



Village of Spencerport

Financial Management

Report of Examination

Period Covered:

June 1, 2011 — April 25, 2013

2013M-134



Thomas P. DiNapoli

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State of New York Office of the State Comptroller

Division of Local Government and School Accountability

September 2013

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 Spencerport, entitled Financial Management. 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*

Introduction

Background

The Village of Spencerport (Village) is located in the Town of Ogden in Monroe County and has a population of approximately 3,600.¹ The Village provides various services to its residents including electric, sewer, street maintenance, snow removal, and general government support. The Village's 2013-14 budgeted expenditures (appropriations) totaled approximately \$6.4 million and were funded primarily by real property taxes, sales tax, State aid, and utility use charges.

The Village is governed by an elected Board of Trustees (Board), which comprises a Mayor and four Trustees. The Board is responsible for the general management and control of the Village's financial affairs. The Mayor serves as chief executive officer. The Village has a separate Clerk and a Treasurer. The Treasurer serves as chief financial officer and budget officer, and is responsible for the custody of Village monies.

Objective

The objective of our audit was to review the Village's financial management practices. Our audit addressed the following related question:

- Did the Board adopt realistic budgets and maintain reasonable levels of fund balance?

Scope and Methodology

We examined the financial management of the Village for the period June 1, 2011, through April 25, 2013. We expanded our scope back to the 2007-08 fiscal year and forward to May 31, 2013, to review fund balance and budgeting trends.

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

¹ From the 2010 Census

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 Management

The Board is responsible for making sound financial decisions that balance the level of services desired and expected by the Village's residents with the ability and willingness of the residents to pay for such services. It is important for Village officials to adopt written policies and procedures to govern budgeting practices and the level of fund balance² to maintain for each fund, and to adopt long-term plans that set forth the Village's financial objectives and goals. The Board should adopt budgets that include realistic estimates of revenues and expenditures, based on actual financial results from prior years along with other relevant available data, and that use surplus fund balance as a funding source, when appropriate. The Board may retain a reasonable portion of unexpended surplus funds³ to be used as a funding source in the event of unforeseen circumstances. The Board may then appropriate a portion of fund balance as a revenue source in the ensuing year's budget to reduce the tax levy. This should lead to a planned operating deficit,⁴ which can be a means of prudently using excess fund balance, but requires that the amount of available fund balance be accurately estimated to avoid reducing fund balance too much or too quickly and causing financial stress. Conversely, it is not a sound practice to routinely appropriate fund balance that will not actually be used, due to budgetary surpluses built in to revenue and expenditure estimates. This practice misleads taxpayers and often results in increases in excessive fund balances or much smaller decreases than budgeted, as well as excessive tax levies.

Village officials have not adopted policies or procedures to govern budgeting practices or the level of unexpended surplus funds to maintain. Although the Board has been provided with sufficient information to develop accurate budgets, including prior years' operating results and projections of available fund balance, the Board has consistently adopted budgets with unrealistic estimates of

² Fund balance represents the resources remaining from prior fiscal years that can be used as funding sources in the next year's budget to reduce the amount of revenues needed to be raised from other sources.

³ The Governmental Accounting Standards Board (GASB) issued Statement 54, which replaces the fund balance classifications of reserved and unreserved with new classifications: nonspendable, restricted, and unrestricted (comprising committed, assigned, and unassigned funds). The requirements of Statement 54 are effective for fiscal years ending June 30, 2011 and beyond. To ease comparability between fiscal years ending before and after the implementation of Statement 54, we will use the term "unexpended surplus funds" to refer to that portion of fund balance that was classified as unreserved, unappropriated (prior to Statement 54), and is now classified as unrestricted, less any amounts appropriated for the ensuing year's budget (after Statement 54).

⁴ Operating deficits occur when total expenditures exceed total revenues.

revenues, expenditures, and the amount of fund balance to be used to fund operations. The Board consistently overestimated expenditures and/or underestimated revenues, which caused significant positive budget variances. As a result, although the Board appropriated \$3.73 million⁵ in fund balance for the general and sewer funds for our five-year review period, over \$2.9 million⁶ of this amount was not used. Consequently, the Village has accumulated unexpended surplus funds amounting to \$833,139 and \$522,373 in the general and sewer funds (or 43 and 52 percent of expenditures), respectively. These amounts are excessive. Furthermore, the Board has not developed a comprehensive long-term financial plan, which would be a useful tool to reduce the excessive unexpended surplus funds in a manner that benefits the taxpayers.

Village officials informed us that they intentionally used conservative budgeting practices when adopting these budgets. While it is prudent to either maintain enough fund balance to protect against unforeseen circumstances or to budget conservatively, maintaining a substantial fund balance in addition to budgeting very conservatively results in a higher tax levy than necessary.

General Fund – Table 1 illustrates fund balance trends and operating results for the general fund over the last five years as represented in the Village’s financial reports.

Table 1: General Fund – Fund Balance					
	2007-08	2008-09	2009-10	2010-11	2011-12
Appropriated Fund Balance	\$476,075	\$596,733	\$590,081	\$508,143	\$700,836
Operating Surplus (Deficit)	\$107,383	(\$31,714)	(\$99,804)	\$382,539	(\$138,512)
Unused Appropriated Fund Balance	\$476,075	\$565,019	\$490,277	\$508,143	\$562,324
Unexpended Surplus Funds	\$766,003	\$681,721	\$711,792	\$892,120	\$833,139
As a Percentage of Expenditures	39%	38%	39%	52%	43%

From 2007-08 to 2011-12, the Board overestimated expenditures by a total of over \$2.3 million and underestimated revenues by \$766,600 for a total positive budget variance of approximately \$3.07 million (annual average of \$614,000). These positive budget variances diminished the effect of the annual fund balance appropriation in the adopted budgets, and often led to an increase in unexpended surplus funds, or a much smaller decrease than was purportedly planned. As a result, over \$2.6 million (91 percent) of the fund balance appropriated for the last five years was not used.

⁵ The Board appropriated fund balance for the general fund in all five years reviewed for a total of \$2,871,868, and for the sewer fund in four of the five years reviewed for a total of \$357,059.

⁶ General fund \$2,601,838 and sewer fund \$357,059

We reviewed budget-to-actual reports for the general fund for fiscal years 2010-11 and 2011-12 and found that the variances for revenues and expenditures were generally spread throughout the budgets. The following are some specific examples of revenues and expenditures that were unrealistically estimated:

- Sales tax revenue was underestimated by \$71,460 in 2010-11 and \$57,380 in 2011-12.
- Drainage contractual expenditures were overestimated by \$14,115 in 2010-11 and \$47,244 in 2011-12.
- Health insurance expenditures were overestimated by \$36,418 in 2010-11 and \$42,160 in 2011-12.

Sewer Fund – The Board consistently adopted inaccurate sewer fund budgets that generated annual budgetary and operating surpluses, and caused the Village to accumulate significant fund balances.

	2007-08	2008-09	2009-10	2010-11	2011-12
Appropriated Fund Balance	\$0	\$213,867	\$270,000	\$323,170	\$50,135
Operating Surplus (Deficit)	\$268,140	(\$173,304)	\$59,385	(\$192,527)	(\$134,302)
Unused Appropriated Fund Balance	N/A	\$40,563	\$270,000	\$130,643	(\$84,167)
Unexpended Surplus Funds	\$657,988	\$410,595	\$428,299	\$507,401	\$522,373
As a Percentage of Expenditures	71%	24% ^a	47%	46%	52%

^a Expenditures were significantly higher this year than any of the other years, and included the last year of sewer treatment expenses and principal and interest on bond anticipation notes.

From fiscal year 2007-08 to 2011-12, the Board overestimated expenditures in four of the five years by a total of \$683,900. We reviewed budget-to-actual reports for the sewer fund and found that the overestimated expenditures were generally spread throughout the budgets. These budget variances reduced the effect of the fund balance appropriation in the adopted budgets and led to operating surpluses in 2007-08 and 2009-10, and operating deficits that were much less than planned in 2008-09 and 2010-11.⁷ Consequently, \$357,059 (42 percent) of the fund balance appropriated for the last five years was not used. As a result of the overestimated expenditures, and a significantly reduced amount of appropriated fund balance in the 2011-12 budget, unexpended surplus funds actually increased each year since 2008-09 and amounted to 52 percent of expenditures at the end of the 2011-12 fiscal year.

⁷ The sewer fund did have an operating deficit that exceeded the fund balance appropriation in 2011-12.

We reviewed the 2012-13 year-end financial information provided by the Treasurer on July 24, 2013. In the general fund, expenditures were \$310,050 less than budgeted and revenues exceeded estimates by \$50,100 for a total positive budget variance of \$360,150. As a result, \$395,150 (78 percent) of appropriated fund balance was unused. In the sewer fund, a positive budget variance created an operating surplus of \$41,955, further increasing the amount of unexpended surplus funds to \$563,905 or 70 percent of 2012-13 expenditures.⁸

We also reviewed the Board's adopted budget for the 2013-14 fiscal year and found that the Board did not make significant changes to its budgeting practices. As a result, the Village will likely have additional budgetary and operating surpluses and continue to report sizeable unexpended surplus fund balances in the general and sewer funds. In the general fund budget, the Board included slight increases in appropriations and estimated revenues, along with provisions to fund and use reserves. In the sewer fund budget, the Board slightly reduced appropriations and appropriated \$50,000 to fund a reserve, but did not appropriate any fund balance for operations. While the Board has ceased including an unrealistic fund balance appropriation in its sewer fund budget, it still has not adjusted its revenue and expenditure estimates to prevent significant budgetary surpluses. Thus, fund balance will likely grow larger. After we completed fieldwork, Village officials provided us with an informal plan to gradually reduce surplus funds in the sewer fund by appropriating fund balance for debt service in future years.⁹ However, without significant adjustments to revenue and expenditure estimates, the Village will continue to generate operating surpluses and will not actually use the fund balance as planned, just as has occurred in years past.

The Board must make responsible decisions to adopt and monitor more structurally sound budgets that include realistic estimates of revenues, expenditures, and fund balance that will be available and actually used to fund operations. This will help ensure the Village maintains reasonable fund balance levels and does not levy more property taxes than necessary to fund annual operations. The development of a long-term financial plan can help officials determine future needs and identify methods to finance them.

The Board has not developed a formal comprehensive long-term plan to guide its budgeting decisions. While Village officials maintain informal multiyear forecasts for equipment purchases and capital

⁸ Expenditures declined, for the second consecutive year, by over \$197,000 in 2012-13, significantly increasing the percentage of fund balance to expenditures.

⁹ After first exhausting available debt service fund moneys; thus no fund balance will be used in the very near future

projects, they have not combined that with long-term operating plans to demonstrate the planned use of operating funds, surplus fund balance, or reserve funds, in a comprehensive manner, to provide full transparent disclosure to taxpayers and to maximize its usefulness for the Board. Effective plans project operating and capital needs and financing sources over a three- to five-year period to identify revenue and expenditure trends and capital needs, to set long-term priorities and goals, and to avoid large fluctuations in tax rates. They also allow Village officials to assess alternative approaches to address financial issues such as the use of surplus fund balance to finance operations or fund reserves for future expenditures, and to change the service levels provided to residents. It is important that the Board monitor and update any long-term financial plan on an ongoing basis to provide a framework for preparing budgets and to ensure that decisions are guided by the most accurate and current information available. This will help the Board effectively use and reduce the fund balances in the general and sewer funds in a manner that benefits taxpayers. Such uses could include, but are not limited to, paying off debt, increasing necessary reserves, financing one-time expenditures, or reducing property taxes.

Recommendations

1. The Board should adopt policies or procedures to govern budgeting practices and the level of fund balance to be maintained for each fund.
2. The Board should adopt budgets with realistic estimates of revenues and expenditures and the amount of fund balance to be used to fund operations.
3. The Board should develop and implement a long-term financial plan to guide its budgeting decisions and effectively use and reduce fund balances in the general and sewer funds in a manner that benefits taxpayers. Such uses could include, but are not limited to, paying off debt, increasing necessary reserves, financing one-time expenditures, or reducing property taxes. The Board should monitor and update any long-term financial plan on an ongoing basis.

APPENDIX A
RESPONSE FROM LOCAL OFFICIALS

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

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September 5, 2013

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Division of Local Government and School Accountability
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Rochester, New York 14614-1608

Dear Mr. Grant:

This letter will serve as the required response to the Comptroller's draft audit report entitled "Financial Management" for the period June 1, 2011 – April 25, 2013.

The Village Board generally agrees with the recommendations listed in the audit, and will formulate a Corrective Action Plan (CAP) to address these issues in the upcoming weeks. The intention of our Board is to apply the OSC recommendations to supplement our existing planning documents by developing a more formalized, comprehensive long term capital and operating expense strategic plan, and by considering the recommendations and the resulting strategic plan in the 2014-2015 and future budgeting process.

The Village Board thanks the OSC audit team for their recommendations and assistance through this process, and for their concern for the interests of the taxpayers of the Village of Spencerport.

Sincerely,

Joyce Lobene
Mayor

APPENDIX B

AUDIT METHODOLOGY AND STANDARDS

Our overall goal was to assess the adequacy of the internal controls put in place by officials to safeguard Village assets. To accomplish this, we performed an initial assessment of the internal controls so that we could design our audit to focus on the areas most at risk. Our initial assessment included evaluations of the following areas: Board oversight, financial management, cash receipts and disbursements, purchasing, payroll, and information technology. During the initial assessment, we interviewed appropriate Village officials, performed limited tests of transactions, and reviewed pertinent documents, 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, or professional misconduct. We then decided upon the reported objective and scope by selecting for audit the area most at risk. We selected financial management for further audit testing.

To accomplish our objective, we reviewed budgeting practices, results of operations, and fund balance levels for the period June 1, 2011, to April 25, 2013. We expanded the scope back to 2007-08 and forward to May 31, 2013, to review fund balance and budgeting trends. To obtain valid audit evidence, we performed the following audit procedures:

- We interviewed appropriate Village officials and employees to gain an understanding of the Village budget process and to determine internal controls in place.
- We reviewed Village policies, capital planning documents, and Board minutes.
- We analyzed fund balance for fiscal years 2007-08 through 2011-12. We also compared budgeted revenues and expenditures to actual operating results, in total, for fiscal years 2007-08 through 2011-12.
- We compared budget estimates with actual operating results for individual budget line items for fiscal years 2010-11 and 2011-12 to identify any individual line items with significant variances.
- We reviewed total annual revenues and expenditures to determine the operating deficits or surpluses for each fund. We also reviewed budgets for fiscal years 2007-08 through 2011-12 to determine the amount of fund balance that was appropriated for each fund each year. We compared the annual operating surpluses or deficits to the amount of appropriated fund balance for each year and calculated the average amount of appropriated fund balance that was not used.

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 objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

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