



# Village of Silver Creek

## Capital Projects

### Report of Examination

Period Covered:

June 1, 2015 – January 17, 2017

2017M-31



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**

May 2017

Dear Village 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 Village 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 Village of Silver Creek, entitled Capital Projects. This audit was conducted pursuant to Article V, Section 1 of the State Constitution and the State Comptroller's authority as set forth in Article 3 of the New York State General Municipal Law.

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

Respectfully submitted,

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

# Introduction

## Background

The Village of Silver Creek (Village) is located in the Town of Hanover in Chautauqua County and has a population of approximately 2,600 residents. The Village provides various services to its residents, including general government support, street maintenance and improvement, sewer and water, parks and recreation, fire protection and snow removal. General fund appropriations for the 2016-17 fiscal year were approximately \$2 million and were funded primarily with real property taxes, sales tax and State aid.

The Village is governed by an elected Board of Trustees (Board), which is composed of the Mayor and four Trustees. The Board is responsible for the general management and control of the Village's financial affairs. The Mayor is the Village's chief executive officer and appoints nonelected officers, subject to Board approval. The Treasurer is the chief fiscal officer and is responsible for receiving and disbursing funds, maintaining the accounting records and preparing monthly and annual financial reports.

## Objective

The objective of our audit was to evaluate the Village's capital projects. Our audit addressed the following related question:

- Did the Board adequately plan and manage sewer and water capital projects financing?

## Scope and Methodology

We examined the Village's capital projects for the period June 1, 2015 through January 17, 2017. We extended our scope period back to July 18, 2011 to review certain information related to the capital projects.

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

## Comments of Local Officials and Corrective Action

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

The Board has the responsibility to initiate corrective action. A written corrective action plan (CAP) that addresses the findings and recommendations in this report should be prepared and forwarded to our office within 90 days, pursuant to Section 35 of General Municipal

Law. For more information on preparing and filing your CAP, please refer to our brochure, *Responding to an OSC Audit Report*, which you received with the draft audit report. We encourage the Board to make this plan available for public review in the Village Clerk's office.

## Capital Projects

The Board is responsible for adequately planning capital projects, which includes arranging for sufficient financing, setting spending limits and adopting and monitoring project budgets. The Treasurer should monitor financial activity and provide accurate and timely updates to the Board to facilitate the monitoring process over capital project finances. The Board also needs to develop a long-term plan that shows each project's financial impact on the annual operating budget and revise it as needed.

The Board did not adequately manage the finances for the sewer or water capital projects or develop a long-term plan that evaluated each project's financial impact on the annual operating budget. The sewer fund did not have sufficient cash to pay \$296,000 of new debt service costs. As a result, the sewer fund had to borrow approximately \$293,000 from the general fund and the loan has not been repaid because the sewer fund's financial condition has deteriorated. In addition, the Board did not approve water capital project change orders, which resulted in the project's budget being overspent by \$179,000 (5 percent). As a result, there will be limited cash for water operations, and unrestricted fund balance in the water fund will be significantly reduced. Unless these problems are addressed, future operations could be adversely impacted.

### Sewer Capital Project

The Board approved the waste water treatment plant capital project in January 2013 with an estimated maximum cost of \$5 million and increased the maximum cost in May 2014 to \$6.3 million. Construction started in May 2013 and was completed in June 2015. This project was financed through New York State Environmental Facilities Corporation (EFC) loans totaling approximately \$6.2 million.<sup>1</sup>

When a board issues debt to fund a capital project, it needs to assess the operating fund's revenue streams and determine whether user fees and other revenues need to be increased to finance the debt service costs that will be added to the budget. Any money temporarily advanced from one fund to another is required to be repaid as soon as available but in no event later than the close of the fiscal year in which the advance was made.<sup>2</sup>

The Board did not adopt a long-term financial plan that assessed the project's financial impact on the sewer fund or properly plan for the

<sup>1</sup> The loan payments are structured so that the combined principal and interest payments are to be fairly level in each year of repayment.

<sup>2</sup> Per General Municipal Law (GML)

project's debt service costs. The Board did not adopt a surcharge to pay for the debt service and start billing the surcharge until after the Village made the first debt payment. By that time, the sewer fund reported a deficit fund balance and a \$293,000 interfund loan payable to the general fund. It is unclear if the new surcharge imposed by the Board will generate sufficient revenue to improve the sewer fund's financial condition and allow it to pay back the general fund.

The first sewer debt payment owed to EFC, totaling approximately \$296,000, was due in March 2016. In May 2015, the Board discussed imposing a surcharge on sewer bills to raise additional revenue to fund the new debt service payments but took no formal action at that time. In the 2015-16 budget, the Board included only \$221,000 of debt service appropriations instead of the \$296,000 that was needed, resulting in a shortfall of approximately \$75,000.<sup>3</sup>

The sewer fund did not have sufficient cash to make the debt payment in 2016. The Village used general fund cash to pay the sewer fund debt and set up an interfund loan between the general fund and sewer fund. In accordance with GML, this interfund loan should have been repaid in full by the close of the 2015-16 fiscal year. However, the sewer fund had an operating deficit of approximately \$182,000 for 2015-16 and an unrestricted fund balance deficit of approximately \$156,000 as of May 31, 2016. The Board has yet to determine how the sewer fund will repay the general fund but expects to do so over a five-year period.

In May 2016, the Board approved a \$65 quarterly surcharge on each sewer bill<sup>4</sup> and estimated this would raise approximately \$338,000 annually to meet future debt payments. For the 2016-17 fiscal year, the surcharge is estimated to raise \$253,000.<sup>5</sup> The sewer fund should have sufficient funds for the debt payment in 2017. Going forward, any revenue from the surcharge beyond the amount needed for the annual debt payment could prevent future operating deficits and help repay the interfund loan but may not be sufficient to address the accumulated unrestricted fund balance deficit.

The Board may have been able to manage this project more effectively and anticipate its impact on the sewer fund had it adopted a long-term financial plan and adopted a user fee to fund the project's debt service costs in a more timely manner.

<sup>3</sup> This was due to unknown interest rates on the debt at the time of budget adoption. However, the Board received the actual debt schedule in July 2015, which would have provided sufficient time to address the budgetary shortfall.

<sup>4</sup> Five of the largest users pay a higher amount based on annual usage.

<sup>5</sup> The surcharge billings started in August 2016.

## Water Capital Project

The Board authorized the water line replacement project in July 2011 with an estimated maximum cost of \$3.5 million. Construction started in October 2011 and was completed in June 2015. This project was funded through EFC loans totaling approximately \$3.4 million.

The Board and Village officials are expected to monitor capital project costs to ensure that the project's budget is not exceeded, as the budget may be impacted by change orders. The Board should approve change orders prior to the work being performed, in accordance with Village policies. The Board should be notified immediately if the budget is expected to be exceeded so that it can approve additional funding sources and adjust the long-term financial plan accordingly.

The Board and Village officials did not adequately monitor water capital project costs. The Board did not approve project change orders totaling approximately \$308,000 prior to the work being performed. These change orders caused total project costs to exceed the authorized budget by approximately \$179,000 (5 percent). The Board relied on updates from the former Water Superintendent (Superintendent) and the Treasurer to monitor the progress and costs of the project but did not receive accurate and timely updates.

The Superintendent was responsible for overall project management and worked directly with engineers and contractors. The Superintendent and the engineering firm informed the Board of these change orders after the Superintendent had granted verbal approval to the contractors to proceed with the additional construction, but he did not provide the Board with the cost of the additional work. Without the cost, the Board could not determine if project expenditures would stay within the budget and therefore did not plan to authorize additional funding. The Board eventually disputed the change orders but was ultimately forced to pay, by court order, approximately \$353,000, which included \$45,000 in interest due to the delay in payment. Village officials were unable to provide written policies or procedures for the change order approval process, but they indicated that all change orders must be submitted to and approved by the Board before construction can take place.

In August 2016, the Board paid the entire amount of the change orders, including interest, using general fund money. The Board anticipates repaying the general fund in the 2016-17 fiscal year using approximately \$137,000 in project money and approximately \$215,000 from available water fund cash. As a result, there will be limited cash available for water operations and unrestricted fund balance will be reduced to \$311,000, or by approximately 41 percent.<sup>6</sup> As of the end of fieldwork, the Board was considering using approximately \$83,000

<sup>6</sup> Based on the December 31, 2016 reported fund balance.

from a capital reserve to pay for project expenditures. In addition, to limit the use of operating cash, the Board was also considering using approximately \$185,000 from a debt reserve to fund current debt appropriations.

Because the Board did not adequately monitor project finances and properly plan for each project's financial impact on the annual operating budget, the finances of the sewer and water funds have deteriorated. Unless these budgetary and cash flow problems are addressed, future operations could be adversely impacted.

## **Recommendations**

The Board should:

1. Develop a long-term financial plan that addresses capital projects and revise the plan as needed.
2. Ensure that the sewer fund budget includes adequate debt service appropriations.
3. Develop a plan to eliminate the deficit fund balance in the sewer fund and to repay the general fund in a timely manner.
4. Develop written policies and procedures for the oversight and management of capital project finances that include a formal process for approving change orders and monitoring project costs.

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

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

# VILLAGE OF SILVER CREEK

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Nicodemo Piccolo

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Peter Clark  
Village Attorney

Mr. Jeffrey D. Mazula  
Office of the State Comptroller  
110 State Street  
Albany, NY 12236

Dear Mr. Mazula,

The following is the response and corrective action plan from the Village of Silver Creek to the recommendations listed in your audit report covering the period between June 1, 2015 and January 17, 2017.

The Village of Silver Creek was required to embark on the water and sewer capital projects referred to in the report due to consent orders received by the Chautauqua County Department of Health and NYS Department of Environmental Conservation. The Village faced potential fines of up to approximately \$17,000 per day. The Village immediately began the planning of the projects to defer the fines. The Village applied for hardship grants to try to minimize the cost to the taxpayers for both of the projects. The Village was able to obtain a zero percent loan through EFC for the water project and was successful in securing a reduced rate for its sewer project.

**Recommendation #1: Develop a long term financial plan that addresses capital projects and revise the plan as needed.**

*Corrective Action Plan:* The Village will prepare a long-term plan regarding capital projects and revise as needed.

**Recommendation #2: Ensure that the sewer fund budget includes adequate debt service appropriations.**

*Corrective Action Plan:* The Village prepared its 2015-2016 budget prior to the closing of the \$6.2 million loan for the waste water treatment plant. An estimate was made for the debt service based on the information available at the time of the budget. The Village will ensure, as it has in the past, that it includes adequate debt service appropriations for all known obligations and will make its best estimate for debt closings to be made after the budget is adopted.

**Recommendation #3: Develop a plan to eliminate the deficit fund balance in the sewer fund and to repay the general fund in a timely manner.**

*Corrective Action Plan:* The Village has already put into place a plan to eliminate the deficit fund balance and repay the general fund. The Village has included an additional assessment for

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# VILLAGE OF SILVER CREEK

Municipal Building 172 Central Avenue Silver Creek, NY 14136-1397

debt on all sewer billings. This includes an additional amount to repay the general fund. The Village will continue to analyze and revise the assessment to ensure that the general fund is paid back and that the deficit fund balance in the sewer fund is eliminated.

**Recommendation #4: Develop written policies and procedures for the oversight and management of capital project finances that include a formal process for approving change orders and monitoring project costs.**

*Corrective Action Plan:* The Village will prepare written procedures for the oversight and management of capital project finances that include a formal process for approving change orders and monitoring project costs.

Sincerely,

Nicodemo Piccolo, Mayor  
Village of Silver Creek

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## **APPENDIX B**

### **AUDIT METHODOLOGY AND STANDARDS**

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

- We interviewed Village officials to obtain an understanding of sewer and water fund operations and capital project management.
- We reviewed Board minutes and sections of the Village Code pertaining to sewer and water operations, including billing rates and procedures, debt service charges and recent rate increases to cover project costs and debt payments.
- We reviewed project financing applications, project budgets, debt schedules and Board minutes regarding debt issuances.
- We assessed the financial condition of the sewer and water funds as of May 31, 2015.
- We examined accounting records to determine whether capital projects were accounted for properly and expenditures were within authorized amounts.
- We reviewed sewer and water fund budgets to determine if debt payments and revenues were budgeted.

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

## APPENDIX C

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