



Town of Fishkill

Financial Condition and Internal Controls Over Selected Financial Operations

Report of Examination

Period Covered:

January 1, 2008 — July 20, 2009

2010M-61



Thomas P. DiNapoli

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State of New York Office of the State Comptroller

Division of Local Government and School Accountability

August 2010

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 Fishkill, entitled Financial Condition and Internal Controls Over Selected Financial Operations. 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 Fishkill (Town) is located in Dutchess County and provides various services to its 20,200 residents. The Village of Fishkill is located within the Town's boundaries. The five-member Town Board (Board), including the Town Supervisor (Supervisor), is the legislative body responsible for managing Town operations. The Supervisor also serves as the Town's chief executive officer, budget officer, and chief fiscal officer. As of August 2009, the Town had 46 full-time employees, 83 part-time employees (primarily in the Police Department), and 45 seasonal workers.

The Town has 11 sewer and seven water districts which provide services to the residents within each district. For the year ended December 31, 2008, the Town reported expenditures of more than \$14 million for its major operating funds including \$4.8 million for the town-wide general fund, \$3 million for the part-town general fund, \$1.1 million for the town-wide highway fund, and \$1 million for the part-town highway fund. Reported expenditures for the 11 sewer districts and the seven water districts totaled \$2.4 million and \$1.4 million, respectively.

Scope and Objectives

The objectives of our audit were to review the Town's financial condition and the internal controls over selected financial operations for the period January 1, 2008 to July 20, 2009. We extended certain portions of our audit of the Town's financial condition to February 18, 2010. Our audit addressed the following related questions:

- Are Town resources sufficient to fund current operations?
- Are internal controls over cash receipts of selected departments appropriately designed and operating effectively?
- Are internal controls over cash management appropriately designed and operating effectively?
- Are internal controls over information technology appropriately designed?

Audit Results

Three of the Town's major operating funds reported fund deficits totaling \$3 million at December 31, 2008. These deficits were financed by loans from several other funds that have not been repaid. The long-term nature of these loans was not properly disclosed in the fund balances of the lending funds.

When the effect of these long-term loans on the primary lending funds is considered, the unreserved fund deficits in the Town would aggregate to more than \$4.9 million, 35 percent of the 2008 budget. Although Town officials have taken steps to cut expenditures in 2009, they have not developed a comprehensive multi-year plan to address the deficits and cash flow problems.

The Town does not have an effective internal control system in place to adequately safeguard cash receipts in its Building and Zoning, Recreation, and Planning Departments. There was a lack of segregation of duties between the billing and collection functions in these Departments. Also, departmental accounting systems did not always effectively identify each transaction and did not safeguard data from manipulation. Finally, periodic reconciliations were not performed to compare amounts that should have been collected to amounts that were transmitted and deposited. Although we did not find significant deficiencies with the transactions we reviewed, these internal control weaknesses place departmental cash receipts at risk of loss or misuse.

Town officials did not have adequate policies and procedures in place to effectively manage and secure cash deposits. Deposits were not adequately secured because the Board did not monitor compliance with its policy. As a result, security agreements were not properly executed leaving over \$2.2 million at risk at December 31, 2008.

Finally, Town officials have not developed a formal security plan or a disaster recovery plan. Although data back-up files are created daily, those files are not adequately secured or tested. Remote access is granted to information technology (IT) support providers and several Town employees without proper policies and agreements in place. Finally, IT system administration duties are performed by individuals who also perform financial duties. These duties are incompatible. As a result of these weaknesses, the Town's IT system and electronic data are at increased risk of loss, misuse and/or manipulation.

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. Except as indicated in Appendix A, Town officials generally agreed with the recommendations included in our report. OSC's comments on the local officials' response can be found in Appendix B.

Introduction

Background

The Town of Fishkill (Town) is located in Dutchess County and has a population of approximately 20,200. The five-member Town Board (Board), composed of four Council members and the Town Supervisor (Supervisor), is the legislative body responsible for managing Town operations. The Supervisor is the Town's chief executive officer, budget officer, and chief fiscal officer. The Comptroller, appointed by the Board, is responsible for the accounting records. The Receiver of Taxes (Receiver), also appointed by the Board, is responsible for the collections of real property taxes, water and sewer rents and other cash receipts.

The Village of Fishkill (Village) is located within the Town's boundaries. As a result, the Town budgets for (and provides) certain services to residents town-wide and other services to residents outside of the Village (part-town). For example, the Town budgets for parks and recreation services and snowplowing services on a town-wide basis. Services such as police and public safety, building services, home and community services, road, and road repair and maintenance are budgeted for on a part-town basis. The Town has 11 sewer and seven water districts which provide services to the residents within each district. For the year ended December 31, 2008, the Town reported expenditures of more than \$14 million for its major operating funds including \$4.8 million for the town-wide general fund, \$3 million for the part-town general fund, \$1.1 million for the town-wide highway fund, and \$1 million for the part-town highway fund. Reported expenditures for the 11 sewer districts and the seven water districts totaled \$2.4 million and \$1.4 million, respectively. As of August 2009, the Town had 46 full-time employees, 83 part-time employees (primarily in the Police Department), and 45 seasonal workers.

Objectives

The objectives of our audit were to review the Town's financial condition and the internal controls over selected financial operations. Our audit addressed the following related questions:

- Are Town resources sufficient to fund current operations?
- Are internal controls over cash receipts of selected departments appropriately designed and operating effectively?
- Are internal controls over cash management appropriately designed and operating effectively?

- Are internal controls over information technology appropriately designed?

**Scope and
Methodology**

To review financial condition, we examined the Town's financial information for the period January 1, 2006 to February 18, 2010. To review internal controls, we examined selected financial operations for the period January 1, 2008 to July 20, 2009. Our audit disclosed areas in need of improvement concerning cash management controls. Because of the sensitivity of this information, certain vulnerabilities are not discussed in this report but have been communicated separately to Town officials so they could take 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.

**Comments of
Town 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. Except as indicated in Appendix A, Town officials generally agreed with the recommendations included in our report. OSC's comments on the local officials' response can be found in Appendix B.

The Board has the responsibility to initiate corrective action. A written corrective action plan (CAP) that addresses the findings and recommendations in this report should be prepared and forwarded to our office within 90 days, pursuant to Section 35 of the General Municipal Law. For more information on preparing and filing your CAP, please refer to our brochure, *Responding to an OSC Audit Report*, which you received with the draft audit report. We encourage the Board to make this plan available for public review in the Clerk's office.

Financial Condition

A measure of a local government's financial condition is its ability to provide and finance services on a continuing basis. A local government is considered to be in sound financial condition when it can consistently generate sufficient revenues to finance anticipated expenditures, maintain sufficient cash flow to pay bills when due, provide necessary services, and plan and finance capital acquisitions within the community's ability to pay for them. Recurring operating deficits and deficit fund balances are indicative of poor financial condition and significantly affect a government's ability to pay for services.

The Board and Supervisor are responsible for performing the financial planning and management activities necessary to maintain the Town's financial health. These activities include adopting realistic budgets and effectively monitoring the results of operations against those budgets throughout the year. To provide a sound financial basis for providing services, adopted budgets should include accurate estimates of necessary appropriations. To ensure that adequate funding is available for planned services, estimates of revenues and financing sources should be realistic and conservative. Effective monitoring requires that actual revenues and expenditures are routinely compared to budgeted amounts and that, when necessary, timely action is taken by the Board to address revenue shortfalls and/or expenditure overruns.

Three of the Town's major operating funds reported fund deficits totaling \$3 million at December 31, 2008. These deficits were financed by loans from several other funds that have not been repaid. The long-term nature of these loans was not properly disclosed in the fund balances of the lending funds. When the effect of these long-term loans on the primary lending funds is considered, the unreserved fund deficits in the Town would aggregate to more than \$4.9 million, 35 percent of the 2008 budget.

The Board and Supervisor have not adopted realistic budgets to effectively control Town operations. Further, when actual revenues and financing sources did not meet estimates and actual expenditures exceeded available appropriations, the Board did not act to amend the spending plan. Finally, the Town has experienced significant cash flow problems causing a reliance on extensive interfund loans, the use of restricted moneys, and the issuance of revenue anticipation notes (RANs) in 2009. Although Town officials have taken steps to cut expenditures in 2009, they have not developed a comprehensive multi-year plan to address the deficits and cash flow problems.

Fund Deficits

Governmental funds report the difference between their assets and liabilities as fund balance, which is divided into reserved and unreserved portions. The function of reserved fund balance is simply to isolate the portion of fund balance that is not available for the following year's budget, so that unreserved fund balance can serve as a measure of current available financial resources.¹ Also, operating surpluses generally increase available financial resources while operating deficits deplete available financial resources. Sufficient available financial resources (fund balance) are the cornerstone of sound fiscal health.

At December 31, 2008 the Town reported unreserved fund deficits of \$2.51 million in the part-town general fund, \$497,000 in the part-town highway fund, and \$49,200 in the town-wide highway fund. Respectively, these reported deficits represented 84 percent, 50 percent, and 5 percent of each fund's operating expenditures for 2008. In each case, these deficits were caused by several years of operation where expenditures exceeded revenues. Because revenues were not sufficient to finance operations in these three funds, the Town routinely borrowed money from other funds to pay expenditures. The part-town general fund deficit of \$2.51 million was financed through loans from the town-wide general fund, both highway funds, several sewer districts and water districts, and a trust fund. Similarly, the deficits in the two highway funds were also financed through various interfund loans.

Because of the poor financial condition of the part-town general fund and the highway funds, these interfund loans (liabilities) have not been repaid as of December 31, 2009, one year later. The long-term nature of these loans indicates that the corresponding receivables (assets) in the lending funds are not available for spending and, as such, should result in a reservation of fund balance in each of those funds. Properly accounting for the long-term (and non-spendable) nature of the loans receivable in the primary lending funds results in the following unreserved fund deficits at December 31, 2008.

¹ Government Finance Officers Association, *Governmental Accounting, Auditing, and Financial Reporting* (2005)

Lending Funds	Reported Unreserved Fund Balance or (Deficit)	Long-Term Loans Receivable²	Actual Unreserved Fund Balance or (Deficit)
Town-Wide General	\$103,290	\$1,010,490	(\$907,200)
Town-Wide Highway	(\$49,220)	\$346,940	(\$396,160)
Part-Town Highway	(\$497,190)	\$388,080	(\$885,270)
Dutchess Park Sewer	\$592,080	\$662,630	(\$70,550)
Merritt Water	\$283,510	\$464,890	(\$181,380)
Total			(\$2,440,560)

When these deficits are added to the reported deficit in the part-town general fund of \$2.51 million, the result is a total unreserved fund balance deficit of more than \$4.9 million. This represents 35 percent of the Town's \$14 million budget.

Finally, the weakened condition of these lending funds, in turn, prevents them from repaying the interfund loans that they had received from other funds in a timely manner. In effect, the decision to borrow moneys from several other funds to finance the deepening deficits of the part-town general fund and both highway funds has created (directly and indirectly) fiscal stress for most of the Town's operating funds. The moneys loaned directly to those three funds, and then, in turn, to the lending funds, became unavailable to finance the operations that they were intended for.

The operating funds were not the only Town funds used to bail out the part-town general and highway funds. Moneys were also borrowed from the Housing Trust (\$269,385) and capital project moneys (\$1.25 million) to fund the part-town and town-wide general funds.

The poor financial condition of the part-town general fund and both highway funds was the result of recurring operating deficits. From 2006 through 2008, expenditures significantly exceeded revenues in the part-town general fund and the two highway funds resulting in the following operating deficits.

Operating Deficits			
Year	Part-Town General Fund	Town-Wide Highway Fund	Part-Town Highway Fund
2006	(\$949,500)	\$1,200	(\$209,700)
2007	(\$1,297,200)	(\$107,700)	(\$184,300)
2008	(\$302,600)	(\$51,400)	(\$87,000)
Total	(\$2,549,300)	(\$157,900)	(\$481,000)

² Long-term loan receivables are not available for current spending and require a reservation of fund balance.

From 2006 through 2008, Board members consistently adopted unrealistic revenue budgets to govern the operations of these three funds. Compounding the fiscal problems created by adopting unrealistic budgets, the Board routinely failed to monitor expenditures during the year to ensure they stayed within budgeting limits.

For example, over the three-year audit period, part-town general fund departmental revenues were overestimated by \$1.2 million, licenses and permits fees were overestimated by \$500,000 and interfund transfers were overestimated by \$377,500. These three line items represent a total revenue shortfall of more than \$2 million. For the same three-year period, appropriations were overspent a total of \$545,000.

Operating deficits in the town-wide highway fund were caused primarily by the Board appropriating more fund balance than was available. For the 2007 and 2008 budgets, the Board appropriated fund balance of more than \$200,000 as a financing source when only \$112,000 was available. For the part-town highway fund budgets from 2006 through 2008, State aid revenues were overestimated by more than \$290,000 and non-existent fund balance of almost \$280,000 was budgeted as a financing source.

Because impractical spending plans do not provide adequate budgetary control, the need for monitoring financial activities throughout the year is even greater. Effective monitoring requires the Board to react quickly to financial information that accurately identifies revenue shortfalls and/or insufficient budgetary appropriations. It is then the Board's responsibility to adjust its initial projections and funding levels to reflect the actual circumstances. The very existence of the operating deficits is evidence that this monitoring was not done effectively.

Cash Flow

The chronic fund deficits caused by poor budgeting practices significantly impacted the Town's ability to provide and finance services on a continuing basis. Cash flow problems resulted from these deficits. As each year progressed, the Town ran short of cash needed to pay its bills in the part-town general fund and the highway funds. To provide the needed cash for operations, the Board and Supervisor resorted to interfund advances, and using restricted moneys from trust funds and capital projects.

Interfund advances typically represent temporary short-term loans, made with the intention that they will be repaid. These loans are permissible with certain provisions. General Municipal Law (GML) generally authorizes a municipality to temporarily advance moneys held in a fund, and not immediately required for the purpose for

which they were raised or received, to any other fund. This statute also requires that interfund advances be authorized in the same manner as budgetary transfers between appropriations and that repayment be made no later than the close of the fiscal year in which the advances were made. When an advance is made between funds supported by different tax bases, repayment must include the amount of interest that would have been earned on the investment of the moneys.

To fund operations in the part-town general fund for 2006 through 2008, moneys were transferred from other funds. Eventually, these other funds then required cash for operations as their available balances were depleted through these transfers. The cycle would continue as new interfund loans were made to these funds from still other operating funds. Board minutes did not provide any indication that the Board authorized any of these interfund loans. In its 2008 annual report to the State Comptroller's Office, the Town reported a combined liability (outstanding loans due to other funds) of \$10.6 million at December 31, 2008. These loans were not repaid by the end of the fiscal year, as required by GML.

The near-term repayment of any of these loans is questionable as the part-town general fund and most of the other funds do not have sufficient resources to repay the principal, or any required interest. Any repayment would require sizeable increases in future budgets to provide the necessary resources. Because these loans were made between funds with different tax bases and funding methods, taxpayer inequities have been created. For example, moneys raised in water and sewer districts through bills to customers were not used solely to finance those operations. Instead, taxpayers outside those particular districts benefitted from the sewer and/or water revenues collected. Therefore, water and sewer rates in some Town sewer and water districts were higher than necessary to fund operations.

Restricted Moneys — While certain moneys may be advanced to other funds pursuant to GML, some funds are restricted by law from being used for other than their intended purpose. Trust fund moneys are restricted to those purposes outlined in the local law (or resolution) establishing the fund. Proceeds of bonds or notes issued to finance capital projects can generally be used only for their intended purpose. Such proceeds are prohibited from being used to finance day-to-day operations. However, we found that Town officials advanced trust moneys and proceeds of borrowings to other funds for operating purposes.

By local law, adopted in 2004, the Town established an Affordable Housing Trust Fund (AHF). The local law generally restricts the use of AHF moneys to fund the administration and enforcement of the

affordable housing program. However, as of December 31, 2008, \$269,385 of AHF funds were loaned to the part-town general fund.

In addition, in November 2008, the Town issued bonds of \$7 million to finance the Rombout Sewer capital project. In November and December 2008, two transfers totaling \$1,248,000 were made from those bond proceeds to the town-wide general fund and subsequently recorded as a loan to that fund. These transfers were an improper use of borrowed moneys. Local Finance Law does not allow such debt proceeds to be used to finance operations.

When restricted moneys are used for other than their intended purpose there is an increased risk that the moneys may not be available to finance the activities for which they were authorized.

Subsequent Events

As of February 18, 2010, the Town had not yet finalized its annual financial report for the 2009 fiscal year. However, in 2009, the Town continued to experience cash flow difficulties. In October 2009, the Town issued a revenue anticipation note for \$1.8 million to provide needed cash for operations. This note will have to be repaid (with 3.68 percent interest) using revenues received in 2010. The interfund advances outstanding at the end of 2008 were not repaid in 2009 and, in fact, had increased by \$100,000. Per the Town's records, interfund loan balances totaled \$10.7 million³ at December 31, 2009. The 2009 and 2010 budgets for the Town's general and highway funds did not address the accumulated fund deficits. No provisions were included to raise additional funds needed to reduce existing deficits and/or repay outstanding interfund advances. Any surpluses realized in 2009 will have little impact on the deficits accumulated over several years.

While Town officials have taken some steps to cut costs and control spending, they have not developed a comprehensive, multi-year financial plan essential to addressing these fiscal problems. Without a long-term plan that effectively reduces the accumulated deficits in so many of its operating funds, the Town is at an increased risk of not being able to provide essential services.

Recommendations

1. The Board and Town officials should prepare realistic budgets using conservative revenue estimates and reasonable expenditure amounts. The Board should not appropriate non-existent or unavailable fund balance to finance operations.
2. The Board should monitor actual revenues and expenditures throughout the year and amend budgets as necessary.

³ This unaudited figure was provided to us by Town officials after the end of our fieldwork.

3. The Board and Town officials should act to repay all interfund loans still outstanding. Restricted moneys that were loaned should be returned immediately. Future advances should be pre-approved by the Board and made only from those funds permitted by law.
4. The Board should develop a long-term plan to effectively reduce all fund deficits and return the Town to sound fiscal health.

Cash Receipts

The Town's Building and Zoning Department, Recreation Department, and Planning Department collectively received approximately \$2.5 million in 2008. An adequate system of internal controls includes policies, procedures and an accounting system that effectively safeguards cash receipts from loss, waste or misuse. Such a system of internal controls should provide for the segregation of duties so that the same individual is not responsible for calculating amounts due (billing) and collecting payments. An effective accounting system should uniquely identify each transaction where an amount is due. Each payment received should be similarly identified. Once billing and receipt information has been entered into the accounting system, there must be controls in place to prevent and/or detect the manipulation of that information. To ensure that all cash receipts are properly accounted for, the amounts processed/billed should be periodically reconciled to the moneys received and deposited. These reconciliations should be performed by someone other than the person collecting the payments.

The Town does not have an effective internal control system in place to adequately safeguard cash receipts in these three departments. There was a lack of segregation of duties between the billing and collection functions, accounting systems did not always effectively identify and record each transaction and did not safeguard data from manipulation in each of these departments. In addition, periodic reconciliations were not performed to compare amounts that should have been collected to amounts that were received, transmitted, and deposited. Although we did not find significant deficiencies with the transactions we reviewed, these internal control weaknesses place departmental cash receipts at risk of loss or misuse.

Segregation of Duties

Fees to be charged for departmental services should be determined by the individual who will perform the service(s). Properly calculating the necessary fees and then recording the amounts due in the accounting system establishes accountability over the moneys to be collected. Any adjustments to recorded amounts due should be made by this individual also. Someone else should then collect and record all payments. This segregation of duties helps ensure that all moneys due are properly collected, recorded and deposited. In each of these three departments, this segregation of duties was lacking.

Building and Zoning Department — The Building Department charges Board-established fees for services such as issuing building permits, performing fire inspections, conducting file searches, and

enforcing zoning regulations. Fees are often paid in person at the Building Department Office and weekly cash receipts average more than \$9,500. For 2008, reported revenues for the Building Department totaled \$552,957.

The Building Department is staffed with a department head, a building inspector, two fire inspectors, and two secretaries. However, duties are not adequately segregated among these individuals to provide sufficient control over moneys received. One person, a secretary, is responsible for verifying the fees⁴ to be charged, collecting payments, and recording the payments in the Department's accounting system. All moneys are kept by the secretary until she remits them to the Receiver for deposit into the Town's bank account. As a result, the secretary could misappropriate Department moneys without being detected.

Recreation Department — The Recreation Department charges fees for services such as summer and winter youth and adult recreation programs and senior citizen programs. For program participation, parents or participants complete an application that includes the amount of the fee due. These fees range from \$25 to \$800 and total reported revenues for 2008 were \$225,803.

The Recreation Department is staffed with a Director and two recreation leaders.⁵ However, duties are not segregated among these individuals to adequately safeguard cash receipts. One of the leaders checks the applications, verifies the fees to be charged, collects payments and records the payments into the Department's accounting system. If this person is absent, the Director or the other leader accepts applications and payments and puts it in the leader's office for her to record later. Moneys collected are transmitted to the Receiver for deposit into Town bank accounts. As a result, the leader could misappropriate Department moneys without being detected.

Planning Department — The Planning Department collects fees for reviewing and approving subdivisions including application fees, recreation fees, site inspection fees and downstream drainage fees. Fees and escrow amounts are determined according to the Town's fee schedule. When an application is received, a fee is collected and the Department also collects an escrow amount for costs⁶ associated with preparing the site plan. Escrow amounts range from \$100, but more often \$1,000 to \$25,000. Total reported receipts for 2008

⁴ In many instances, the customer initially calculates the fee when filling out the application.

⁵ The Town contracts with other individuals to run the programs.

⁶ Such costs for engineers and/or consultants are paid through the Town's accounts payable system.

were \$1,087,500. At year-end, the Town reported balances totaling \$608,872 for the escrow accounts.

The Planning Department is staffed with a secretary. She collects various fees, records the moneys collected into the department's accounting system, and regularly transmits moneys to the Receiver for deposit. The secretary also calculates the amounts due and collects payments for the escrow accounts. If additional escrow moneys are needed later on, she notifies the customer and collects those payments also. As a result, the secretary could misappropriate Department moneys without being detected.

Accounting Records

Uniquely identifying billing and payment transactions helps establish accountability. Each time a service is provided the transaction and resulting amount due must be uniquely identified. Each time money is received the payment transaction must also be uniquely identified and referenced to the service transaction that resulted in the payment. Accountability is best accomplished by assigning each transaction a number that has not been previously used. These numbers should be assigned consecutively. Press-numbered documents and/or logs of numbers used help ensure the integrity of the identification system.

To effectively maintain the accountability established when amounts due (and subsequent payments) are recorded, the accounting system must be safeguarded from manipulation. Accounting system controls must ensure that recorded amounts due (billed) are only changed with authorized approval. The person recording moneys collected should not be able to change the recorded amount due. Such changes should only be made by the person (inspector, etc.) who initially calculated the amount due. All changes should be tracked within the accounting system.

In each of the three Departments reviewed, the accounting system did not effectively identify all transactions and adequately safeguard cash receipts data from subsequent manipulation. Amounts due for services requested or performed and submitted applications are not recorded in the accounting system. Transactions are only recorded at the time of payment. The Recreation Department issues unnumbered receipts to payees. The Planning Department does not issue receipts. Only the Building Department's accounting system assigns unique identification numbers to building permit, fire inspection and file search payment transactions. Although this system effectively identifies payment transactions, internal controls are weakened when an auxiliary program is used to summarize cash activity. In each Department, a staff member uses a spreadsheet program (separate from the accounting system) to prepare the transmittal report that accompanies the moneys remitted to the Receiver for deposit. These

spreadsheet programs allow data to be easily altered or deleted without leaving any evidence of the changes made.

When amounts due are not uniquely identified and entered into the accounting system (by someone other than the person collecting the payments), there is an increased risk that errors or irregularities could occur and go undetected. Unnumbered, single-copy documents could be easily lost or destroyed and then the corresponding moneys could be misappropriated. When recorded data can be easily altered or deleted without detection, the information produced by that accounting system is unreliable and any accountability for cash receipts is lost.

Periodic Reconciliations

Effective reconciliations of receipts to amounts due are only possible when initial accountability is established by segregating duties and maintained by controlling accounting system changes. Then, someone other than the person collecting and recording payments should periodically compare amounts collected with amounts deposited. Such reconciliations will help detect any moneys that were not properly deposited in Town bank accounts. In each department reviewed, periodic reconciliations were not performed to account for all cash receipts. Amounts due are not effectively compared to amounts collected and deposited for the departments.

For example, in the Building and Zoning Department, amounts due are based on sequentially numbered applications⁷ for building permits and fire inspections. The applications are not compared to amounts remitted to the Receiver for deposit. Similarly, amounts due based on manual records of application numbers issued are not compared to transmittals. Also, amounts due based on reports of sequentially-numbered file searches are not reconciled to the amounts transmitted for deposit. In the Recreation Department class rosters are not reviewed (for the number of participants listed) to determine the amounts that should have been collected and deposited. The Recreation Director does reconcile amounts recorded in the spreadsheet program to the Town's accounting records. However, this reconciliation is not completely effective. It will only detect posting errors and will not detect receipts that were not properly recorded or deposited. Finally, the Planning Department does not periodically compare amounts per approved applications to amounts recorded and deposited to ensure that all moneys are accounted for.

Proper reconciliations performed by someone other than the person collecting cash receipts can help detect errors and irregularities. Because of accounting system weaknesses and the inadequate

⁷ The software also sequentially numbers final permits, approved by the appropriate inspector.

segregation of duties, effective reconciliations can only be performed using data from third-parties, obtained outside the accounting system. Without such data generated and verified by someone other than the person collecting departmental moneys, there is no assurance that all moneys are properly accounted for.

Because of the internal control weaknesses in the three Departments, we reviewed selected cash receipt transactions for each of the Departments.⁸ We found minor errors, which we discussed with Town officials. Our limited review did not reveal any instances of wrongdoing.

Recommendations

5. Applications for services should be processed and fees should be calculated by someone other than the person collecting the payments.
6. Each application/transaction should be uniquely and consecutively identified (numbered). The identifying numbers should be referenced on the press-numbered receipts issued by the person collecting payment.
7. Applications processed should be periodically reconciled to moneys transmitted and deposited to ensure that all cash receipts are properly accounted for. Such reconciliations should be performed by someone other than the person collecting the moneys.

⁸ See Appendix C for a detailed list of the transactions

Cash Management

Effective management and safeguarding of municipal cash deposits is crucial for efficient operations. Local officials must have policies and procedures in place that control cash transactions and adequately safeguard all deposited moneys.

Cash investment policies and procedures help ensure that moneys are not lost, wasted, or misused. Written agreements with Board-designated depositories effectively protect the Town's interests and safeguard deposits from loss due to bank failure. Because of the size and significance of municipal cash deposits, many of the policies and procedures to manage and safeguard these assets are incorporated in statute. For example, GML requires local governments to adopt a written investment policy and requires that all securities pledged by banks to secure deposits be held pursuant to a written security and custodial agreement.

Municipal deposits, including invested moneys, must be adequately safeguarded. Moneys must be deposited in Board-designated, statutorily-authorized banking institutions. Such deposits are then protected up to the limits of the Federal Deposit Insurance Corporation (FDIC) coverage. Amounts on deposit in excess of this coverage must be secured by written agreements and pledges of collateral. Investments of municipal moneys are controlled by an investment policy that limits the types of permissible investments to those authorized by statute.

Town officials did not have adequate policies and procedures in place to effectively manage and secure cash deposits. Deposits were not adequately secured because the Board did not monitor compliance with its policy. As a result, security agreements were not properly executed. Because of these weaknesses, Town moneys are at an increased risk for loss or misuse.

The Town's investment policy, adopted by the Board in 1992, provides a framework of controls over invested moneys. The policy identifies the types of investments that are permitted and outlines the requirements for securing those investments. Among other things, the policy allows investments in time deposit accounts in, and certificates of deposits issued by, a bank or trust company authorized to do business in New York State. The investment policy requires that investments be secured by FDIC coverage or obligations of the United States, obligations of Federal agencies guaranteed by the United States, obligations of New York State, or obligations of New York State local governments. Where such obligations are pledged

as collateral to secure Town moneys, the policy states that collateral shall be preferably delivered to a custodial bank with which the Town has entered into a custodial agreement.

Although the Board has established a policy and framework of controls over Town investments, it has not effectively monitored these controls. Written agreements were not in place to effectively secure deposits in excess of FDIC coverage. We reviewed the collateral agreements with six banks holding Town funds. One agreement was not signed or dated and another agreement was signed, but not dated. In the event of default by a banking institution, an incomplete or unsigned document may not adequately protect the Town and could result in lost funds in excess of FDIC coverage. As of December 31, 2008, the Town had \$346,734 and \$1,889,036 invested/deposited with these two banks. In addition, the Town's collateral agreements generally allow a much broader range of obligations than those allowed in the Town investment policy. Our review of the securities pledged as collateral indicated the obligations were allowed under GML, but not the more stringent requirements of the Town's investment policy.

When policies adopted by the Board to safeguard Town deposits and investments are not followed, there is an increased risk that moneys could be lost. Improperly executed security agreements could lead to a loss of funds should the Town need to obtain securities pledged on its behalf. Without procedures in place to monitor investment and banking activities, the Board cannot ensure that all controls are in place and working as intended.

Recommendations

8. The Board should ensure that the key provisions of its investment policy are followed. Fully-executed security agreements should be in place with all banks holding Town deposits.
9. The Board should review its investment policy's provision regarding the types of obligations the Town will accept as pledged collateral to secure its investments. The Board should ensure that future pledged collateral agrees with the provisions in its investment policy.

Information Technology

The Town's information technology (IT) system is a valuable and essential part of operations, used for accessing the internet, communicating by email, processing and storing data, maintaining financial records, and reporting to State and Federal agencies. The routine reliance on and the complexity of these computerized applications creates internal control risks such as unauthorized access to data and equipment, unauthorized changes to data master files, and the loss of data or equipment. If the IT system fails, the results could range from inconvenient to severe. Even small disruptions in processing can require extensive effort to evaluate and repair. Accordingly, Town officials are responsible for establishing internal controls over the IT system and data to protect these assets against the risk of loss, misuse, or improper disclosure of sensitive data.

Town officials have not developed a formal security plan or a disaster recovery plan. Although data back-up files are created daily, those files are not adequately secured or tested. Remote access is granted to IT support providers and several Town employees without proper policies and agreements in place. Finally, IT system administration duties are performed by individuals who also perform financial duties. These duties are incompatible. As a result of these weaknesses, the Town's IT system and electronic data are at increased risk of loss, misuse and/or manipulation.

Security Plan

Town officials are responsible for developing a formal written security plan to document the process for evaluating security risks, identify and prioritize any vulnerable areas, and document the process for discussing and determining solutions. It is important for the plan to establish a framework for an ongoing process to identify areas of risk, and to develop and monitor the effectiveness of the policies and procedures to control those risks. Officials should distribute the security plan to all Town employees who have access to applications, servers, and networks. The plan should also establish a security management structure and clearly assign security responsibilities.

Town officials have not developed a formal, written security plan. Without a well-developed, written, security plan, areas that could be at risk may be overlooked, and the internal controls that are put into place to control risk may not be appropriate and/or effective. In the event of a security breach, critical data could be lost, stolen, or corrupted.

Disaster Recovery Plan

A disaster recovery plan is intended to identify and describe how Town officials plan to deal with potential disasters. Such disasters may include any sudden, catastrophic event (e.g., fire, computer virus, or inadvertent employee action) that compromises the availability or integrity of the IT system and data. Contingency planning to prevent loss of computer equipment and data as well as the procedures for recovery in the event of an actual loss is crucial to an organization. The plan needs to address the roles of key individuals and include precautions to be taken to minimize the effects of a disaster so officials and responsible staff will be able to maintain or quickly resume day-to-day operations. In addition, disaster recovery planning involves an analysis of continuity needs and threats to business processes and may also include significant focus on disaster prevention.

Town officials have not developed a comprehensive disaster recovery plan. Therefore, in the event of a disaster, Town personnel have no guidelines or plan to follow to prevent the loss of equipment and data or to appropriately recover data. The lack of a disaster recovery plan could lead to loss of important financial data along with a serious interruption to Town operations, such as not being able to process checks to pay vendors or employees.

Data Backup

It is important for Town officials to back up (i.e., create a copy of) computer processed data on a routine basis, and the copy must be stored at an environmentally and physically secure off-site location for retrieval in case of an emergency. The back-up data also needs to be periodically tested to ensure that the data could actually be restored in the event of a problem.

Although the Town performs daily and weekly data backups of its financial system, it does not store the data back-up tapes in a secure off-site location. Instead, a Town employee performs the data backup and maintains custody of the tapes, which are stored with the servers, on-site. As a result, backups of Town data are exposed to the same hazards of the original data and would likely be damaged or destroyed with the original data if a disaster were to occur.

The Town does not have a formal process to periodically restore system data from the back-up copies. Therefore, there is no assurance that the back-up data is complete, accurate and reliable and that the restoration will be successful. The Town risks losing valuable computer-processed data if its system were to become compromised and back-up files were not able to restore it to normal operations.

Remote Access

Remote access is the ability to log onto a network from off-site locations using a computer, a modem or internet access, and remote-access software. Remote access causes security risks for an otherwise

secure network because off-site computers, even if physically secure, may be vulnerable to threats from other systems. If remote access capability is granted to third parties and employees, then policies, procedures and agreements need to be established for the access. Regular monitoring of such access will help to preserve the integrity of Town systems and data.

Town officials have not established and implemented policies and procedures governing remote access and, as a result, the Town is at risk of unauthorized changes to the system, programs, or data without the knowledge of Town officials. Without an acceptable-use policy and/or remote-access agreements with the Town's providers of application support and its employees,⁹ there is an increased risk that the Town's IT resources could be compromised or unauthorized transactions could be initiated and not be detected.

System Administrator

To control electronic access, a computer system or application needs a process in place to uniquely identify users and establish relationships between a user and a network, computer, or application. Accounts are created by the system or application administrator that contain information about the users, access rights to files, applications, directories and other computer resources. To provide for a proper segregation of duties and internal controls, a financial software system must allow users access to only the computer functions that are necessary to fulfill their job responsibilities, and it must prevent users from being involved in multiple aspects of financial transactions. In addition, because a user with administrative rights can add new users, change users' passwords and rights, and control and use all aspects of the software, he/she should not be involved in financial functions.

The administration of the Town's computerized financial system is under the control of the Comptroller and the principal account clerk, who serve as the system administrators. As the system administrators, the Comptroller and the principal account clerk have unrestricted access to the financial system and the ability to assign user privileges. With administrator rights, the Comptroller and the principal account clerk can access all financial operations (including payroll and general ledger) and have the ability to change financial data and then conceal the transaction. Without a segregation of duties between system administration, payroll, and general ledger operations, there is an increased risk that unauthorized access and/or modification to data may occur and go undetected.

⁹ Remote access is granted to seven Town employees, including the network administrator and the accounting software administrator.

Recommendations

10. Town officials should develop a formal, written security plan.
11. The Town should develop and implement a formal disaster recovery plan, identifying potential risks and detailing responses to be taken. Town officials should distribute the plan to all responsible parties, periodically test the plan, and update the plan as needed.
12. Town officials should store backups of Town information at an environmentally and physically secure off-site location. In addition, this data should be periodically tested to verify that it is capable of restoring the Town's system.
13. The Board should establish policies and procedures that ensure remote access to computer assets and data is effectively restricted to authorized personnel and to define acceptable use of computer and technology resources. Access should be restricted through increased controls over users with remote access to the system.
14. The Board should assign IT system administration to someone not involved in day-to-day financial operations.

APPENDIX A

RESPONSE FROM TOWN OFFICIALS

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

The "Observation" and "Recommendation" side headings included in the Town's response do not match the commentary of our findings or the actual recommendations included in our report.

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August 2, 2010

Kenneth Madej, Chief Examiner
Local Government and School Accountability
State of New York, Office of the State Comptroller
110 State Street
Albany, New York 12236

Re: Town of Fishkill – Preliminary Draft Examination Findings

Dear Mr. Madej:

We've had the opportunity to review the preliminary draft examination findings that you forwarded to us and offer this as our response.

FINANCIAL CONDITION

Observation:

Interfund loans (liabilities) have not been repaid as of December 31, 2009.

Recommendation:

The loans receivable in the primary lending funds need to be properly accounted for.

Response:

Included among the Interfund loans is a loan for the Rombout sewer facility, a significant portion of which was repaid in 2009.

Observation:

The board routinely failed to monitor expenditures during the year to ensure they stayed within budgeting limits.

Recommendation:

The board should regularly monitor expenditures versus budget, as a matter of course.

Response:

The board now monitors financial statements on a monthly basis. The Supervisor now meets with the Comptroller at least on a weekly basis.

Observation:

The Town used restricted moneys from trust funds and capital projects to finance operations.

Recommendation:

Trust funds and moneys designated for capital projects should only be used for the purposes set forth in their authorizing legislation or resolution, as the case may be.

Response:

The affordable housing trust fund of Fishkill was set up by local legislation which did not explicitly provide that this fund was restrictive for purposes of GML 9-a (1)(b), or otherwise. It is a creature of local rather than state legislation. The purposes of the fund include, for instance, expenditures for general infrastructure improvements which happen to advance affordable housing. The Town intends, by local law, to clarify the nature of this fund in relation to GML 9-a(1)(b) to address the interpretation issue raised by the Comptroller. The Town intends to restore the outstanding inter-fund advance as part of its fiscal plan.

Observation:

There was a total unreserved fund balance deficit of more than \$4.9 million.

Recommendation:

The loans receivable should have been properly accounted for, and budgets should have been enacted that would have financed town operations.

Response:

The Town strongly disagrees with the State's \$4.9 Million figure. The State is overstating the Town's unreserved deficit by including inter-fund borrowings and assuming that the General Fund Outside Town cannot pay back the borrowings from the other funds. This add-back creates an "artificial expense", but NYS's calculation does not show the "artificial revenue" which would be correspondingly created. The Due To/From issue is essentially one of cash flow and not a fund balance issue, since the Town has the ability to borrow to cover these inter-fund borrowings. The Town and NYS acknowledge the fund balance deficits as accurate, as shown in the Town's audited financial statements. As noted above the "due from/due to" impacts the cash position for each fund, it doesn't impact the fund balance. The Town has developed a Five Year Plan to restore its fund balances to a positive position and keep it on solid footing.

See Note 1 Page 30

Observation: The Town consistently outspends revenue.

Recommendation:

The Town needs to cut costs and control spending, and develop a comprehensive multi-year financial plan to address its fiscal problems.

Response: The Town has prepared a multi-year fiscal forecast and is actively cutting costs and controlling spending. The combined amount of savings has totaled total approximately \$1,683,466 since 2008 (or \$2,745,794 since 2004). These savings were achieved in a number of ways, including compressing the work week to four days, downsizing staff, elimination of pay increases, and institution of user fees for recreation programs. Shortfalls were more a result of revenues that did not meet expectations due to various economic conditions not only in the Town, but also on a state and national level.

CASH RECEIPTS

Observations:

The Town lacks internal controls to safeguard cash receipts, and placing departmental cash receipts at risk of loss or misuse.

Recommendations:

The Town should implement an accounting system that provides for segregation of duties, uniquely identifies each transaction, detects manipulation of information, and is periodically reconciled to the moneys received and deposited.

Response:

There was absolutely no evidence of any malfeasance with respect to cash receipts. The Town cannot realistically employ the number of people required to be able to implement the segregation of duties as recommended, when it must operate with minimal staffing doing the maximum job given the limited budget with which the Town conducts its operations.

See
Note 2
Page 30

Observation:

There is a lack of segregation of duties and proper reconciliation of deposits versus receipts.

Recommendation:

Fees should be calculated by someone other than the individual collecting and processing their payment; periodic reconciliation of receipts versus deposits should be conducted to ensure proper accounting, and this should be done by someone other than the person who collects the moneys.

Response:

There were no instances of wrongdoing. The Town must operate on a limited budget and cannot afford to hire additional staffers whose main duty is to ensure segregation of duties at all times. We work with the minimum number of staffers doing the maximum work, because it is simply not affordable to increase staff beyond that which is absolutely essential. We feel it is important to note that in each instance where the Town was criticized for not segmenting the handling of cash from other portions of the transactions, the suggestions in the audit report are impractical given the necessarily minimal number of employees in those departments. As an example, the building department's inspectors are out in the field doing their inspections, and not waiting behind a counter to calculate fees or collect and record payments. That leaves two administrative assistants to take care of the money. It is impractical and we have no way to pay the salary and benefits required to hire additional staffers solely to ensure that there is no opportunity for crossover of the individual tasks as has been suggested. The same situation repeats itself in the recreation and planning departments. We ask our staff to multitask and expect the departments to do more with less because we cannot afford to bulk the departments with additional clerks whose main purpose is to ensure absolute compliance with the segregation suggestions. We feel that these departments handle incoming fees and deposits in substantially the same way that similar departments in other communities across New York do, and in a way that is the accepted norm given the limited resources with which we must all make do. We feel that more attention should have been paid to the fact that absolutely no instance of impropriety on the part of any of our staff members was found during your examination.

See
Note 2
Page 30

APPENDIX B

OSC'S COMMENTS ON THE TOWN OFFICIALS' RESPONSE

Note 1

Accounting for these interfund loans as current (available) assets ignores the fact that they have not been repaid as of end of the subsequent fiscal year. For that reason, they cannot be considered available for spending. Because they are not available for current spending, accounting standards and guidance require that available (unreserved) fund balance be reduced (reserved) by the amount of such loans. Our report shows the effect these reservations of fund balance had on the Town's major operating funds that made the loans. There are no "artificial" expenses or revenues involved.

Reported fund balances may be accurate, but the unreserved (available) fund balance is over-stated by the amounts shown in our report.

Note 2

There are a number of ways that Town officials could enhance controls without adding additional staff. Town officials could reassign duties of existing staff so that the work of one employee serves to check on the work of another. In addition, Town officials could institute compensating controls, such as additional supervisory or Board review of transactions, to address situations where sufficient staff is not available. Although our limited testing of cash receipts did not identify any improprieties, if current practices are not changed, there is a high risk that moneys may be misappropriated and go undetected.

Note 3

This section of the response letter was redacted because of the sensitive nature of the information. Our audit disclosed areas in need of improvement concerning cash management controls. Because of the sensitivity of this information, certain vulnerabilities were not discussed in this report but have been communicated separately to Town officials so they could take corrective action.

APPENDIX C

AUDIT METHODOLOGY AND STANDARDS

Our overall goal was to assess the adequacy of the internal controls put in place by 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 condition and control environment, cash receipts and disbursements including departmental income, purchasing, payroll and personal services, and information technology. During the initial assessment, we interviewed Town officials, performed limited tests of transactions, and reviewed pertinent documents such as Town policies and procedures manuals when available, Board minutes, and financial records and reports.

After reviewing the information gathered during our initial assessment, we determined where weaknesses existed, and evaluated those weaknesses for the risk of potential fraud, theft and/or professional misconduct. We then decided upon the reported objectives and scope by selecting for audit those areas most at risk. We selected for further review financial condition, cash receipts, cash management, and information technology.

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

- We interviewed Town officials responsible for financial oversight and for maintaining accounting records to gain an understanding of the Town’s policies and procedures.
- We reviewed the Supervisor’s management of financial operations and, on a test basis, compared reported assets and liabilities to supporting documentation.
- We reviewed budget versus actual statements to examine variances, analyzed changes in fund balance to determine trends and evaluated factors contributing to fund balance. We compared budget estimates to actual revenues, expenditures, and fund balances to determine if the revenue estimates were reasonable and if fund balance was available. We also reviewed documents pertaining to reserve funds and interfund transfers.
- We reviewed accounting records including bank reconciliations, cash receipts, and annual budgets.
- For departmental cash receipts, we interviewed appropriate officials and examined records to determine the fees collected by the department. We also reviewed cash receipt records maintained by the departments and compared receipts recorded in the general ledger with deposits made to the bank.
 - o For the Building and Zoning Department, we reviewed 95 transactions with 102 cash receipts totaling \$38,651 collected.
 - o For the Recreation Department, we reviewed 132 receipts totaling \$27,724 for three programs with 101 participants. We traced activity attendance sheets to the cash receipts summary to the deposit in the bank.

- o For the Planning Department, we reviewed six of 18 applications amounting to \$119,925 in application fees and \$36,172 of escrow received and four transactions that included \$631,125 of recreation fees, \$29,500 of site inspection fees and \$426,520 of downstream drainage fees.
- We reviewed internal controls and procedures over cash management. We reviewed bank collateral agreements and the collateral provided.
- We reviewed internal controls and procedures over the computerized financial databases to help ensure that the information produced by such systems was reliable.

We conducted our performance audit in accordance with generally accepted government auditing standards (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 D

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