

Town of German Flatts

Financial Condition and Conflict of Interest

FEBRUARY 2020



OFFICE OF THE NEW YORK STATE COMPTROLLER
Thomas P. DiNapoli, State Comptroller

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Report Highlights

Town of German Flatts

Audit Objective

Determine whether the Town Board:

- Adequately managed the Town’s financial condition, and
- Ensured that Town officials did not have prohibited interests in Town contracts.

Key Findings

- The Board has not adequately managed the Town’s financial condition. The combined fund balance of the four main operating funds declined \$144,719, from a \$57,650 deficit balance at the end of 2014 to a \$202,369 deficit balance of at the end of 2018.
- The Board has not adopted multiyear financial and capital plans.
- A Board member had a prohibited interest in Town contracts totaling approximately \$782,100.

Key Recommendations

- Develop and adopt budgets with realistic estimates of revenues and expenditures based on historical trends or other known factors.
- Develop and adopt multiyear financial and capital plans.
- Ensure that officials and employees are familiar with and follow the requirements General Municipal Law as they relate to conflicts of interest.

Town officials agreed with our recommendations and indicated they planned to take corrective action.

Background

The Town of German Flatts (Town) is located in Herkimer County (County). It is governed by the Town Board (Board), which is comprised of the Town Supervisor (Supervisor) and four council members. The Board is responsible for the general oversight of the Town’s operations and finances, including adopting annual budgets.

The Supervisor serves as the Town’s chief fiscal officer and budget officer. The Town has an outside accountant who assists the Supervisor with maintaining the accounting records and preparing financial reports.

Quick Facts

Employees	27
Population	13,258
2019 Appropriations	\$2.5 million

Audit Period

January 1, 2018 – June 30, 2019. We extended our audit period back to December 31, 2014 for trend analysis.

Financial Condition

What Is Effective Financial Condition Management?

Financial condition may be defined as a town's ability to balance recurring expenditure needs with recurring revenue sources, while providing desired services on a continuing basis. A town in good financial condition generally maintains adequate service levels during fiscal downturns and develops resources to meet future needs. Conversely, a town in fiscal distress usually struggles to balance its budget, can suffer through disruptive service level declines, has limited resources to finance future needs and may have minimal cash available to pay current liabilities.

To effectively manage financial condition, it is essential for Town officials to develop reasonable, structurally balanced budgets and manage fund balance responsibly. Realistic budgets should be based on historic or known trends, which provide sufficient recurring revenues to finance recurring expenditures. If annual revenues are not sufficient to fund expenditures, an operating deficit will occur. When a town has recurring annual operating deficits, fund balance will be depleted and ultimately will go into a deficit position.

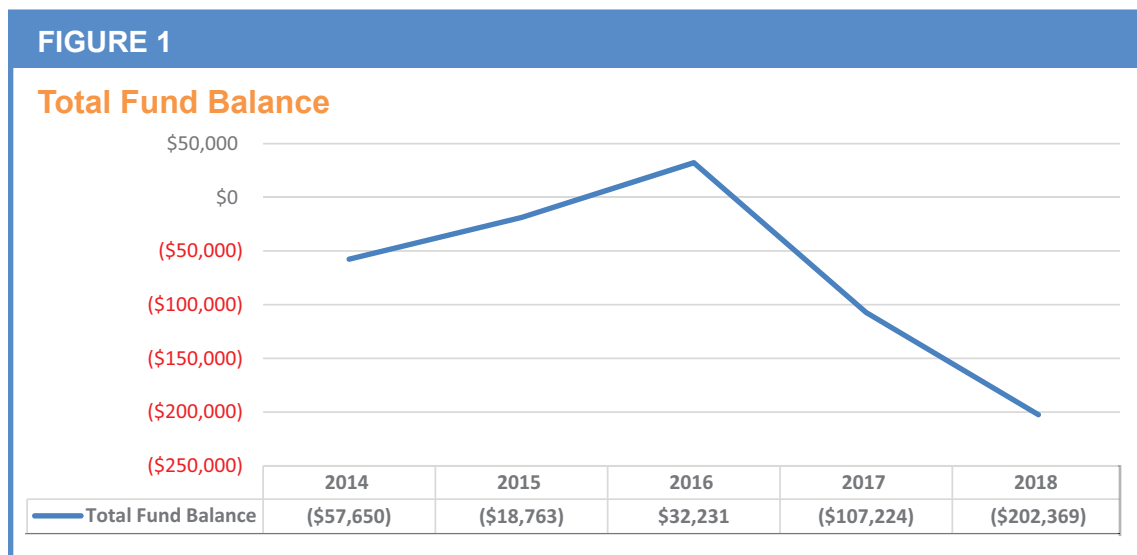
Maintaining a reasonable level of unrestricted fund balance is an essential component of financial management. If the amount retained is too low, a town may not have a sufficient financial cushion for managing emergencies or other unanticipated occurrences and is often forced to resort to short-term borrowing to meet cash flow needs. Although external short-term borrowing such as revenue anticipation notes (RANs) may be used to alleviate temporary cash flow shortages, this type of debt should not be routinely relied upon to finance Town operations and these loans must be paid back within the statutory timeframes.

Another important Board responsibility is to plan for the future by setting adequate long-term priorities and goals. To address this responsibility, it is important for the Board to develop comprehensive multiyear financial and capital plans to estimate the future costs of ongoing services and capital needs.¹ Effective multiyear plans project operating and capital needs and financing sources over a three- to five-year period and allow the Board to identify developing revenue and expenditure trends, set long-term priorities and goals and avoid large fluctuations in tax rates. It also ensures that decisions are guided by the most accurate information available.

¹ Refer to our multiyear financial planning resources available at: <https://www.osc.state.ny.us/localgov/planbudget/index.htm>.

The Board Has Not Adopted Realistic Budgets, Depleting the Town’s Overall Fund Balance

The Board needs to improve its budgeting and monitoring of the Town’s financial operations and take timely action to improve the Town’s declining financial condition. The Town’s main operating funds are the general town-wide (TW), general part-town (PT), highway TW and highway PT funds. The total fund balance for these four funds combined has declined \$144,719 from a deficit of \$57,650 at the end of 2014 to a deficit of \$202,369 at the end of 2018 (Figure 1).



Our previous audit² of the Town in 2015 found that the general town-wide fund balance had declined significantly over the prior three fiscal years due to annual operating deficits caused by budgets that relied on fund balance as a financing source along with unrealistic expenditure estimates. During this period, the Town applied for and was awarded grants to make improvements to a local park. The grant award called for the Town to pay a portion of the overall costs of the improvements without reimbursement (referred to as “matching fund grants”) and to pay other costs up front prior to seeking reimbursement from grant proceeds. The Board did not adequately budget for these matching funds and lacked available uncommitted cash to pay the upfront costs. As a result, the Town was forced to issue short-term debt (revenue anticipation notes, or RANs) to provide sufficient cash for its grant commitments and operations throughout the year.

For the Town to restore depleted fund balances and provide for adequate cash flow resources, we previously recommended that the Board establish realistic

² Town of German Flatts – Fiscal Stress (2015M-217)

budget estimates and adopt a fund balance policy. We also recommended that the Board decrease its reliance on short-term borrowing to finance Town operations and develop comprehensive multiyear financial and capital plans.

The Board did adopt a fund balance policy requiring the Town to maintain a reasonable amount of unrestricted fund balance equivalent to 10 percent of the ensuing year’s budgeted appropriations for each fund. However, the Board has not adopted realistic budgets or developed comprehensive financial plans during the four years following our previous audit, and continues to rely on short-term debt for cash flow purposes.

The Town’s unrealistic budgets have resulted in unplanned operating deficits in three of its four operating funds over the past four years (2015 through 2018) because expenditures exceeded revenues. While the general TW fund experienced operating surpluses totaling \$188,130 during this period, this was not sufficient to restore fund balance to a positive position. The general TW fund ended 2018 with a deficit fund balance of nearly \$147,000.

In addition, the Town’s other three major operating funds experienced net operating deficits totaling \$332,849 during the same period. As shown in Figure 2, expenditures exceeded budgeted appropriations in the general PT fund and both highway funds, and revenues were not sufficient to cover these expenditures. As a result, the general PT and highway PT funds showed deficit fund balances of about \$76,400 and \$92,000, respectively, as of December 31, 2018.

Figure 2: Operating Results and Fund Balance (Four-Year Period 2015-2018)

Operating Fund	General Town-Wide	General Part-Town	Highway Town-Wide	Highway Part-Town	Total All Four Funds
Estimated Revenues^a	\$4,706,893	\$688,536	\$1,834,302	\$1,996,286	\$9,226,017
Actual Revenues	\$4,718,691	\$688,135	\$1,996,783	\$3,574,467	\$10,978,076
Revenue Variance	\$11,798	(\$401)	\$162,481	\$1,578,181	\$1,752,059
Budgeted Appropriations	\$4,706,893	\$688,536	\$1,834,302	\$1,996,286	\$9,226,017
Actual Expenditures	\$4,530,561	\$915,870	\$2,006,076	\$3,670,288	\$11,122,795
Expenditure Variance	\$176,332	(\$227,334)	(\$171,774)	(\$1,674,002)	(\$1,896,778)
Percent (Over)/Under Budget	4%	(33%)	(9%)	(84%)	(21%)
Operating Surplus/(Deficit)	\$188,130	(\$227,735)	(\$9,293)	(\$95,821)	(\$144,719)
Fund Balance	(\$146,895)	(\$76,354)	\$112,856	(\$91,976)	(\$202,369)

a Estimated revenues are equal to budgeted appropriations each year. The Board did not appropriate fund balance to finance the budgets because most funds did not have sufficient fund balance available.

The PT funds had the largest budgetary variance due to significant costs over the last three years relating to a lawsuit involving a property located in a flood zone (PT general fund) and flood mitigation work (PT highway) that were not budgeted

for adequately.³ For example, for fiscal years 2015 through 2018, the Town budgeted a total of \$60,875 for legal costs associated with the ongoing lawsuit but actual expenditures totaled \$305,853 during the same period. In 2017 the Board issued a \$79,000 budget note to help pay these unbudgeted costs, but the Board did not make provisions in the 2018 budget for the repayment of this budget note; consequently, the Town negotiated an interest-only payment option with the bank that year. Subsequently, in 2018, the Board issued a \$79,000 bond anticipation note (BAN) to pay off the \$79,000 budget note previously issued and then again did not include a provision in the 2019 budget for paying off the \$79,000 BAN.

In addition, the Town has continued its practice of pursuing discretionary grant money for park improvements that require matching funds and payment of other costs up front prior to seeking reimbursement. These actions drained cash resources needed to fund other Town operations. For three out of the last four budget years, the Board did not make sufficient provisions in its budgets to pay these matching and upfront costs. For example, in 2015, 2017 and 2018, the Board budgeted a total of \$85,000 for park grant improvement expenditures but actually expended \$132,319, which was \$47,319 (56 percent) more than budgeted.

Because the Board has not accurately estimated expenditures each year, it has continued issuing short-term debt to bridge the gap between actual and budgeted expenditures. To the detriment of the Town's financial condition, the Board did not make the necessary provisions each year to repay its short-term debt. At the end of 2014, the Town's short-term debt in all funds totaled \$275,000. The Town ended 2018 with short-term debt totaling \$269,132. As a result, the Town paid short-term interest totaling \$26,203 with a net reduction of just \$5,868 in short-term debt principal. In order to reduce reliance on short-term debt to pay bills and other obligations when they become due, Town officials need to rebuild fund balance and cash balances to provide adequate cash flow to address the Town's needs.

Realistic budget estimates, in conjunction with a comprehensive multiyear operational plan designed to fund recurring expenditures with recurring revenues, are critical to the Town's fiscal health.

To help the Board and other officials better understand municipal budgeting, we provided them with training in September 2019, prior to the adoption of the 2020 budget.

³ The flood mitigation expenditures were improperly recorded in the highway fund and should have been recorded in the capital project fund. Subsequent to our audit fieldwork we provided technical assistance to the Town Supervisor and accountant to properly record these expenditures.

The Board Has Not Adopted Multiyear Financial and Capital Plans

Town officials have not developed comprehensive, written multiyear financial and capital plans. Such plans would be a useful tool for the Board to adequately address the Town's long-term operational and capital needs. Without multiyear financial and capital plans, the Board's ability to effectively manage the Town's finances and adequately plan for future capital needs is diminished. Multiyear plans would also help guide officials as they develop future budgets and provide more transparency to taxpayers on the Board's long-term financial and capital goals.

What Do We Recommend?

The Board should:

1. Develop and adopt budgets with realistic estimates of revenues and expenditures based on historical trends or other known factors.
2. Include appropriate provisions in the annual budgets to ensure the Town has sufficient resources to pay off its short-term debt in a timely manner.
3. Take measures to ensure the Town rebuilds its fund balances to the level established in the fund balance policy.
4. Develop comprehensive multiyear financial and capital plans that project operating and capital needs and financing sources over a three- to five-year period. These plans should be monitored and updated on an ongoing basis.

Conflict of Interest

What Is a Conflict of Interest?

New York State General Municipal Law (GML)⁴ limits the ability of municipal officers and employees to enter into contracts in which both their personal financial interest 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 that they serve when they have the power or duty – either individually or as a board member – to negotiate, prepare, authorize or approve the contract; authorize or approve payment under the contract; audit bills or claims under the contract; or 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, either express or implied.

Municipal officers and employees have an interest in a contract when they receive a direct or indirect monetary or material benefit as a result of a contract with the municipality they serve. Municipal officers and employees are also deemed to have an interest in the contracts of, among others, a firm, partnership or association of which they are a member or employee and a corporation of which they are an 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 municipal governing board and included in the official board minutes. The Town has a Code of Ethics which also describes the situations that would require public disclosure.

A Board Member Had a Prohibited Interest in Town Contracts

One Board member is the sole owner of an insurance brokerage firm (brokerage firm). The Town purchased various insurance policies, such as group health, dental, prescription, life and supplementary insurance, for Town employees and officers through the Board member's brokerage firm. The Town spent \$782,100 for group health and dental insurance and prescription drug benefits, from January 2018 through June 2019. As a result, as the sole owner of the brokerage firm, the Board member received approximately \$31,900 in sales commissions from the insurance companies for the brokerage services.

Each agreement with an insurance company to provide insurance benefits (e.g., group health insurance coverage) to Town officers and employees is a "contract" for purposes of Article 18 of GML.⁵ As the sole owner of the brokerage

⁴ GML, Article 18

⁵ GML, Section 800[2]

firm, the Board member receives either a direct or indirect monetary or material benefit (i.e., sales commissions) as a result of the contracts, and therefore has an “interest” in the contracts.⁶ As a member of the Board, this individual had powers or duties that could give rise to a prohibited interest, including the ability to authorize or approve the contracts, authorize or approve payments under the contracts, audit bills or claims under the contracts or appoint someone to perform that function. Therefore, unless an exception applied, the Board member would have a prohibited interest in each of the contracts.

There is an exception set forth in GML which provides that a municipal officer’s or employee’s interest in a contract is not prohibited if the contract was entered into prior to the time he or she was elected or appointed as a municipal officer or employee. The Board member, who was appointed to fill a vacancy in April 2017 and was subsequently elected in the fall 2017 election, did not have a prohibited conflict of interest in the 2017 agreement between the Town and each of the insurance companies, because the contracts predated the Board member’s appointment or election to office. The pre-existing contract exception, however, does not apply to renewal contracts. As such, the Board member had a prohibited interest in the 2018 and the 2019 insurance renewal agreements between the Town and the insurance companies.

Town officials are accountable to the public, especially when the expenditure of taxpayer money is involved. When Town officials, in their private capacities, conduct business with the Town, the public may question the appropriateness of the transactions. Such transactions may create an actual conflict of interest or the appearance of impropriety and/or may result in improper enrichment at taxpayer expense. After we discussed the conflict of interest with the Board member during fieldwork, the Board member consulted with the Town Attorney and subsequently resigned from the Board effective September 3, 2019.

What Do We Recommend?

5. The Board should ensure that all officials and employees are familiar with and follow the requirements of Article 18 of GML as they relate to conflicts of interest.

⁶ GML, Section 800[3]

Appendix A: Response From Town Officials

L. Peter Rovazzi
Supervisor

John R. Brewer
Scott Hendrix
Arthur Sterling
Pandora Watkins
Town Council

Town of German Flatts

66 East Main Street
Mohawk, New York 13407-1137
Phone: 315-866-1370 • FAX: 315-866-9640

Pamela A. Jones
Town Clerk

Cherri L. Hyer
Receiver of Taxes

Andrew J. Dutcher
*Superintendent of
Highways*

January 28, 2020

Rebecca Wilcox, Chief Examiner
Syracuse Regional Office
State Office Building, Room 409
333 E. Washington Street
Syracuse, NY 13202-1428

Re: Response Letter to Financial Condition & Conflict of Interest Draft Audit Report

Dear Ms. Wilcox,

The Town of German Flatts acknowledges receipt of the Draft Audit Report and intends this letter to serve as the Town's response to the Draft Report. After review of the Draft Audit, the Town agrees with the facts and findings presented in the Report.

The Town has already begun addressing the findings and implementing the key recommendations outlined in the report. The Town of German Flatts intends to submit a corrective action plan referencing the key findings and recommendations found in the Examination Report in the near future.

The Town of German Flatts would like to thank the auditors for their time spent reviewing and identifying declining fiscal trends, that with immediate action, will improve the financial condition of the Town. The Town recognizes the importance of the findings and is appreciative of the efforts the audit team expended to educate our Town Officials on how to implement corrective action.

Sincerely,

L. Peter Rovazzi
Supervisor, Town of German Flatts

Appendix B: Audit Methodology and Standards

We conducted this audit 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. To achieve the audit objectives and obtain valid audit evidence, our audit procedures included the following:

- We interviewed Town officials responsible for financial oversight and reviewed Board meeting minutes to gain an understanding of the Town's budget development and monitoring process.
- We traced all balance sheet accounts and a sample of individual revenue and expenditure accounts from the Town's accounting records to the 2018 annual update document (AUD), which is the annual financial report (AFR) completed and submitted to our office. Our test included the general town-wide (TW), general part-town (PT), highway TW and highway PT funds.
- We compared the budget estimates to actual results for 2015 through 2018 and reviewed the adopted budgets to determine whether total budgeted revenues and appropriations were reasonable. We assessed the operating funds (general TW, general PT, highway TW and highway PT) for 2018 to determine which individual revenue and expenditure estimates had the largest budget-to-actual variances. We interviewed Town officials to identify reasons for any large or unusual budget variances.
- We assessed fund balance at year-end from 2014 through 2018 for the operating funds and analyzed the results of operations.
- We reviewed AFRs and records to identify short-term borrowings, the amount of each issuance and the items the Town anticipated to borrow the money for.
- We interviewed Town officials to determine whether they had any multiyear financial or capital plans.
- We interviewed Town officials to determine whether they had developed procedures to identify potential conflicts of interest and to monitor for potential conflicts of interest.
- We obtained representations from Board members and other Town officials that disclosed their outside employment and business interests, and those of their spouses, for the audit period. We compared these disclosures to cash disbursement records to determine whether the Town had financial transactions that might constitute prohibited conflicts of interest.

We conducted this performance audit in accordance with GAGAS (generally accepted government auditing standards). 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.

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 provided 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 the CAP available for public review in the Town Clerk's office.

Appendix C: Resources and Services

Regional Office Directory

www.osc.state.ny.us/localgov/regional_directory.pdf

Cost-Saving Ideas – Resources, advice and assistance on cost-saving ideas

www.osc.state.ny.us/localgov/costsavings/index.htm

Fiscal Stress Monitoring – Resources for local government officials experiencing fiscal problems

www.osc.state.ny.us/localgov/fiscalmonitoring/index.htm

Local Government Management Guides – Series of publications that include technical information and suggested practices for local government management

www.osc.state.ny.us/localgov/pubs/listacctg.htm#lmgm

Planning and Budgeting Guides – Resources for developing multiyear financial, capital, strategic and other plans

www.osc.state.ny.us/localgov/planbudget/index.htm

Protecting Sensitive Data and Other Local Government Assets – A non-technical cybersecurity guide for local government leaders

www.osc.state.ny.us/localgov/pubs/cyber-security-guide.pdf

Required Reporting – Information and resources for reports and forms that are filed with the Office of the State Comptroller

www.osc.state.ny.us/localgov/finreporting/index.htm

Research Reports/Publications – Reports on major policy issues facing local governments and State policy-makers

www.osc.state.ny.us/localgov/researchpubs/index.htm

Training – Resources for local government officials on in-person and online training opportunities on a wide range of topics

www.osc.state.ny.us/localgov/academy/index.htm

Contact

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