



Town of Canandaigua

Fund Balance, Water Operations and Information Technology

Report of Examination

Period Covered:

January 1, 2015 – April 12, 2017

2017M-109



Thomas P. DiNapoli

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State of New York Office of the State Comptroller

Division of Local Government and School Accountability

September 2017

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 Canandaigua, entitled Fund Balance, Water Operations and Information Technology. This audit was conducted pursuant to Article V, Section 1 of the State Constitution and the State Comptroller's authority as set forth in Article 3 of the 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*



State of New York Office of the State Comptroller

EXECUTIVE SUMMARY

The Town of Canandaigua (Town) is located in the central part of Ontario County and has a population of approximately 10,000 residents. The Town provides various services to its residents, including water, street lighting, highway maintenance, snow removal and general government support. The Town's 2017 appropriations were approximately \$10.5 million, funded primarily by sales taxes, real property taxes, water rents and park fees.

The Town is governed by an elected Town Board (Board) composed of the Town Supervisor (Supervisor) and four Board members. The former Supervisor left office at the end of 2016 and an interim Supervisor was appointed in 2017. The Board is responsible for the general management and control of the Town's operations including financial affairs, water districts and security over the information technology (IT) environment. The Supervisor is the chief executive officer and chief financial officer, and is responsible for maintaining the financial records and providing monthly reports to the Board that summarize the Town's financial activities. The Supervisor is assisted by a bookkeeper and contracted certified public accountant.

The Board appointed a Town Manager in 2017 to be the chief administrative officer responsible for day-to-day operations. The Town uses the services of an outside vendor for IT support and technical assistance as needed, and the Town Clerk serves as the network administrator. Additionally, the Highway/Water Superintendent and water clerk administer the day-to-day aspects of the Town's water operations.

Scope and Objective

The objective of our audit was to evaluate the Town's financial management, oversight of water district financial operations and IT controls for the period January 1, 2015 through April 12, 2017. We expanded our scope back to January 1, 2014 to review fund balance trends. Our audit addressed the following related questions:

Did the Board:

- Effectively manage Town finances by properly planning for and using fund balance?
- Provide adequate oversight of the financial operations of the Town's water districts?
- Ensure that the Town's IT assets were adequately safeguarded?

Audit Results

The Board did not effectively manage Town finances. The Board did not adopt a sufficient fund balance policy governing the accumulation of fund balance, develop a long-term financial or capital plan, including a plan for reserves, or require a cash flow analysis. As a result, at the end of 2016, the general fund's unrestricted fund balance totaled more than \$3.2 million, 101 percent of the ensuing year's appropriations.

The Board has not established an overall plan for how water district operations will continue, including a financial plan. There are no procedures in place for the accounting records to be maintained for each water district or extension to ensure that costs are equitably and appropriately distributed to respective districts. As a result, Town officials do not perform reconciliations to determine whether all properties in each district or extension are paying the appropriate amounts. We found that districts were not being charged equitably for all costs. Additionally, the water clerk overbilled one account \$3,447 in 2016 because the rate in the software was not changed to the new 2016 Board-adopted rate for this account and penalties were not assessed for all late payments in the month reviewed. The Board did not adopt a policy for adjustments and does not approve adjustments to water accounts. The water department staff made 378 adjustments with net reductions totaling \$57,861 without explicit Board authorization or sufficient documented explanations for the adjustments. These adjustments ranged from \$2 for waiving penalties to \$630 for reducing the amount of gallons billed.

The Board has not adopted IT policies sufficient to protect its IT assets and did not ensure the adopted computer use policy was enforced or monitored. In addition, the Board did not ensure it had adequate written agreements with the IT service provider or banks used for online banking. Town officials also did not adequately segregate online banking duties and did not dedicate a separate computer for online transactions. Town officials did not generate or review audit trail, exception and change reports, and the Board did not adopt a disaster recovery plan. As a result, there is an increased risk that the Town's IT data and components will be lost or misused and that the Town will not be able to resume critical operations in the event of a system failure.

Comments of Local 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 generally agreed with our recommendations and indicated they plan to initiate corrective action.

Introduction

Background

The Town of Canandaigua (Town) is located in the central part of Ontario County and has a population of approximately 10,000 residents. The Town provides various services to its residents, including water, street lighting, highway maintenance, snow removal and general government support. The Town's 2017 appropriations were approximately \$10.5 million, funded primarily by sales taxes, real property taxes, water rents and park fees.

The Town is governed by an elected Town Board (Board) composed of the Town Supervisor (Supervisor) and four Board members. The former Supervisor left office at the end of 2016 and an interim Supervisor was appointed in 2017. The Board is responsible for the general management and control of the Town's operations including financial affairs, water districts and security over the information technology (IT) environment.

The Supervisor is the chief executive officer and chief financial officer, and is responsible for maintaining the financial records and providing monthly reports to the Board that summarize the Town's financial activities. The Supervisor is assisted by a bookkeeper and contracted certified public accountant. The Board appointed a Town Manager in 2017 to be the chief administrative officer responsible for day-to-day operations. The Town uses the services of an outside vendor for IT support and technical assistance as needed, and the Town Clerk serves as the network administrator. Additionally, the Highway/Water Superintendent and water clerk administer the day-to-day aspects of the Town's water operations.

Objective

The objective of our audit was to evaluate the Town's financial management, oversight of water district financial operations and IT controls. Our audit addressed the following related questions:

Did the Board:

- Effectively manage Town finances by properly planning for and using fund balance?
- Provide adequate oversight of the financial operations of the Town's water districts?
- Ensure that the Town's IT assets were adequately safeguarded?

Scope and Methodology

We examined the financial management, oversight of water operations and IT controls for the period January 1, 2015 through April 12, 2017. We expanded our scope back to January 1, 2014 to review fund balance trends. Our audit examined the adequacy of certain IT controls. Due to the sensitivity of some of this information, we did not discuss the results in this report, but instead communicated them confidentially to Town officials.

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.

Comments of Local Officials and Corrective Action

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 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 Clerk's office.

Fund Balance

The Board has a responsibility for managing and maintaining the Town's fiscal health. To maintain good fiscal health, it is imperative that the Board adequately plan for current and future operating and capital needs. A reasonable, stable fund balance is one element of effective long-range planning and can have several benefits including stabilizing real property tax rates. This can be accomplished, in part, by creating a multiyear financial and capital plan which, when updated and properly used, allows Board members to identify developing revenue and expenditure trends, set long-term priorities and goals, and assess the effect their decisions will have on fund balance levels.¹ Too little fund balance may be an indication of financial problems, while too much fund balance may be an indication of improper financial planning, poor budgeting or over taxation.

The Board has not effectively managed Town finances. The Board did not develop a long-term financial or capital plan, including a plan for reserves, or require a cash flow analysis. As of the end of 2016, the general fund's unrestricted fund balance totaled more than \$3.3 million, or 11 times its real property tax levy and 101 percent of the ensuing year's appropriations. Although the Board reduced general fund appropriation estimates by \$387,239 (11 percent), it also reduced revenue estimates by \$222,821 (8 percent) even though prior year revenues had been underestimated. In addition, the Board increased appropriated fund balance by \$60,582 (11 percent). As a result, fund balance will likely increase again in the ensuing year.

Fund Balance

A reasonable amount of unrestricted fund balance should be retained from year to year to mitigate current and future risks and ensure the continuation of essential services during fiscal downturns. As a best practice, the Board should adopt a policy establishing what is considered an adequate level of fund balance to be maintained – and how to maintain that level – to provide guidance to Town officials during the annual budgeting process. In determining a reasonable amount of fund balance, Town officials should consider factors such as the timing of receipts and disbursements and the volatility of some revenues and expenditures.

The Board has not adopted an adequate policy or plan to guide officials in determining a reasonable amount of fund balance or

¹ Fund balance represents the resources remaining from prior fiscal years that can potentially be used to lower property taxes, be retained at reasonable levels to manage unexpected costs or be set aside in reserve accounts to finance future costs for a variety of specified objects or purposes.

the circumstances and manner in which excessive fund balance amounts should be used. Possible uses include, but are not limited to, appropriating fund balance to lower the ensuing year's tax levy, establishing various reserves that could fund future equipment purchases or capital projects, or helping to stabilize the tax levy in times of financial problems.

The Board's adopted fund balance policy is inadequate because it does not address Town funds other than the general fund. It also provides for a minimum general fund balance, but does not indicate a reasonable level of unrestricted fund balance to be maintained. Additionally, Town officials are not calculating the level of fund balance to determine whether the general fund balance is at the minimum policy requirement or at an excessive level.

Town officials have accumulated general fund balance beyond an amount reasonably necessary to address unexpected circumstances or unanticipated events. Maintaining fund balance at greater than reasonable levels contributes to real property tax levies that are higher than necessary because the excessive balance is not being used to fund operations. While the Board budgeted for the use of appropriated fund balance and reserves as a financing source from 2014 through 2016, the more than \$1 million in total appropriated fund balance went unused. Further, appropriated reserves totaling \$500,000 were not used in 2014 or 2016.

The excessive fund balance was caused primarily by budget variances. The Board underestimated revenues in each of the three years totaling approximately \$903,000 (3 to 17 percent) and overestimated appropriations totaling more than \$2.33 million (18 to 30 percent). These budget variances were generally throughout the line items. Due to these budget deficiencies, the general fund had operating surpluses in each of the three years totaling more than \$1.55 million, resulting in unrestricted fund balance increasing \$1.38 million (76 percent) over this period (Figure 1).

The Board does not receive a cash flow analysis or fund balance estimates to assist in preparing the budget and monitoring financial condition. The general fund's trend of having an operating surplus is likely to continue in 2017. Although the Board reduced appropriation estimates by \$387,239 (11 percent), it also reduced revenue estimates by \$222,821 (8 percent) even though prior year revenues had been underestimated. The Board also increased appropriated fund balance \$60,582 (11 percent). As a result, fund balance likely will increase during the ensuing year.

Figure 1: Unrestricted Fund Balance at Year End as a Percentage of the Next Year's Budget

| General Fund | | |
|--------------|-------------|------|
| 2014 | \$2,265,893 | 67% |
| 2015 | \$3,022,391 | 82% |
| 2016 | \$3,186,059 | 101% |

Multiyear Financial Planning

Multiyear financial planning is a tool towns can use to improve the budget development process. Planning on a multiyear basis will enable Town officials to identify developing revenue and expenditure trends, establish long-term priorities and goals, and consider the impact of current budgeting decisions on future fiscal years. It also allows Town officials to assess the merits of alternative approaches (such as using unrestricted funds or establishing and using reserves) to finance its operations. Any long-term financial plan should be monitored and updated on a continuing basis to provide a reliable framework for preparing budgets and to ensure that information used to guide decisions is current and accurate.

Town officials told us that they were working on a draft capital plan that they anticipated completing and presenting to the Board in the summer of 2017. However, Town officials have not yet developed a comprehensive multiyear financial plan to help identify the potential effects of financial decisions and identify uses for the significant amounts of fund balance that have been accumulated.

Town officials are responsible for ensuring the resources accumulated are used effectively and in a transparent manner. Sound budgeting practices, combined with a comprehensive financial and capital plan, for the Town over a three to five-year period will enable officials to assess various approaches to financial issues, such as the use of fund balance to finance operations or fund reserves for future expenditures.

Recommendations

The Board should:

1. Amend and adopt policies and procedures to govern budget development and monitoring practices and explanations for the level of unrestricted funds to maintain.
2. Adopt budgets with realistic estimates of revenues, expenditures and the amount of fund balance to be used to fund operations.

3. Implement plans to address and properly utilize excess fund balance.
4. Develop and adopt comprehensive multiyear financial and capital plans and plan for reserves. These plans should be monitored and updated on an ongoing basis.

The Supervisor should:

5. Prepare fund balance and monthly cash flow projections and provide them to the Board to assist in making informed financial decisions.

Water Operations

It is essential for the Board and Town officials to develop policies and plans to maintain water operations and to ensure costs are allocated on an equitable basis to property owners residing within each district or extension. There are two types of assessments that may be imposed on behalf of the Town's special districts: a benefit assessment, which is a charge imposed in proportion to the benefits received by the property (often on a unit basis), and an ad valorem levy, which is imposed in the same manner and at the same time as real property taxes (i.e., generally, an amount per \$1,000 of assessed value). Water districts are assessed on an ad valorem basis unless the petition or notice of public hearing contains a statement that the district is being formed on a benefit basis. Town Law provides that when a water district is established under either the ad valorem or benefit basis, the method of financing may not be changed. In addition, Town Law requires that all extensions to a water district must be charged on the same basis as the parent district.

The Board is responsible for setting water rates and ensuring that water rents are properly billed, collected and enforced. It is also critical for the Board to address the process for documenting and approving adjustments to customer accounts and the application of penalties for late payment. Town officials should also perform periodic reconciliations of water purchased to water billed to identify unaccounted-for water so they can monitor and identify the cause of any significant water loss.

The Board has not provided sufficient fiscal oversight of the Town's water operations. As a result, there is limited guidance for staff on how to account for the various districts and extensions.² For example, there are no procedures for the accounting records to be maintained for each water district or extension to ensure that costs are equitably and appropriately distributed. Town officials are not performing reconciliations to determine whether all properties in each district or extension are paying the appropriate amounts, such as comparing properties on tax rolls to properties billed for water, comparing district boundaries to properties assessed charges for each district, and comparing properties receiving water to those metered and paying for usage.

Town officials told us that, prior to 2014, they did not have sufficient water district records and that, while certain water operations³ are

² The Town has a consolidated water district comprised of 30 water districts or extensions.

³ Revenue for water rents from billing and specific water operation expenditures.

tracked in the accounting software, separate fund balance records for each water district are not maintained in the software. Therefore, in 2014 the Town developed the current spreadsheet format to track fund balance for those districts and extensions with debt. However, Town officials told us that this record is only updated at budget preparation time. Therefore, Town officials are not routinely monitoring individual districts' fund balance.

We reviewed the resolutions⁴ for establishment of the 41⁵ water districts and extensions as well as the consolidated district. Generally, we found that districts and extensions were assessed by the correct method (ad valorem or benefit basis). However, while two districts were correctly charged on a benefit basis for debt, they were incorrectly charged on an ad valorem basis for operations and maintenance charges. As a result, property owners in these districts are not correctly being charged for all related costs.

For the districts and extensions separately listed on the spreadsheet, we reviewed their taxes, special assessments, debt and operation and maintenance contributions to assess whether the appropriate funds were raised to cover the respective district's or extension's costs. Town officials were unable to provide debt schedules to support listed debt charges totaling \$105,000 (29 percent of Town administered debt). Additionally, the Town did not charge one district for debt prior to 2016 or for operations and maintenance prior to 2017 since the district's establishment in 2010. As a result, at the end of 2016, the district had a deficit fund balance and owed nearly \$40,000 to the consolidated water district.

We reviewed the quarterly billing for July 2016 and found, with one exception, accounts were properly billed. The water clerk overbilled one account \$3,447 in 2016 because the rate in the software was not updated with the new 2016 Board-adopted rate for this account. We also reviewed the penalties assessed for late payments in August 2016 and found that Town officials are not correctly assessing them. We identified 62 late water bill payments (42 percent) totaling \$4,052 that were not assessed a penalty. As a result, the Town did not assess or collect penalties totaling \$405. Town officials told us that they were looking into a new software program to assist them in addressing this problem. Because this is an ongoing issue, it is likely that additional penalty revenue went uncollected.

⁴ Town officials were unable to provide the resolution originally establishing the consolidated district, but provided a subsequent resolution for when other districts were merged into the consolidated district in 1990.

⁵ The 30 districts and extensions comprising the consolidated district and 11 districts or extensions that are administered by or for other towns.

The Board did not adopt a policy for adjustments to water accounts. As a result, the Board and Town officials are not provided with a detailed listing of adjustments. The Water Superintendent verbally approved adjustments. Although water department staff told us that they provide significant adjustments to the Board, they did not have any threshold for what made an adjustment significant and told us that there were one or two adjustments presented to the Board in the past year.

During the period January 2015 through February 2017, there were 624 adjustments with a total net reduction of \$330,710. This includes 122 adjustments that did not have an effect on the total dollar amount billed, such as a status change when water was shut off for the winter or when a reread of a meter resulted in the same amount to be billed. Of the remaining 502 adjustments, 124 with net reductions totaling \$272,849 had sufficient explanations documented in the software to determine the purpose of the adjustment (such as correcting billing errors or waiving late payments) and 378 with net reductions totaling \$57,861 had no or insufficient explanations. Due to the lack of Board guidance, water department staff made adjustments ranging from \$2 for waiving penalties to \$630 for reducing the amount of gallons billed without explicit Board authorization. We reviewed Board members and Town officials' water bills and found no indication of fraud.

Although Town officials have the information available, they are not performing a reconciliation for water loss. Unaccounted-for water can result for various reasons, such as faulty meters, unmetered customers and underground leaks. Procedures should be in place to monitor and identify the cause of unaccounted-for water. Although we calculated the Town's water loss to be reasonable, procedures should be in place to calculate and identify the cause of unaccounted-for water. Because the Town purchases its water, water loss could significantly increase its costs. Additionally, a large volume of unaccounted-for water could be a warning sign of significant infrastructure problems.

Overall, the Board's insufficient oversight of the Town's water operations' financial operations has led to inequities and lost revenue.

Recommendations

The Board should:

6. Adopt a policy for water district accounting to ensure properties are properly charged and charges are equitably distributed.
7. Adopt a policy for water adjustments to ensure that there is a process in place to document the purpose for and approval of adjustments.

Town officials should:

8. Establish appropriate accounting records and account for each water district as a separate entity.
9. Ensure penalties are charged for all late payments, as appropriate.
10. Perform and document reconciliations to ensure that all properties in each district/extension are paying the appropriate amounts.
11. Adopt procedures to monitor and identify the cause of water loss, including performing periodic reconciliations of water purchased to water sold.
12. Ensure that Board-adopted billing rates are updated in the software.

Information Technology

IT assets and computerized data are valuable resources that Town officials rely on for making financial decisions, processing transactions, keeping records and reporting to State and federal agencies. The potential consequences of an IT system failure range from inconvenient to severe. Accordingly, Town officials are responsible for establishing, designing and implementing a comprehensive system of internal controls over the Town's IT system. The Board is responsible for adopting and periodically updating formal policies focused on protecting data and hardware from loss or misuse due to errors, malicious intent or accidents (disasters). In addition, software controls should be in place so that deletions and adjustments cannot be made without authorization. A process should also be in place to review data entered into and changed in the system. Town officials should also obtain detailed written agreements with service providers and implement controls to secure assets when using online banking. A disaster recovery plan should be developed to prevent the loss of computerized data and to help Town personnel resume operations in the event of a disaster.

The Board has not adopted IT policies to sufficiently protect its IT assets and did not ensure the adopted computer use policy was enforced or monitored. In addition, the Board did not ensure that adequate written agreements had been executed with the IT service provider or banks used for online banking. Town officials also did not adequately segregate online banking duties and did not dedicate a separate computer for online transactions to limit access to online bank accounts. Town officials did not generate or review audit trail, exception and change reports, and the Board did not adopt a disaster recovery plan. As a result, there is an increased risk that the Town's IT data and components may be lost or misused and that the Town will be unable to resume critical operations in the event of a system failure.

Policies

IT security policies describe the tools and procedures to protect data and information systems, define appropriate user behavior and explain the consequences of policy violations. Therefore, it is essential for the Board to establish IT security policies for all IT assets and information. The Board should periodically review these policies, update them as needed and stipulate who is responsible for monitoring them. New York State Technology Law (STL) requires the Board to adopt a breach notification policy.

Although the Board adopted acceptable use policies, it has not ensured the policies are enforced or monitored. The Board has not

adopted other IT policies addressing data backups, the sanitation and disposal of hardware and electronic media, online banking, user accounts, access rights, passwords, remote access, personal, private and sensitive information (PPSI), mobile devices, connecting personally owned devices to the network, adjustments, audit trail, exception and change reports, hardware and software inventories and use of electronic signatures. The Board has also not adopted a breach notification policy as required by STL.

The computer use policy restricts the use of computers and IT resources for Town purposes. The policy also states that the Town has the right to monitor use and that installed software must be authorized. However, Town officials are not utilizing software or other means to monitor use and do not have an authorized software inventory listing. Additionally, users are not provided with cyber security training or training on the Town's policies. Without an inventory policy, Town officials are not maintaining a hardware inventory.

While IT policies do not guarantee the safety of the Town's IT assets or electronic information, the lack of policies increases the risk that data from hardware and software systems may be lost or damaged by inappropriate access and use. Without formal policies that explicitly convey practices to safeguard data, officials cannot ensure that employees are aware of their responsibilities.

Professional Services Agreement

Town officials must ensure that they have qualified IT personnel to manage the Town's IT environment. This can be accomplished through Town employees, an IT service provider or both. To avoid potential misunderstandings and to protect Town assets, there should be a written agreement with the IT service provider that clearly states the needs and expectations for services. It is essential that the agreement include provisions relating to the confidentiality and protection of PPSI and specify the level of service to be provided by the vendor. Insufficient or vague agreements can, among other things, contribute to confusion over who has responsibility for various aspects of the IT environment, which puts the Town's data and computer resources at greater risk for unauthorized access, misuse and loss.

The Town Clerk serves as the network administrator and the Town uses an IT service provider for IT services and support. However, the Town's agreement with the IT service provider is inadequate because it does not define roles and responsibilities and does not include all services provided, such as monthly maintenance checks. Additionally, the agreement does not contain any provisions for confidentiality and protection of PPSI. Therefore, the Town does not have assurance that its data will be safeguarded and confidentially maintained. Without ensuring sufficient and adequate IT support, the Town's IT assets and data are at an increased risk of loss and misuse.

Online Banking

General Municipal Law (GML) allows towns to disburse or transfer funds in their custody by means of electronic wire transfers, provided that the governing board has entered into a written agreement with the bank. Because transfers of funds and automated clearing house (ACH) payments typically involve significant amounts of money, the Town must control the processing of its online transactions to help prevent unauthorized transactions from occurring. Requiring a second authorization or notification of completed transactions provides an added level of security. The Town could also require banks to provide e-mails to Town officials alerting them every time an online transaction occurs. Good management practices would limit the users authorized to execute online banking activities and the computers on which the activity can take place. It is essential that Town officials establish procedures to ensure that staff are securely accessing banking websites to help reduce the risk of unauthorized transfers from both internal and external sources.

Bank Agreement – The Town has one bank that it uses for online transactions including electronic and external wire transfers and ACH payments. The Town does not have an agreement with the bank that contains provisions for how electronic and wire transfers will be performed, including a security procedure, identifying the names and numbers of bank accounts from which transfers can be made, or identifying individuals authorized to request transfers as required. Without an adequate online banking agreement, Town officials cannot be assured that funds are being adequately safeguarded during online transactions.

Segregation of Duties – The bookkeeper has online access to most of the Town's bank accounts, which enables her to make transfers between Town accounts without the review or authorization of another Town official. In addition, the bank does not send any notifications to Town officials for these transfers or ACH transactions, and there is no secondary authorization required. Furthermore, there is no dollar limit on the amount that can be transferred. While the accounting firm hired to assist with bookkeeping reviews bank statements and performs reconciliations after the end of each month, inappropriate transactions could go undetected for longer than necessary.

Authorized Access – The Town did not sufficiently limit authorized access to the Town's online bank accounts because it did not dedicate a separate computer for these transactions. Further, both online banking users also used their Town computers for personal and non-business use. In addition, neither user has received Internet security awareness training. Without this training, users could unintentionally expose the Town's online bank accounts to threats from malicious software, which could endanger Town assets.

We selected one month of online banking and ACH transactions to review and found that all 24 transactions totaling \$728,027 were for appropriate Town purposes. We recognize that, in March 2017, Town officials took an additional and proactive step to prevent loss by purchasing computer fraud and funds transfer insurance coverage. Although this may not prevent the Town's initial loss, it will provide some reimbursement from actual losses in accordance with the insurance policy. However, dedicating a computer for online banking and providing Internet security training for those involved in online transactions can help reduce the Town's risk of funds being misappropriated due to unauthorized access.

Audit Trail, Exception and Change Reports

A computerized system should provide a means of determining the identity of individuals who have accessed the system and what transactions were processed. Audit trails, exception reports, and change reports maintain a record of activity by system or application process, as well as changes to a financial system. Audit trails maintain information such as the identity of each person who has accessed the system; the time and date of the access; what activity occurred; and the time and date of logoff. Exception reports should provide detailed exceptions to ordinary transactions. Change reports should provide changes made, such as adding a new vendor or changing a pay rate. Town officials should review these reports to monitor user activity and changes to the data to provide a mechanism for individual accountability, reconstructing events and problem monitoring.

Although the Town's financial software and various software programs used by other departments have the capability of producing an audit trail, these reports are not regularly generated or reviewed. Additionally, the software used by various departments do not require authorization for adjustments, deletions⁶ or changes to data. Further, Town officials are not routinely generating or reviewing exception and change reports to monitor activity, increasing the risk of errors and irregularities occurring and going undetected and uncorrected.

Disaster Recovery Plan

A disaster recovery plan provides a framework for reconstructing vital operations to ensure the resumption of time-sensitive operations and services in the event of a disaster. Such disasters may include any sudden, catastrophic event (e.g., fire, computer virus, power outage or a deliberate or inadvertent employee action) that compromises the availability or integrity of the IT system and data. The plan should detail the precautions to minimize the effects of a disaster and enable the Town to maintain or quickly resume mission-critical functions. The plan should include a significant focus on disaster prevention and

⁶ Certain software programs limited the ability to make deletions.

should be distributed to all responsible parties, periodically tested and updated as needed.

The Board has not adopted a disaster recovery plan. In addition, the Town does not have an off-site backup, so data would not be available if the Town Hall was not operational. In the event of a disaster, Town personnel do not have guidelines or a plan to follow to help minimize or prevent the loss of equipment and data, or guidance on how to implement data recovery procedures. As a result, the Town is at risk for the loss of important data and the disruption of time-sensitive operations, such as processing checks to pay vendors and employees.

Recommendations

The Board should:

13. Adopt comprehensive IT-related policies for data backups, the sanitation and disposal of hardware and electronic media, online banking, user accounts, access rights, passwords, remote access, PPSI, mobile devices, connecting personally owned devices to the network, adjustments, audit trail, exception and change reports, hardware and software inventories, use of electronic signatures and breach notification. The Board also should ensure adopted IT policies are enforced and monitored.
14. Ensure that officials and employees receive adequate Internet security awareness training and training on the Town's IT policies.
15. Revise the agreement with the IT service provider to reflect current service provisions and provisions for confidentiality and protection of PPSI.
16. Ensure that the Town has a sufficient written online banking agreement.
17. Ensure notifications and other security measures available from the Town's bank are utilized, including e-mail notifications that advise Town officials every time an online transaction occurs.
18. Adopt a comprehensive disaster recovery plan and ensure the plan is distributed to all essential personnel.

Town officials should:

19. Periodically generate and review audit trails, exception reports and change reports.

20. Designate a computer to be used only for online banking transactions.
21. Monitor computer usage to ensure compliance with the Town's acceptable use policy.

APPENDIX A

RESPONSE FROM LOCAL OFFICIALS

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

Town of Canandaigua

5440 Routes 5 & 20 West
Canandaigua, NY 14424
(585) 394-1120 * Fax: (585) 394-9476
townofcanandaigua.org
Established 1789

September 8, 2017

Gabriel F. Deyo
Deputy Comptroller
Office of the NYS Comptroller
110 State Street
Albany, NY 12236

RE: Town of Canandaigua response to audit # 2017M-109

Dear Deputy Comptroller Deyo:

Thank you for providing a copy of your draft audit report for response from the Town of Canandaigua. The following response is relative to the four sections of the audit report including Executive Summary, Fund Balance, Water Fund, and Information Technology.

A corrective action plan will be provided to you once the Town Board of the Town of Canandaigua has had an opportunity to consider a resolution adopting and approving the corrective action plan.

Executive Summary – Audit Results

The Town of Canandaigua Town Board has reviewed the comments in the draft report and has shared some additional details with the audit team around the town's existing fund balance policy. The Board takes exception to the statement that it does not manage Town finances and is providing a summary of the information presented during our post-audit meeting supporting our position.

The Board has made many improvements over the past several years in the management of fund balance and takes their fiduciary responsibility regarding town finances very seriously.

- The Town Board each month publishes the full agenda proactively including the documentation associated with every resolution for the public to view. The attachments include the monthly financial summary from the Town's independent auditing firm inclusive of the cash balances of each fund and all reserves.
- At the monthly Town Board meeting, the monthly financial reports are reviewed and voted on by members of the Town Board for acceptance. The Town Board members

routinely discuss funds, vouchers, expenditures, revenue and budgeting during each meeting.

- The Town Board contracted with an independent certified accounting firm since 2014 to provide guidance of Town finances in accordance with General Accepted Accounting Principles (GAAP). It should be noted the auditors never met with our accounting firm, likely resulting in incomplete information relative to certain findings.
- In order to more effectively manage the Town's finances, the Town Board of the Town of Canandaigua has reorganized a Town Finance Committee. The Finance Committee reviews items on the Town Board agenda relative to finance and make recommendations to the Town Board in advance of the Town Board meeting. The Finance Committee includes a Town Board member, who serves as Chair; the Town Manager, Bookkeeper, staff, residents, and representatives of the Town's Certified Accounting Firm.

Relative to management and concern regarding our fund balance level and plans:

Since 2015, the Town Board has planned for the use of a portion of unassigned fund balance to offset expenditures relating to the construction of a new highway facility. Monthly updates are reflected in meeting minutes, and passage of the following resolutions clearly demonstrates the Town Board's plan for fund balance:

Resolution # 2016-168, adopted July 18, 2016 establishing a reserve fund for building;
Resolution # 2016-237, adopted October 17, 2016 transferring \$ 1,000,000 for building;
Resolution # 2016-275, adopted December 19, 2016 design development of building;
Resolution # 2016-284, adopted December 19, 2016 SEQR determination for building;
Resolution # 2016-291, adopted November 21, 2016, relating to bonding for building;
Resolution # 2016-292, adopted November 21, 2016, relating to permissive referendum;
Resolution # 2016-320, adopted January 9, 2017 encumbrance of funds;
Resolution # 2017-170, adopted April 21, 2017, relating to advertise for sealed bids;
Resolution # 2017-172, adopted April 26, 2017, relating to release of BIDS;

The Town Board of the Town of Canandaigua has adopted a multi-year capital improvement plan (Resolution # 2017-220) on June 19, 2017 that includes a fifteen year plan relative to capital expenditures, improvements, sources of funding, and the source of revenue to offset the expenditure. The capital plan includes facilities owned or operated by the Town of Canandaigua and equipment.

The Town Board is continuously working on improving our methods of managing the town's finances. One of our goals is to provide a stable tax rate for residents. The Town's tax rate for 2017 was \$.89 per thousand, and estimated for 2018 at \$.91 per thousand. The ability to provide consistency of the tax rate is due to our management of fund balance levels and financial planning by the Town Board.

Since the audit, a number of changes have already begun to address items identified in the report and institute additional efficiencies. Actions include: appointment of a new Town Supervisor, a new Town Board member, a Town Manager, new water billing software, new IT policies, restructuring of Financial Office, amending the Fund Balance Policy, adoption of new Capital

Plan, changes to the Town Hall building security to protect both physical and IT assets, new accounting software, IT analysis, shared services with neighboring municipalities, review and examination of existing contracts, construction of new highway facility, new budget preparation procedure, and fund balance policy appropriations.

Relative to the numbered recommendations:

1. The town is amending our existing fund balance policy to include additional controls around the levels of fund balance and additional forecasting.
2. The largest item in our town budget is sales tax revenue which has proved difficult to predict but has a large impact. We will continue to review our budgeting process for improvements.
3. We will formalize the fund balance plan to ensure it is easier for everyone to understand.
4. A 15 year capital plan was adopted thru Board resolution prior to the audit report and we are implementing a forecasting process to improve our ability to make decisions
5. We are investigating a new financial system to facilitate the budgeting and reporting process.
6. The Water district policy will be reviewed.
7. A policy will be implemented and followed for water adjustments.
8. Each water fund will be separated.
9. A policy for late payment penalty adjustments will be established and followed.
10. Water district reconciliations will be performed and documented.
11. A policy will be established to compare water purchased to water sold. Reconciliations will be performed and limits established for reconciling items that require additional follow-up.
12. We will review our new water billing software to ensure we can verify the correct rates have been updated and implement a policy to ensure updates are correct.
13. IT policies will be implemented to address the improvement opportunities noted.
14. The Town Board is already considering a new IT policy for users.
15. Our current IT service agreement will be reviewed and modified.
16. An on-line banking agreement will be reviewed.
17. On-line banking policies will be reviewed and improved.
18. The disaster recovery plan will be updated.
19. Internal control mechanisms will be reviewed.
20. We will look into designating a computer for on-line banking.
21. The IT team will investigate methods to ensure compliance with acceptable usage.

Thank you for the opportunity to share our progress relating to the items you have identified.

Sincerely,

Greg Westbrook, Town Supervisor
Town of Canandaigua

cc: Town Board
Town Manager
Town Clerk

APPENDIX B

AUDIT METHODOLOGY AND STANDARDS

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

- We interviewed Town officials and employees to determine the controls and processes in place and gain an understanding of the IT environment, water operations, financial planning and financial condition.
- We reviewed Board minutes, policies, employee handbook (computer use policies), written agreements, budgets and fee schedules.
- We reviewed total annual revenues and expenditures to determine the operating deficits or surpluses for each fund and determine the impact of the deficit or surplus on fund balance.
- We analyzed fund balance and compared budgeted revenues and expenditures to actual operating results for fiscal years 2014 through 2016 and with the 2017 budget.
- We reviewed individual line item budget-to-actual results for 2014 through 2016 for the general fund.
- We reviewed the appropriation of fund balance and compared it to actual use.
- We reviewed the establishment of water districts and extensions and compared the method of assessing charges to the method established at creation.
- We reviewed the taxes, special assessments, debt and operation and maintenance contributions for each district and extension to assess whether the appropriate funds were raised to cover their respective costs. This included reviewing available debt schedules and recalculating taxes, special assessments and operation and maintenance charges.
- We recalculated water bills for each account for July 2016 and compared our calculations to the amounts billed. We reviewed variances to identify their cause.
- We utilized a random number generator to select a sample of 50 water accounts to review their meter reading reports. We determined whether the meter reads carried over correctly from quarter to quarter on the billings for July 2015 through January 2017.
- We recalculated penalties to be assessed on water payments for one month when late fees would first be assessed, August 2016, and compared our calculation to penalties charged.
- We reviewed adjustments from January 2015 through February 2017 to identify the number and total net dollar value of adjustments and identify adjustments to Board members and Town officials. We also reviewed documentation to assess whether adjustments were authorized and had sufficient explanations.

- We calculated water loss for 2015 using the 2015 Annual Water Quality Report, the latest annual report available at the time of testing.
- We reviewed all online banking transactions for one month to determine whether they were appropriate Town expenditures. We judgmentally selected July 2016, a recent month prior to audit notification.

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

APPENDIX C

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