



Village of Speculator Financial Condition

Report of Examination

Period Covered:

June 1, 2009 — August 31, 2013

2013M-381



Thomas P. DiNapoli

Table of Contents

	Page
AUTHORITY LETTER	2
INTRODUCTION	3
Background	3
Objective	3
Scope and Methodology	3
Comments of Local Officials and Corrective Action	3
FINANCIAL CONDITION	5
Recommendations	8
APPENDIX A Response From Local Officials	9
APPENDIX B Audit Methodology and Standards	11
APPENDIX C How to Obtain Additional Copies of the Report	13
APPENDIX D Local Regional Office Listing	14

State of New York Office of the State Comptroller

Division of Local Government and School Accountability

April 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 Board of Trustees 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 Speculator, entitled Financial Condition. 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 Speculator (Village) is located in the Town of Lake Pleasant in southern Hamilton County. The Village encompasses 45 square miles and has approximately 320 residents. 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 management and control of the Village's financial affairs, including establishing internal controls over financial operations. The Village Clerk/Treasurer, as chief financial officer, is responsible for receiving, disbursing and maintaining custody of Village moneys in addition to maintaining accounting records.

The Village provides various services to its residents, including general government support, street maintenance and improvement, snow removal, lighting, fire protection, recreation and cultural activities, refuse collection, recycling and water and sewer services. The Village accounts for most of its financial activity in the general, water and sewer funds. For the 2013-14 fiscal year, the Village's adopted appropriations are approximately \$1.7 million, funded primarily with real property taxes and water and sewer charges.

Objective

The objective of our audit was to review the Village's financial condition. Our audit addressed the following related questions:

- Did the Board effectively manage the Village's financial condition?

Scope and Methodology

We examined the Village's financial condition and budgeting practices for the period of June 1, 2009 through August 31, 2013.

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.

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 Clerk's office.

Financial Condition

A key measure of the Village's financial condition is its level of fund balance, which is the difference between revenues and expenditures accumulated over time. The Village may retain a reasonable level of unexpended surplus funds¹ as a financial cushion in the event of unforeseen financial circumstances. When maintained at reasonable levels, fund balance provides cash flow and can be used to help finance the next fiscal year's operations. When a fund does not have sufficient cash to meet its current obligations, governing officials are often forced to explore options such as obtaining loans from other funds.²

The Board did not effectively manage the Village's financial condition. The Board did not develop sound revenue budget estimates; it also failed to increase water and sewer rates, which drive the revenues in these funds. As a result, water and sewer revenues were overestimated by an average of 25 percent and 21 percent, respectively, which caused fund balance to decrease significantly in both funds from fiscal years 2009-10 through 2011-12. Unplanned operating deficits caused both the water and sewer funds to have a deficit fund balance. As shown in Table 1, over a four-year period, the deficit fund balance in the water fund grew by a total of \$61,274, or 51 percent,³ while the sewer fund balance declined by a total of \$42,974, or 132 percent. Although both funds had an operating surplus in the 2012-13 fiscal year, the funds still ended the year with deficit fund balances of \$181,522 in the water fund and \$10,424 in the sewer fund. The Village's general fund loaned moneys to these funds to offset the funds' deficit balances. Furthermore, the poor financial condition of the water and sewer funds has negatively impacted the cash flow of the Village's general fund.

¹ The Government Accounting Standards Board (GASB) issued Statement 54, which replaces the fund balance classifications of reserved and unreserved with new classifications: nonspendable, restricted and unrestricted (comprising committed, assigned and unassigned funds). The requirements of Statement 54 are effective for fiscal years ending June 30, 2011 and beyond. To ease comparability between fiscal years ending before and after the implementation of Statement 54 we will use the term "unexpended surplus funds" to refer to that portion of fund balance that was classified as unreserved, unappropriated (prior to Statement 54), and is now classified as unrestricted, less any amounts appropriated for the ensuing year's budget (after Statement 54).

² General Municipal Law authorizes Villages to temporarily advance moneys that are not immediately needed in one fund to any other fund.

³ From a deficit of \$120,248 at the beginning of fiscal year 2009-10 to a deficit of \$181,522 at the end of fiscal year 2012-13

Table 1: Water and Sewer Funds Financial Condition

Water Fund				
	FY 2009-10	FY 2010-11	FY 2011-12	FY 2012-13
Beginning (Deficit) Fund Balance	(\$120,248)	(\$133,407)	(\$174,129)	(\$212,536)
Results of Operations	(\$13,159)	(\$40,722)	(\$38,407)	\$31,014
Ending Unexpended (Deficit) Fund Balance	(\$133,407)	(\$174,129)	(\$212,536)	(\$181,522)
Sewer Fund				
	FY 2009-10	FY 2010-11	FY 2011-12	FY 2012-13
Beginning (Deficit) Fund Balance	\$32,550	\$15,161	(\$42,453)	(\$53,818)
Results of Operations	(\$17,389)	(\$57,614)	(\$11,364)	\$43,394
Ending Unexpended (Surplus/Deficit) Fund Balance	\$15,161	(\$42,453)	(\$53,817)	(\$10,424)

The unplanned deficits in the water and sewer funds were caused by the Board overestimating water and sewer rent revenues.⁴ The Board did not adopt budgets which contained realistic water and sewer rent revenue estimates based on historical and other relevant information.⁵ Instead, the Board overestimated water and sewer revenues, by an average of approximately 25 percent for water revenues and 21 percent for sewer revenues, in the 2009-10 through 2012-13 adopted budgets, as shown in Table 2.

Table 2: Water and Sewer Revenue Estimates

Water Rent Revenues					
	FY 2009-10	FY 2010-11	FY 2011-12	FY 2012-13	FY 2013-14
Budgeted Revenues	\$193,727	\$213,231	\$220,025	\$225,299	\$251,432
Actual/Projected Revenues ^a	\$150,121	\$151,974	\$178,811	\$210,889	\$212,239
Variance	(\$43,606)	(\$61,257)	(\$41,214)	(\$14,410)	(\$39,193)
Sewer Rent Revenues					
	FY 2009-10	FY 2010-11	FY 2011-12	FY 2012-13	FY 2013-14
Budgeted Revenues	\$264,246	\$262,494	\$262,861	\$273,143	\$298,649
Actual/Projected Revenues ^b	\$187,649	\$206,178	\$229,207	\$266,388	\$268,288
Variance	(\$76,597)	(\$56,316)	(\$33,654)	(\$6,755)	(\$30,361)

^a We projected 2013-14 fiscal year water rent revenues by applying the increase in the water rate to the 2012-13 fiscal year gallons billed.

^b We projected 2013-14 fiscal year sewer rent revenues by applying the increase in the sewer rate to the 2012-13 fiscal year estimated gallons billed.

The Board overestimated water rent revenues by between \$14,410 and \$61,257 from the 2009-10 fiscal year to the 2012-13 fiscal year. Similarly, the Board overestimated sewer rent revenues by between \$6,755 and \$76,597 during the same period. While the water and sewer rent revenue estimates were more realistic in 2012-13 compared to prior years, we projected the Village's 2013-14 estimated revenues for both water and sewer rents to be overestimated by at least \$30,000 each.

⁴ The water and sewer funds are financed primarily by user charges for water and sewer services.

⁵ Such as the number of customers, historical usage and established rates

Although the Board increased the 2013-14 revenue estimates for both water and sewer rents,⁶ it did not support the revenue estimate increases by also raising water and sewer rates accordingly. For the 2013-14 fiscal year, the Board only raised the water usage rate by \$0.06 per 1,000 gallons. When we projected⁷ the rate increase, we found that it will only raise an additional \$1,350 of water rent revenue in 2013-14, which is \$39,193 less than the Board estimated for water rent revenue in the 2013-14 budget. The Board also increased the sewer rent usage rate by \$0.10 per 1,000 gallons of water used.⁸ We projected the increase in the sewer rate and found that it will only generate an additional \$1,900 of revenues in 2013-14, which is \$30,361 less than the sewer rent revenues estimate in the 2013-14 budget. The practice of increasing revenue estimates without adequately increasing the rates that drive those revenues puts the Village in a position where it will regularly fall short of revenue estimates.

Additionally, the deficit fund balances in the water and sewer funds caused both funds to experience cash flow problems. As a result, the general fund loaned moneys to the water and sewer funds to provide cash to pay obligations, as shown in Table 3.

Table 3: Water and Sewer Funds Cash Position at End of Year				
Water Fund				
	FY 2009-10	FY 2010-11	FY 2011-12	FY 2012-13
Total Cash Balance	\$15,572	\$7,079	\$1,629	\$1,000
Average Monthly Expenditures	\$14,497	\$16,341	\$18,602	\$15,514
Interfund Loans Due to the General Fund from the Water Fund	\$166,731	\$193,940	\$232,624	\$208,539
Sewer Fund				
	FY 2009-10	FY 2010-11	FY 2011-12	FY 2012-13
Total Cash Balance	\$39,690	\$31,196	\$1,902	\$1,000
Average Monthly Expenditures	\$19,420	\$22,546	\$20,412	\$18,914
Interfund Loans Due to the General Fund from the Sewer Fund	\$56,682	\$93,010	\$80,850	\$43,848

The water and sewer funds both reported minimal cash balances at the end of the last four fiscal years and these small cash balances were offset by substantial interfund loan balances owed to the general fund. As of May 2013, the water and sewer funds both had cash balances of \$1,000 each, while the water fund owed \$208,539 and the sewer fund owed \$43,848 to the general fund. Had the general fund not made these loans to the water and sewer funds, both funds would have had

⁶ The Village increased the 2013-14 water rent revenue estimate by more than \$26,000 from the 2012-13 estimate and increased the 2013-14 sewer rent revenue estimate by more than \$25,000 from the 2012-13 estimate.

⁷ Based on the gallons of water used in the 2012-13 fiscal year

⁸ The usage rate for sewer customers is also based on the number of gallons of water used.

material deficit cash balances and would not have been able to meet their cash flow needs. The failure to repay these interfund loans in a timely manner also caused cash flow problems in the general fund, as shown in Table 4.

Table 4: General Fund Financial Condition at End of Year				
	FY 2009-10	FY 2010-11	FY 2011-12	FY 2012-13
Unexpended Surplus Fund Balance	\$326,634	\$309,627	\$489,266	\$322,689
Unexpended Surplus Fund Balance as a Percentage of Appropriations	36%	35%	55%	29%
Total Cash Balance	\$3,492	(\$24,045)	\$78,172	\$107,505
Average Monthly Expenditures	\$67,055	\$71,286	\$73,350	\$88,116
Interfund Loans Due to the General Fund from the Water and Sewer Funds	\$223,413	\$286,950	\$313,474	\$252,387

The Village's general fund had substantial unexpended surplus funds of between 29 and 55 percent of budgetary appropriations at the end of each fiscal year. However, the general fund's cash position was restricted because the ending cash balance was less than the amount of average monthly expenditures in the 2009-10 and 2010-11 fiscal years. Furthermore, as of May 31, 2011, the general fund reported a deficit cash balance of \$24,045. The general fund's cash flow problems were caused by the significant outstanding interfund loans made to the water and sewer funds. While the general fund's cash balance has steadily increased over the past three years, the water and sewer funds' unstable financial positions may cause future cash flow issues for the general fund if additional interfund loans are made and not repaid in a timely manner. It is essential that, going forward, Village officials implement and maintain reasonable budgeting practices to eliminate the deficits in the water and sewer funds and make provisions to repay their outstanding loans to the general fund.

Recommendations

1. The Board should develop and adopt budgets that include realistic estimates for revenues and expenditures, particularly the revenue estimates for water and sewer rents.
2. The Board should review all outstanding interfund loans in the water and sewer funds and take action to repay them as soon as possible.
3. The Board should develop a plan to eliminate the fund balance deficits in the water and sewer funds and improve the financial condition of these funds in a timely manner.

APPENDIX A

RESPONSE FROM LOCAL OFFICIALS

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

MAYOR
Letty J. Rudes

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Karen McComb
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VILLAGE CLERK-TREASURER
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March 28, 2014

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RE: Village of Speculator Financial Condition Report of Examination

The Village of Speculator received the NYS Comptroller's draft audit report covering the period of June 1, 2009 – August 31, 2013. The Board of Trustees reviewed the draft and the mayor and clerk-treasurer met with representatives from OSC on March 5, 2014. The Village Board appreciates the efforts of OSC in putting the report together and the professional way the audit was conducted. The Village Board offers the following as a response and Corrective Action Plan.

We concur with the findings and results of the audit and agree that the situation warrants examination. With the current budget process, the Board is in working toward realistic estimates and to balance expenses with income at a rate that will be acceptable by the users. The outstanding interfund loans will be paid back gradually as the increase in fees and its affect on the customers will allow. There is a true desire of the Board of Trustees to have the Water and Sewer Funds self-supporting to alleviate the stress on the General Fund. Knowing that this situation was not created overnight, it is understandable that it will not be corrected in a short period of time.

We thank the auditors for their report and plan to work consistently on remediation.

Sincerely,

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APPENDIX B

AUDIT METHODOLOGY AND STANDARDS

Our overall goal was to assess the Village's financial condition and adequacy of the internal controls put in place by Village officials to safeguard Village assets and monitor financial activities. To accomplish this, we performed an initial assessment of the Village's financial condition and internal controls so that we could design our audit to focus on those areas most at risk.

During the initial assessment, we interviewed appropriate Village officials, performed limited tests of transactions and reviewed pertinent documents, such as Village policies, 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 on the reported objective and scope by selecting for audit those areas most at risk. We selected the financial condition for further review.

To accomplish our audit objective and obtain relevant audit evidence, our procedures included the following:

- We interviewed the Mayor, Trustees, and the Clerk/Treasurer to gain an understanding of the Village's financial management policies and procedures. This included inquiries about the Village's budgeting practices and the development of plans to maintain the Village's fiscal stability.
- We reviewed the Village's accounting records for the general fund, sewer fund and water fund for fiscal years 2011-12, 2012-13 and 2013-14, as of August 31, 2013, to ensure that they were complete and accurate. Specifically, we reviewed balance sheet accounts to verify that they were properly recorded and supported, and revenues and expenditures to verify that they were supported and recorded in the proper fund.
- We compared the adopted budgets for the general fund, sewer fund and water fund for fiscal years 2009-10 through 2012-13 with the actual results of operations to determine if the budgets were realistic.
- We performed additional analysis for those revenue estimates we identified as unrealistic, including reviewing historic trends and transactions and identifying and reviewing other relevant information such as user charge rates. We also interviewed officials to gain an understanding of the methodology used to estimate these revenues.
- We analyzed the Village's financial records for the general fund, sewer fund, and water fund for fiscal years 2009-10 through 2012-13 to determine if these funds' financial condition had declined. We also evaluated any factors contributing to any declines.
- We reviewed the Village's accounting records to determine all of the interfund loans that were made and to determine if they were repaid.

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

APPENDIX C

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