased; and that there is evidence confirming the goods or services were received. It is essential for Board members to conduct a thorough review of each claim, adequately document their review, and ensure that the formal approval of claims for payment is recorded in the Board minutes.

⁴ Pursuant to Village Law, the Board may, by resolution, authorize payment in advance of audit of claims for public utility services, postage, freight, and express charges; however, such prepaid claims still must be presented for audit at the next regular Board meeting.

The Clerk-Treasurer prepares an abstract listing all the claims to be reviewed by the Board. After approving each claim, the abstract is to be approved by all Board members certifying that the claims are legitimate and directing the Clerk-Treasurer to pay them. Once payment has been made, the invoice should be stamped or marked as paid.

We found that the Board does not audit claims and does not approve all abstracts prepared by the Clerk-Treasurer. During our audit period, the Village paid 2,047 claims totaling \$4,424,974 and 74 claims out of the Restoration account totaling \$63,344.

Audit of Claims – We tested 24 claims from the Village operating account totaling \$11,155 and 10 claims from the Village Restoration account totaling \$3,958⁵ to determine if the Board audited the claims. Additionally, we performed testing on six payments, totaling \$1,800, made specifically to the Clerk-Treasurer from the Restoration account. We found the following:

- For the 24 claims paid out of the operating account, only one Board member signed the claims indicating approval for payment. Only one claim had an invoice that was stamped or marked paid.
- Eleven of the 24 claims were included on abstracts that were not approved by the Board.
- All 10 claims paid out of the Restoration account had invoices that were not stamped paid, eight were approved by just one Board member, and two were not approved at all.
- We examined six additional payments⁶ from the Restoration account made to the Clerk-Treasurer because the Clerk-Treasurer has custody of the account checkbook with the ability to write checks without oversight. Although we found no discrepancies related to these payments and they were for legitimate Village purposes, all six payments were approved by only one Board member.

Abstracts – The Board does not receive or approve all abstracts. We reviewed abstracts prepared by the Clerk-Treasurer during the fiscal year June 1, 2010 to May 29, 2011, comprising 146 abstracts totaling \$2,422,107 and 1,031 claims.

⁵ We randomly selected claims paid to typical vendors during our audit period.

⁶ We examined all claims in the Restoration account made payable to the Clerk-Treasurer.

- The Board neither received nor approved 134 abstracts, which included 458 claims totaling \$1,287,509.
- During our review of the Village’s abstracts we found performance payments made to three individuals in December 2010 totaling \$3,000. No claims exist for these payments, they were not approved by the Board, and they were made from budget lines other than personal services. For example, the Highway Foreman received a \$1,500 performance payment from the central garage contractual account rather than central garage personnel services account.
- The Board did not approve claims for three holiday parties that were held during December 2010, totaling \$2,854. One of the invoices was not itemized. Village officials also informed us that there was an open bar at that event and alcoholic beverages were provided.
- None of the 74 claims paid from the Restoration account, totaling \$63,344, were listed on any abstract.
- There were three claims for luncheons, totaling \$431. Two of these claims, totaling \$169, were not approved by the Board. These two claims were annotated “Highway lunch - thank you for snow plowing.” The use of taxpayers’ money for purposes other than official Village business is not appropriate.

The Board’s failure to audit claims, as required by Village Law, and to authorize the Clerk-Treasurer to pay claims without approving all abstracts increases the risk that unauthorized disbursements of Village funds may be made for inappropriate purposes. Furthermore, the exclusion of Restoration Account vouchers from the formal claims approval process eliminates an important control for ensuring the appropriate use of these moneys.

Clerk-Treasurer

The Board is responsible for ensuring that there is an appropriate system of checks and balances over Village operations so no one individual controls all aspects of a financial transaction. The same individual should not receive and deposit cash, prepare and disburse checks, record transactions in the accounting records, and perform monthly bank reconciliations. If it is not practical to adequately segregate these financial duties, the Board must exercise sufficient oversight to ensure that transactions are properly recorded and reported and that moneys are accounted for properly.

Segregation of Duties – The Board did not adequately segregate the Clerk-Treasurer’s financial duties or establish compensating controls. The Clerk-Treasurer has administrative-level access to the Village’s financial software application, and is responsible for all aspects of financial and recordkeeping duties. Because these duties are not segregated, the Clerk-Treasurer could initiate improper transactions and conceal them from the Board.

For example, the Clerk-Treasurer maintains the Village’s accounting records, writes journal entries, and generates the abstracts of claims, all without review by the Board. The Clerk-Treasurer also receives and opens the bank statements and reconciles Village bank accounts. No other employee takes custody of the bank statements, and no Board member performs a review of the bank reconciliations upon completion by the Clerk-Treasurer.

In addition, the Clerk-Treasurer has the authority to write checks and has access to the Mayor’s signature stamp. The Clerk-Treasurer also has authority to make bank transfers on her own, without prior authorization by the Board and with no review of the transfers upon completion.

The Clerk-Treasurer is the only Village employee who performs the weekly payroll function. She is able to add and remove employees and change pay rates without any oversight. Further, the Board does not review the final prepared payroll. The Clerk-Treasurer is also the clerk of the Village Court and as such maintains the books and records. Additionally, the Clerk-Treasurer performs the annual audit of the Justice Court records.

The Board did not provide increased oversight or implement compensating controls to address the increased risk caused by the lack of segregation of duties. This lack of adequate segregation of duties results in a high risk that inappropriate transactions can occur.

Financial Reports – The Board needs complete, accurate, and current financial information to effectively monitor the Village’s financial operations. The Clerk-Treasurer should provide detailed monthly financial reports to the Board that include budget-to-actual comparisons for revenues and expenditures, amounts received and disbursed during the month, trial balances and reconciled bank statements. The Board needs this information to monitor the Village’s financial condition and compliance with the adopted budget.

The Board did not require interim Clerk-Treasurer’s reports, and the Clerk-Treasurer did not provide detailed monthly reports to the Board. Although the Clerk-Treasurer provided an abstract and a list

of bank accounts with current balances, the Board did not receive budget-to-actual reports, cash flow reports, bank reconciliations, or trial balances. Therefore, the Board did not know that budget appropriations were over-expended and does not have the information it needs to make informed financial decisions.

Check Signing – The Clerk-Treasurer is the official custodian of all Village funds and the authorized signatory on Village bank accounts. All payments from Village funds, except as authorized by law, must be made by check. Village Law stipulates that the Mayor may sign Village checks only if the Clerk-Treasurer and the Deputy Clerk-Treasurer are absent or unable to do so, and when authorized by Board resolution. A second signature on checks represents a review and approval of cash disbursements, indicating the disbursements are for appropriate purposes. The Clerk-Treasurer can sign checks with a facsimile signature, affixed by a check signer or other machine under the supervision of the person whose signature it represents. A check-signing device should be used only by the individual whose name it bears or under that person’s direct supervision, and should be stored in a secure location. A rubber stamp of a signature cannot be used, because it is not considered an appropriate check-signing device as authorized by Village Law. A rubber signature stamp can be easily replicated or taken, and, therefore, is not a secure device for affixing signatures on checks.

Village checks require the signatures of both the Mayor and the Clerk-Treasurer. We found that the Clerk-Treasurer and Deputy Clerk-Treasurer use rubber signature stamps to affix the signatures of the Mayor and Clerk-Treasurer to Village checks. The signature stamp for the Mayor is kept in the same location as the Clerk-Treasurer’s stamp and the stock of blank checks. The stamps are used regularly by the Clerk-Treasurer and Deputy Clerk-Treasurer, regardless of whether the Mayor is present. The Clerk-Treasurer has custody of the Restoration account checkbook, signs the checks manually, and uses the Mayor’s stamp to affix his signature. The Board does not provide adequate oversight and approval of checks disbursed from the operating account because only one Board member approves each claim and, additionally, there is no Board oversight or approval of the Restoration account checks. These claims are approved by one Board member and are not listed on any abstract provided to the Board for review and approval.

Due to these control weaknesses, we performed tests on checks disbursed during the audit period to determine if there were any discrepancies or transactions of a questionable nature. Our examination

of 204 checks⁷ paid from the general fund, totaling \$493,176, found no exceptions; all checks disbursed were for legitimate business purposes. We also reviewed 10 claims paid from the Restoration account and six payments written to the Clerk-Treasurer (see Claims Processing finding) and did not find any exceptions.

While we did not find any discrepancies or questionable transactions, the failure to establish sufficient controls to safeguard the Mayor's and Clerk-Treasurer's signature stamps increases the risk that unauthorized individuals could sign checks for other than legitimate purposes without being detected. Moreover, without adequate oversight of all check disbursements or compensating controls, there is a risk that someone could sign checks for items outside of the normal course of business and remain undetected.

Recommendations

1. The Board should develop and or revise as necessary, adopt and implement policies and procedures as required by GML and sound business practice.
2. The Board should adopt structurally balanced budgets with realistic estimates that enable operations to be financed without relying on non-recurring revenue sources. The Board should closely monitor budgetary estimates against actual results throughout the year and take corrective action as required.
3. The Board should develop and implement a plan to address the deficit in the general fund balance and monitor fund balance carefully in the future.
4. The Board should conduct a thorough and deliberate audit of all claims against the Village, before they are paid, ensuring that each claim has sufficient supporting documentation and represents a valid Village expenditure. The claims should be included on an abstract submitted to the Board and approved by all Board members.
5. The Board should evaluate the Clerk-Treasurer's duties and, where practicable, assign duties and responsibilities to provide for proper internal controls. Where it is not practicable to segregate duties, the Board should establish adequate compensating controls, including periodic reviews of bank reconciliations, online bank activity, and accounting records.

⁷ We randomly selected three months (October 2010, May 2011, and December 2011) for our test, using a random number generator. We examined all 204 checks disbursed from the three selected months.

6. The Board should monitor the Clerk-Treasurer's financial activities by requesting and reviewing interim financial reports.
7. The Mayor and Clerk-Treasurer should immediately discontinue use of the signature stamps. If the Village decides to use a check-signing device, it should be authorized by the Board and at all times be in the Clerk- Treasurer's possession, and only be used by the Clerk-Treasurer or under the Clerk-Treasurer's direct supervision.

Conflict of Interest

Article 18 of GML limits the ability of municipal officers and employees to enter into contracts in which both their personal financial interests and their public powers and duties conflict. Unless a statutory exception applies, GML prohibits municipal officers and employees from having an interest in contracts with the municipality they serve when they also have the power or duty – either individually or as a member of a board – to negotiate, prepare, authorize or approve the contract; to audit bills or claims under the contract; or to appoint an officer or employee with any of those powers or duties. Municipal officers and employees have an interest in a contract when they receive a direct or indirect monetary or material benefit. Municipal officers and employees are also deemed to have an interest in certain contracts, including the contracts of their spouse, minor children and dependents (except employment contracts with the municipality). As a rule, interests in actual or proposed contracts on the part of a municipal officer or employee, or his or her spouse, must be publicly disclosed in writing to the municipal officer or employee’s immediate supervisor and to the governing board.

For a number of years, the Village has operated a four-week summer day camp. Each spring, the Village entered into verbal agreements with certain individuals to run the camp. One of these individuals was elected to the Board in June 2011.

In the spring of 2011, prior to the Board member’s election, the Village entered into a verbal agreement with the future Board member and his spouse to continue running the camp during the summer of that year. The Board member and his spouse were paid as independent contractors, on the basis of vouchers for payment submitted to the Village. Three of the Board member’s dependent children worked at the camp that summer and were also paid as independent contractors.

For the summer of 2012, based on advice provided by the Village attorney, the Village ceased contracting with the Board member in connection with the camp. During that summer, however, the Board member’s spouse and two of his dependent children again worked at the camp. Similar to 2011, the spouse and dependent children were paid as independent contractors, on the basis of vouchers submitted to the Village.⁸

⁸ In 2012, the Board member approved one claim for \$450 for his spouse and four claims totaling \$796 for his children by signing each of the five claim vouchers.

For purposes of GML Article 18, each verbal agreement between the Village and the Board member, his spouse, or his dependent children was a contract with the Village. The Board member had an interest in each of his contracts with the Village because he received a direct monetary benefit as a result of the contract. The Board member was also deemed to have an interest in the contracts of his spouse and dependent children. Because the Board audits claims against the Village, the Board member also had at least one of the powers and duties that could give rise to a prohibited interest in the contracts. Therefore, unless an exception applied, the Board member had a prohibited interest in each such contract.

There is an exception in GML which provides that a municipal officer's or employee's interest in a contract is not prohibited if the contract was entered into prior to the time he or she was elected or appointed as a municipal officer or employee.⁹ The pre-existing contract exception, however, does not apply to renewal contracts. Therefore, the exception would not apply to the 2012 verbal agreements between the Village and the Board member's spouse and two dependent children. Because it appears no other statutory exceptions applied in this case, we believe the Board member had a prohibited interest in each of these contracts.

In addition, the Board member's participation in the process of approving payments to his spouse and children raises an ethical issue. In this regard, GML Article 18 requires every village to adopt a code of ethics setting forth for the guidance of its officers and employees standards of conduct reasonably expected of them. A code of ethics must contain provisions addressing certain issues, and may generally regulate or prohibit conduct such as participation in matters involving self-interest or the interests of close family members.

Although the Village has a code of ethics, it has not been updated since 1970 and does not address situations requiring Board members to recuse themselves. Even in the absence of a code provision requiring recusal, however, we believe that the Board member should not have participated in the process of approving payments to his spouse and children, in order to avoid any appearance that his actions were motivated by self-interest or partiality.

⁹ Because the 2011 verbal agreements between the Village and the Board member, his spouse and his dependent children pre-date the Board member's election, it appears this exception applied and that, therefore, the Board member did not have a prohibited interest in the contracts for the summer of 2011, but was still required to disclose his interests in the contracts.

Finally, the mayor of a village is required to cause a copy of the village's code of ethics to be distributed to every village officer or employee. The Village, however, does not provide a copy of its code of ethics to new officers and employees.

When municipal officials conduct business with the municipality for which they serve, or when their close family members do so, the public may question the appropriateness of the transactions. These transactions can create an actual conflict of interest, or at least an appearance of impropriety, and/or may result in the improper enrichment of the officers or employees at taxpayer expense.

Recommendations

8. The Board should confer with the Village attorney with respect to preventing future conflicts of interest in connection with the operation of the Village's summer camp.
9. The Board should establish controls to help detect and prevent the Village from entering into contracts in which an officer or employee has a prohibited interest.
10. The Board should review the Village's code of ethics and update it as appropriate.
11. The Mayor should ensure that new Village officers and employees receive a copy of the Village's code of ethics.

Information Technology

Computerized data is a valuable resource that Village officials rely on to make financial decisions and report to State agencies. If computers on which this data is stored fail, or the data is lost or altered either intentionally or unintentionally, the results could range from inconvenient to catastrophic. Even small disruptions can require extensive time and effort to evaluate and repair. For this reason, it is important that Village officials adopt formal policies addressing acceptable computer use, data breach notification, and disaster recovery, and monitor computer system access.

The Board has not established adequate internal controls to effectively safeguard the Village's computer system and data. Village officials have not developed comprehensive information policies and procedures that provide guidance to Village employees on all aspects and appropriate use of IT resources, and have not addressed the security of the Village's systems and financial data. Finally, the Village has not developed a formal disaster recovery plan to help prevent and address the effects of potential disasters. As a result, the Village's IT resources, are subject to an increased risk of unauthorized access, manipulation, theft, and loss.

Acceptable Use Policy

Good internal controls over computerized data include a policy that defines the Board's goals for the acceptable use of equipment and computing systems, and security measures to protect the Village's resources and confidential information. The policy must address the acceptable use of email accounts and the Internet, and appropriately limit or prohibit the installation of software on Village computers. It is important that the policy includes provisions for enforcement, and that system users provide acknowledgement that they are aware of and will abide by the policy.

The Board has not adopted and implemented a comprehensive acceptable use policy or procedures to ensure the security of the Village's IT system. Although we did not find any inappropriate use of Village computers, without a comprehensive acceptable use policy there is an increased risk that the Village's IT resources are not adequately protected. While comprehensive computer use policies do not alone guarantee the safety of the Village'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.

User Access

The Board is responsible for establishing and implementing internal controls over access to computer data and systems to reduce the risk of misuse and/or alteration of data that can result in potential financial loss. Effective access controls restrict users' access to only those applications, resources, and data that are necessary for their day-to-day duties and responsibilities. To provide for a proper segregation of duties, a financial software application should prevent users from being involved in multiple aspects of financial transactions. It is also important that the system administrator – who can add new users, change users' rights, and control all aspects of the Village's financial software – is not responsible for the Village's business transactions.

The Board has not established comprehensive policies and procedures to ensure a proper segregation of duties in the computerized environment. We reviewed the access rights to the Village's financial software for all users and found that the Clerk-Treasurer has Supervisor Level access, which is similar to a system administrator account in that it allows complete access to the financial software application. Therefore, the Clerk-Treasurer can add, modify, and delete information in the applications' modules, as well as add, modify and delete user accounts. Furthermore, the Clerk-Treasurer has the ability to clear (purge) the application's activity log. Because the Clerk-Treasurer is involved in financial transactions, it is important that she does not have the ability to control all aspects of the financial accounting system.

The identified incompatible duties and failure of the Board to effectively address the safeguarding of computer data through internal controls over user access increases the risk of misuse and/or alteration of data, which could result in financial loss. Improper transactions can be initiated and funds misappropriated without detection.

Remote Access

Remote access is the ability to access the municipality's computer system from the Internet or other external source. Remote access must be controlled, monitored, and tracked so that only authorized individuals are allowed access. Policies and procedures should address how remote access is granted, who is given remote access, and how it will be monitored and controlled.

The Board has not established policies and procedures for remote access to ensure that computerized data is properly safeguarded. Village officials granted remote access to the Village's computer system to an outside IT consultant for repair and maintenance of the system. While Village staff authorizes access to the system, no one monitors remote users' activity after they enter the system. Although the Village's system can generate an audit log (record of transactions), Village officials do not print, maintain, or review such logs. As a

result, there is a risk that computerized data could be compromised and unauthorized activity could go undetected.

Breach Notification Policy

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 Section 208 requires cities, counties, towns, villages, and other local agencies to establish an information breach notification policy. The Board is required to establish this policy to describe how the Village would notify residents if their private information was, or is reasonably believed to have been, acquired by a person without valid authorization. It is important for the disclosure to be made in the most expedient time possible and without unreasonable delay, 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 Village does not have an information breach notification policy. In the event that private information is compromised, Village officials and employees may not be prepared to notify affected individuals.

Data Backup

A strong system of internal controls includes a system to back up (create a copy of) computer-processed data. Sound business practices require Village officials to complete a daily backup of the Village's electronic data so that it can be restored in the event of loss. Backup data should be stored at an environmentally and physically secure off-site location and routinely tested to ensure its integrity.

Village officials have not adopted comprehensive data backup policies and procedures. Although the Village performs daily data backups, there are no written procedures telling staff how long and where backup media should be maintained. Additionally, the Village has made no attempt to determine the validity of backed-up data and the effectiveness of data recovery efforts (see Disaster Recovery Plan, below) by routinely testing a restoration of the backup.

During our fieldwork, the Deputy Clerk-Treasurer experienced problems with her computer and put in a request for service with the Village's outside IT consultant. After the consultant completed an attempt to restore data from a backup, the Deputy Clerk-Treasurer found that some of her work was missing. The failure of the Village to come to an agreement with the IT consultant as to what data would be backed up and how often resulted in a loss of data that may not be recoverable or will require considerable time to recover.

Disaster Recovery Plan

A disaster recovery plan (DRP) describes how an organization will deal with potential disasters or major disruptions. A DRP describes procedures in event of the loss of equipment or data, to permit the data recovery and the precautions to be taken so that the effects of a disaster or major disruption will be minimized, allowing the organization to either maintain or quickly resume mission-critical functions. Such disasters may include any sudden, catastrophic event (e.g., fire, computer virus, or deliberate or inadvertent employee action) that compromises the availability or integrity of the IT system and data.

The Board had not established formal policies or procedures to address potential disasters or major disruptions. In the event of a disaster or major disruption, Village personnel have no guidelines or plan to follow to recover the loss of equipment and data. They have also not completed an analysis of disaster and major disruption prevention. The failure to establish a DRP could result in the loss or damage of essential information which may not be recoverable.

Recommendations

12. The Board should adopt and implement a comprehensive computer policy for IT operations. This policy should establish guidelines for acceptable use of equipment and systems.
13. The Board should adopt policies and procedures for user access rights and require that system administrator rights are assigned to an individual not involved in Village financial operations.
14. The Board should develop policies and procedures for controlling remote access to the computer system data, defining who can access the system, the methods to gain access, and the responsibility to review remote access logs.
15. The Board should adopt an information breach notification policy.
16. The Board should develop data backup procedures requiring data to be backed up on a daily basis, and copies of the backup to be stored at a secure off-site location for retrieval in case of an emergency. Officials should periodically test the backups to determine if the data can be fully restored.
17. The Board should develop and adopt a formal disaster recovery plan that addresses the range of potential threats to the Village's IT system and provides procedural guidance for employees to follow if the Village's IT systems or data are lost or damaged. This plan should be distributed to all responsible parties and periodically tested and updated as needed.

APPENDIX A

RESPONSE FROM LOCAL OFFICIALS

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



Trustees

Robert W. Fischer
Timothy H. Cox
John Riordan, Jr.
Denise Gibson

Village Attorney

John P. Finnerty, Esq.

Village Clerk & Treasurer
Christine O'Shea

Dept. of Public Works
Charles Fischer

Code Enforcement
Vincent P. Clancy

Joseph A. McNulty, Mayor

February 6, 2013

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

I thank the Office of the Comptroller for their carefully considered audit of our village's operations.

I have read the auditor's report and in general, I concur with your findings and recommendations.

As of July 1, 2012, many of the recommendations in your audit were already implemented. The other recommendations are presently under review.

The Board of Trustees and I are working diligently on many of the report's recommendations and I look forward to implementing them as a general practice in our Village's operations.

I wish to submit this response to your draft report with comments where appropriate to correct a few items which we feel merit further explanation and correction within your report.

We are working on our formal Corrective Action Plan, which will be submitted within the allotted time.

The Village of Brightwaters is, we believe, the only village in the State of New York that has no bonds or other public indebtedness. This is one part of a great legacy a governmental body can leave to its future residents. This legacy comes at a cost, however. We have a very lean governmental structure with minimal overhead and low recurring costs. All elected officials serve with no compensation. All of our boards are staffed with volunteers of exceptional

dedication and experience. We plan major capital expenditures carefully based on our known cash flows, and we only authorize projects that can be afforded with the assets available at the time. We are very proud of this legacy, and of our village. Your report will help us to fine-tune and modernize our policies and procedures so they will serve us well into the future.

Detailed Discussion:

- We agree that the Board will ensure that policies and procedures required by GML and sound business practices will be used.
- We agree that structurally balanced budgets with tighter monitoring of monthly adjustments is desirable. We take issue with your claim that the Village relies on non-recurring revenue sources. Please refer to our expansion on this topic, below.
- We take issue with the topic of a deficit in our general fund balance. Please refer to our expansion on this topic, below.
- Auditing of claims has been expanded to include all Trustees and more documentation of each claim.
- Our Clerk-Treasurer is overseen by the Mayor, a Trustee with direct responsibility over the office, and indirectly through a professional relationship with our accountants, Sheehan & Company. The Board will attempt to develop formalized procedures that will further enhance the security and efficiency of a small office environment. Please note that this village has only 2 full time office staff: the Clerk-Treasurer, and the Deputy Clerk.
- The Board has begun to monitor the activities of the Clerk-Treasurer more closely.
- The use of signature stamps will cease, and a secure check signing method will be procured. For the time being, all check related equipment is kept under lock and key.
- We disagree with the findings of a conflict of interest regarding the summer camp. Please refer to our expansion on this topic, below.
- The Board will create written policies to cover cases of possible conflict of interest.
- The Board will review the Code of Ethics and update it as needed.
- The Village Code of Ethics is contained in the Village Code Book, which is distributed to each Trustee at the beginning of service, to volunteer board members such as the Planning Board and Board of Appeals, and to our office employees. Your claim to the contrary is wrong. We also have already expanded this policy to include our six highway yard employees, and our Code Enforcement Officers.
- The Board will document and expand upon the existing computer operations policy.
- The Board will create a formalized system for administering user rights, and assign formal control of those rights to a formal system administrator.
- The Board will document and formalize our existing policies concerning remote access to our computers, and require the system administrator to periodically review remote usage logs.
- The Board will create an information breach policy. We wish to note that no

See
Note 1
Page 31

See
Note 2
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such breach has ever occurred nor been attempted, and that no restricted or sensitive data pertaining to any resident is kept on our computers. The village has the means to distribute information quickly to our residents by digital, automated telephone, and physical delivery.

- The Board will document and enhance our existing data backup policies, and require backups to be kept offsite, and tested periodically.
- The Board is in the process of creating a formal disaster recovery plan. It will be available to our clerical and technical staff in the event of an emergency.
- Concerning the confidential information in your audit, we understand those findings and wholeheartedly agree with their merit. These matters will be addressed shortly.

Item 2 Comments:

We take issue with your claim of reliance on non-recurring funding. We can easily understand how one could come to that conclusion by looking at a narrow window of accounting periods with no historical perspective, and without the benefit of more precise accounting techniques on our side. We take full responsibility for the lack of accounting precision that leads to this misunderstanding, and welcome this opportunity to improve those standards in the light of this audit.

See
Note 3
Page 31

Brightwaters' income is derived from taxes and other revenue sources. Taxes comprise roughly half of income. Our other sources of income are varied and disparate, but they are generally recurring items such as State grants for roads, etc. When we do roadwork, we use funds saved for the purpose in the NYS CHIPS program. We often partner with utility companies who must do roadwork on their own behalf, and are obligated to restore our roads to our satisfaction. This strategy, which was developed by Mayor McNulty, has been extraordinarily successful in getting many of our roadways rebuilt at a fraction of the out-of-pocket costs normally associated with this work. We plan an expansion of the utilities work in order to rebuild larger sections of road than originally planned. We take responsibility for the finishing-off of the roadways, allowing the utility companies to pay us for their portion of the work. This provides the Village with a very reliable source of revenue, since the timing and scope and cost of the work is well known.

Such was the case in this issue. The Village contracted for a large amount of roadwork to be done in conjunction with several utility roadwork jobs. Many of the costs were borne during one fiscal year. Repayment for that work was expected to occur in the same year, but was delayed for several months, causing it to be received in the following fiscal year. Our accountants, Sheehan & Company noted this disparity during their normal auditing cycle and called a meeting with the Mayor immediately. By the time the meeting occurred, the monies had been received and banked. When the situation was explained, and the current balances examined, Sheehan agreed that there was not a problem.

See
Note 4
Page 31

Again, we take full responsibility for the lack of accounting precision that led to this misunderstanding. We will ensure that our accounting standards and budgeting processes are improved in order to eliminate similar misunderstandings in the future.

We welcome this opportunity to improve those standards in the light of this audit. The Village of Brightwaters does not rely on non-recurring funding. In fact we are very careful in taking on only those expenses that have already been budgeted and sources of funding secured.

Item 3 Comments:

We acknowledge that our year-end fund balances have deteriorated over the years and will require further improvement. Our certified results filed with the OSC containing our balance of 5/31/12 shows a small yet clear surplus. Your preliminary report on page 9, table 1 was based on preliminary findings, and should be corrected. Your report also correctly shows an operating surplus for the FY 2010-2011 and FY 2011-2012 periods.

See
Note 5
Page 31

Item 8 comments:

Your characterization of the situation with our village summer camp as a conflict of interest is misplaced, and fails to grasp the essential nature and communal value of a small village.

Brightwaters has run a short summer camp for very young children since the 1950's. In recent times, it is run for about one month, and is widely lauded as one of the best of its kind. Often in the history of this camp a local teacher has been in charge. This is not a short term arrangement: once tasked with the job, the people who run this camp understand this is a long term commitment to the youngsters and parents of Brightwaters. For the past ten years or so, that job has been done by one family, the Coxes. The Cox family has a long, distinguished history here. The senior Cox was Mayor in the 1990's, and a well respected teacher and coach. Tim and his wife Eileen are well respected teachers, Tim having been a successful coach and administrator at our local high school for many years. We would not be able to find a better respected couple to be involved with our village children. When Tim ran for Trustee, everyone understood the issue with the camp. It was a subject of discussion among the Trustees at the time, and discussed at public meetings with a complete acceptance of the situation among the community.

See
Note 6
Page 31

We acknowledge the possible appearance of conflict to an independent observer, and we recognize the solution to this can be easily accommodated by asking Trustee Cox to refrain from voting on the one yearly abstract that covers summer camp expenses. We also agree that we will create formal policies to ensure that any possible appearance of a future conflict of interest is handled in a way that satisfies our fiduciary obligations, and ensures complete transparency to all of our residents.

See
Note 6
Page 31

Respectfully,

Joseph A. McNulty, Mayor
Inc. Village of Brightwaters

APPENDIX B

OSC COMMENTS ON THE VILLAGE'S RESPONSE

Note 1

If Village officials feel that segregation of duties is not possible, they should establish compensating controls.

Note 2

During our fieldwork, the Clerk-Treasurer told us that she was not aware that the code of ethics needed to be distributed to every officer and employee of the Village, that officers and employees needed to acknowledge receiving it, and that it needed to be posted in every Village property.

Note 3

The \$642,020 that the Village received from compensation for loss and Federal aid for emergency disasters in fiscal years 2010-11 and 2011-12 is in fact substantial non-recurring revenue. Further, our examination of financial operations was not limited to a narrow window of accounting periods but covered an expanded scope of three fiscal years, from June 1, 2009 through May 31, 2012. Except for the 2011-12 fiscal year, our review was based on audited financial statements.

Note 4

We have added an explanatory footnote (2) for clarification.

Note 5

Our calculation of fund balance for the 2011-12 fiscal year was based on the Village's budget-to-actual report provided to us in June 2012. Village officials did not provide any documentation to show otherwise during the course of our audit fieldwork. The AUD was filed electronically in September 2012, subsequent to our audit fieldwork. After our exit conference on February 4, 2013, we requested supporting documentation to substantiate a \$91,376 difference between the budget-to-actual report and the AUD, which would have resulted in a modest surplus, but none was provided. Further, the AUD presents unaudited numbers, which may not reflect the Village's true financial position.

Note 6

The prohibited conflict of interest cannot be easily resolved by simply asking a Trustee to refrain from voting. The Trustee had a prohibited interest in each of the contracts between the Village and his spouse and two dependent children. The Trustee also participated in the process of approving payments to them. The Board should confer with the Village attorney with respect to preventing future conflicts of interest.

APPENDIX C

AUDIT METHODOLOGY AND STANDARDS

Our overall goal was to determine if the Board provided adequate oversight of fiscal operations. To accomplish this, we performed an initial assessment of the internal operations 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 personal services, information technology, and the internal operations of the individual Village departments.

During the initial assessment, we interviewed appropriate Village officials to obtain an understanding of the organization and the accounting system, performed limited tests of transactions, and reviewed pertinent documents, such as Village policies and procedures manuals, Board minutes, and financial records and reports. In addition, we obtained information directly from the computerized financial databases and then analyzed it electronically using computer-assisted techniques. This approach provided us with additional information about the Village's financial transactions as recorded in its databases. Further, we reviewed the Village's internal controls and procedures over the computerized financial databases to help ensure that the information produced by such systems was reliable.

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 and/or professional misconduct. We then decided on the reported objective and scope by selecting for audit those areas most at risk. We selected Board oversight of financial operations for further audit testing, particularly over the Clerk-Treasurer's duties and claims auditing, controls over conflict-of-interest disclosure, and information technology.

- We analyzed financial data for the general fund from available accounting records, reports, and the Village's annual audited financial statements for the 2009-10 and 2010-11 fiscal years to determine trends in the Village's financial activity.
- We reviewed the minutes of the Board proceedings, pertinent Board resolutions, relevant policies and procedures, and financial and budgetary information related to our audit objective. We reviewed financial information provided to the Board and interviewed appropriate Village officials, trustees, and employees.
- We randomly selected three non-consecutive months (October 2010, May 2011, and December 2011) in our testing of transactions within the general fund, to verify if bank reconciliations were timely, up-to-date, accurate, and reviewed by the Board.
- We reviewed bank statements and reconciliations for the three non-consecutive months chosen for our general fund testing, and compared the reconciled balances to the internal financial statements and traced the outstanding items per the reconciliation to the cleared transaction in later months.
- We reviewed the general fund journal entries recorded during our audit period for reasonableness and evidence of independent review.

- Using the three randomly selected non-consecutive months for our general fund testing, we reviewed 204 check images from bank statements to determine who signed the checks and to confirm Village officials' explanations of their check-signing procedures.
- We randomly selected 10 checks paid from the Restoration account to determine if these payments were for legitimate Village purposes. We selected an additional six payments made to the Clerk-Treasurer to determine the level of Board oversight of all payments, and thus over the account itself.
- Using the three randomly selected months for our general fund testing, we reviewed 26 bank transfers to verify that these transfers were conducted for legitimate business purposes.
- We traced disbursement checks to original claim vouchers to confirm that claims were properly audited and authorized by the Board, sufficiently itemized, contained sufficient supporting documentation, were for proper and necessary Village purchases, and contained evidence that the goods/services were received.
- We examined the Village's abstracts of claims and compared these abstracts against the Board minutes to determine if claims were being properly reviewed by the Board.
- To investigate the conflict of interest concerning the Board member, we interviewed Village officials and reviewed Board minutes. We also reviewed claims packages, payment histories, and budget schedules to show amounts paid to the Board member and his family. Finally, we reached out to the Office of the State Comptroller's (OSC) Legal Services Division to determine whether a conflict of interest existed.

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 D

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