



Village of Depew

Internal Controls Over Capital Projects

Report of Examination

Period Covered:

June 1, 2006 — October 12, 2012

2013M-29



Thomas P. DiNapoli

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State of New York Office of the State Comptroller

Division of Local Government and School Accountability

April 2013

Dear 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 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 Village of Depew, entitled Internal Controls Over Capital Projects. This audit was conducted pursuant to Article V, Section 1 of the State Constitution and the State Comptroller's authority as set forth in Article 3 of the General Municipal Law.

This audit's results and recommendations are resources for local government officials to use in effectively managing operations and in meeting the expectations of their constituents. If you have questions about this report, please feel free to contact the local regional office for your county, as listed at the end of this report.

Respectfully submitted,

*Office of the State Comptroller
Division of Local Government
and School Accountability*

Introduction

Background

The Village of Depew (Village) is located in the Towns of Cheektowaga and Lancaster in Erie County (County), has a population of approximately 15,300 and encompasses almost 5.1 square miles. The Village is governed by an elected Village Board (Board), which comprises four Trustees and a Mayor. The Mayor serves as the chief executive officer and the Village Administrator (Administrator) serves as the chief fiscal officer, and is responsible for maintaining the Village's accounting records and preparing financial reports.

The Village provides various services to its residents, including street maintenance, sewer service, recreation programs, refuse collection, fire protection, drainage services, and general government support. Most of the expenditures incurred in providing these services are funded with real property taxes, sales tax, State aid, user fees, and various local revenues. The Village's expenditures for the 2011-12 fiscal year totaled approximately \$12.4 million.

In recent years, the Village has undertaken several capital projects for energy performance and sewer system improvements and acquired certain machinery and equipment. Excluding transfers to other funds, capital project type expenditures over the last six fiscal years¹ totaled approximately \$6.4 million. The Village finances its capital projects mainly through the issuance of indebtedness for these various purposes.

Objective

The objective of our audit was to determine whether the Village properly recorded capital project activity. Our audit addressed the following question:

- Did the Village properly record capital project activity and ensure the related use of debt proceeds and interfund activity is proper?

Scope and Methodology

We reviewed capital project activity for the period June 1, 2006 to October 12, 2012.

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

¹ 2006-07 through 2011-12

**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. Village officials generally agreed with our recommendations and indicated they planned to initiate corrective action.

The Board has the responsibility to initiate corrective action. A written corrective action plan (CAP) that addresses the findings and recommendations in this report should be prepared and forwarded to our office within 90 days, pursuant to Section 35 of the General Municipal Law. For more information on preparing and filing your CAP, please refer to our brochure, *Responding to an OSC Audit Report*, which you received with the draft audit report. We encourage the Board to make this plan available for public review in the Village Administrator's office.

Capital Projects

The purpose of a capital projects fund is to account for all of the financial activity related to the acquisition or construction of major capital assets. The Board and Village officials are responsible for establishing procedures to properly authorize, finance, and monitor the status of individual capital projects to ensure that moneys are properly accounted for and used only for their intended purposes. The Board is responsible for establishing the project's maximum authorized amount and identifying how the Village will finance the project. Further, Local Finance Law requires the Village to use debt proceeds only for the object or purpose for which the debt was issued.

The Administrator is responsible for maintaining separate financial records for each authorized capital project that includes information sufficient to document each project's complete financial history and establish accountability for all the resources provided for a particular purpose. Since the Village issued debt to finance certain capital projects, any excess funds from these projects, including any other resources committed to the project that were commingled with the proceeds of debt, must be restricted for related debt service.² Furthermore, investment income earned on the proceeds of debt must be used in accordance with Local Finance Law provisions.

We found significant problems with the accounting for and reporting of capital project activity as well as the use of certain debt proceeds. The Administrator did not maintain capital project records in a manner that readily provides information about actual resources committed and expenditures incurred throughout the course of each project, which often span two or more fiscal years. Rather, the Administrator recorded certain capital project activity in the sewer fund, together with routine sewer operations, which are budgeted for annually by the Board. The commingling of all of these resources and transactions in the sewer fund does not allow for capital activity to be appropriately monitored against project authorizations approved by the Board as well as for compliance with legal requirements related to debt proceeds. Moreover, when capital activity is not accounted for in the capital projects fund, as required by generally accepted accounting principles, the likelihood of misclassifications and other accounting errors occurring is increased, which results in misleading reporting of capital activity.

Accounting Records – The Administrator does not maintain adequate records to account for and monitor capital project activity, by project,

² Local Finance Law Section 165

in the capital projects fund, to provide a clear financial picture of each project. Also, the Administrator did not properly record debt proceeds in accordance with statutory requirements. In the 2005-06 fiscal year, the Administrator improperly recorded \$1.5 million of bond anticipation note (BAN) proceeds in the sewer operating fund to finance a capital project. In general, major capital acquisition or construction extending beyond a year and/or financed by obligations should be recorded in the capital projects fund.

We reviewed three of the several capital projects that the Village has undertaken during our audit period, including two phases of a sewer project. The Village borrowed \$4.2 million for the projects based on three separate bond resolutions. However, because the Administrator does not record each project separately, she could not demonstrate that the financial activity related to these projects was properly accounted for, and reported. For example, we found that the Administrator improperly recorded approximately \$1.4 million of capital expenditures for one project in the sewer fund instead of in the capital projects fund.

We also found that the Board did not properly close the three projects we reviewed. Once a project is completed, the Board should take action to close the project and dispose of any unexpended balance based upon the source of the project's funding. Unexpended funds originating from bonds, or from multiple sources which include debt proceeds, must be applied to the related debt (i.e., transferred to a debt service fund and restricted only to redeem the related debt). In short, unexpended funds originating from bonds or from multiple sources commingled with debt proceeds cannot be used to subsidize operations.

We also found that the Village did not establish a debt service fund to restrict the use of the unexpended funds to pay debt associated with these capital projects. The Administrator indicated that she relies on the Village's external auditor to address the disposition of remaining capital moneys.

Furthermore, the use of interest earned on debt proceeds must be restricted in accordance with statutory provisions. It could be used either for payment of principal and interest on the debt or for the purpose for which the debt was authorized, if the Board included interest earned as a financing source. The Administrator did not restrict the use of interest earned on debt proceeds and improperly recorded interest earnings in the general and sewer funds. According to the Administrator, the Village's external auditor recommended that she record interest earnings in this manner. Our review of the numerous adjusting journal entries provided by the external auditor

to correct the Administrator's accounting records did not disclose any entries to address the erroneous treatment of interest earned on debt proceeds and other commingled project resources. As such, it appears that these interest earnings were accounted for as revenue of the general and sewer funds and used for operating purposes.

Interfund Transactions – During our audit period there were numerous interfund transfers and interfund advances that were recorded. To address the improper recording of capital project activity in the sewer fund the Administrator, based on recommendations from the external auditor, reported that the capital projects fund was owed approximately \$1.3 million from the sewer fund to address the reclassification of a BAN payable that was misreported in the 2007-08 fiscal year.

Once the project was completed and permanent financing issued, the Village paid off the note payable with bond proceeds and eliminated the reported due to/due from balances by recording transfers between the operating funds and the capital projects fund. Project costs were originally recorded in the sewer fund at the time they were incurred rather than in the capital projects fund. This resulted in the sewer fund incorrectly reporting a deficit fund balance. The notes to the audited financial statements for the 2009-10 fiscal year stated that the “sewer fund deficit of \$701,548 ... will be funded when bond anticipation notes are redeemed from permanent financing through the issuance of serial bonds.”³ Had the Administrator properly established a project in the capital projects fund and recorded all the related activity there, including the issuance of the BAN, the sewer fund would not have reported a deficit. In addition, the interfund transactions that were recorded to remedy the improper accounting for the BAN, resulted in expenditures being double counted. Given the materiality of the activity, this presentation is misleading for those relying on the audited financial statements.

General Municipal Law (GML) authorizes cash advances between Village funds but requires that repayment be made as soon as moneys are available, but no later than the close of the fiscal year in which the advance was made. These advances are required to be authorized by Board action.

³ The only mechanism for an operating fund deficit to be eliminated by the issuance of indebtedness requires specific authorization by the NYS Legislature for deficit financing. See also Local Finance Law Section 10.10.

The following interfund advances were reported as of May 31, 2012:

Table 1: Interfund Advances as of May 31, 2012		
Fund	Due From Other Funds	Due To Other Funds
General	\$561,000	\$57,000
Sewer	\$111,000	-
Capital Projects	-	\$528,000
Fiduciary	-	\$87,000
Total	\$672,000	\$672,000

We found no indication that the Board authorized these interfund advances, and the advances were not repaid within the same fiscal year. In the audited financial statements, \$528,000 in cash was reported in the capital projects fund at May 31, 2012. However, the Village had no ongoing capital projects. According to the Administrator, the cash represented \$268,000 for a sewer capital reserve, \$35,000 for another capital reserve and the remaining \$225,000 was related to other projects. However, she could not provide documentation identifying which specific projects these moneys related to, or whether any of these moneys were residual debt proceeds or other resources that were commingled with debt proceeds and therefore must be restricted for debt service. Furthermore, the capital projects fund also reported that the entire \$528,000 was ‘due to other funds.’ If indeed the \$268,000 and the \$35,000 reflected Board-authorized capital reserves, it is unclear to what other fund these moneys were due to, since no capital reserves were reported in any funds in the audited financial statements. The Administrator stated that she did not know why they were not reported and that the external auditor received all bank reconciliations, budgets and other related information for these reserves. The Administrator was also unable to provide documentation to indicate where the capital reserve moneys originated from and if the Board had properly established them in compliance with GML requirements. The total balance in these reserves since February 2009 has ranged from \$254,000 to \$303,000.

These capital project errors occurred because the Board did not properly monitor or provide adequate direction to the Administrator, instead placing undue reliance on her to handle the Village’s finances. Moreover, the Administrator places undue reliance on the Village’s external auditor to address the accounting and reporting of certain activity. The Administrator is responsible to maintain accurate records of operating activity, capital projects and reserve funds. The external auditors are responsible to attest to the financial statements prepared by the Administrator.

Recommendations

1. The Administrator should review relevant publications on accounting, financial management, and municipal operations available on the State Comptroller's website⁴ and consider attending financial management training, especially those focused on capital project accounting and reporting and debt financing.
2. The Administrator should properly record each capital project separately in the capital projects fund.
3. The Board should use the records for each capital project to track the progress and costs of each project.
4. The Board should take action when a capital project is complete and the Administrator should properly dispose of any excess funds, in accordance with relevant statutory provisions.
5. The Administrator should ensure that debt proceeds, other project resources commingled with debt and all interest earnings are deposited, accounted for, and expended in strict accordance with statutory requirements.
6. The Administrator should identify all moneys remaining from recently completed capital projects by identifying and summarizing revenues and other funding sources, as well as project expenditures, then return any moneys to the capital projects fund and/or debt service fund, as appropriate.
7. The Board should approve all interfund transactions and ensure that the Administrator reviews all outstanding balances of interfund advances, taking appropriate action to eliminate them by the end of the fiscal year.
8. The Administrator should have a complete understanding of any adjustments recommended by the external auditor prior to recording them.
9. The Board should ensure that capital reserves are properly established and used in accordance with statutory requirements and that the Administrator properly records and reports any such authorized reserves.

⁴ <http://www.osc.state.ny.us/localgov/pubs/index.htm>

APPENDIX A
RESPONSE FROM LOCAL OFFICIALS

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

Village of Depew

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www.villageofdepew.org

Mayor
Steven Hoffman
716-681-4396

April 8, 2013

Trustees
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Jesse Nikonowicz
Michael Nolder
Juliano Pecora

State of New York
Office of the State Comptroller
110 State Street
Albany, NY 12236

Re: Internal Controls Over Capital Projects 2013M-029

**Village
Attorney**
Mark Aquino

This letter serves as the Village's response to the Comptroller's audit referenced above. Regarding the accounting records for the capital projects, there was an issue in the 2005-2006 fiscal year where the journal entries for the revenue and expenditures for a sewer project were recorded in the Sewer Fund and not the Capital Fund. The entries have since been moved to the proper fund. Excel spreadsheets have been implemented to track the capital projects and were used in the past.

**Village
Administrator**
Elizabeth Melock
716-683-7451 x127
716-683-1398 (fax)


The Debt Service Fund was closed many years ago at the advice of the Village's auditing firm. The interest was retained in the General Fund which is used to pay the principal and interest on the debt. The Debt Service Fund will be utilized in the future for any interest earned on borrowed funds.

Interfund Transfers – There are spreadsheets that have the breakdown for the funds in the Sewer Capital Reserve Account, Capital Projects Account and Capital Reserve Account. The Reserves were established before the current Village Administrator and due to time and personnel constraints, she was not able to research ten to twenty years of Village Board minutes to see when the reserves were established. Interfund transfers were always approved by a blanket resolution at year end by the Board. Due to Due Froms have been zeroed out in the May 31, 2013 fiscal year. Future Interfund Transfers, not already listed in the budget, will be listed individually on resolutions and approved by the Board.

The Village Administrator will be attending the State's Advanced Accounting School October 22-23, 2013 in the Village of Arcade to re-familiarize herself with the above items.

Please contact me at shoffman@villageofdepew.org or 716-681-4396 x129 if you have any further questions.

Sincerely,

Steven Hoffman 
Mayor

APPENDIX B

AUDIT METHODOLOGY AND STANDARDS

During the initial assessment, we interviewed appropriate Village officials, performed limited tests of transactions, and reviewed pertinent documents, such as Village policies and procedures, 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, and/or professional misconduct.

We then decided upon the reported objective and scope by selecting for audit the area we felt was most at risk. Our objective was to determine whether the Village properly recorded capital project activity during the period June 1, 2006 to October 12, 2012. To achieve our objective and obtain valid audit evidence, we performed the following audit procedures:

- We interviewed Village officials and employees.
- We reviewed Board minutes and relevant financial records and reports made available to us, such as the annual financial report and the Village's audited financial statements.
- We analyzed capital projects' funding sources/revenues and expenditures and reviewed three significant capital projects.
- We traced capital expenditures reported in the 2008-09 fiscal year to claim vouchers to ensure they were supported and related to the project.
- We summarized certain cash balances reported since the 2006-07 fiscal year to determine whether they related to properly established capital reserves and that they were properly reported and used.
- We reviewed interfund transfers and interfund advances during six fiscal years (2006-07 to 2011-12).

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

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