



# City of Little Falls

## Internal Controls Over Selected City Operations

### Report of Examination

Period Covered:

January 1, 2011 — July 31, 2012

2013M-214



Thomas P. DiNapoli

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# State of New York Office of the State Comptroller

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## Division of Local Government and School Accountability

November 2013

Dear City 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 City Council 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 City of Little Falls, entitled Internal Controls Over Selected City 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

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# EXECUTIVE SUMMARY

The City of Little Falls (City) is located in Herkimer County and has approximately 4,900 residents. The nine-member Common Council (Council) is the City's legislative branch and comprises the Mayor and eight Aldermen. The Mayor is the City's chief executive officer and the Treasurer is the chief fiscal officer.

The City's budgeted operating fund expenditures totaled \$5.9 million for the 2013 year. The City provides services to its residents, including general government support, police and fire protection, street maintenance and snow plowing, water and sewer services, refuse and garbage, and parks and recreation.

### **Scope and Objectives**

The objectives of our audit were to examine the City's internal controls over the Treasurer's Office and accountability over water operations for the period January 1, 2011 to July 31, 2012. Our audit addressed the following related questions:

- Are internal controls over the Treasurer's cash receipts and disbursements adequately designed and operating effectively to safeguard City assets?
- Does the City adequately monitor the amount of water produced in comparison to the amount sold to customers and address excessive water loss?

### **Audit Results**

The Council and Treasurer have not ensured adequate internal controls are in place over cash receipts and disbursements handled by the Treasurer's Office. The Treasurer did not perform adequate bank reconciliations and did not record all financial transactions accurately, completely, timely and in a clear and transparent manner. In addition, there is not adequate segregation of duties within the Treasurer's Office.

Bank reconciliations prepared by the Treasurer were not complete and accurate. The Treasurer's June 2012 main checking account bank reconciliation shows a difference of \$14 between the bank and book balances; however, we calculated a difference of \$4,518. This was due in part to the Treasurer including checks as outstanding that had already cleared the bank. The Treasurer's outstanding check list for June 2011 was also inaccurate. He identified outstanding checks totaling \$98,305, but the actual outstanding checks totaled \$62,222. The Treasurer could not explain this discrepancy. The

failure to properly reconcile bank accounts increases the risk that improper transactions could occur and go undetected and uncorrected.

The Treasurer did not routinely record all financial transactions in a clear and transparent manner. We found unsupported, untimely, unrecorded and inaccurately recorded transactions. The Treasurer made journal entries that reduced the cash balance in the accounting records by \$114,163 without support or reasonable explanation, including a reduction of \$93,714 in December 2011. The Treasurer told us he made this entry to reconcile the bank account. The Treasurer did not record three deposits totaling \$20,794 in the accounting records and he did not record a \$14,114 deposit until 10 months after it was received. Transactions were not always recorded with the appropriate account code. For example, the Treasurer recorded a \$158,365 court-ordered property tax refund as a machinery expense. The Treasurer wrote two checks out of the main checking account to cover shortages of \$415 in daily deposits. Although this made it look like the daily deposits were complete because he substituted the checks for missing receipts, it did not actually make up the shortage because the checks were drawn on the same bank account to which they were being deposited. When the Treasurer does not properly record transactions, the City lacks an audit trail and is more susceptible to errors and misconduct. In addition, the Council does not have complete and accurate financial records for effectively managing City operations.

The Council and Treasurer have not ensured that duties are adequately segregated related to collecting, recording and depositing receipts; recording disbursements; and preparing bank reconciliations. Further, user access within the financial software was not limited based on job duties, and employees shared certain user accounts. While our sample testing did not identify fraudulent activity, the degree of unsupervised control that the Treasurer was permitted to have over the City's financial activity has not only resulted in inaccurate accounting records and reports, but also created a risk that funds could be misappropriated and improper activities easily concealed.

Finally, the Federal Environmental Protection Agency (EPA) has established an industry goal of 10 percent for unaccounted-for water losses. The City is losing 54 percent of the water it distributes, which is substantially higher than the EPA goal. In 2011, the City reported that 719 million gallons of water was treated and 331 million gallons was delivered or used, leaving 388 million gallons of unaccounted-for water. The cost of unaccounted-for water for 2011 is about \$265,000. Unaccounted-for water creates a production expense for the City for which there is no revenue.

### **Comments of Local Officials**

The results of our audit and recommendations have been discussed with City officials and their comments, which appear in Appendix A, have been considered in preparing this report. City officials generally agreed with our recommendations and indicated that they plan to initiate corrective action.

# Introduction

## Background

The City of Little Falls (City) is located in Herkimer County (County) and has a population of approximately 4,900. The Common Council (Council) is the City's legislative branch and is comprised of eight elected members and the Mayor. The Council has oversight responsibilities and can adopt and amend local laws, ordinances and resolutions. The Mayor is the City's chief executive officer and the presiding Council member.

The City provides various services to its residents, including general government support, police and fire protection, street maintenance and snow plowing, water and sewer services, refuse and garbage, and parks and recreation. These services are primarily financed by real property taxes, State aid, sales tax and sewer and water rents. The City's budgeted expenditures for the 2013 fiscal year are \$5.9 million.

The elected Treasurer is the City's chief fiscal officer. The Treasurer's Office includes the Treasurer and two clerks. In addition to collecting real property taxes and other receipts, the Treasurer is responsible for collecting County real property taxes from January through March. At the end of the collection period, the Treasurer refers unpaid County taxes to the County for collection.

The Board of Public Works (BPW) is the governing body responsible for the City's water distribution system. The distribution system is overseen by the Chief Water Treatment Plant Operator (Chief Operator). The City provides water services to approximately 1,700 metered customers.

## Objectives

The objectives of our audit were to examine the City's internal controls over the Treasurer's Office and its monitoring of the water distribution process. Our audit addressed the following related questions:

- Are internal controls over the Treasurer's cash receipts and disbursements adequately designed and operating effectively to safeguard City assets?
- Does the City adequately monitor the amount of water produced in comparison with the amount sold to customers and address excessive water loss?

**Scope and  
Methodology**

We examined selected City operations including internal controls over the Treasurer’s Office and water distribution monitoring for the period January 1, 2011 to July 31, 2012.

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 is included in Appendix B of this report.

**Comments of  
Local Officials and  
Corrective Action**

The results of our audit and recommendations have been discussed with City officials and their comments, which appear in Appendix A, have been considered in preparing this report. City officials generally agreed with our recommendations and indicated that they plan to initiate corrective action.

The Common Council 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 Common Council to make this plan available for public review in the City Clerk’s office.

## Treasurer's Office

The Council and Treasurer are responsible for ensuring there are adequate internal controls over cash receipts and disbursements to properly safeguard the City's cash assets. It is important for the Council to establish policies and procedures and provide sufficient oversight of those officers and employees who receive or disburse cash. For example, one person should not control all phases of a transaction (cash custody, recordkeeping and reconciliation).

The Treasurer, as the City's chief fiscal officer, is responsible for the receipt, disbursement and custody of City moneys. The Treasurer is also responsible for the basic accounting functions and for establishing internal controls to provide reasonable assurance that cash transactions are properly initiated, accurately recorded, reconciled and properly approved and documented. It is critical that the Treasurer maintains suitable records and documents financial information accurately in order to provide the Council with reliable financial information that it needs to effectively manage City operations.

The City's accounting records were in considerable disarray and the Council, along with the Treasurer, has not established adequate internal controls over cash receipts and disbursements to adequately safeguard City assets. The Treasurer did not perform adequate bank reconciliations and did not record all financial transactions accurately, completely, timely and in a clear and transparent manner. For example, the Treasurer made numerous adjustments to cash, including a \$93,714 unexplained adjustment to decrease cash, to reconcile his records to the bank balance. In addition, the Treasurer has not adequately segregated duties. Although our audit testing did not disclose any instances of fraud, the unreliable bank reconciliations, poor accounting records and lax controls and oversight of cash receipts and disbursements create an environment that is highly susceptible to fraud occurring and going undetected. As a result, the City's assets are at significant risk of loss.

### **Bank Reconciliations**

The reconciliation of bank balances to general ledger cash balances is an essential control activity which allows officials to verify that all cash receipt and disbursement transactions are captured and correctly recorded. Monthly bank reconciliations provide for the timely identification, correction and documentation of differences between City records and bank cash balances. It is a good business practice to have someone other than the person who prepares bank reconciliations review and approve them.

The Treasurer performs monthly bank reconciliations for the City's 15 bank accounts; however, there is no procedure in place for anyone to review the reconciliations. Our review of bank reconciliations showed that the Treasurer did not complete bank reconciliations for the main checking account for four months during our audit period – January 2011, October 2011, November 2011 and July 2012. The main checking bank account includes cash transactions for all of the City's main operating funds (general, water and sewer), therefore increasing the importance of an accurate and timely reconciliation.

In addition, we examined the Treasurer's most recently completed bank reconciliations, which included 14 bank accounts as of July 31, 2012,<sup>1</sup> and the main checking bank account as of June 30, 2012. We found that the Treasurer did not perform adequate or accurate bank reconciliations for the main bank checking account and a payroll bank account. Although the Treasurer's reconciliation of the main checking bank account shows an unidentified difference of \$14 as of June 30, 2012, our review of the bank reconciliation disclosed an unidentified difference of \$4,518.<sup>2</sup> We found significant errors in the Treasurer's bank reconciliation, including the following:

- Outstanding checks on the Treasurer's reconciliation totaled \$18,204, but the actual total of outstanding checks equaled \$2,070 – a difference of \$16,134.
- The Treasurer adjusted his book balance for deposits not yet recorded; however, the amount he adjusted by was too low by \$4,302. He adjusted the wrong amount for one deposit and did not account for several others.
- The Treasurer's reconciliation shows various adjustments for checks that cleared the bank but were not yet recorded in the records. The net effect of errors made in his adjustments was \$7,300. One check for \$12,745 should not have been included because it had not actually cleared the bank yet. Another check was incorrectly listed for \$55, when the check actually cleared the bank for \$5,500 – a difference of \$5,445.

The Treasurer made similar errors in the reconciliation of a payroll bank account. Because of the inaccuracy found in the Treasurer's

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<sup>1</sup> The July 2012 reconciliation for the main checking bank account was not complete at the time of our testing.

<sup>2</sup> The adjusted bank balance exceeded the general ledger cash balances after factoring in certain deposits and cleared checks that were not entered into the accounting records for the month of June 2012. This reconciliation does not take into account other errors found during our audit period, as described later in this report.

outstanding check lists, we reviewed the outstanding check lists prepared by the Treasurer for the main checking bank account for other months during our audit period and we identified numerous errors. For example, the Treasurer's reconciliation for June 2011 showed a written total of \$98,305 for outstanding checks used to adjust the bank balance, but when the list of checks was added, the total actually equaled \$62,222 – a difference of \$36,083. The Treasurer's bank reconciliation showed his cash ledger balance agreed with this adjusted bank balance within \$125. However, the Treasurer could not explain how he was able to "reconcile" the bank account within \$125 when there was a \$36,083 error in the outstanding check list total he used in the reconciliation.

Additionally, the Treasurer did not provide a sufficient explanation for two journal entries totaling \$93,714 that he made in December 2011 to decrease the general ledger cash balance of the sewer fund. There was no documentation to support these adjustments and the Treasurer told us he made the entries to reconcile his records to the main checking bank account as of December 31, 2011. Had the Treasurer been reconciling the bank accounts accurately and investigating the differences, he would have been able to identify and correct any errors soon after they occurred rather than simply reducing the recorded cash balance in the records.

Because of the numerous errors that we found in our testing, we determined that the Treasurer's bank reconciliations are flawed and unreliable. Without sufficient bank reconciliations, the Council does not have assurance that the accounting records are correct or that moneys are accounted for properly.

## **Journal Entries**

Appropriate controls over journal entries should include supervisory approval and review before transactions are initiated and recorded. Journal entries used to enter certain financial transactions or adjustments into the accounting system must be adequately supported and documented to explain the purpose of the entries. As a general rule, the Treasurer should use the cash disbursements module in the accounting system rather than journal entries to record check payments in order to maintain a clear audit trail of check disbursements.

We reviewed 274 journal entries that reduced the general ledger cash balance by \$8.95 million to assess the adequacy and appropriateness of the journal entries. The Treasurer makes journal entries without any oversight or approval. In addition, he made journal entries that did not appropriately reflect the transaction and did not have adequate support for all the journal entries made. For example:

- We found 12 journal entries that did not have adequate support. These entries reduced the ledger cash balance in the accounting records by \$114,163. This included the two journal entries in December 2011 totaling \$93,714 that the Treasurer told us were made to reconcile the main operating bank account. When we asked the Treasurer to provide the reasons and documentation for the remaining \$20,449 in unsupported adjustments, he did not provide sufficient explanations or evidence. When unsubstantiated reductions are made to ledger cash balances, there is an increased risk that the accounting records contain errors or that the adjustments are made to hide inappropriate transactions.
- The Treasurer used journal entries to record manual checks totaling about \$5 million, including, for example, \$1.5 million for health insurance premiums. Journal entry descriptions for manual checks typically included check numbers but did not include the payee name, making it easier to hide inappropriate payments because the checks do not show up on check registers when they are entered as journal entries.
- The Treasurer made 28 journal entries, representing 21 checks, totaling \$638,000 that were not supported with documentation to justify the amount and the purpose of the entries. While these check payments appear routine in nature (e.g., insurance, retirement, debt service), it is important to retain supporting invoices for expenditures.
- The Treasurer made a journal entry to record a \$158,365 payment for a court-ordered property tax refund with the description of “bond payment” and inappropriately recorded this payment in the capital fund – machinery expenditures account code. As a result, the records are not accurate.

When journal entries in the accounting records are not reviewed and approved and not adequately supported, there is an increased risk that the records contain errors or irregularities and that adjustments could be made to cover up fraudulent transactions.

## **Recordkeeping**

Complete and accurate accounting records are essential to provide the Council with accurate information on which to base decisions. Principles of accounting are not being followed when cash transactions occur and are either not recorded or recorded incorrectly. The result is incomplete records, records that are not an accurate representation of activity, and a lack of an audit trail. The Treasurer did not record transactions or activity in the accounting system in a transparent manner. For example:

- When the Treasurer issues a replacement check, he does not void the original check in the accounting system and does not record the replacement check. Each pay period a computer-generated check is produced to pay the amounts withheld for each employee for certain insurance elections. One retiree also remits a payment each month for this particular insurance election. The Treasurer writes void on the original system checks, but does not void them in the accounting system. Then, he writes a manual check to pay the insurance invoice for the withheld amounts plus the retiree's amount without recording the check in the records. The Treasurer does not retain evidence of receipt of the retiree payment and subsequent deposit, and he does not retain the insurance invoice. When the records do not provide a clear audit trail, it is difficult to verify the legitimacy of transactions.
- Cash receipts and disbursements between City bank accounts are not always recorded in the accounting system. For example, when golf fees are paid by credit card, the funds are deposited into the City's main checking account and the Treasurer writes a manual check from the main account to the golf fund bank account. At that time, the receipt is recorded in the golf fund. There is no record of the initial receipt received and the manual check is not recorded in the accounting records.
- Checks are not always recorded for the right amount. For example, one manual check cleared the bank for \$2,227, but was recorded for \$2,727 – a difference of \$500. The Treasurer did not make a journal entry to correct the \$500 difference. Instead, when the Treasurer issued the following month's check to the same vendor he wrote it for \$500 more than the invoice indicated, but recorded it at the invoice amount (which was \$500 less). This does not provide a clear and accurate audit trail of the transactions that actually occurred.
- The Treasurer deposited a \$250,000 check from an area business in May 2012 for a bridge project and recorded it as a credit to accounts receivable in the general fund. Because a receivable was never originally recorded as a debit for the expected revenue, the Treasurer's entry resulted in understating accounts receivable and the receipt of the money was never recognized in a revenue account. After we brought this to the Treasurer's attention, he made an entry to correct the receivable balance and record the revenue in the capital fund. However, he incorrectly recorded the payment from the business as State aid.

## Segregation of Duties

The primary purpose for segregating cash custody, recordkeeping and reconciling duties is to prevent any one person from controlling all phases of a transaction and/or to prevent or detect errors, irregularities or fraudulent activity. The Council and Treasurer are responsible for ensuring that duties are segregated and controls are in place to ensure that cash receipts are deposited and recorded as received, and disbursements are properly documented and authorized. Where it is not practical to segregate these key duties, mitigating controls should be established to prevent or detect errors and irregularities. Mitigating controls can include such things as one person reviewing another's work or management review. Further, good financial software controls can help ensure accountability by providing the means to identify individual users and determine the transactions processed by them.

The Council and Treasurer have not ensured that duties are adequately segregated related to collecting, recording and depositing receipts; recording disbursements; and preparing bank reconciliations. The Treasurer's Office is operated by the Treasurer with a senior account clerk and an account clerk assisting with the office's daily operations. All three have full user access rights to the accounting system (including payroll) and the ability to make adjustments or journal entries in the accounting system without prior approvals or review, collect and record cash receipts, and prepare and record accounts payable check disbursements. In addition, the Treasurer and the senior account clerk take deposits to the bank and have check-signing authority, and the Treasurer performs the bank reconciliations. Even though the Treasurer reviews daily receipt journals and moneys provided for deposit by the senior account clerk and account clerk, this control may not detect irregularities, because each of the clerks has the ability to adjust records and moneys for deposit. Also, all three individuals share a user account to access the City's real property tax program and water/sewer module for receipts, so if a problem did arise, City officials would not be able to determine which of these individuals was responsible for the error or irregularity.

In addition, the Treasurer is solely responsible for payroll disbursements including, entering and updating pay rates, processing payrolls and direct deposits, and printing and distributing payroll checks. The Treasurer also certifies the payrolls that he processes. Any official or employee with these conflicting duties could make unauthorized changes to pay rates or process inappropriate payroll disbursements without detection.

Because the records were in such disarray and there was a lack of segregation of duties without adequate oversight, there is an increased risk that fraud could occur without City officials' detection.

To address this risk, in addition to our testing of bank reconciliations and journal entries, we tested canceled checks for payments that have a higher risk of being inappropriate (e.g., payments to City personnel, cash or unusual vendors.) We reviewed 275 canceled checks totaling \$637,326 for support and authorization. We also reviewed bank withdrawals (other than checks) for two months totaling approximately \$1 million and tested certain payroll disbursements. Other than the concerns listed below, we did not find any inappropriate payments or withdrawals for the samples tested.

- The Treasurer made 27 payments totaling \$106,757 without the audit and approval of the related claims by the appropriate Board<sup>3</sup> and he made 33 payments totaling \$98,035 prior to the audit and approval of the appropriate Board. In addition, 11 payments totaling \$12,204 were made without supporting invoices. The payment of claims by the Treasurer without the Board's prior audit and approval or adequate supporting documentation increases the risk that City moneys could be expended for inappropriate purposes.
- The Treasurer wrote two checks out of the main checking bank account and payable to the City of Little Falls to cover cash shortages of \$415 in two daily deposits, but he did not record the checks in the accounting system. The purpose was to add the checks to the daily deposit to make the bank deposit equal the daily receipts reports. However, this did not actually make up the shortage because the check was drawn on the same bank account that it was being deposited into.
- The Treasurer wrote two checks totaling \$372 payable to Cash that were not audited and approved by the Board. He told us that one of the checks for \$240 was for a golf refund for a customer; however we could not verify that the money was actually refunded to the customer. He did not provide an explanation for the \$132 check.
- The Treasurer and other office staff used cash collected in the Treasurer's Office to cash 64 City-issued checks totaling \$15,327. These checks were primarily the Treasurer's own payroll checks and checks written for petty cash. When reviewing a sample of deposit compositions, we also found four personal checks totaling \$683 that were substituted for cash that was removed from the cash drawer. Allowing

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<sup>3</sup> The City Charter requires claims to be audited by a standing committee of the Common Council. Other claims are audited by their respective board/commissions (i.e., Police/Fire Commission, Recreation Commission, Golf Commission or Bureau of Public Works).

checks to be substituted for cash received or on hand changes the composition of moneys to be deposited and compromises internal controls because it blurs the distinction between City and personal funds.

We also performed tests of cash receipts, including examining major cash receipts totaling approximately \$7.4 million, to determine if they were recorded and deposited intact (in the same amounts and form – cash, check or money order – as received) and timely. We also reviewed adjustments made to the City’s real property taxes. We found some receipts were not recorded in the accounting records. In addition, because the Treasurer and clerks did not record the forms of payments received (cash or check) and they used cash on hand to cash personal and other checks, we could not verify that all moneys were deposited intact. Our testing also found:

- The Treasurer did not record three deposits totaling \$20,794 in the accounting records and did not record a \$14,114 deposit made in February 2012 until December 2012. By not recording all receipts, or recording them unreasonably late, the Treasurer could easily conceal errors and/or irregularities.
- The Treasurer inappropriately granted farm exemptions to four properties, reducing their 2011 City tax bills by \$3,242. Real property exemptions may only be approved by the City Assessor. In addition, we reviewed 2011 City property tax collections and found that not all applicable late fees were recorded. Fees of \$422 were not recorded or deposited. The Treasurer does not have the authority to waive late fees or grant exemptions.
- The Treasurer’s Office does not maintain adequate records to account for County property taxes and penalties collected, which totaled over \$937,000 in 2011. When County taxes are received, staff members in the Treasurer’s Office mark the property listing on the hardcopy County tax roll as paid and then deposit the money into a separate City bank account. The Treasurer does not maintain chronological cash receipt records or a receivable control during the collection period to account for County property taxes, nor does he maintain any records to show what individual tax receipts make up each deposit. As a result, there is no way to trace these transactions from the point-of-collection through the accounting records to bank deposits.
- The City retains the late penalty fees collected for the County taxes. The Treasurer told us he considers any money remaining

in the bank account after settlement with the County to be penalty and interest, but he has no supporting documentation to verify the interest and penalties collected. We evaluated the timing of bank statement deposits to determine the reasonableness of the amount the Treasurer attributes to interest and penalties collected. We estimate that, based on 2011 bank statement deposit dates,<sup>4</sup> the Treasurer should have collected at least \$4,137 in late penalty fees. However, the Treasurer recorded \$3,524 in fees, which is \$613 (15 percent) less. The failure to maintain complete records increases the risk that receipts can be misappropriated.

While our sample testing did not identify fraudulent activity, the failure to segregate duties, failure to monitor and ensure the proper maintenance of accounting records and lack of independent reconciliation of cash balances resulted in inaccurate accounting records and a lack of reasonable assurance that City assets are properly safeguarded and accounted for.

## **Recommendations**

1. The Treasurer should attend training courses for accounting that cover the preparation of bank reconciliations and the maintenance of records to be able to perform the basic accounting duties of his job as the City's chief fiscal officer.
2. The Treasurer should perform complete, accurate and timely monthly bank reconciliations and ensure that any discrepancies are promptly identified and resolved. The Treasurer should submit the monthly bank reconciliations along with bank statements and canceled checks to the Council or the Council's designee for review.
3. The Treasurer should ensure that all journal entries are properly authorized and supported before they are initiated and recorded.
4. The Treasurer should record check payments as checks in the accounting system and not as journal entries.
5. The Treasurer should ensure that the City's accounting records are accurate, timely and transparent and include all activity as it occurred.
6. The Treasurer should segregate the duties of all employees in the Treasurer's Office and, when not feasible to adequately segregate duties, establish effective oversight procedures.

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<sup>4</sup> We estimated late fees based on monthly deposits for February, March and April in total.

7. The Council should ensure that someone who is not involved with payroll processing reviews and certifies the payrolls.
8. The Council should establish policies to ensure that computer access rights are compatible with the job duties and responsibilities of the users and that each user is assigned an individual user account in order to access the systems.
9. The Treasurer should establish procedures to ensure that all moneys paid to the City are properly recorded (including the payee, date, purpose and form of payment) and deposited as received.
10. The Treasurer should ensure that City funds are not used to cash personal checks.
11. When cash overages or shortages are identified during the deposit preparation process, the Treasurer should immediately investigate the cause. The Treasurer should not write a City check and include it in the deposit to make the deposits look complete.
12. The Treasurer should maintain a cash receipt record of County tax payments and penalties received and document the individual receipts that make up each deposit. He should also maintain a receivable control account for County taxes and periodically reconcile it to the list of unpaid taxes to ensure that the records are accurate.
13. Real property tax exemptions should be granted by the City Assessor, not the Treasurer.
14. The Treasurer should provide evidence to the Council that he has implemented the recommended internal controls. If he does not provide sufficient evidence, the Council should consider taking other actions as necessary to safeguard City funds.

## Water Accountability

An effective water accounting system includes the periodic reconciliation of water produced with water billed to customers and used for municipal purposes. The reconciliation is a first step in controlling water losses, reducing system costs and identifying unaccounted-for water. Unaccounted-for water includes losses that could result from source meter errors, faulty customer meters, accounting procedure errors, storage tank overflows, theft or underground leaks. The Federal Environmental Protection Agency (EPA) has established an industry goal of 10 percent for unaccounted-for water system losses. Procedures should be in place to monitor and identify the cause of water loss that is greater than the industry goal.

The City's municipal water comes from two springs, a lake and a reservoir, all of which are located north of the City's limits. The City's water is treated at a chlorination station and a slow-sand filtration plant. The City distributes water to about 1,700 metered and billed<sup>5</sup> customers and also uses water for several unmetered City purposes such as flushing mains and hydrants, fighting fires and running bleeders.<sup>6</sup> The City's Board of Public Works (BPW) is responsible for water treatment and distribution and the Chief Operator oversees day-to-day activities.

The Chief Operator prepares an annual drinking water quality report for the BPW and the public, which includes a calculation of unaccounted-for water. Unaccounted-for water is calculated by subtracting water delivered and an estimate of other unmetered uses from total water distributed. In 2011, the City reported that 719 million gallons of water was treated and 331 million gallons<sup>7</sup> was delivered or used, leaving 388 million gallons of unaccounted-for water, or 54 percent of the water it distributes, which is substantially higher than the EPA established goal of 10 percent.

We performed an analysis of water loss for 2011. Our analysis produced similar results of water distributed and delivered to those reported by the Chief Operator. According to our analysis, the City

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<sup>5</sup> Although the City meters most of its own water usage, the City does not bill itself.

<sup>6</sup> Bleeder valves serve the purpose of purging air out of a water bound pipeline, draining water from pipes in cold areas prone to freezing and for purposes related to drainage and testing of water samples.

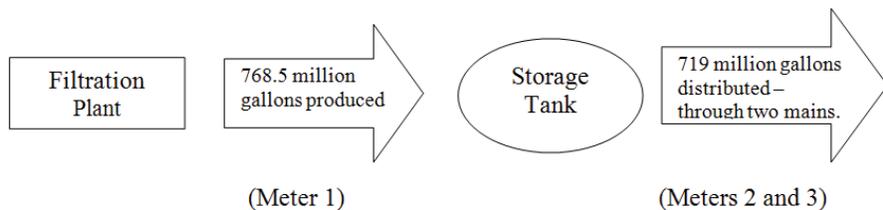
<sup>7</sup> The 331 million gallons is comprised of 281 million gallons of metered water sales and an estimated 50 million gallons for other uses. The Chief Operator estimates these 50 million gallons of water was used for other (unmetered) municipal purposes. He indicated that this was a practice carried forward from his predecessor, but there is no written documentation to support this estimate.

distributed 719 million gallons of water and delivered and or used 330 million gallons, leaving 389 million gallons of unaccounted-for water.<sup>8</sup>

Unaccounted-for water creates a production expense for the City for which there is no revenue. We calculated that the City spent approximately \$0.68 per 1,000 gallons to distribute water in 2011.<sup>9</sup> Therefore, the 389 million gallons of unaccounted-for water in 2011 cost the City about \$264,520.

City officials told us they believe the unaccounted-for water is due to underground leaks. The Mayor stated that the City has taken steps in the past few years to reduce lost water, such as bringing in a firm to detect leaks, repairing 15 underground leaks and 13 hydrants and replacing an improperly sized water meter at one of its large customers. While we did not recompute unaccounted-for water for 2010, the City's annual water reports show that approximately 100 million fewer gallons were lost in 2011 than 2010.<sup>10</sup>

We also found that the City had an additional 49.5 million gallons of unaccounted-for water at the City's storage tank, where water is metered before (Meter 1) and after storage (Meters 2 and 3), and prior to water being distributed or used, as shown below:



The meter before the storage tank shows that the City produced and treated 768.5<sup>11</sup> million gallons of water, but the meters after the storage tank indicate that only 719 million gallons were distributed. The Chief Operator told us that he attempted to investigate the

<sup>8</sup> Our calculation differed by about 1 million gallons. The Chief Operator included golf course water in the metered amount delivered; however, that meter is before filtration and therefore we did not include it.

<sup>9</sup> We computed the \$0.68 per 1,000 gallons cost based on the 719 million gallons of water distributed and the variable water fund costs, as reported by the City on its annual financial report for 2011. We did not include fixed costs such as debt service or salaries.

<sup>10</sup> The City's 2010 Annual Water Report stated the City had 487 million gallons of unaccounted-for water.

<sup>11</sup> We did not use the meter readings prior to the storage tank in our calculation of unaccounted-for water and did not include this potential water loss in the cost of the water because the Chief Operator indicated that the meters after the storage tank were more reliable. These are the meter readings he uses in his calculation of water distributed and used.

cause of the difference between the filtration plant and storage tank meters by contacting the manufacturer about the meters. He said the manufacturer indicated the meters were calibrated at the factory. The manufacturer's website indicated that there could be as much as a 2 to 5 percent margin of error on a single gauge and that the error in the gauge readings has a tendency to increase over time and use. The Chief Operator does not believe it is possible to lose this much water at the storage tank, even with overflow.

## **Recommendations**

15. The Common Council and the BPW should investigate the causes of excessive water loss and take appropriate action to reduce water loss and costs.
16. The BPW and the Chief Operator should investigate the cause of the differences in meter readings from before and after the storage tank and take appropriate action.
17. The BPW and City officials should evaluate their estimate of authorized unmetered water uses and document the basis for estimates used in the water loss calculation.

**APPENDIX A**  
**RESPONSE FROM LOCAL OFFICIALS**

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



OFFICE OF  
**MAYOR**  
659 E. Main Street  
Little Falls, New York 13365

Office: (315) 823-0001 Fax: (315) 823-0580

Hon. Robert J. Peters, Sr.  
Mayor

Home: (315) 823-4907

**November 8, 2013**

**Office of the New York State Comptroller  
Att: Thomas P. DiNapoli, State Comptroller  
110 State Street  
Albany, New York 12236**

**Dear Mr. DiNapoli:**

***This is to confirm our recent meeting, held to discuss the audit of the City of Little Falls by the New York State Comptrollers' Office.***

***This included a review of the City's past funding procedures, and the Office of the Comptrollers' recommendations, to eliminate and correct problems that were found, to ensure that the taxpayers' money is being used effectively and efficiently.***

***You have my assurance that these corrective recommendations will be followed in a timely manner. When all measures have been thoroughly addressed, a final report will be sent to your attention.***

***Sincerely,***

***Mayor Robert J. Peters, Sr.***

***pc: City Clerk Klra Andrilla  
City Treasurer David Petkovsek***

***mek***

## APPENDIX B

### AUDIT METHODOLOGY AND STANDARDS

During this audit, we examined internal controls over the City Treasurer's Office and evaluated water accountability for the period January 1, 2011 to July 31, 2012. To accomplish our audit objectives and obtain relevant audit evidence, our procedures included the following:

- We interviewed City officials and documented and evaluated internal controls over key aspects of the recordkeeping and cash receipts and disbursements processes.
- We obtained check disbursement information from the City's accounting system and analyzed the data to assess its reliability. We verified that checks that cleared City's bank accounts during our audit period were available for our examination.
- We examined significant cash receipts (greater than 5 percent of fund revenues) to determine whether they were recorded and deposited intact and timely. We examined the following cash receipts: State aid of \$887,000, City real property taxes of \$2.8 million, County real property taxes of \$937,000, County receipts of \$2.5 million, ambulance receipts of \$22,000, timber receipts of \$116,000 and contractual sewer receipts of \$186,000. We contacted third-party municipalities, reviewed contracts and billings to verify revenues sent to the City or billed by the City and traced these revenues into the City's records and bank accounts.
- We compared deposits from the bank statement to the records for the first quarter of 2011. We contacted the bank to obtain three days of bank deposit compositions during that time, reviewed the documentation for evidence of substitutions and reviewed a triplicate receipt book for miscellaneous receipts to verify deposits were recorded. We judgmentally selected the first quarter of 2011 as our test period with no expectation that more or fewer errors would occur in that quarter than any other period.
- We examined all check withdrawals in July 2011 and May 2012 for all bank accounts to determine whether they were authorized and to verify consistency between the canceled checks and authorizations (e.g., abstract, prepay list, voucher). We used a random number generator to select these two months from our 19-month audit period.
- We examined non-check bank withdrawals from all bank accounts for July 2011 and May 2012 to determine whether they were authorized and appropriate.
- We examined high-risk check disbursements to determine whether they were authorized and appropriate. We scanned all bank statements for all bank accounts during our audit period and judgmentally selected high-risk canceled checks (e.g., checks made out to cash, the City of Little Falls, City officials and unusual vendors). We traced these checks to authorizations (e.g., Council signed abstracts, prepay lists and vouchers).
- We reviewed all journal entries that were credits to cash for authorization and/or appropriateness.

- We verified that salaries paid agreed with authorizations for individuals with the ability to sign checks.
- We examined the accuracy and timeliness of the Treasurer’s bank reconciliations. We examined the last month completed in the audit period because it was current and relevant. Additionally, we reviewed the Treasurer’s outstanding check lists for the main checking account for accuracy.
- We interviewed City officials and employees and reviewed relevant documents to evaluate their process for reconciling water produced to water billed and used for municipal purposes.
- We compared the amount of water produced by the City to the amount of water billed to customers for 2011. We compared our water loss calculation with the City’s calculation. We then compared the amount of unaccounted-for water to the EPA’s industry goal for water system losses.
- We reviewed the variable costs associated with water production and computed a cost per 1,000 gallons of water and then we computed a cost for the City’s 2011 unaccounted-for water.

We conducted this 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 C

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**APPENDIX D**  
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**DIVISION OF LOCAL GOVERNMENT**  
**AND SCHOOL ACCOUNTABILITY**

Andrew A. SanFilippo, Executive Deputy Comptroller  
Gabriel F. Deyo, Deputy Comptroller  
Nathalie N. Carey, Assistant Comptroller

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