



# Village of Port Byron

## Financial Monitoring and Information Technology

### Report of Examination

Period Covered:

June 1, 2011 — June 17, 2013

2014M-116



Thomas P. DiNapoli

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# State of New York Office of the State Comptroller

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## **Division of Local Government and School Accountability**

August 2014

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 Port Byron, entitled Financial Monitoring 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

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### EXECUTIVE SUMMARY

The Village of Port Byron (Village) is located in the Town of Mentz in Cayuga County and has approximately 1,300 residents. The Village provides various services to its residents, including water and sewer, fire and police protection, street maintenance and general government support. Budget appropriations for the general, water and sewer funds in 2013-14 were approximately \$1.3 million, funded primarily by real property taxes, sales taxes, State aid and water and sewer rents.

The Village is governed by a Board of Trustees (Board) which comprises four elected Trustees and an elected Mayor. The Board is responsible for the general oversight of the Village's operations and the design and implementation of internal controls to safeguard Village assets from loss or misuse. The Mayor is the chief executive officer and serves as the Village's budget officer.

The Clerk-Treasurer is the chief fiscal officer and the tax collector for the Village and serves as the information technology (IT) administrator. The former Clerk-Treasurer referred to in this report began her employment with the Village April 9, 1990 and retired effective October 5, 2012, prior to the start of our fieldwork.<sup>1</sup>

#### **Scope and Objectives**

The objectives of our audit were to examine the Village's financial operations, internal controls and IT for the period June 1, 2011 through June 17, 2013. We expanded the scope back to January 1, 2011 to review payroll tax reports, which are based on the calendar year. Our audit addressed the following related questions:

- Did the Board provide adequate oversight of the Village's finances?
- Are controls over IT adequately designed to ensure the Village's IT assets and computerized data are safeguarded?

#### **Audit Results**

We found that the Board did not monitor the Village's finances. The Board has not ensured that adequate policies and procedures required by law and sound business practice have been adopted, regularly reviewed and updated, monitored for compliance and distributed to officials and employees. It did not ensure that the Clerk-Treasurer maintained accurate accounting records. It also did not ensure that duties in the Clerk-Treasurer's office were properly segregated or provide mitigating controls, which created an environment that allowed for the possible misappropriation of Village funds.

<sup>1</sup> On April 1, 2013, the Deputy Clerk-Treasurer was appointed as the Clerk-Treasurer.

The lack of monitoring also led to the Village accumulating fund balance in excess of its current needs. We calculated<sup>2</sup> an estimated fund balance level for the general, water and sewer funds at the 2012-13 year end, and we estimate unexpended surplus funds to be excessive at \$474,479 (82 percent) for the general fund and \$131,095 (91 percent) for the sewer fund. The water fund, at \$59,360 (23 percent), is more reasonable, but still high.<sup>3</sup> Furthermore, there was no oversight of water/sewer account adjustments, which were made by the former Clerk-Treasurer without the Board's approval and resulted in approximately \$300,000 in reductions and \$269,000 in added charges to customer accounts during our audit period. The Board also did not provide adequate oversight of payroll taxes, where Federal monthly and quarterly payroll-tax reports were filed late or incorrectly on numerous occasions and the Village incurred approximately \$4,000 in penalties and interest during the audit period alone. Additionally, the Board does not complete or contract with an independent auditor for an annual audit of the Clerk-Treasurer's books and records.

Finally, the Board has not established policies and procedures related to acceptable use, computer security, breach notification or online banking, and the Board has not adopted a disaster recovery plan to address potential disasters. Therefore, IT assets are at risk for unauthorized, inappropriate and wasteful use.

### **Comments of Local Officials**

The results of our audit and recommendations have been discussed with 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 that they intend to implement corrective action.

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<sup>2</sup> Due to the poor state of financial records, fund balance needed to be calculated based on cash balances from bank statement activity.

<sup>3</sup> Although the Mayor stated that he believed the Village had established and funded reserves, it could not be determined if these reserve funds were legally established, and there was no inclusion of reserve funds in the financial records. Therefore, we did not restrict any portion of fund balance for reserves and these higher balances may be reduced by formally creating, funding and properly accounting for Board-authorized reserves.

# Introduction

## Background

The Village of Port Byron (Village) is located in the Town of Mentz in Cayuga County and has approximately 1,300 residents. The Village provides various services to its residents, including water and sewer, fire and police protection, street maintenance, street lighting, snow and brush removal, garbage pickup and general government support. Budget appropriations for the general, water and sewer funds in 2013-14 were approximately \$1.3 million, funded primarily by real property taxes, sales taxes, State aid and water and sewer rents.

The Village is governed by a Board of Trustees (Board) which comprises four elected Trustees and an elected Mayor. The Board is responsible for the general oversight of the Village's operations and the design and implementation of internal controls to safeguard Village assets from loss or misuse. The Mayor is the chief executive officer and serves as the Village's budget officer. The Mayor appoints all non-elective officers, subject to Board approval, including the Clerk-Treasurer, who serves as chief fiscal officer.

The Clerk-Treasurer is responsible to, among other things, have custody of all Village moneys, collect and deposit cash received, maintain the accounting records, file financial reports and sign checks. The Clerk-Treasurer is also the tax collector for the Village and is responsible for processing weekly payroll and water and sewer billings and collections. The Clerk-Treasurer also serves as the Village's information technology (IT) administrator. The former Clerk-Treasurer referred to in this report began her employment with the Village April 9, 1990 and retired effective October 5, 2012, prior to the start of our fieldwork.<sup>4</sup>

Prior to the former Clerk-Treasurer's retirement, the Village contracted for a review of its policies and procedures with a certified public accounting (CPA) firm during the 2011-12 fiscal year. As a result of this review and concerns over the activities of the former Clerk-Treasurer, the Board approved the CPA firm to return and perform a financial audit. Due to the poor state of the accounting records and additional work required to straighten out the books and records, the CPA firm identified and corrected what it could by working within the agreed upon budget. However, it was unable to complete a financial audit due to the Board's desire to not spend the additional funds necessary to complete the work. On October 23, 2012, the Mayor contacted our office concerning the issues identified and requested an audit.

<sup>4</sup> On April 1, 2013, the Deputy Clerk-Treasurer was appointed as the Clerk-Treasurer.

## Objectives

The objectives of our audit were to examine the Village's financial operations, internal controls and IT. Our audit addressed the following related questions:

- Did the Board provide adequate oversight of the Village's finances?
- Are controls over IT adequately designed to ensure the Village's IT assets and computerized data are safeguarded?

## Scope and Methodology

We examined the Village's financial operations, internal controls and IT for the period June 1, 2011 through June 17, 2013. We expanded the scope back to January 1, 2011 to review payroll tax reports, which are based on the calendar year. 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 is included in Appendix B of this report.

Because of the sensitivity of certain areas in need of improvement concerning IT controls, certain vulnerabilities will not be discussed in the written report but will be communicated confidentially to Village officials in a separate letter so that they can take corrective action.

## 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 that they intend to implement 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 Clerk-Treasurer's office.

## Financial Monitoring

The Board is responsible for the oversight of the Village's financial operations and ensuring that policies and procedures are in place to safeguard Village resources. The Board fulfills this responsibility in part by instituting appropriate internal controls to provide reasonable assurance that cash and other resources are properly safeguarded, transactions are properly authorized and recorded and financial reports are accurate, timely and reliable. The Board must ensure that no individual controls all aspects of financial transactions, or it must implement compensating controls to mitigate risk. According to Village Law, the Board is also responsible for annually auditing the books and records of the Clerk-Treasurer.

We found that the Board did not adequately monitor the Village's finances. The Board has not ensured that adequate policies and procedures required by law and sound business practice have been adopted, regularly reviewed and updated, monitored for compliance and distributed to officials and employees. It did not ensure that the Clerk-Treasurer maintained accurate accounting records. It also did not ensure that duties in the Clerk-Treasurer's office were properly segregated or provide mitigating controls, which created an environment that allowed for the possible misappropriation of Village funds.

The lack of Board monitoring also led to the Village accumulating fund balance in excess of its current needs. We calculated<sup>5</sup> an estimated fund balance level for the general, water and sewer funds at the end of 2012-13 and estimated unexpended surplus funds would be excessive at \$474,479 (82 percent) for the general fund and \$131,095 (91 percent) for the sewer fund. Fund balance is more reasonable, but still high, for the water fund, which was at \$59,360 (23 percent).<sup>6</sup>

Furthermore, there was no oversight of water and sewer account adjustments, which were made by the former Clerk-Treasurer without the Board's approval and resulted in unauthorized adjustments which included approximately \$300,000 in reductions and \$269,000 in added charges to customer accounts during our audit period. After

<sup>5</sup> Due to the poor state of financial records, fund balance needed to be calculated based on cash balances from bank statement activity.

<sup>6</sup> Although the Mayor stated that he believed the Village had established and funded reserves, it could not be determined if these reserve funds were legally established, and there was no inclusion of reserve funds in the financial records. Therefore, we did not restrict any portion of fund balance for reserves and these higher balances may be reduced by formally creating, funding and properly accounting for Board-authorized reserves.

improvements were made to the process by the Board and with the current Clerk-Treasurer in place, we found no unauthorized adjustments reducing the amounts billed and all additional charges were supported.

The Board also did not provide adequate oversight of payroll taxes, where Federal monthly and quarterly payroll tax reports were filed late or incorrectly on numerous occasions and the Village incurred approximately \$4,000 in penalties and interest charges during the audit period alone. Additionally, the Board does not complete or contract with an independent auditor for an annual audit of the Clerk-Treasurer's books and records.

## **Policies and Procedures**

Written policies are a key component of adequate Board oversight and an organization's internal control environment, because they formally establish and communicate to staff the manner in which to conduct the day-to-day operations of the organization. General Municipal Law (GML) requires the Board to adopt written policies relating to investments and procurements not subject to competitive bidding and to adopt a code of ethics. These policies are to be reviewed annually and updated as necessary. It also is important for the Board to develop written policies for finance-related areas<sup>7</sup> to help ensure that its financial objectives are met. Finally, Village officials are responsible for developing written procedures to effectively implement the Board-adopted policies.

The Board has not adopted any finance-related policies. Although the Village has established the three other policies required by law, two of these policies are outdated. The Village's procurement policy is undated, but includes outdated legal requirements, has not been annually reviewed as required and has not been updated in more than three years. A code of ethics was adopted in 1978 but has not been updated since that time. The Board adopted an updated investment policy in April 2012. Further, Village officials and employees, including the Clerk-Treasurer who performs most financial related duties, were not aware of the existence of these policies prior to our request for them and, therefore, were not familiar with the requirements of these policies in order to ensure and monitor compliance. Without adequate policies in place that are appropriately distributed to officials and employees and a plan to implement and monitor compliance of these policies, the Village's control environment is weakened because the Board has not communicated its expectations to Village officials and employees on how to conduct Village operations. Also, without Board-established guidelines that are regularly updated or distributed to officials and employees, individuals will be left to generate their own informal procedures.

<sup>7</sup> Policies for cash receipts and disbursements, payroll, leave accruals, budgeting, credit cards, cell phones, billings/collections/adjustments and IT

## Records and Monitoring

The Board is responsible for the Village's overall financial management, including monitoring and evaluating financial operations. Therefore, it is essential that complete, accurate and timely accounting records are maintained by the Clerk-Treasurer to properly account for and report the Village's financial condition and activities. Although the Mayor has primary responsibility for managing the Village's day-to-day activities, the entire Board shares responsibility for fiscal oversight, including establishing a system of financial reporting. Complete and accurate accounting records maintained on a current basis provide the Board with the essential information needed to effectively manage and safeguard cash, properly monitor the Village's fiscal affairs and develop realistic budgets. The Clerk-Treasurer is responsible for maintaining accurate financial records and reports, and the Board is responsible for providing adequate segregation over the duties performed by the Clerk-Treasurer or implementing mitigating controls such as a review of her work.

Financial Recordkeeping – The Board should ensure that sufficient and accurate financial records are maintained and that it receives the financial reports necessary to monitor financial operations, including those that enable it to verify that financial transactions are properly authorized, recorded and reported. Good management practice requires the Clerk-Treasurer to prepare and provide interim financial reports to the Board that include a periodic list of receipts, disbursements and ending balances for each Village bank account, as well as monthly budget status reports.

The Board did not fulfill its obligation to provide oversight of financial operations. It did not ensure that the Clerk-Treasurer maintained accurate accounting records. The Village's financial records were inaccurate and unreliable. The Village hired a CPA firm to review and assist in updating and reconciling the financial records. Because the former Clerk-Treasurer did not perform bank reconciliations and poorly maintained the Village's financial records, the Village required adjustments as of May 31, 2012<sup>8</sup> totaling \$153,500<sup>9</sup> to reduce recorded cash balances to agree with the bank balances. In addition to the inaccurate cash balances, the cash receipts and disbursements journals contained inconsistencies. As a result of the inaccurate recordkeeping, the Village lost the beginning months of the 2012-13 electronic financial data when it needed to erase the data

<sup>8</sup> The CPA firm noted \$116,500 of adjustments was caused by inaccurate/untimely entries recorded; due to poor records, it was unable to determine the cause for the other \$37,000 discrepancy.

<sup>9</sup> Subsequent to audit fieldwork, the Clerk-Treasurer provided new support for certificates of deposit (CDs) that the Village had as of May 31, 2012, totaling approximately \$118,000. Because Village officials were not previously aware of these additional funds, this adjustment may not be accurate.

and begin the fiscal year's records anew using the CPA's corrected figures. As a result, the new Clerk-Treasurer had to re-enter months of data while also maintaining current operations. Consequently, the financial records were not able to be reconstructed and updated in a timely manner, and as of June 17, 2013 the financial records were only completed through June 2012.

The Board also did not request or receive interim financial reports for receipts, disbursements, budget-to-actual information and cash balances from the former Clerk-Treasurer to assist in monitoring the financial operations. Although Board members indicated that the former Clerk-Treasurer generated reports and kept them in a binder in her office, where they were available for review, the reports were never formally presented to the Board and were not reviewed. The current Clerk-Treasurer provides a monthly report of cash receipts and disbursements, but the Board does not receive a report on cash balances. Additionally, because financial records are not up to date, the Clerk-Treasurer is unable to provide a budget-to-actual report and the Board does not have the information required to monitor the Village's financial affairs.

The lack of monitoring led to the Village accumulating fund balance in excess of its current needs. We estimated<sup>10</sup> the fund balance amounts as of the end of 2012-13 to be approximately \$654,205 (113 percent)<sup>11</sup> for the general fund, \$100,210 (38 percent) for the water fund and \$136,705 (95 percent) for the sewer fund. Based on 2013-14 budget figures, the Village appropriated fund balance of \$179,726, \$40,850 and \$5,610 for the general, water and sewer funds for the 2013-14 fiscal year. Therefore, estimated unexpended surplus funds would be excessive at \$474,479 (82 percent) for the general fund, and \$131,095 (91 percent) for the sewer fund and is more reasonable for the water fund at \$59,360 (23 percent).<sup>12</sup>

The Board's lack of reliable financial information prohibits it from making sound financial decisions, limits its ability to adopt accurate budgets and could lead to excessive tax levies and user charges. If the Board was better informed, it could adopt budgets that are much more structured, reliable and transparent to the taxpayers.

<sup>10</sup> Due to the poor state of financial records, fund balance needed to be calculated based on cash balances from bank statement activity.

<sup>11</sup> Percentages are fund balance amount as a percentage of 2012-13 expenditures.

<sup>12</sup> Although the Mayor stated that he believed the Village had established and funded reserves, it could not be determined if these reserve funds were legally established, and there was no inclusion of reserve funds in the financial records. Therefore, we did not restrict any portion of fund balance for reserves and these higher balances may be reduced by formally creating, funding and properly accounting for Board authorized reserves.

Segregation of Duties – A key component of an effective system of internal controls is the segregation of incompatible duties, i.e., accounting records maintenance, cash custody and bank reconciliations. When it is not feasible to segregate duties, the Board must establish mitigating controls, such as enhanced management oversight or monthly reconciliation of bank balances by someone who does not have the ability to enter or modify transactions in the accounting records. The Board should also provide oversight of disbursements by auditing and approving all claims for payment prior to the disbursements being made.<sup>13</sup> An individual independent of the financial operations should use audit logs and change/adjustment reports as a means of determining who is accessing the system, the entries being made and what changes have been made in the system.

The Board did not establish an adequate segregation of duties or mitigating controls over the Clerk-Treasurer's financial duties. Consequently, the former Clerk-Treasurer was responsible for most aspects of the Village's cash receipts, disbursements, payroll and water and sewer billings and collections.<sup>14</sup>

The Board did not receive or review adequate financial information. Because the Board or a designated independent official or employee was not reviewing bank statements and reconciliations, the Board was not aware that the former Clerk-Treasurer did not perform bank reconciliations. In addition, there was no review of system activity through an audit log, change report or adjustment report.

As a result of the lack of Board oversight to verify the accuracy and appropriateness of the Clerk-Treasurer's work, the Board did not timely identify certain discrepancies in the Village's operations,<sup>15</sup> records, reports, payments and water and sewer adjustments. As a result, the Village's financial records were inaccurate and incomplete, the Village incurred penalties and interest<sup>16</sup> that could have otherwise been avoided and it lost potential revenue due to unauthorized adjustments<sup>17</sup> made to water and sewer accounts. Further, this created an environment that allowed for the possible misappropriation of Village funds. The former Clerk-Treasurer received a check<sup>18</sup> in the

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<sup>13</sup> Certain claims may be paid prior to Board audit (e.g., fixed salaries, debt service, public utility services, postage, freight and express charge).

<sup>14</sup> Including receiving and depositing cash, preparing and signing checks, making bank transfers, billing and adjustments for water and sewer, maintaining accounting records, receiving and opening bank statements and reconciling bank accounts.

<sup>15</sup> For example, deposits were not made intact and water and sewer amounts were incorrectly allocated to each fund.

<sup>16</sup> See "Payroll Taxes."

<sup>17</sup> See "Water and Sewer Adjustments."

<sup>18</sup> February 2011

amount of \$600 for the sale of surplus police equipment<sup>19</sup> by the police department.<sup>20</sup> Instead of depositing this check directly into a Village bank account, the former Clerk-Treasurer was able to cash this check and there was no record of this money ever being deposited into a Village account.<sup>21</sup>

The Board's lack of oversight of the Clerk-Treasurer's duties and limited involvement in the Village's financial activities allowed for the possible misappropriation of Village funds by the former Clerk-Treasurer. If the Board had regularly performed or required a proper review of records, it may have identified the inaccuracies sooner.

In May 2013, another individual was hired to work in the Clerk-Treasurer's office and the Village planned to divide tasks in order to provide more accountability in the office. The current Clerk-Treasurer provided information subsequent to audit fieldwork on the division of duties. In general, the office clerk completes the following tasks: receipt of water and sewer rents and taxes, taking daily deposits to the bank, review of bank reconciliations and entering vouchers into the accounting system. The Clerk-Treasurer is responsible for balancing the cash register and cash receipts book, preparing deposits and bank reconciliations, reviewing the monthly abstract, writing checks and preparing weekly payroll.

## **Water and Sewer Adjustments**

Village officials should ensure that the Clerk-Treasurer prepares water and sewer bills based on usage and in accordance with the Board-approved rate structure. Billing adjustment procedures should, at a minimum, require that a designated official, not involved in the collection and recording of these charges, approve each adjustment and adequately document the origination, justification, amount and date it was approved. The Board also must provide sufficient oversight of those officers and employees involved in these processes and ensure that proper Board approval and documentation occurs when billing adjustments are necessary.

<sup>19</sup> Firearms

<sup>20</sup> According to Village Law, the Village is allowed to sell unneeded personal property, including firearms. Additionally, Penal Law requires a local police department selling unneeded firearms to contact the State Police with the make, model and serial number(s) of all firearms sold. The Village police department did not comply with this legal requirement following this particular sale and stated that they do not notify any other agencies or outside parties when a firearm sale is made.

<sup>21</sup> The former Clerk-Treasurer claims the check was cashed in February 2011, the cash was held for deposit until the next fiscal year and the money was eventually deposited in September or October of 2011. However, due to the poor state of the Village's records, there is no way to determine if the money was actually deposited. Additionally, if the former Clerk-Treasurer did in fact deposit the money months later, this would have still been inappropriate. The check should have been deposited, and the Village could have chosen to expend these funds in the new budget year.

The Board did not establish adequate water and sewer billing adjustment procedures. We found that the Board did not provide sufficient oversight of the Clerk-Treasurer during billing and collection of water and sewer rents. As a result, the former Clerk-Treasurer made undocumented and potentially inappropriate adjustments to customer accounts without the knowledge of the Mayor or Board.

Due to this lack of oversight, we reviewed and summarized all adjustments made during the audit period, which included approximately \$300,000 in reductions and \$269,000 in added charges to customer accounts. We determined that approximately \$297,000 of the reductions were made by the former Clerk-Treasurer, and the remaining \$3,000 were made by the current Clerk-Treasurer.

In addition, we selected a sample of adjustments for further review to evaluate reasonableness and determine if adjustments were properly supported. We selected<sup>22</sup> adjustments from two billing quarters and randomly selected 20 adjusted customer accounts for review. We identified the following discrepancies:

- For the quarter ending July 2011, approximately \$6,500 out of \$112,500 (almost 6 percent) billed was reduced from customer accounts. None of these adjustments had Board approval or sufficient, appropriate supporting documentation. Through discussions with the current Clerk-Treasurer and review of account histories, we determined that about \$2,200 was for reasonable purposes, such as appropriate adjustments to vacancy rates or for minimal usage.<sup>23</sup> In addition, approximately \$1,000 of the potentially reasonable adjustments was due to billing errors made when customers received both a final bill and a regular cycle bill in the same quarter. The remaining \$4,300 in reductions potentially were made inappropriately, including unsupported adjustments made to remove penalties from certain customer accounts.
- Of the 20 account adjustments reviewed, we calculated approximately \$63,700 in net reductions made to customer accounts.<sup>24</sup> After discussion with the current Clerk-Treasurer, it was determined that approximately \$62,200 of total net adjustments was potentially reasonable, while approximately \$1,550 was unsupported and potentially inappropriate.

<sup>22</sup> See Methodology for further information.

<sup>23</sup> The former Clerk-Treasurer appropriately adjusted bills that were for actual vacant properties to vacancy rates after the system generated bills at the normal rate. Additionally, adjustments to bills for the discounted rate given for less than 2,000 gallons of water usage were deemed appropriate.

<sup>24</sup> \$64,000 reductions and \$300 additions

Because the Board did not provide sufficient oversight of Clerk-Treasurer operations and allowed the existence of significant unsupported account adjustments, we obtained and reviewed deposit compositions<sup>25</sup> to determine if any payments could be traced to adjustments made. We found two payments (from different deposits) for water and sewer totaling approximately \$400 where the payments were not recorded in the payment journal and adjustments were made to reduce the account balances to zero. These payments were deposited in the bank account. This could be evidence of a misappropriation by substituting these check payments for cash payments made by other customers.

Additionally, we sent confirmations to 23 water and sewer customers who had unauthorized adjustments reducing their account balances by more than \$150 during our audit period. Based upon the responses received, the adjustments appeared reasonable and we therefore determined that no further follow up was necessary.

The process for adjustments was amended after the Deputy Clerk-Treasurer alerted the Mayor and Board to a significant amount of unauthorized adjustments that had occurred over several years. The Clerk-Treasurer now provides an adjustment report to the Board each month for approval. Our review of adjustments for the April 2013 billings<sup>26</sup> did not identify any negative adjustments to customer accounts. Adjustments increasing account balances made during this quarter were adequately supported, and explanations for adjustments appeared to be appropriate.

Without adequate oversight of customer billings and collections, the Board was unaware of improper adjustments made by the former Clerk-Treasurer to customers' water and sewer accounts. As a result of these adjustments, the Village failed to realize potential revenues that it would have otherwise received had the adjustments not been made.

## **Payroll Taxes**

Employers are required to withhold appropriate State and Federal taxes from employee earnings. Payroll tax reporting and remitting must be performed in accordance with applicable State and Federal regulations. The failure to comply with these regulations can result in the employer being charged substantial interest and penalties.

The former Clerk-Treasurer filed delinquent and incorrect payroll tax reports and received multiple notices from the Internal Revenue Service (IRS) regarding these inaccurate filings and resulting interest and penalties. The Board was unaware of these notices and that

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<sup>25</sup> See Methodology for further details.

<sup>26</sup> April bills include usage from January-March.

the former Clerk-Treasurer paid interest and penalties to the IRS without its approval. Once Village officials became aware of the interest and penalties, after the former Clerk-Treasurer left Village employment, they began discussions with the IRS in an attempt to have these incurred additional fees reduced. As a result of the Board's lack of oversight, the Village was assessed substantial penalties and interest<sup>27</sup> for the audit period, totaling \$4,025.<sup>28</sup> As of the end of audit fieldwork, the Village had not yet paid these delinquent penalty and interest amounts.

## **Annual Audit**

Village Law requires that the Board annually audit, or have a Village officer, employee or certified public accountant audit, the records and reports maintained by the Clerk-Treasurer. This annual audit serves as an important internal control over cash receipts and disbursements by providing independent verification that transactions have been properly recorded and that cash has been properly accounted for. It also provides Board members with an added measure of assurance that the financial records and reports contain reliable information on which to base financial decisions.

The Board did not audit, or contract with an independent auditor to audit, the Clerk-Treasurer's records. The Mayor stated that he was unaware of the annual audit requirement. The Board's failure to perform or contract for an annual audit of the Clerk-Treasurer's records resulted in deficiencies in financial records and errors remaining undetected and uncorrected. Without an annual audit, the Board's management oversight authority and its ability to effectively monitor the Village's financial operations are significantly diminished, and there is an increased risk that Village funds could be mishandled.

## **Recommendations**

The Board should:

1. Review and update its policies annually, and establish written policies related to Village financial operations.
2. Review the duties of the Clerk-Treasurer and implement procedures to compensate for the lack of segregation of duties.
3. Ensure that the Clerk-Treasurer is meeting the fundamental responsibilities of the position by:
  - Ensuring moneys are disbursed based only on Board approved claims and certified payroll,

<sup>27</sup> After adjustments and abatements were considered by the IRS

<sup>28</sup> \$3,767 in penalties and \$258 in interest

- Requiring accounting records to be kept in an accurate and complete manner,
  - Requiring that cash per the accounting records is periodically reconciled to cash per the bank statement,
  - Requiring timely and accurate monthly and annual financial reports,
  - Requiring deposits to be made intact and
  - Ensuring that all required State and Federal payroll taxes are accurately prepared and timely filed and remitted.
4. Monitor financial activities by requesting and reviewing detailed interim financial reports. The reports should contain detailed information so that the Board has sufficient and appropriate information to make informed decisions regarding the Village's operations.
  5. Review and approve all adjustments made to customers' water and sewer accounts and ensure that they are adequately documented and supported.

## Information Technology

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

The Board has not established policies and procedures related to acceptable use, computer security, breach notification or online banking, and the Board has not adopted a disaster recovery plan to address potential disasters. Therefore, IT assets are at risk for unauthorized, inappropriate and wasteful use.

### Policies and Procedures

Policies and procedures over IT constitute good internal controls and provide criteria and guidance for computer related operations of a municipality. Effective protections of computing resources and data include an acceptable use policy that informs users about appropriate and safe use of Village computers, a security plan which identifies potential risks and how to reduce system threats, a breach notification policy that identifies actions to take if personal and confidential information is released to unauthorized parties and a disaster recovery plan with guidance for minimizing loss and restoring operations should a disaster occur.

Acceptable Use – An acceptable use policy defines the Board's intended use of equipment and computing software and the security measures that are designed to protect the Village's system and confidential information. The policy should address, but not necessarily be limited to, the acceptable use of the Internet and email, password security, access to and use of confidential information and the installation and maintenance of software on Village computers.

The Village has not established an acceptable use policy. Without comprehensive policies that explicitly convey the appropriate use of the Village's electronic equipment, Village officials cannot be assured that users are aware of their responsibilities and there are no consistent standards for which users are held accountable. The lack of an acceptable use policy increases the risk of inappropriate computer use (either intentional or accidental), which could potentially expose the Village to malicious attacks or compromise systems and data, including key financial and confidential information.

Computer Security – Computer users need to be aware of security risks and properly trained in practices that reduce the internal and external threats to the system. It is essential for Village officials to develop a formal, written security plan to document the process for evaluating and assessing security risks, to identify and prioritize potentially dangerous issues and to document the process for discussing and determining solutions. An effective IT security plan also includes provisions for the monitoring of computer use to ensure compliance, as well as provisions for policy enforcement. The implementation of effective IT policies and procedures facilitates the protection of computerized data resources from internal and external threats.

Village officials have not developed a formal, written computer security plan. Because of the failure to address potential security weaknesses and develop a written, enforceable security plan, areas that could be at risk may have been overlooked and informal policies and procedures to control risk may be inconsistently applied or ineffective. A lack of a formal security policy also leaves the Village vulnerable to the risks associated with individual use, including viruses, spyware and other forms of malware that could potentially be introduced through non-work-related websites or programs. The Village's IT assets are also more susceptible to loss or misuse when users are not aware of security risks and practices necessary to reduce those risks.

Breach Notification – State Technology Law requires local governments to establish an information breach notification policy. The policy should detail how employees would notify State residents whose private information was, or is reasonably believed to have been, acquired by a person without valid authorization. The disclosure should 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 Board has not adopted a breach notification policy. By failing to adopt an information breach notification policy, in the event that

private information is compromised, Village officials and employees may not understand or be prepared to fulfill their legal obligation to notify affected individuals.

Disaster Recovery – It is also essential that Village officials develop a formal disaster recovery plan that addresses the range of threats to the computerized system. The plan should focus on sustaining the entity’s critical business functions during and after service disruption. It is important that Village officials analyze data and operations to determine which are the most critical and what resources are needed to recover and support these operations in the event of an emergency. Once the disaster recovery plan is finalized, Village officials should distribute it to all responsible parties, periodically test procedures to make sure they work as intended and update the plan as needed.

The Board has not adopted a disaster recovery plan that addresses IT. Therefore, in the event of a disaster, Village personnel have no guidelines or plan to help minimize or prevent the loss of equipment and data or to provide guidance for implementing data recovery procedures. As a result, the Village’s IT assets are at an increased risk of loss or damage, and there could potentially be costly disruptions to operations.

## **Online Banking**

Online banking allows the convenience of moving money between bank accounts and to external accounts, reviewing transaction histories, reconciling accounts in real time and monitoring cash balances. GML allows local governments to disburse or transfer funds in their custody by means of electronic transfer.<sup>29</sup> Because connecting to the Internet is a necessary part of the online banking process, the Village’s online bank accounts must be monitored on a regular basis for unauthorized or suspicious activity. Wire transfers must be strictly controlled and closely monitored. Effective controls over wire transfers include a written policy that identifies authorized online banking activities and electronic funds transactions and establishes who may initiate, approve, transmit, execute, record and reconcile wire transfer transactions. At least two people should be involved in wire transfer transactions. The policy should segregate duties so that no one person is able to approve wire transfers and also transmit or execute the transaction. Ideally, the recording function should also be delegated to someone who does not have approval or transmittal duties.

<sup>29</sup> Electronic transfers include intra-bank transfers (between accounts within the same bank) and inter-bank, or wire, transfers (between banks).

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

The Village has one bank with which it conducts online banking, including electronic transfers. However, the Village does not have policies or procedures in place for monitoring online banking functions and transactions and does not have a written agreement with the bank to establish the conditions, authorizations and processes for safeguarding Village funds that are transferred electronically. There is no requirement in place for the bank to contact an independent Village official for verification of an electronic transfer. In the absence of a callback process to confirm a payment order, there are no controls to decrease the likelihood of errors, unauthorized transfers, or misappropriation of Village funds. In addition, the Clerk-Treasurer has the ability to initiate and transmit electronic transfers between bank accounts at the same bank without formal prior approval, increasing the risk that Village moneys could be transferred into unauthorized bank accounts. Without formal monitoring of online banking activities and a specific, written agreement that is understood and followed by all personnel involved, there is a risk that Village funds could be stolen or misused.

## **Recommendations**

6. The Village should adopt policies and procedures governing IT, including those related to acceptable use, computer security, breach notification and disaster recovery.
7. The Board should establish written policies and procedures that provide well-designed internal controls over on-line banking, including adequate segregation of duties. When duties cannot be adequately segregated, procedures should provide for independent review and prior approval of transactions.
8. Village officials should enter into a comprehensive agreement with the Village's bank that:
  - Establishes the process to be followed for electronic transfers of funds,

- Identifies the names and numbers of the bank accounts from which transfers may be made,
- Identifies the individuals authorized to request the transfer of funds and
- Requires the bank to contact an individual independent of the wire transfer process for authorization of all wire transfers.

## **APPENDIX A**

### **RESPONSE FROM LOCAL OFFICIALS**

The local officials' response to this audit can be found on the following pages. The response sufficiently explains the relevance of the information included in the attachments. Therefore, the attachments are not included.

July 28, 2014

New York State Office of The State Comptroller  
Division of Local Government and School Accountability  
110 State Street  
Albany NY 12236

To Whom It May Concern:

Response to the preliminary draft documents sent to the Village of Port Byron dated July 8, 2014.

First, I would take this opportunity to thank Ed Grant and the NYS Comptrollers Office for responding to our request for a professional look at the Village of Port Byron's financial status and recommendations to the Village to strengthen our financial system. The staff sent to work at Port Byron was very professional in all aspects of the job.

Now our response to the findings in the report. The Board and myself, The Mayor, realized before this was sent to us that we would get a strong rebuke for a lack of oversight, but it does seem in the report that it was over emphasized to a large degree. Our request for an audit came after we detected a strong feeling that our office needed a refresher and tightening up of policies and procedures. Complacency seemed to have set in at the level of Clerk/Treasurer. First we employed a financial firm out of Syracuse to examine how we approached business in the office, to review what we did and to make strong recommendations to "tighten" up procedures with stronger policies. They spent much time examining and finally came up with a report in May of 2012. The Board went through the report and instated new policies to take effect June 1, the start of the new fiscal year. In the last couple years more unexpended balances have been used for larger purchases by the Village. through hints from the Deputy Clerk, I realized there was still problems and called for a 3 month checkup by the firm once again to review how we had done. By the latter stages of September, the Clerk/treasurer resigned/retired and the Deputy Clerk, Janice Harwood, was put in charge.

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For the Hearing Impaired, please dial NYS RFI AY 1.800.662.1220

*"The Village of Port Byron is an equal opportunity provider and employer. To file a complaint of discrimination, write: USDA, Director, Office of Civil Rights,*

*1400 Independence Avenue, S.W., Washington, D.C. 20250-9410, or call 800.795.3272 (voice) or 202.720.6382 (TDD)."*

Now the truth of how the former Clerk/Treasurer conducted herself on her job. The deceit, lies, errors, not completing things and failure to meet obligations to the state and federal government. Yes, lack of oversight but when being lied to, and information being withheld, as one trustee stated, "she only told the board what she wanted us to know.", the records in shambles that had to be recreated to do the AUD of 2012, that is when I requested for the audit came about.

With the new Clerk/Treasurer and the new policies and procedures instituted by the Board of Trustees much headway had been made, to correct many areas of concern. To answer some of the findings that the former Clerk/Treasurer was responsible for such as adjustments in the water-sewer billing program, which in all probability occurred for a couple reasons, her lack of understanding what the program could do and the fact she refused to call the company and ask for help, I got the reply from the company itself when I and the new clerk called. The former Clerk/Treasurer was told if people had problems with bills they should address the board, She made her own adjustments illegally rather than have the public inform the board that she was making mistakes or adjusting bills. The former Clerk/Treasurer's submissions of IRS payments with penalties for late and incorrect filings. These went back farther than the audit period. Excess funds included reserve accounts and myself and the Board believed that they were established, as we had used them we believed properly.

I will include a copy of new policies instituted June 1, 2012 by the Board.

There were other discoveries made after the former Clerk/Treasurer was gone, such as, one check cashed in the bank, the she endorsed and left the bank with the cash, vouchers that were stuffed in folders that were never presented to the Board and these were some not to be pre-audited but she paid without board approval. She also made an exceptional amount of transfers in her bookkeeping without presenting them for authorization. Vouchers and checks were not numbered correctly in sequence because of her methods of doing things.

In summary, of a much lengthier response, again we can all agree lack of oversight by the Board and Mayor, but much of it was allowed by a degree of trust placed in a person everyone felt knew her job. As it turned out, she didn't and the Village suffered for it, both financially and reputation wise.

Sincerely,

Mayor Wilson and Village of Board of Trustees

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## **APPENDIX B**

### **AUDIT METHODOLOGY AND STANDARDS**

Our overall goal was to assess the adequacy of the internal controls and financial management practices put in place by officials to safeguard Village assets. 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: Board oversight, financial management, cash receipts and disbursements, purchasing, payroll and leave accruals, IT and internal financial operations of individual Village departments.

During the initial assessment, we interviewed appropriate Village officials, performed limited tests of transactions and reviewed pertinent documents, such as Village policies and procedures manuals, Board minutes and financial records and reports. Further, we reviewed the Village's internal controls and procedures over the computerized financial databases to determine if the information produced by such systems was reliable.

After reviewing the information gathered during our initial assessment, we determined where the greatest weaknesses existed and evaluated those weaknesses for the risk of potential fraud, theft or professional misconduct. We then decided on the reported objectives and scope by selecting for audit those areas most at risk. We selected Board oversight of the Clerk-Treasurer's duties and IT for further audit testing.

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

- We interviewed appropriate Village officials and reviewed pertinent documents, including Village policies, Board minutes, budgets and financial records and reports.
- We reviewed adjustments to cash balances for May 31, 2012 made by the Village based on bank reconciliations completed by a CPA firm the Village previously engaged.
- We randomly selected a sample of two months of claims and disbursements from the period that the former Clerk-Treasurer was employed (December 2011) and the period after the former Clerk-Treasurer retired (November 2012) to review for proper itemization, supporting documentation and reasonableness. We also compared cash receipts journal, duplicate deposit slips, register tapes with the summary of activity, summary deposit report and bank statements to determine if receipts were deposited and deposits were properly recorded.
- We compared 2011-2012 financial information for the general, water and sewer funds with the 2011-2012 Annual Financial Report submitted to OSC by randomly selecting a sample of accounts from each of assets, liabilities, revenues and expenditures, to determine if reported information agreed with the accounting records.
- We selected October 2011 to further assess the reliability of financial records. We compared financial records to bank statement activity for reliability.

- We randomly selected the July 2011 billing quarter by using a random number generator, which selected one quarterly billing cycle from the portion of our audit period that the former Clerk-Treasurer was employed due to prior issues identified, to re-calculate customer water and sewer bills and penalties to determine accuracy, and compared the total amount billed to the total amount collected for the quarter to determine any difference.
- We reviewed, totaled and summarized all water and sewer account adjustments made during our audit period and determined whether adjustments were made by the former Clerk-Treasurer or current Clerk-Treasurer.
- We randomly selected 20 customer account adjustments from our audit period by using a random number generator that selected adjustments from a sample arranged by date. We assessed the reasonableness of adjustments by reviewing supporting documentation and through discussion with the Clerk-Treasurer.
- We randomly selected two quarters for testing by selecting one quarter from the period before and one from the period after the former Clerk-Treasurer left employment. Our selection periods included June 2011 through September 2012 and October 2012 through May 2013. We reviewed all adjustments made during each of these quarters to determine if adjustments were supported and appropriate.
- We sent water and sewer account confirmations to 23 customers, by determining all customer accounts with adjustments during the audit period and selecting those accounts with negative adjustments greater than \$150 for confirmation.
- We obtained deposit compositions containing canceled check images from the Village's bank for June through August 2011 and March through May 2013. We then traced the detail (individuals and amounts) to duplicate tax bills or water and sewer sales reports to determine the completeness of deposits and financial system daily deposit/payment records to determine if deposits were recorded as payments.
- We reviewed quarterly account transcripts received from the IRS for 2011 and 2012 to determine interest and penalties assessed for late or incorrect filing of Federal payroll taxes for each quarter and adjusted these amounts by these interest and penalties that were later abated or removed by the IRS.
- We calculated unexpended surplus funds for the general, water and sewer funds for 2012-13 using May 2012 through April 2013 bank statements, June 2012 water and sewer sales reports, 2012-13 claims, abstracts and deposit slips. We also reviewed appropriated fund balance estimates for 2013-14 and considered these figures when determining unexpended surplus funds.
- We discussed IT controls with Village officials and, through physical observation, determined if these assertions were valid.
- We obtained and analyzed computerized data for the audit period using the Audit Command Language software to identify and review unusual transactions.

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

## **APPENDIX C**

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