



Chautauqua Utility District Banking

Report of Examination

Period Covered:

January 1, 2014 – March 27, 2017

2017M-121



Thomas P. DiNapoli

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State of New York Office of the State Comptroller

Division of Local Government and School Accountability

October 2017

Dear District 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 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 Chautauqua Utility District, entitled Banking. This audit was conducted pursuant to Article V, Section 1 of the State Constitution and the State Comptroller's authority as set forth in Article 3 of the New York State General Municipal Law.

This audit's results and 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 Chautauqua Utility District (District) is located within the Town of Chautauqua in Chautauqua County. The District was established by an act of the New York State Legislature in 1934 (Act) and provides water, sewer and lighting services to approximately 1,400 customers located in and around the Chautauqua Institution.¹ The Act, which has been amended from time to time, provides basic guidelines for the administration of the District's affairs. The District is governed by an elected five-member Board of Commissioners (Board) which includes a Chairman, Secretary and Treasurer. The Board is responsible for the general management and oversight of District financial and operational affairs.

The Operations Superintendent (Superintendent) is responsible for the general management of District operations under the Board's direction. The District employs an administrative assistant (assistant) who is responsible for all accounting functions, which includes collecting and depositing cash, recording all cash activity in the accounting records and preparing bank reconciliations.

Budgeted appropriations for 2016 totaled approximately \$1.3 million, which were funded primarily with water and sewer rents and real property taxes.

Objective

The objective of our audit was to determine if banking transactions are adequately safeguarded. Our audit addressed the following related question:

- Do the Board and District officials properly monitor banking activities?

Scope and Methodology

We examined the District's banking practices for the period January 1, 2014 through March 27, 2017.

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. Unless otherwise indicated in this report, samples for testing were selected based on professional judgment, as it was not the intent to project the results onto the entire population. Where applicable, information is presented concerning the value and/or size of the relevant population and the sample selected for examination.

¹ A not-for-profit 750-acre community located near Chautauqua Lake.

**Comments of District
Officials and Corrective
Action**

The results of our audit and recommendations have been discussed with District officials, and their comments, which appear in Appendix A, have been considered in preparing this report. District officials generally agreed with our recommendations and indicated they plan 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 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 Secretary's office.

Banking

The Board should adopt written policies and procedures designed to ensure that cash is safeguarded, including disbursements by check and electronic transactions. For example, the policy should ensure that cash disbursements, whether electronic or by check, are supported and approved and that there is a proper segregation of duties.

The Board has not adopted comprehensive written policies or adequately segregated financial duties to properly monitor banking activities. Although our review did not indicate any inappropriate banking activity, we found payments were made without Board approval. Further, the Board did not provide sufficient oversight over the assistant whose duties were inadequately segregated. As a result, there is an increased risk that cash payments or electronic transfers may be made for inappropriate purposes and not be detected in a timely manner.

Electronic Transactions

The District should have a comprehensive policy that addresses online banking activities. The policy, at a minimum, should include a description of the type of online transactions allowable, who will authorize and record online transactions and who will have access to conduct online banking. The policy should address any legal responsibilities for conducting online banking. Employees who execute electronic transfers should not prepare or record entries in the accounting records or reconcile bank accounts. When it is impractical to segregate these duties, a compensating control, such as supervisory reviews of these transactions, should be implemented.

The Board did not adopt any written comprehensive online banking policies. The District uses online banking services to pay bills, make debt service payments, remit employee payroll tax withholdings to the State and federal governments and fund the District's pension plan.² However, the Board has not adequately segregated the assistant's duties or provided sufficient oversight over these transactions. For example, the assistant has the ability to initiate and process bill payments, including pension payments, without Board review and record these transactions in the accounting records.

We reviewed 303 electronic payroll transfers totaling approximately \$1.26 million, nine electronic transfers for debt payments³ totaling

² The propriety of whether it is permissible to participate in this type of plan was not within the scope of our audit.

³ District officials told us that to process an electronic transfer a Board member accompanies the assistant to the bank where the transfer is processed.

\$345,700 and 48 electronic withdrawals from the pension account, for contributions and administrative fees, totaling \$118,790. All these transactions were for legitimate purposes.

Without comprehensive policies and procedures that adequately segregate duties and provide sufficient oversight, there is an increased risk that questionable online banking activity could occur and not be detected in a timely manner.

Cash Disbursements

The Act requires that “all bills against the District shall be vouchered and audited by the Board... and shall be paid by check of the District... and countersigned by any two officers thereof.” The Superintendent reviews and approves the claims, and the assistant prepares the checks and a report listing all checks (check list) and presents them along with the claims to the Board for review and approval.

Although the Board reviews the check lists and approval is noted in the Board minutes, it does not routinely review the claims or compare the checks to the claims as part of the audit and approval process. Therefore, if a check were missing from the check list, Board members would be unaware a check was issued unless they signed the check.

We identified 68 checks that were either not listed or listed as void.⁴ Eighteen (26 percent) of these checks totaling \$4,740 cleared the bank. For example, four utility payments totaling \$2,096, a \$1,000 consulting fee and a \$507 health insurance payment were not on the check list but cleared the bank. All these checks appeared to be for legitimate purposes and were recorded in the accounting records. Furthermore, all but three checks were countersigned by two Board members.

District officials made 66 online vendor payments totaling \$3,914. One recurring bill payment⁵ was not included on the check list but was recorded as a disbursement via a journal entry, thus circumventing the Board’s audit and approval process. Because Board members did not routinely review journal entries the Board cannot be assured that all disbursements are recorded. Additionally, when the Board does not audit all payments, there is an increased risk that the District could pay for goods and services that are improper expenditures.

Bank Reconciliations

Preparing bank reconciliations provides a way for officials to identify, correct and document differences between the District’s records and

⁴ The assistant told us that voided checks are not retained on file.

⁵ A \$25 monthly charge for video conferencing services was not included on the check list. Another recurring monthly payment of approximately \$63 for insurance was included.

bank statements. Such reconciliations permit timely identification and correction of errors. Reconciliations should be prepared by an official or employee who is independent of the cash receipts and disbursements process. Someone other than the individual preparing the reconciliations should review them. The person who prepares the bank reconciliation should scan check images to identify any improper or suspicious payees and ensure checks are signed by the appropriate officials.

In addition, procedures should be in place to identify and respond to potential fraudulent activity. Bank accounts should be routinely monitored for unauthorized or suspicious transactions. Further, as part of the reconciliation process it is important District officials review cash balances to determine whether cash clearing accounts have excessive balances. For example, the District deposits employee tax withholdings in a separate payroll bank account, and subsequently disburses the funds to the State and federal governments. The District should not have more cash in these accounts than is needed.

The Board did not ensure that bank reconciliations, statements or canceled check images were reviewed to detect potential improper payments or unauthorized transactions. The Board and District officials did not act on the external auditor's recommendations, made over the past several years, to review bank reconciliations.⁶ Additionally, District officials did not periodically analyze the payroll or pension bank accounts to determine whether cash balances were higher than necessary.

We reviewed canceled check images for 32 disbursements totaling \$41,637 to determine whether there were any inappropriate disbursements or transactions. Except for a few minor exceptions, which we discussed with officials, all checks were supported and appeared to be for legitimate purposes. We also reviewed the bank reconciliations as of December 31, 2016⁷ and found that reported cash balances reconciled with the bank statement balance.

Our analysis of electronic transfers to the payroll and pension accounts showed an unidentified balance totaling approximately \$3,100 in the payroll account and an unidentified balance totaling approximately \$3,900 in the pension account, which could result in unauthorized use of these funds. District officials hold cash in these accounts as custodian and any cash balances should be paid to other agencies.

⁶ This recommendation was included in the external auditor's management letter to District officials in 2014, 2015 and 2016.

⁷ For the operating, payroll, pension and construction checking accounts and operating savings account.

Without proper oversight errors and irregularities could occur and not be detected and corrected in a timely manner. Further, without Board adopted policies and procedures, District officials cannot be certain that cash assets are properly accounted for, approved for payment and for legitimate District purposes.

Recommendations

The Board should:

1. Develop policies and procedures for banking activities, which include segregating duties and monitoring and overseeing transactions.
2. Ensure that District officials routinely conduct a timely analysis of the payroll and pension bank accounts.

The Assistant should:

3. Ensure that check lists include all check disbursements and retain all voided checks.
4. Conduct an analysis of the payroll and pension accounts to determine the nature and source of the excess money held in these accounts.

APPENDIX A

RESPONSE FROM DISTRICT OFFICIALS

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



P. O. Box M, Chautauqua, NY 14722 · 716-357-5865 · cud@windstream.net

September 18, 2017

Jeffrey D. Mazula, Chief Examiner
New York State Comptroller
295 Main Street, Suite 1032
Buffalo, NY 14203-2510

Dear Mr. Mazula:

At its monthly meeting held on September 14, 2017, the Chautauqua Utility District Board of Commissioners voted to accept the draft findings of your office regarding banking and other financial controls of the district.

The Chautauqua Utility District will meet with its legal and financial advisors to begin working on a corrective action plan including the implementation of, and documentation of, additional finance and banking safeguards. We will diligently work on these matters with the anticipation of being able to provide your office with the corrective action plan within 90 days from receipt of the final report.

We look forward to finalizing this matter with your office.

Very truly yours

Robert McClure
Chairman, Board of Commissioners

APPENDIX B

AUDIT METHODOLOGY AND STANDARDS

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

- We interviewed Board members and District employees to gain an understanding of current banking practices and activities.
- We obtained bank account information from bank officials.
- We reviewed Board minutes for the approval of claims.
- We scanned check sequences on check lists prepared between January 1, 2014 and December 31, 2016 to identify missing check numbers and determine whether these checks cleared the bank.
- We reviewed canceled check images for the period January 1, 2014 through December 31, 2016 to determine whether there were any payments made to unusual vendors, unusual payments (e.g., cash) or payments to employees. Based on our review, we judgmentally selected 32 checks totaling \$41,637 to determine whether these payments were proper expenditures.
- We reviewed all electronic transfers made from January 1, 2014 through December 31, 2016 to determine if they were appropriate transactions and discussed any unsupported transfers with District officials.
- We reviewed the prepared bank reconciliations as of December 31, 2016 and compared them to recorded cash balances to determine whether the balances agreed.
- We reviewed the transfers into the pension (approximately \$122,000) and payroll (approximately \$1.26 million) accounts made from January 1, 2014 through December 31, 2016 and compared them to corresponding account disbursements to determine whether there were any residual balances in these accounts.

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

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