



Town of Henrietta

Financial Management and Purchasing

Report of Examination

Period Covered:

January 1, 2011 — March 29, 2013

2013M-208



Thomas P. DiNapoli

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State of New York Office of the State Comptroller

Division of Local Government and School Accountability

January 2014

Dear Town 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 Town 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 Town of Henrietta, entitled Financial Management and Purchasing. This audit was conducted pursuant to Article V, Section 1 of the State Constitution and the State Comptroller's authority as set forth in Article 3 of the General Municipal Law.

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

Respectfully submitted,

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



State of New York Office of the State Comptroller

EXECUTIVE SUMMARY

The Town of Henrietta is located in Monroe County. The Town provides various services to its residents including street maintenance, snow removal, sewer, drainage, parks and recreation, library and general government support. Budgeted appropriations totaled approximately \$17 million for 2012. The Town is governed by an elected Town Board (Board) which comprises four Council members and a Town Supervisor (Supervisor). The Board is responsible for the general oversight and control of the Town's financial affairs. The Supervisor is the chief executive officer and the chief fiscal officer.

Scope and Objective

The objective of our audit was to review the Town's financial management and internal controls over purchasing for the period January 1, 2011 through March 29, 2013. We extended our scope back to January 1, 2008 to compare fund balance and actual revenue and expenditure amounts to budgeted amounts for trend analysis. Our audit addressed the following related questions:

- Did the Board provide adequate oversight of the Town's budgeting and financial operations to ensure Town resources are used effectively?
- Did the Board establish adequate internal controls over purchasing to ensure that Town resources were used only as authorized and effectively?

Audit Results

The Board and Town officials have not developed long-term financial plans, policies or procedures to govern budgeting practices and the level of unexpended surplus funds to maintain. Lacking an established financial plan and budgetary guidance, the Board has adopted budgets that were not based on sound and realistic estimates of revenues and expenditures, and the Town has accumulated a significant amount of unexpended surplus funds.¹ For example, the general and drainage district funds had unexpended surplus funds totaling approximately \$10.7 million and \$2 million at the end of the 2012 year. These amounts represented 164 and 321 percent of 2012 expenditures.

¹ The Governmental 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).

Also, the Board did not provide sufficient oversight over financial operations, or establish and monitor policies and procedures to help ensure that the Supervisor properly accounted for all financial activity and adequately segregated financial duties. As a result, the Supervisor's reports provided to the Board were not sufficient to monitor the Town's finances. Additionally, the Supervisor maintained more bank accounts than were necessary and did not properly account for all Town activity and cash balances, in sufficient detail, or in the correct funds. Finally, the Supervisor assigned incompatible duties to the payroll clerk and did not provide sufficient oversight as a compensating control.

We found that the Town did not develop adequate policies and procedures over the use of credit cards. The Town also did not monitor compliance with its code of ethics policy and entered into contracts that resulted in a Board member having a prohibited interest pursuant to article 18 of the General Municipal Law. Additionally, the Town did not implement policies or procedures to help properly classify individuals as independent contractors or employees, and made payments totaling \$175,000 to four individuals as independent contractors, who likely should have been treated and compensated as employees. If the Town incorrectly classifies an employee as an independent contractor, it can be held liable for employment taxes for that worker and possibly be assessed a penalty.

Comments of Town Officials

The results of our audit and recommendations have been discussed with Town officials and their comments, which appear in Appendix A, have been considered in preparing this report. Town officials were not in total agreement with portions of our budgeting findings, but indicated they will take corrective action related to the majority of the findings. Appendix B contains our comments on issues raised in the Town's response.

Introduction

Background

The Town of of Henrietta is located in Monroe County. The Town covers approximately 35 square miles and has a population of about 43,000. The Town provides various services to its residents including street maintenance, snow removal, sewer, drainage, parks and recreation, library and general government support. Most of the expenditures incurred in providing these services are accounted for in the general and highway funds. The Town also maintains special revenue funds to account for financial activity of various special districts and specific activities such as sewer operations and the Town library.² The Town's budgeted appropriations for the 2012 fiscal year were approximately \$17 million, funded primarily with real property taxes, sales tax and sewer charges.

The Town is governed by an elected Town Board (Board) which comprises four Council members and a Town Supervisor (Supervisor). The Board is responsible for the general oversight and control of the Town's financial affairs. The Supervisor is the chief executive officer and the chief fiscal officer. As the chief fiscal officer, the Supervisor is responsible for the custody of Town moneys, maintaining accounting records, preparing the budget subject to Board approval and preparing monthly and annual financial reports. The Finance Office includes two full-time and one part-time staff, who process financial transactions and maintain accounting records on the Supervisor's behalf.

Objective

The objective of our audit was to review the Town's financial management and internal controls over purchasing. Our audit addressed the following related questions:

- Did the Board provide adequate oversight of the Town's budgeting and financial operations to ensure Town resources are used effectively?
- Did the Board establish adequate internal controls over purchasing to ensure that Town resources were used only as authorized and effectively?

Scope and Methodology

We examined financial management and internal controls over purchasing of the Town of Henrietta for the period January 1, 2011 through March 29, 2013. We extended our scope back through January 1, 2008 to compare fund balance and actual revenue and expenditure amounts to budgeted amounts for trend analysis.

² These funds may have different tax bases than the general and highway funds, which encompass the area served by the special district.

**Comments of
Town Officials and
Corrective Action**

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

The results of our audit and recommendations have been discussed with Town officials and their comments, which appear in Appendix A, have been considered in preparing this report. Town officials were not in total agreement with portions of our budgeting findings, but indicated they will take corrective action related to the majority of the findings. Appendix B contains our comments on issues raised in the Town's response.

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 Town Clerk's office.

Financial Management

The Board is responsible for making sound financial decisions that balance the level of services desired and expected by the Town's residents with the ability and willingness of the residents to pay for such services. It is important that the Board adopt long-term plans that set forth the Town's financial objectives and goals, as well as written policies and procedures to govern budgeting practices and the level of fund balance³ to maintain in each fund, including established reserves. The Board should adopt budgets that include realistic estimates of revenues and expenditures, and that use surplus fund balance as a funding source, when appropriate. The Board may retain a reasonable portion of unexpended surplus funds⁴ to be available in the event of unforeseen circumstances. The Board may also establish and place moneys into reserve funds to finance the future costs of a variety of items or purposes.⁵ The Board's responsibility to effectively manage the Town's finances includes monitoring the Town's bank accounts and control over cash to ensure that it is properly safeguarded. Additionally, the Board should ensure that the Supervisor properly accounts for and reports all Town financial activity and adequately segregates financial duties among Town employees.

The Board and Town officials have not developed long-term financial plans, policies, or procedures to govern budgeting practices and the level of unexpended surplus funds to maintain. Lacking an established financial plan and budgetary guidance, the Board has adopted budgets that were not based on sound and realistic estimates of revenues and expenditures, and the Town has accumulated a significant amount of unexpended surplus funds. Also, the Board did not provide sufficient oversight over financial operations, or establish and monitor policies

³ Fund balance represents the resources remaining from prior fiscal years that can be used as funding sources in the next year's budget to reduce the amount of revenues needed to be raised from other sources.

⁴ The Governmental 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).

⁵ The statutes under which reserve funds are established determine how they may be funded, expended and discontinued. The Board is responsible for ensuring that reserve funds are maintained in accordance with statutory requirements and are in the best interest of the Town.

and procedures to help ensure that the Supervisor properly accounted for all financial activity and adequately segregated financial duties. As a result, the Supervisor's reports provided to the Board were not sufficient to monitor the Town's finances. Additionally, the Supervisor maintained more bank accounts than were necessary and reasonable to meet legal and accounting requirements. He also did not properly account for all town activity and cash balances, in sufficient detail, or in the correct funds. Moneys were reported in the Trust and Agency account that should have been reported in the operating funds. Finally, the Supervisor assigned incompatible duties to the payroll clerk and did not provide sufficient oversight and review.

Budgeting Practices

It is important for the Board to implement policies and procedures and long-term financial plans to assist in the development and monitoring of accurate and realistic annual budgets. The Board should develop budget estimates based on the most accurate and up-to-date financial information possible, including prior years' operating results, past expenditure trends and anticipated future needs and available information from outside sources related to projected changes in significant revenues or commodity prices. Expenditures must be funded by budgeted revenues, including the calculated real property tax levy necessary to close projected gaps. The Board must ensure that budgeted appropriations are not significantly overestimated, because this can cause the calculation for the real property tax levy to exceed the amount actually necessary to provide Town services. Another basic component of local government budgeting is the appropriation of surplus fund balance to reduce the real property tax levy required to finance operations. However, it is not a sound practice to routinely adopt annual budgets that appropriate fund balance that will not actually be used. This practice misleads taxpayers and often results in excessive tax levies.

The Board did not adopt detailed budget policies and procedures for accurately estimating revenues, expenditures and available fund balance as well as for determining the appropriate levels of unexpended surplus funds to retain for unforeseen occurrences or cash flow issues and to appropriate as a funding source. Further, Town officials had not developed a comprehensive long-term financial plan to identify developing revenue and expenditure trends, set long-term priorities and goals, avoid large fluctuations in tax rates and assess the effect and merit of alternative approaches to address financial issues. Although Town officials regularly update a multiyear equipment replacement schedule, it does not address the Town's operations as a whole, to provide guidance for addressing large fund balances; maintaining a reasonable level of unexpended surplus funds; and identifying, prioritizing and strategically addressing future financial needs. Because the Town lacked comprehensive budgeting policies and financial plans, the Board adopted annual budgets with unrealistic

estimates for revenues, expenditures and the amount of fund balance that would be used to balance the budget. These practices resulted in the accumulation of excess funds which could have been put to productive use in the interest of Town taxpayers, including real property tax reductions.

General Fund— The Board did not develop reasonable spending plans with realistic estimates of general fund revenues, expenditures and fund balance to be used to fund operations. The Board routinely underestimated revenues and over-estimated expenditures in its adopted budgets for the last five years (2008 through 2012), which generated significant budgetary and operating surpluses. Under-estimated revenues totaled \$8.3 million and over-estimated expenditures totaled \$7.2 million, for a total positive budget variance of nearly \$15.5 million over the five years. Had the Board based revenue and expenditure estimates on historical data, it may have avoided such significant variances. For example, the Supervisor told us that since his election,⁶ the Town has lost seven full-time employees. However, the funds for their salaries and benefits remain in the Town budget and contribute to the sizeable annual budgetary surpluses.

	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	Total
Budgeted Revenues	\$5,474,638	\$5,661,849	\$5,699,305	\$5,593,094	\$6,153,802	\$28,582,688
Actual Revenues	\$7,525,667	\$6,773,802	\$7,231,581	\$7,838,839	\$7,561,040	\$36,930,929
Underestimated Revenues	\$2,051,029	\$1,111,953	\$1,532,276	\$2,245,745	\$1,407,238	\$8,348,241
Budgeted Expenditures	\$7,223,970	\$7,698,805	\$7,919,452	\$7,570,580	\$8,151,919	\$38,564,726
Actual Expenditures	\$6,061,544	\$6,227,485	\$6,249,164	\$6,255,096	\$6,589,237	\$31,382,526
Overestimated Expenditures	\$1,162,426	\$1,471,320	\$1,670,288	\$1,315,484	\$1,562,682	\$7,182,200
Total Positive Budget Variance	\$3,213,455	\$2,583,273	\$3,202,564	\$3,561,229	\$2,969,920	\$15,530,441

The Board’s failure to adopt budgets with more accurate revenue and expenditure estimates has contributed to the sizeable fund balances maintained by the Town. The Board has consistently appropriated fund balance totaling approximately \$10 million in the general fund over the last five years, which should have resulted in planned operating deficits and declining general fund balances. In reality, as shown in Table 2, the budgets resulted in operating surpluses in all five years, with actual revenues exceeding actual expenditures by a total of \$5.5 million. Thus, while the appropriation of fund balance in the budget should have caused operating deficits of approximately \$10.4 million, the general fund instead had operating surpluses. As a result, fund balance actually increased each year and amounted to 164 percent of expenditures at the end of 2012. Fund balances at this level unreasonably exceed any appropriately conservative financial cushion the Board should maintain for the ensuing fiscal year.

⁶ He was first elected in 2007 for the 2008-09 two-year term.

Table 2: Operating Surplus

	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	Total
Revenues	\$7,525,667	\$6,773,802	\$7,231,581	\$7,838,839	\$7,561,040	\$36,930,929
Expenditures	\$6,061,544	\$6,227,485	\$6,249,164	\$6,255,096	\$6,589,237	\$31,382,526
Operating Surplus	\$1,464,123	\$546,317	\$982,417	\$1,583,743	\$971,803	\$5,548,403
Appropriated Fund Balance	\$1,749,332	\$2,036,956	\$2,220,147	\$2,451,634	\$1,998,117	\$10,456,186
Unexpended Surplus Funds ^a	\$6,329,557	\$6,691,209	\$7,378,435	\$9,277,208	\$10,775,763	
As a Percentage of Expenditures	104%	107%	118%	148%	164%	

^a Total fund balance reduced by the amounts that are appropriated or reserved

It is prudent to either maintain enough fund balance to protect against unforeseen circumstances or to budget conservatively. However, maintaining a substantial fund balance in addition to budgeting very conservatively results in a higher tax levy than necessary. Although the Town does not levy taxes in the general fund, the Board has the ability to use surplus general fund balance to reduce the tax levy in the library and highway funds.⁷ Furthermore, the Town has consistently maintained and reported large cash balances and, as of December 31, 2012, reported general fund cash totaling \$11 million. The liquidity of the Town's assets reduces the need to maintain a large fund balance.

Town officials indicated that the Town had no specific plans for the use of its sizeable fund balance. However, they did discuss potential future expenditures that could reduce fund balance, such as the possible need for new court and recreation facilities. Including these types of potential uses in a comprehensive long-term financial plan (previously discussed) would enable the Board to thoroughly and strategically consider its future needs and options and present them in a formal and transparent manner to taxpayers as they make ongoing financial decisions.

Drainage District —The Board also developed unreasonable budgets and accumulated a significant amount of surplus funds in the drainage district. As of December 31, 2012, the Town was maintaining approximately \$2 million in unexpended surplus funds in its drainage district, which was 321 percent of the 2012 expenditures, well in excess of the annual amount needed to operate this district.

⁷ The Town does not have a Village so these tax bases are the same, and surplus fund balance can be transferred from the general fund. Additionally, the Town could allocate a portion of the sales tax and/or mortgage taxes they receive to these funds, in order to reduce the revenues necessary to be raised by taxes.

Table 3: Drainage District – Appropriations and Fund Balance						
	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	Total
Revenues	\$866,550	\$835,622	\$866,519	\$911,083	\$812,866	\$4,292,640
Expenditures	\$633,989	\$608,887	\$1,093,914	\$642,650	\$625,812	\$3,605,252
Operating Surplus	\$232,561	\$226,735	(\$227,395)	\$268,433	\$187,054	\$687,388
Unexpended Surplus Funds	\$1,552,474	\$1,779,209	\$1,551,814	\$1,820,247	\$2,007,301	
As a Percentage of Expenditures	245%	292%	142%	283%	321%	

The Town levies property taxes⁸ to cover the drainage district expenses. The Supervisor told us that the district underwent some large projects in past years, but no large projects were planned for upcoming years. Therefore, he was able to reduce the tax rate for the district by 1 percent in 2011 and 5 percent in 2012. However, the district continues to accumulate excessive funds as the tax levy is still higher than necessary.

In addition, the budget estimates for the district were not reasonable. The Board overestimated drainage expenditures by over \$892,000 in total, or an average of 20 percent, from 2008⁹ through 2012. These overestimates created operating surpluses in four of the five years, which further contributed to the excessive fund balance in this district.

We reviewed the Town’s 2013 general fund and drainage district budgets as well as budget to actual results as of November 14, 2013 and believe that the Town will end the year with operating surpluses and increased fund balances, in both funds even though it appropriated another \$1.3 million of fund balance in the general fund and \$76,000 in the drainage fund.

Management Oversight

The Board is responsible for the oversight of the Town’s financial operations. It should exercise this oversight by adopting and monitoring policies and procedures that give guidance on how financial functions are to be performed and require the Supervisor to properly account for and report all Town assets and operations and adequately segregate all financial duties. The Supervisor, as chief financial officer, is responsible for the day-to-day financial operations of the Town. These responsibilities include establishing well-designed internal control procedures that provide reasonable assurance that Town assets are safeguarded and properly accounted for.

Supervisor’s Monthly Reports — Town Law requires the Supervisor, at the end of each month, to submit a monthly report to the Board

⁸ Special assessments, at per unit rates, totaling \$815,249 in the 2013 budget, and averaging \$821,000 over the last five years

⁹ 2010 was the only year out of the last five years in which expenditures exceeded appropriations. Out of the other four years, appropriations were between 23 percent and 38 percent above actual expenditures.

of all moneys received and disbursed during the month. To increase their usefulness, these reports should also include detailed monthly and year-to-date budget and actual comparisons and balance sheet accounts, including reconciled cash balances for each fund. Complete and accurate monthly reports provide essential financial information, which the Board can use to monitor the Town's financial position and compliance with the adopted budget.

The Supervisor provided reports to the Board on a quarterly basis. These reports included the total year-to-date revenues and expenditures by fund without the monthly detail. These reports on their own, however, are not sufficient for Board members to effectively monitor the financial position and operations of the Town. The Supervisor provided the Board with neither a detailed statement of all moneys received and disbursed for the month as required, nor balance sheet reports or evidence of bank reconciliations. The Supervisor's failure to provide complete financial reports hinders the Board's ability to provide financial oversight.

Cash Management and Reporting — The Supervisor is responsible for the proper management and accounting and reporting of all cash resources belonging to or in the custody of the Town. The Supervisor should ensure that the finance office maintains only the minimum number of bank accounts to properly account for all funds in accordance with laws and regulations; maintains proper records and reconciliations to substantiate all balances held; and properly accounts for and reports all held moneys in the accounting records, in the appropriate funds in accordance with applicable laws and governmental accounting practices. Minimizing the number of bank accounts can eliminate extra time-consuming and confusing record-keeping, and aid the cash manager in ascertaining cash balances available for investment.

We found that the Town maintained 31 different bank accounts at five different banks, which required extra transactions and reconciliation work, and cumbersome recordkeeping procedures outside of the Town's financial software. Five of these bank accounts had balances of less than \$0.10, and should be closed to prevent inappropriate use and simplify the recordkeeping and reconciliation processes. Additionally, the Town is maintaining multiple bank accounts for the same fund or purpose, for no clear reason or benefit. Most funds have moneys in two different money market accounts¹⁰ along with a checking account. Because the Town uses one zero-balance disbursement account to make vendor payments and another to make payroll payments for all operating funds, no other checking accounts

¹⁰ The Town has two pooled money-market accounts, containing moneys allocated to 12 different funds or special purpose accounts; seven of them have moneys in both pooled accounts.

are needed. Further, maintaining all moneys for one fund or purpose in one money market account would provide for more streamlined accounting and eliminate some of the Finance office's unnecessary and convoluted procedures, tracking spreadsheets, etc.

In addition, the Town maintains 14 of the cash accounts – most of which it reports in the Trust and Agency (TA) fund – outside of its regular financial system, which bypasses the internal controls the Town has put in place over its regular cash disbursement process and increases the risk for fraud or other irregularities to occur; however, our testing did not identify any significant exceptions. Furthermore, many of these cash accounts should not be reported or accounted for in the TA fund at all. The TA fund should be used to account for assets held by the Town as an agent or custodian for individuals or other organizations. The items most clearly belonging in the TA fund include developer bid deposits and employee health reimbursement accounts, which made up \$1.18 million (in three bank accounts) of the \$2.6 million (45 percent) reported as cash in the TA fund. Some of the more significant examples of moneys that are improperly accounted for in the TA fund are discussed in the following paragraphs.

While reviewing balances recorded in the TA fund as of December 31, 2012, we found that four Town bank accounts, with balances totaling approximately \$193,000, held idle moneys and have had limited to no activity for several years, aside from interest earned. Town officials were unsure of the origin of these funds, most of which appeared to be left-over moneys from old capital projects. Two of these accounts were reported in the TA fund instead of the capital projects fund. The Town should research these accounts to determine where these moneys came from and where they belong and distribute the moneys appropriately and close the idle bank accounts; for example, moneys left over from closed capital projects should be returned to the original contributing fund.

We also found balances in excess of \$1.3 million that would have been more appropriate to record and report in the operating funds. For example:

- Park Land Fees — Pursuant to Town Law, the Town can assess a fee for residential construction. The fee must be deposited into a trust fund and used to acquire land for parks, playgrounds, or other recreational purposes. The transactions and balance of these moneys should be recorded in a special revenue (CM) fund.¹¹ As of December 31, 2012, the Town had accumulated in the TA fund approximately \$1,146,000 in

¹¹ The CM fund should be used to account for those revenues that are legally restricted to expenditures for specific purposes and for trusts that benefit the local government where principal and interest may be expended.

unexpended fees for this purpose, including \$53,500 collected in 2012.

- **Ambulance** — The Town can provide ambulance services by either establishing a special district or as a general town-wide function. There is evidence that the Town established a special district (District) effective January 1, 1991 to assist in providing ambulance services to its residents. However, we could not determine if the Town completed all steps necessary to finalize the establishment of the District. Currently, the Town contracts with a not-for-profit ambulance corporation (Contractor) for ambulance service. The Town raised real property taxes, approximately \$676,000 in 2012, to supplement user charges for this service.¹² These taxes are deposited in a designated ambulance account in the TA fund and disbursed to the Contractor in two equal payments, in March and in May. While the money resides in the Town's account, it accumulates interest. As of December 31, 2012, the Town had accumulated approximately \$36,000 in interest in this account. As a result of this accounting treatment, the real property taxes, user charges, interest and related expenditures are not reported in the Town's financial statements and the accumulated balance is misreported in the TA fund. Depending on the method of providing ambulance service, these transactions and balance should be recorded in a special district (SM) fund or in the general fund.
- **Golf course** — The Town owns a golf course and contracts out the operations to a local company (Company). The Town currently receives quarterly payments of \$5,625 from the Company for the rights to operate the course. The Town deposits these receipts and records the related revenues and expenses in the general fund. Under a previous contract, the Town had deposited half of the fees in the TA fund¹³ (with the other half in the general fund) and this accumulated surplus remains recorded in the TA fund. As of December 31, 2012 the accumulated surplus was approximately \$164,000. The Town should be including these moneys as designated fund balance in the general fund.

¹² The not-for-profit ambulance corporation's 2010 Internal Revenue Service (IRS) form 990 reported emergency medical service program revenue of approximately \$1,904,000 for that year. While these charges may be collected by the Contractor, they are Town moneys and must be remitted by the Contractor to the Town, even if the contract provides that as part of the consideration for providing the service, the Contractor will receive an amount equal to the charges.

¹³ The previous contract required the Town to set aside and accumulate half of the fees received from the Company to be used from time to time for major improvements to the golf course, but did not and cannot require the Town to deposit such funds in the TA fund.

By not reporting these transactions and balances correctly, Town officials have not ensured that the Town's financial statements give a true picture of the scope of Town operations and, as a result, have compromised the transparency of Town finances to the taxpayers.

Segregation of Duties — The Board has not adopted any formal policies, nor has the Supervisor developed detailed procedures, for ensuring that financial duties are adequately segregated or that sufficient review and oversight procedures are in place. As a result, the Supervisor assigned incompatible duties to the payroll clerk and did not provide sufficient oversight and review. The Supervisor did not complete or assign someone other than the payroll clerk to complete the required payroll certifications or bank reconciliations. With incompatible duties and limited oversight, there is increased opportunity for this individual to misappropriate cash and conceal the shortage.

We reviewed¹⁴ a risk-based sample of payroll records for employees to determine if they were paid appropriately. Although we did not find any significant exceptions during our review, without properly segregating the payroll clerk's duties, the Town has an increased risk that improper payments could occur.

Recommendations

1. The Board should adopt policies and Town officials should establish procedures to govern budgeting practices that include determining a reasonable level of unexpended surplus funds to be maintained.
2. The Board should develop and use a comprehensive multiyear financial plan.
3. The Board should develop more accurate revenue and expenditure estimates for the general fund and drainage district budgets.
4. The Board should develop a plan to effectively use and reduce the unexpended surplus fund balances in the general and drainage district funds. If the Board believes it is necessary to accumulate money for a future planned purpose, it should consider formally establishing or funding an authorized reserve. Otherwise, officials should use the surplus fund balance identified in this report in a manner that benefits taxpayers. Such uses include paying off debt, increasing necessary reserves, financing onetime expenses, or reducing property taxes in the library and/or highway funds.
5. The Board should ensure that they receive the necessary financial reports from the Supervisor each month and use these reports as a tool to manage the financial position of the Town.

¹⁴We included the payroll clerk in our review due to the lack of internal controls.

6. The Board should review the Town's bank accounts and close those that are unnecessary.
7. Town officials should research the bank accounts that are holding idle moneys and take action as deemed appropriate.
8. The Supervisor should research transactions and balances currently being accounted for and reported in the trust and agency fund and ensure they are properly recorded and reported.
9. The Board should research the method chosen to provide ambulance service to its residents. Once determined, the Board should ensure that expenditures and related revenues are established, recorded and reported in conformance with law and accounting regulations.
10. The Supervisor should segregate the duties of the payroll clerk and ensure that a payroll certification is completed.

Purchasing

An effective system of internal controls over purchasing includes policies and procedures to provide reasonable assurance that the Town is using its resources effectively and complying with applicable laws and regulations. The Board is responsible for establishing and monitoring procurement policies to help ensure the prudent use of Town moneys when procuring goods and services and to protect against favoritism, extravagance, fraud and corruption.

We found that the Town did not develop adequate policies and procedures over the use of credit cards. Also, we found that the Town did not monitor compliance with its code of ethics policy and entered into contracts that resulted in a Board member having a prohibited interest pursuant to Article 18 of the General Municipal Law. Additionally, the Town did not implement policies or procedures to help properly classify individuals as independent contractors or employees, and made payments totaling \$175,000 to four individuals as independent contractors, who likely should have been treated and compensated as employees.

Credit Card Policy

The Board should establish a comprehensive credit card policy, which identifies the individuals who are authorized to use credit cards, defines dollar limits for purchases, describes the types and circumstances of purchases allowed and specifies the prior approval and documentation needed to support the purchase. The policy should also include procedures for monitoring credit card use to promote accountability and responsibility.

The Board has not adopted a comprehensive credit card policy to provide formal authorization and guidance over the use of Town credit cards. The Supervisor's secretary maintains one Town credit card and requires the user to sign the card out and in after use, with the Supervisor's permission. Various Town departments also have store purchase credit cards, with six different vendors. We found that there was lack of knowledge relating to the use and control of these purchase cards. The finance office was not sure which departments had which store purchase cards, and the departments had varied, informal procedures for controlling the custody and use of the cards. Additionally, we found that the finance office was shredding the credit card statements for two of the six purchase card vendors, which eliminated the ability for us or the Board to verify that all charged transactions were appropriate and approved.¹⁵ Therefore, we requested

¹⁵ *Records Retention and Disposition Schedule MU-1* requires such records be retained for six years.

credit card statements from those vendors and examined 112 credit card purchases, totaling about \$14,000, for the Town’s credit card and six purchase cards to determine if there was proper documentation and approvals. We identified various minor discrepancies related to supporting documentation, which we discussed with Town officials. While we did not find any significant exceptions, the Board’s failure to adopt a comprehensive credit card policy, monitor credit card usage and ensure documentation is retained, could result in charges paid that were not properly supported and questionable expenses charged to the Town.

Prohibited Interest in Contracts

General Municipal Law (GML) requires the Board to adopt a code of ethics. Additionally, local government officials are responsible for acting in the best interests of their constituents without undue personal influences, and should have a formal system in place to ensure compliance with their code of ethics and the conflict of interest provisions of GML. A local government can require that officials and employees who are involved in the procurement process file annual financial disclosure forms that can help the governing board, or Board of Ethics, identify occurrences of or potential conflicts of interest.¹⁶

Article 18 of GML limits the ability of municipal officers and employees to enter into contracts in which both their personal financial interests and their public powers and duties conflict. Unless a statutory exception applies, GML prohibits municipal officers and employees from having an “interest” in contracts with the municipality for which they serve when they also have the power or duty – either individually or as a board member – to negotiate, prepare, authorize, or approve the contract; to authorize or approve payment under the contract; to audit bills or claims under the contract; or to appoint an officer or employee with any of those powers or duties. For this purpose, a “contract” includes any claim, account, demand against or agreement with a municipality, express or implied. Municipal officers and employees have an interest in a contract when they receive a direct or indirect pecuniary (monetary) or material benefit as a result of a contract. Municipal officers and employees are also deemed to have an interest in the contracts of: their spouse, minor children and dependents (except employment contracts with the municipality); a firm partnership or association of which they are a member or employee; and a corporation of which they are an

¹⁶ While GML requires only municipalities with populations of 50,000 or more to require certain officers and employees to file annual financial disclosure statements, smaller local governments may require such disclosure by local action, to obtain information pertinent to officers’ or employees’ financial involvement in businesses or organizations that may impair their ability to fairly and impartially perform their duties. According to the 2010 census, the Town has a population of approximately 43,000.

officer, director or employee, or directly or indirectly own or control any stock. As a rule, interests in actual or proposed contracts on the part of a municipal officer or employee, or his or her spouse, must be publicly disclosed in writing to the municipal officer or employee's immediate supervisor and to the governing board of the municipality.

Although the Town's code of ethics requires disclosure of financial interests, it does not include requirements for annual disclosure forms or any other procedures for collecting and reviewing information regarding the outside business interests of Town officials and employees. Furthermore, the Town's code of ethics has not been updated since 2001 and has not been adequately disseminated; several Town officials and employees were not aware that a code of ethics existed. Therefore, we collected and reviewed documentation of outside business interests from selected Town officials and employees, and compared this information with Town vendor lists and payment history. We found that, during our audit period, the Town entered into one or more "contracts" by periodically making purchases of goods, totaling \$5,269, from a corporation of which a Board member is an officer and 45 percent stockholder. As an officer and stockholder of the corporation, the Board member is deemed, by statute, to have an "interest" in each of these contracts. Furthermore, as a Board member, this individual has a number of powers and duties that can give rise to a prohibited interest, including the power to audit and approve claims for payment. This interest was not disclosed in Board minutes as required by GML and the Town's code of ethics policy. Although we were informed that the Board member tried to refrain from auditing claims from his business,¹⁷ recusal is not an exception to Article 18 of GML.¹⁸ Therefore, since it does not appear that any of the statutory exceptions apply to these circumstances, the Board member has a prohibited interest in the contracts.

When Town officials, in their private capacities, conduct business with the Town for which they serve, the public may question the appropriateness of the transactions. Such transactions may create an actual conflict of interest or, at a minimum, the appearance of impropriety.

Consulting Services

When a Town hires independent contractors to provide services, it should do so based on contractual agreements that clearly indicate the contract period, the services to be provided and the basis for compensation for those services. Furthermore, Town officials should examine the business relationship between the Town and the

¹⁷ The Town has a rotating schedule of which a Board member completes the detailed review of the claims and subsequently the entire Board approves the claims for payment at the Board meeting.

¹⁸ See, e.g., Ops St Comp No. 2000-7

contractor when entering into such contracts to ensure that the Town correctly establishes that the individual is an independent contractor, and not an employee. This is important because, among other things, the Town must generally withhold and report appropriate Federal and State taxes for its employees, but not for independent contractors. In determining whether an individual providing a service is an employee or independent contractor, Town officials must consider all information that provides evidence of the degree of control and independence. The IRS provides guidance in correctly classifying workers as employees or independent contractors, and refers to a list of 20 common law factors to aid in that determination.

We tested payments to four individuals, who received payments totaling \$175,000 during our audit period, to verify their status as independent contractors and to ensure payments were supported by written contracts. We found that three individuals, whose responsibilities include completing site visits for construction projects within the Town, did not have a written contract with the Town describing their duties and responsibilities. We were also informed that each of the three individuals is under the direct control and supervision of the Town Engineer. For example, the Town Engineer is responsible for determining where each individual reports to work and assigns them specific inspections to complete each work day. The Town also provides these individuals with materials and equipment, including the use of Town vehicles, computers and cell phones, to complete their assigned duties. These three individuals are paid hourly and must track and report hours worked.

The fourth individual provides assistance to the Supervisor on special projects, and also performs certain established advisory duties such as those related to insurance and investments. Although this individual has a written “memorandum of understanding” relating to his services to the Town, he provides those services under the direct control and supervision of the Supervisor. We also found that the Town provides this individual with an office, supplies and equipment, to complete his assigned duties.

These four individuals did not meet the majority of the 20 common law criteria for classification as independent contractors, and should likely have been treated as employees. For example:

- They are performing routine and essential functions for the Town.
- The Town controls the work performed by determining where and how they work, the order of their work and provides them instructions and training.

- The individuals all use office space, materials and equipment provided by the Town.
- They receive regular payments and are compensated based on a regular rate, such as hourly, daily, or monthly, instead of receiving a certain sum for a completed job.
- They do not provide the same or similar services to the public or to other employers.

If the Town incorrectly classifies an employee as an independent contractor, it can be held liable for employment taxes for that worker, and possibly be assessed a penalty. It could also complicate issues such as liability for negligence and workers' compensation.

In addition, two of the four individuals currently serve as members of the Town's planning board. If, in fact, these individuals were properly designated as independent contractors, there would be a question of whether these individuals violated the conflict of interest provisions of Article 18 of GML by serving as Town planning board members and contracting with the Town as independent contractors. Even if, when closely examined, the individuals' duties would not be in conflict with their responsibilities as independent contractors, each would still be required to publicly disclose their "interest" in their "contract" to the Board and in the official Board minutes.

Recommendations

11. The Board should establish adequate internal controls over credit card use with the adoption of a comprehensive credit card policy that should, at a minimum:
 - Identify authorized users,
 - Set credit limits,
 - Require that credit cards be issued in the name of the Town and the authorized user,
 - Establish custody of purchase cards when not in use,
 - Require proper documentation for use,
 - Retain records for a minimum of six years, and
 - Establish a means to recoup unauthorized expenditures.
12. The Board should review and update the Town's code of ethics and ensure that its provisions are known, understood and followed by Town officials and employees.

13. The Board should ensure that all Town officials and employees are familiar with and comply with the requirements of Article 18 of GML.
14. Town officials should cease doing business with the Board member's business.
15. Town officials should carefully review, with consultation from the Town's counsel as appropriate, the status of individuals currently considered to be independent contractors to determine if they should properly be designated as employees.
16. The Board should enter into a written agreement with all individuals it determines to be valid independent contractors, indicating the contract period, the services to be provided, the timetable for completion and the basis for compensation.

APPENDIX A

RESPONSE FROM TOWN OFFICIALS

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



TOWN OF HENRIETTA

County of Monroe • State of New York
475 Calkins Road, P.O. Box 999, Henrietta, N.Y. 14467 (585) 334-7700

MICHAEL B. YUDELSON
Supervisor

WILLIAM J. MULLIGAN, JR.
JANET B. ZINCK
JACK W. MOORE
M. RICK PAGE
Council Members

December 31, 2013

Edward V. Grant, Jr., Chief Examiner
Office of the State Comptroller
The Powers Building
16 West Main Street, Suite 522
Rochester, New York 14614-1608

Dear Mr. Grant:

Thank you for the opportunity to respond to Office of the State Comptroller regarding the Draft Report of your audit of the Town of Henrietta for the period January 1, 2011 to March 29, 2013.

Before commenting on the findings themselves, please note our compliments and thanks for the two members of your staff who performed the on-site portion of the audit. They were both extremely professional and courteous and were able to answer questions that arose for the Town as a result of their examination.

Also, for the record, my term as Supervisor ends today (Dec. 31, 2013) and Jack Moore will become Supervisor on January 1, 2014. As a result, I am submitting this Response to the audit on behalf of the Town and Mr. Moore will be submitting the Corrective Action Plan that is required by your office. Mr. Moore was on the Town Board for the full period covered by the audit, as were all the other present board members (with the exception of Councilman Page, who became a Board member in October 2011) so they will be fully able to prepare the Plan on behalf of the Town. Items from your Draft Report not mentioned in this Response will be addressed in the Corrective Action Plan.

Financial Management

The very first line of your office's Draft Report section titled Financial Management states that the Town Board "is responsible for making sound financial decisions that balance the level of services desired and expected by the Town's residents with the ability and willingness of the residents to pay for such services". The Town has indeed met that responsibility, as our residents enjoy a high level of services and also appreciate having the lowest tax rate of any of the towns in Monroe County, with the exception of one town that has no town tax at all. At \$1.21 per thousand of assessed valuation, it is considerably lower than the other Monroe County towns. Furthermore, the tax rate has not increased since 2006. As elected officials, the Town Board has consistently taken the position, based on feedback from our constituents, that it

is better to have a tax rate that remains unchanged as opposed to having it cut based on a surplus, only to have it bounce back up sooner than it would had the rate remained constant.

Since the time that the OSC examination began in the Spring of 2013, incoming Supervisor Moore did state that he intended to lower the tax rate. Although this was not done by the Board for the 2014 Budget, they will be able to address the issue in their Corrective Action Plan.

As was discussed with the OSC representative who oversaw the work of the on-site examiners during our exit discussion meeting on December 9, 2013, the Town Board has been discussing the possibility of buying and/or building one or two facilities to replace facilities that the Town currently rents. We do understand that the OSC would like to see the Town place funding for these potential projects in a designated and restricted account until final decisions are made. Although this would not reduce the amount of the funds held by the Town, it would decrease the amount that is “available” for use.

The Corrective Action Plan will address what the Town Board intends to do to “ensure proper oversight of financial matters”. While the draft report identifies incompatible duties assigned to the payroll clerk, it also said that OSC’s examination of the payroll “did not identify any significant exceptions”. It is understood and agreed that it would be a best practice to address this issue, which was the result of working with a very small staff which makes “double checks” difficult. It is important to note that the Draft Report addresses the potential for problems/errors resulting from this situation but also found no such errors for the Payroll and Accounts Payable processes, or for the use of Town credit cards.

Budgeting Practices (including Fund Balance)

A considerable amount of the Draft Report focused on the large fund balances that currently exist. While the amount of expenses incurred did regularly come in lower than budgeted, and the revenues received did also regularly exceed forecasted revenues, this was not because of any intent by the Town to do so.

See
Note 1
Page 28

Expenditures

The Town has worked very hard to control spending, because our constituents expect it of us. Remembering that the budget process begins when we are little more than halfway through the year makes it somewhat difficult to forecast with certainty. Although some expenses are known with certainty (such as wages for members of the Collective Bargaining Unit), others are not.

As an example, although total Town spending increased less than 9% during the five year period of 2008 to 2012, the cost of providing benefits for our employees increased by 61%.

Another example is our required payment to your office, the State Comptroller’s Office, for retirement benefits for our employees. For the period of 2009 to 2012 total Town spending increased by less than 6% (as did the budgeted expenditures) but our payment to the State

Comptroller's Office, increased by **133%**. By the time we make our December 2014 payment, the increase over 2009 will be 198%, despite the rebound of the stock market.

It is also noted that your draft report states that despite a decrease of seven full-time employees, "the funds for their salaries and benefits remain in the Town budget" and contribute to the annual surplus. That is completely inaccurate. The funds for a Finance Director have been kept in the budget because of the expectation that at some point that position would be filled. The other positions were all previously removed from the budget.

See
Note 2
Page 28

Revenues

Conversely, and although there are several factors that contribute to the growth of the Fund Balance that the Board will look at, the revenue we have received as our portion of the sales tax sharing program has been the main reason for the growth of the General Fund. Consider these numbers:

During the period of 2007 to 2013, the budgeted amount of sales tax revenue to be received was increased by 40%, from \$1.5M to \$2.5M (and is \$2.85M for 2014). However the amount we received **over the budgeted** amount for that same period was \$5.83M. For comparison's sake, the amount that the fund balance in the General Fund increased during that same period of time was \$5.98M. Another factor that affected the amount that was budgeted is that when the budget for the following year is prepared, the Town has only received two of the four quarterly payments, making it more difficult to forecast for the following year.

See
Note 3
Page 28

Consulting Services/Independent Contractors

Supervisor Yudelson has discussed this situation with the Town Board previously, most recently during the Board's Budget Workshop meetings in November 2013, and let them know that his understanding of labor laws would deem that most, if not all, the individuals identified in the Draft Report would be classified as employees by the NYS Labor Department should they examine the situation. At the Budget Workshop meeting, the Town Board decided to wait for this Draft Report and any potential directive from the Labor Department before taking any action. The Board will address this in their Corrective Action Plan.

Conclusion

The cover letter for the Draft Report says that a top priority of your office is to help local government officials. As mentioned earlier, having your examiners on-site was very helpful to us and of course provided the opportunity to better understand what the Comptroller's Office expects from the Town.

To more efficiently provide that type of assistance to the Town and not have a situation where your examination identifies concerns on the scope that this report does, it would be helpful and more prudent to have increased and more regular input from the Comptroller's Office. Nobody at the Town remembered having had a similar examination or review done, and inquiry to your

staff revealed that the last time the Office of the State Comptroller performed such a review was **23 years ago**, for the year 1990.

The Town of Henrietta looks forward to working with the Office of the State Comptroller to address the issues contained in the Draft Report.

Sincerely,

Michael Yudelson
Supervisor

APPENDIX B

OSC COMMENTS ON THE TOWN'S RESPONSE

Note 1

We acknowledge that budgets are estimates, but the Board can estimate more accurately by using several years' historical data, as well as completed quarters of the current year, to formulate its projections. Failure to adjust estimates after repeated significant variances implies intent to generate budgetary surpluses.

Note 2

The Supervisor stated to the audit team during fieldwork that he had kept seven unfilled positions – mostly management level – funded in the budget. This is in line with our budget to actual analysis of specific budget lines over three years, which identified approximately \$500,000 in budgetary surplus for several personal service lines. This practice has contributed to the Town's excessive fund balance.

Note 3

We agree that the significant positive variances for sales tax revenues has been a large contributor to the Town's excessive fund balance, particularly since the Supervisor told the audit team that the Board has routinely budgeted sales tax very conservatively, which has helped generate consistent and substantial operating surpluses.

APPENDIX C

AUDIT METHODOLOGY AND STANDARDS

Our overall goal was to assess the adequacy of the internal controls put in place by Town officials to safeguard Town assets. To accomplish this, we performed an initial assessment of the internal controls so that we could design our audit to focus on those areas most at risk. Our initial assessment included evaluations of the following areas: financial oversight, cash receipts and disbursements, purchasing, payroll and information technology. During the initial assessment, we interviewed appropriate Town officials, performed limited tests of transactions and reviewed pertinent documents, 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, or professional misconduct. We then decided on the reported objective and scope by selecting for audit those areas most at risk. We selected the Town's financial management and controls over purchasing for further audit testing.

The objective of our audit was to review the Town's financial management and controls over purchasing. To accomplish our objective, we reviewed financial management and purchasing controls for the period January 1, 2011, to March 29, 2013. We expanded the scope back to 2008, to review fund balance and budgeting trends. To achieve the objective of this audit and obtain valid audit evidence, we performed the following audit procedures:

- We interviewed appropriate Town officials to gain an understanding of Town processes and operations and to determine if internal controls were in place over financial management and purchasing.
- We reviewed the minutes of the Board meetings from January 1, 2011 through March 29, 2013 for significant activity related to budgeting and purchasing.
- We analyzed fund balance for 2008 through 2012.
- We compared budgeted revenues and expenditures to the operating results for fiscal years 2008 through 2012.
- We reviewed the total annual revenues and expenditures to determine the operating deficits or surpluses for each fund.
- We reviewed budgets for 2008 through 2013 to determine the amount of fund balance that was appropriated for each fund year.
- We reviewed all Town bank accounts and the related reconciliations for November and December 2012. We discussed the purposes of the bank accounts with various Town officials.
- We reviewed the Supervisor's reports for compliance with GML.

- We reviewed a risk-based sample of payroll records for five employees to verify payroll for one pay period. The sample included the payroll clerk.
- We randomly selected five cell-phone bills to review usage activity. The selection was made by running a macro on all cell-phone bills paid in our audit period based on the electronic disbursement data received from the Town.
- We randomly selected three-to-five payments per credit or purchase card. The selection was made by running a macro on the credit and purchase card purchases paid for in our audit period based on the electronic disbursement data we received from the Town.
- We obtained and examined responses to our conflict of interest inquiries and based on the results of these inquiries, we completed a search of the electronic disbursement data we received from the Town.
- We reviewed independent contractor versus employee status by determining if these contractors meet the majority of the 20 common law criteria for classification as independent contractors.

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 D

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