

**Nassau County
Office of the Comptroller
Field Audit Bureau**



**Financial Audit of
Sanitary District No. 6
Town of Hempstead**

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MA-05

October 12, 2005

NASSAU COUNTY
OFFICE OF THE COMPTROLLER

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Executive Summary

Background

In Nassau County, the county government is not responsible for collecting or disposing of solid waste from residents and commercial establishments. Instead, garbage collection in Nassau is arranged by the county's towns, cities, villages and, in some unincorporated areas not served by the towns, by a number of local, special "sanitary districts."¹ Local sanitary districts provide services only to residents and commercial establishments within their borders, and district expenses are paid for through local tax levies.²

Earlier this year, the County Assessor and others pointed out that the revenue raised and expenditures made by special taxing districts such as these sanitary districts occurred with little public scrutiny or governmental oversight. In response, our office undertook audits of the financial operations of a sample of Nassau's sanitary districts: The Port Washington Garbage District in North Hempstead; the Syosset Sanitary District in Oyster Bay, and Sanitary Districts 1, 2 & 6 in Hempstead. The sanitary districts in the sample generally maintained high tax rates or experienced large tax rate increases from 2004-2005 when compared to districts performing similar functions. Special sanitary district operations vary in size and complexity; some retain independent offices with fully equipped staffs while others share town administrative resources. In a few instances, districts contract with private haulers for refuse collection services.

This audit report reviews the financial operations of Sanitary District No. 6 in the Town of Hempstead (district), which retains its own independent office with a fully equipped staff to provide refuse collection services to 30,080 residential and 1,806 commercial parcels. The district provides curbside refuse service to residential and commercial properties three times a week and recyclable pickup once a week, at an annual cost of \$17,368,113 for 2003 and \$19,668,364 for 2004. The district derives all of its operating revenues, other than interest earned on investments, from real property tax assessments collected by the town of Hempstead and forwarded to the district semiannually.

Audit Scope and Methodology

The scope of our audit was limited to an examination of the district's administrative policies, procedures and expenses; procurement practices and contract monitoring; an analysis of operating costs and the appropriateness of its fund balance for fiscal years 2003 and 2004.

This audit was conducted in accordance with generally accepted government auditing standards. These standards require that the audit is planned and performed to obtain reasonable assurance that the audited information is free of material misstatements. The audit includes examining documents and other evidence to substantiate the accuracy of information tested, including all relevant records and contracts. It includes testing for compliance with applicable laws and regulations and any other auditing procedures

¹Nassau County sanitary districts are governed by the New York State Town Law, the Nassau Civil Divisions Act, and the Nassau County Charter.

² Town Law Article 12 § 198.

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necessary to complete the examination. We believe that the audit provides a reasonable basis for the audit findings and conclusions.

A Board of Commissioners (Board) consisting of six commissioners³ oversees the financial operation of the district. Administrative expenses, including but not limited to commissioners' and administrative salaries and benefits, legal and professional expenses, and insurance, totaled \$2,364,361 for 2003 and \$3,245,539 for 2004. These amounts were 14% and 17% of district expenses in 2003 and 2004 respectively.

The Board designates the banks or trust companies to serve as depositories for district funds, authorizes investments of district funds and approves claims for payment. The Board engages a Certified Public Accountant to perform an annual audit. In addition, the district employs three attorneys and engages five law firms to handle the district's legal matters. The Board appoints the secretary to the board, the treasurer, and the district general supervisor, all of whom manage the district's day to day functions. All receipts and disbursements are reported at each biweekly board meeting.

The district has 50 refuse disposal routes. Its 16 sanitation supervisors receive an average base salary of \$66,604.

Cost Analysis of Operations

In Sanitary District No. 6, residential and commercial property owners paid an average tax levy per parcel of \$798 in 2004 and \$736 in 2003. Tax levies vary annually, based on district budgeted expenses and estimated use or accumulation of fund balances. We note that the 2004 average tax levy for garbage collection and disposal (\$798) considerably exceeds the cost of local policing in District 6's service area (\$620), as reflected in the police district tax (not including the countywide police headquarters tax). The district's average taxes per parcel were higher than the \$605 and \$586 levy paid in 2004 and 2003, respectively, by residents and commercial establishments in the Town of Hempstead whose garbage is picked up by the town. The cost per ton for the district was \$298 and \$278 in 2004 and 2003 respectively compared to \$241 and \$238 for the Town of Hempstead. The Town of Hempstead provides curbside refuse pickup two times per week, recyclables pickup once per week; the district provides curbside refuse pickup service three times per week, and recyclables pickup once per week.

Summary of Significant Audit Findings

Poor Administrative, Financial and Operating Practices – Lack of Internal Controls

The Board of Commissioners does not provide sufficient oversight to ensure that district administration, financial transactions and operations are cost efficient, appropriate, and in compliance with applicable laws and regulations.

³ According to the Nassau County Civil Divisions Act, "There shall be elected at such election **five** resident taxpayers of such district as commissioners thereof..." Nassau County Civil Divisions Act §202 (b).

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We found that the district:

- has only one formal written policy, intended to govern procurement. The district, however, does not follow its procurement policy. It does not have formal written policies and procedures for any other accounting and operating functions;
- does not segregate duties, which increases the risk that errors or irregularities may occur and go undetected;
- does not have conflict of interest rules or a code of ethics to guide employees in making appropriate decisions;
- has inadequate internal controls over cash disbursements, which resulted in duplicate payments to a vendor, disbursements without proper authorization and approval of inappropriate expenses;
- does not review its health insurance bills, which resulted in the district paying benefits for a terminated employee at a cost of \$4,932, as well as overpayment of Medicare Part B reimbursements for individuals who are no longer eligible for such payments;
- does not adhere to its own informal policy of paying for benefits only for those employees who work at least 20 hours a week. The district spent \$62,672 in 2003 and \$63,191 in 2004 on benefits for certain employees who worked less than 20 hours;
- does not have procedures in place to ensure that a proper bank reconciliation is performed for each bank account. One of the three bank accounts is reconciled to the district's checkbook and not the general ledger, and cancelled checks are not reviewed for proper endorsement because the district only receives images of the front of its checks;
- does not have a policy in place regarding the management of fixed assets and assets are not tagged for inventory purposes; and
- has no controls over the management of fuel use by district vehicles; the district does not use the Gas Boy System's (the district's automated fuel dispensing system) fuel usage and mileage monitoring features.

Procurement Practices

There are significant weaknesses in the district's procurement practices. We found that the district:

- is not in compliance with General Municipal Law (GML) §103's competitive bidding requirement governing purchases of similar items that in the aggregate

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exceed \$10,000. We found purchases that were not in compliance with GML §103 totaling \$416,000 during the 2003-2004 audit period;

- did not comply with its own procurement policy to maintain documentation regarding quotes or bids received for any of the purchases reviewed during the audit. For the 12 invoices tested, totaling \$48,488, no evidence was found that quotations were obtained and documented as required;
- lacks controls over the purchase order process to provide assurance that the correct goods and services are being ordered at the best price. Purchase order descriptions are vague, pricing information is not required and the purchase orders are given to vendors upon delivery of items which are actually ordered by phone;
- approved the hiring of a computer consultant without obtaining a resume or statement of qualifications as required by district policy.
- has been paying its former Secretary to the Board a sum of \$300 per month (\$3,600 per year) since 1985 without evidence that a business purpose exists for this arrangement;
- in addition to its three staff attorneys, used the services of five law firms without benefit of retainer agreements; and
- does not require its consultants to verify hours spent on district business.

Payroll Processing & Time and Leave

The district has approximately 240 employees; payroll costs were \$9.8 million in 2003 and \$10.6 million in 2004. We found poor internal controls in place over personnel transactions, including:

- The district does not require employees to use time clocks or timesheets.
- A lack of segregation of duties and oversight leading to errors in payroll check processing.
- No defined work week for approximately 40 nonunion workers
- Union employees are paid an hourly rate for a 40-hour work week. However, we observed that most of these employees work significantly less than an eight-hour day, usually five hours per day. Therefore, based on a 25-hour work week, sanitation workers have an effective hourly rate of \$36.30 per hour and supervisors have an effective hourly rate of \$52.02.
- The district had overtime expenditures of \$22,306.62 in 2003 and \$17,418.20 in 2004. There are no written procedures on processing overtime; the district does not maintain any records justifying the purpose of the overtime. For example, we found that one employee was paid overtime of \$6,553 in 2003 and \$6,043 in 2004 without any records to justify these payments.
- There is no process for employee terminations that ensures that the terminated employee is removed from the payroll in a timely manner. Employee terminations are not documented, but communicated verbally to the employee who processes payroll.
- All three staff attorneys, a community service representative and an employee assistant specialist are treated as employees, for purposes of FICA and employee

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benefits, when they do not appear to meet the Internal Revenue Service (IRS) definition of an employee.

Appropriateness of Fund Balance

The district restricts \$2.8 million of its fund balance for operating expenses until the district receives its first tax payment in February. An additional \$3.0 million and \$2.3 million in 2003 and 2004 respectively is unrestricted. We found that the restricted portion of the district's reserves appears to be prudent to ensure the orderly operation of the district. However, the unrestricted portion may be excessive and the district should consider whether some portion should be returned to the taxpayer in order to lower future tax assessments.

Role of External Auditor

Government Auditing Standards, Amendment No. 3, *Independence*, requires that audit organizations evaluate the nature and significance of the nonaudit services provided to the audited entity and carefully consider the need to avoid situations that could lead reasonable third parties to conclude that the auditor is not able to maintain independence in conducting audits.

We found that the district relies heavily on its external auditor for both permitted and prohibited nonaudit services and does not employ personnel with apparently adequate financial and accounting expertise to evaluate and approve any nonaudit services provided. It appears that auditor independence is impaired. We also noted that the district does not have a policy to periodically rotate its auditor.

Sanitary District No. 6 Response

On September 13, 2005 we submitted a draft report to district officials with a request for comments. The district's comments were received on September 28, 2005. The district's comments and our response to those comments are included as an addendum to this report (Appendix).

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Poor Administrative, Financial and Operating Practices – Lack of Internal Controls

While the district's policies "do not necessarily need to outline in specific detail each and every step of a particular transaction... [they] should provide guidance to help promote and maintain accountability."⁴ The district generally lacks these guidelines for its employees and operations.

Audit Finding (1):

Procurement of Goods & Services

The district does not follow its own procurement policy. We found:

- a. Lack of Competitive Bidding - Our review disclosed that the district did not comply with GML §103 which requires that the purchase of similar items, which in aggregate cost over \$10,000 be procured through competitive bidding. GML §103 states that "Competitive bidding is required when it is known or can reasonably be anticipated, that the aggregate amount to be spent on like items will exceed the competitive bidding threshold over the course of a fiscal year. Generally, items of the same or similar nature which are customarily handled by the same vendor should be treated as a single item for the purpose of determining whether the dollar threshold will be exceeded." The bidding process helps assure the prudent and economic use of public moneys and facilitates the acquisition of goods of desired quality at the lowest cost. During the 2003-2004 audit period, the district made aggregate, similar purchases exceeding \$10,000 from the same seven vendors during both audit period years. These purchases totaled approximately \$416,000 and should have been subject to competitive bidding. There was no evidence that the district obtained competitive bids for these purchases.⁵

In addition, the district has a written procurement policy governing the purchase of goods and services between \$1,000 and \$9,999 that are not required to be competitively bid. The district's policy states that quotations must be obtained for these purchases, and that documentation is required for each action taken in connection with each procurement.⁶ We tested 12 invoices totaling \$48,488 and found that the district failed to maintain any evidence that quotations were obtained and documented as required.

⁴ A Study of Cash Internal Control Practices for Local Governments in New York State, State of New York, Office of the State Comptroller, Division of Municipal Affairs , 2000-PS-5, pg.4.

⁵ The purchases were for Truck parts and maintenance, Building repairs and maintenance and cleaning supplies.

⁶ A Study of Cash Internal Control Practices for Local Governments in New York State, State of New York, Office of the State Comptroller, Division of Municipal Affairs , 2000-PS-5, pg.4.

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- b. Professional Services – The district’s procurement policy states that professional service providers are to be selected based on criteria including education and training. The district spent \$113,689 in 2003 and \$103,329 in 2004 for professional services.

We found that the district:

- did not follow its procurement policy in the selection of its current computer consultant. The Board approved the hiring based solely on a proposal letter that was submitted by the consultant without a resume or statement of qualifications. The district paid the consultant \$35 per hour for services that are essentially those of an accounting clerk, performed under the direction of the district’s Treasurer and the external auditor. For example, in Nassau County, a comparable position of Audit Assistant II’s *maximum* earnings per hour would be \$25.75, substantially less than \$35 per hour. We noted that although the consultant's proposal letter states she can install software, the district contracted with another party, during the time of our fieldwork, for software installation services;
 - has paid its former secretary to the board a \$300 monthly retainer since 1985 to consult on district business. There is no evidence that the Board has reviewed this arrangement since that time. The district expended approximately \$72,000 over this 20 year period without any documentation supporting the arrangement, such as written work products (reports, memorandums) or records of the nature and frequency of actual services provided;
 - has been using the same external auditor since the late 1980’s. The district does not have a contract with the auditor and the latest engagement letter is from the year 2000. We found that the auditor bills the district on a monthly basis for accounting and tax services. We found no documentation to support the tax service billings and noted that the payroll related tax filings, along with the remittances, are done by the district’s payroll vendor. We also noted that in 2004, the external auditor billed the district for an additional \$7,350 for nonaudit services rendered in connection with compliance with Governmental Accounting Standards Board pronouncement #34 (GASB 34), however we found no supporting documentation that detailed the specific services performed or the time spent by the auditor; and
 - pays a lobbyist \$12,000 per year; however there was no documentation stating and supporting the need for this expense; evidence of the work performed or details of the time worked.
- c. Lack of Clearly Defined Roles and Responsibilities for Legal Counsel – The district treats its three attorneys as employees. These attorneys, however, do not have office space at the district, are not accountable for their time to the district and the district could not provide current documentation describing their specific duties and responsibilities. These attorneys appear to function as outside contractors, not as employees. *See* Internal Revenue Code §3121(d)(2).

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- In addition to the three attorneys, the district utilizes the services of five law firms. The district could not provide retainer agreements for these firms and the board minutes state only that they were engaged to perform services on the district's behalf.
- d. **Purchasing** - A review of the purchasing process found several internal control weaknesses. For example:
- Although a purchase requisition form is used, it is not fully completed or used to prepare a purchase order prior to the purchase being made. Instead, orders are placed by phone.
 - Purchase orders should be used to initiate a purchase; however purchase orders are created by the treasurer and approved by the secretary to the board after the order has been placed. The purchase orders do not contain part numbers, unit prices, price extensions or the purpose of the purchase. There was no evidence that prices were verified. The purchase orders are not provided to the vendor until after the delivery of the goods.
 - Purchase orders are not issued in sequential order.
 - Some purchase order books were missing. The district could not locate the purchase order books from the period May 7th to June 10th, 2003.
 - There was no verification that goods invoiced were actually received, such as a comparison to packing slips or receiving reports.

Audit Recommendations:

a. **Competitive Bidding**

The district should:

1. ensure that all procurement is done in compliance with GML Article 5-A §103; and
2. take steps to ensure that adequate documentation is maintained to support purchases in compliance with the district's purchasing policy, as well as compliance with GML §103.

b. **Professional Services**

The district should:

1. follow its own written procurement policy for professional services and review its hiring practices for consultants to ensure that they were hired based on relevant criteria, including education and training;
2. review the consultant arrangements with the lobbyist and the former secretary to the board and make a determination if there is a valid governmental reason

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to continue with these arrangements. If these positions are required for a bona fide district purpose, the district should conduct a competitive process;

3. update the engagement letter and enter into a contract with its external auditor so that fees and services are clearly understood by both parties;
4. determine the nature and necessity of the tax work that is being billed to the district;
5. clearly define the roles and responsibilities of counsel and review the need for engaging five law firms in addition to employing three in-house counsels;
6. consult IRS regulations to determine whether the district's in-house counsels and computer consultant should be considered employees or consultants;
7. require an accounting of the hours the in-house counsels spend on district business; and
8. obtain retainer agreements with outside counsels.

c. Purchase Orders

The district should review its purchasing process to ensure that the following controls are included:

1. approved purchase orders are the basis for placing orders with vendors;
2. purchase orders are filled out completely;
3. pricing information is confirmed as part of the purchase order process;
4. packing slips and goods received are matched against the purchase orders at time of delivery, and the packing slips are attached to the invoices for processing; and
5. purchase order books should be safeguarded and purchase orders should be written in sequential order so that they can be tracked and monitored to minimize the likelihood of misplacing them.

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Audit Finding (2):

Lack of Segregation of Duties

An effective internal control system requires the separation of duties so that no single individual controls most or all phases of a transaction. Concentrating key duties, such as authorization, recordkeeping and custody, with one individual weakens internal controls and significantly increases the risk that errors and/or irregularities might occur and go undetected and uncorrected in a timely manner. Equally important is that personnel with adequate financial and accounting expertise are employed to perform these duties. In addition to segregation of duties and qualified personnel, written job descriptions are important to establish clear day-to-day roles and responsibilities for each employee. We found the following weaknesses:

- a) The district has concentrated key duties such as cash receipts, authorization over cash disbursements, recordkeeping and custody, with one individual. For example, the secretary to the board can initiate purchases of goods and services, has sole authority to approve purchase orders, approves claim vouchers evidencing receipt of goods or services, and has access to the stamp used to sign checks.
- b) Employees are not cross-trained and there is no evidence of supervision of existing functions.
- c) The treasurer has complete control over the district's accounting functions. No checks exist over the exercise of his authority; he both initiates and approves financial transactions. His responsibilities include:
 1. entering transactions into the general ledger;
 2. preparing bank deposits;
 3. executing wire transfers;
 4. maintaining custody of the signature stamp which is used to sign checks;
 5. maintaining custody of check stock;
 6. preparing checks for payment;
 7. preparing the semimonthly financial report to the board;
 8. issuing purchase orders;
 9. approving vendors;
 10. maintaining vendor records; and
 11. having custody of the petty cash fund and making disbursements from the fund without anyone else at the district verifying the balance of the fund;
- e) There are three supervisors who can initiate a purchase requisition; however, there is no segregation of duties because the same employee who initiates the purchase receives the purchased items and verifies their receipt. There is a lack of segregation of duties over purchases of vehicle parts for repairs and maintenance. These weaknesses place the district at risk for the purchase of car/truck parts for

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personal use and that this inappropriate use may go undetected. The district spent \$ 118, 273 and \$103, 321, in 2003 and 2004 respectively, for parts and supplies for use in vehicle repairs done by the district. The district's informal practice is to order parts as needed rather than maintaining a parts inventory. The mechanics place these orders by phone and then send the requisition to the treasurer. We found that there is lack of internal controls over the purchase and use of parts because:

- the same mechanic who orders the parts takes delivery of the parts from the vendor;
- there is no matching of items ordered to items received because verbal phone orders are poorly documented; and
- the district does not document the district truck or vehicle that parts are ordered for or reconcile the district truck and vehicle maintenance records with parts ordered, delivered or used.

Audit Recommendations:

The district should:

- 1) establish a proper segregation of duties, which can be facilitated by cross training so that functions can be rotated;
- 2) require an employee, other than the petty cash custodian, to perform periodic verifications of the fund balances;
- 3) ensure that responsibility for ordering vehicle parts is segregated from the receipt of the parts and that parts ordered are matched to the receipt of parts before invoices are paid;
- 4) reconcile parts ordered to parts used in repairs to ensure that parts purchased are being used in district vehicles;
- 5) develop written job descriptions that clearly define roles and responsibilities. The secretary to the board should have oversight responsibilities over the payroll and timekeeping process; and
- 6) remove custody of the signature stamp from the district's treasurer and have the board members, designated as signatories, maintain custody of the stamp.

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Audit Finding (3):

Lack of Written Policies and Procedures

The district disbursed over \$17.3 million and \$19.7 million in 2003 and 2004 respectively without having written policies and procedures for many of its accounting and operating processes and functions.

We found no policies or procedures related to:

- establishing conflict of interest and ethical standards;
- guidelines defining proper supporting documentation and procedures for the review of claim vouchers;
- processes to ensure proper review of vendor compliance with contracts;
- board approvals or budgetary constraints;
- guarding against the payment of unauthorized, unsubstantiated or inaccurate payments;
- credit card usage;
- reimbursement for travel, meetings and conferences;
- payroll processing;
- supervisory review over financial transactions;
- requirements for an intermunicipal agreement for fuel purchased for resale to the Incorporated Village of Stewart Manor Sanitation Department; and
- fixed assets or a policy on sale of surplus equipment.

As a result we found:

- duplicate payments to a vendor, Long Island Sanitation, of \$1,903;
- payments made on copies of invoices of \$982;
- disbursements made without properly authorized purchase orders or with incomplete vendor claim forms totaling \$7,969;
- payments of sales tax even though the district's purchases are tax exempt; and
- damages to a vehicle owned by the General Supervisor were reimbursed based on a repair estimate instead of actual costs.

We also found that the district does not have a written policy regarding appropriate reimbursement for business expenses; instead, the Board approves expenses on a case by case basis. We found weak controls over expenses which led to the approval of inappropriate or undocumented items such as:

- a. \$1,177.80 for a Board meeting at a restaurant, without any indication of the date of the dinner, or persons attending the meeting;
- b. \$38.50 for a bar bill and a trip to an aquarium;

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- c. \$187.50 for limousine services during a time period when there was no Board authorization for travel; and
- d. \$1,790 in expenditures for lunches and dinners that did not have names of attendees noted.

Audit Recommendations:

The district should:

- 1) adopt written, fiscally responsible policies and procedures to ensure that the district only makes payments for bona fide district expenses;
- 2) formalize a conflict of interest/code of ethics as part of the district's operating procedures to guide employees in making appropriate decisions, deter wrongdoing and to encourage honest and ethical conduct;
- 3) promulgate cash disbursement policies and procedures to include the specific steps that must be performed when reviewing a claim voucher for accuracy, completeness, and compliance with contractual, board approval and budgetary requirements. The procedures should include descriptions of what constitutes acceptable supporting documentation, as well as how to document the steps that were done, by whom and when; and
- 4) make payments only when supported by an original invoice to prevent duplicate payments.

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Audit Finding (4):

Personal Use of District Vehicles

The district does not have a policy or Board resolution regarding the personal use of district vehicles. Most district vehicles are returned to the premises at the end of the work day; the secretary to the board, the general supervisor and two regional supervisors take home district vehicles daily. The district does not impute taxable income to these employees for the commuting use of its vehicles as required by the IRS. In addition, there was no evidence that full-time commuting use of the district vehicles by district personnel was warranted.

Our review also disclosed that the district does not:

- mark all vehicles with permanently affixed Sanitation District No.6 seals and in some instances removable magnetic seals are used; and
- monitor gasoline usage and mileage for its vehicles, although monitoring functions are available through the district's Gas Boy System.

Audit Recommendations:

The district should:

- 1) adopt a Vehicle Usage Policy for all district vehicles, including those used by supervisors for district business and those where personal use is permitted. The terms of vehicle assignment and use should be clearly stated;
- 2) establish procedures to monitor the gas usage and the mileage for all vehicles;
- 3) affix permanent district seals to all district owned vehicles to facilitate district monitoring and allow district residents to observe how the vehicles are being used;
- 4) impute taxable income in accordance with IRS regulations to employees that are allowed personal use of district vehicles; and
- 5) reevaluate its policy of allowing district personnel to use district vehicles for commuting use within the district.

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Audit Finding (5):

Fixed Assets

The district's fixed asset net valuation was \$4.1 million in both 2003 and 2004. The district has poor internal controls over its fixed assets because:

- assets are not tagged for inventory purposes; and
- the district relies on the external auditor to maintain the fixed asset listing.

We also found that the district's practice is to sell or trade-in all surplus equipment to another municipality, and that the district management was verbally advised by the district's counsel that the equipment can only be transferred in this manner. However, the district could not provide documentation as to how trade-in values or selling prices were determined. This practice differs from the practice found in the county or other municipalities where surplus equipment is disposed of by sale to the highest bidder.

Audit Recommendations:

The district should:

- 1) tag and inventory fixed assets;
- 2) maintain its own fixed asset listing instead of having this function done by the district's external auditor; and
- 3) request that its legal counsel formalize the opinion regarding the sale of surplus equipment including reference to the specific statute or rationale that is the basis for the policy.

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Audit Finding (6):

Insurance

The district costs for insurance coverage was \$4.7 million in 2003 and \$5.2 million in 2004, representing 27% and 26% of total district expenses for 2003 and 2004 respectively. The largest component of insurance costs was premiums paid to the New York State Health Insurance Plan (NYSHIP) these premiums represented more than half of the district's total insurance costs. We found that the district:

- overpaid workers' compensation premiums due to the misclassification of a group of employees;
- paid Medicare Part B reimbursements to surviving spouses that were no longer eligible for this benefit because they had withdrawn from the NYSHIP plan;
- does not have a requirement for an annual eligibility attestation by district Medicare Part B reimbursement recipients;
- continued paying the health benefits premium for a former employee at a cost to the district of \$4,932. Under the federal Consolidated Omnibus Budget Reconciliation Act (COBRA) the district is not required to pay this extension of health insurance benefit's premium and the employee must elect this continued coverage; and
- appears to practice favoritism in its provision of benefits. Although its unwritten policy is to provide employee benefits to employees that work 20 hours or more during the week, the district provided benefits to its part-time lawyers, commissioners, employee assistance representative and community service representative who work less than 20 hours per week at a cost of \$62,672.10 and \$63,190.80 in 2003 and 2004 respectively.

Audit Recommendations:

The district should:

- 1) review employee classification for workers compensation premium ratings;
- 2) monitor eligibility for Medicare reimbursements through an annual attestation;
- 3) provide written communication of employee terminations to the district's benefits administrator so that inactive employees can elect to continue health insurance coverage under COBRA, for which the inactive employee must pay the premium, or be terminated from the health insurance plan; and
- 4) establish and adhere to a written, nondiscriminatory employee benefits policy that does not permit favoritism for employee benefit entitlements.

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Audit Finding (7):

Payroll Processing

The district's total payroll was \$9.8 million and \$10.6 million for 2003 and 2004 respectively and the payroll processing is outsourced to a third party vendor. Employee information is maintained in the payroll database by the district's computer consultant. The payroll is an exception based system that is processed on a biweekly basis and changes to payroll are prepared by the district treasurer who relies on a daily worksheet to record employees' absences for sick, personal or vacation leave. We found poor internal controls over payroll processing due to lack of oversight, lack of a formal processing policy and no segregation of duties. At the end of the pay period, the Treasurer will total up the leave time hours used and give this information to the district's computer consultant for transmission to the payroll service provider.

We found that:

- employee terminations are communicated verbally to the employee who processes payroll, without a documented process, which led to keeping a terminated employee on the payroll for 8 weeks. The employee repaid the excess payment to the district after the district found the error; and
- attorneys are not being penalized for nonattendance at Board meetings even though this is one of the functions of their position as stated on their CS-4 (a form required by the Nassau County Civil Service Commission for all civil service employees). An audit of board meeting attendance revealed that one of the district's attorneys did not attend 26% of the meetings yet he was still getting his full pay. The old job description provided to us listed attending board meetings as a large part of their responsibilities.

We also found that the district is misclassifying employees and outside contractors for payroll tax and employee benefit purposes. For example:

- legal counsel and community and employee service representatives are treated as employees for IRS, New York State Retirement System, and health insurance benefits reporting purposes, when they do not appear to be employees but rather to be outside consultants/contractors. As a result of this treatment, the district makes FICA (Social Security and Medicare) payments for these individuals, and pays for their participation in the NYS Retirement System and for their health insurance benefits(see also p. 11, where we question whether, even if these individuals were employees, they would be entitled to receive health insurance coverage from the district); and
- the computer consultant's role appears to be that of an employee as defined by IRS guidelines She is treated, however, as a consultant for IRS reporting purposes, her employment is not reported to the State Retirement System and she does not receive health insurance benefits from the district.

Findings and Recommendations

Audit Recommendations:

The district should:

- 1) promulgate proper internal control procedures over payroll processing, including segregation of duties, review and oversight of the process and the segregation of duties;
- 2) document transactions regarding hires, resignations and terminations to ensure that all relevant information is properly communicated to the payroll administrator in a timely manner;
- 3) pay attorneys and other professionals based on retainer agreements stipulating hours worked; and
- 4) classify employees based on IRS guidelines.

Audit Finding (8):

Time and Leave

The district has approximately 240 employees and most district employees are covered by a Collective Bargaining Agreement (CBA). According to the CBA, operations workers are required to work a five-day, 8-hour work week. The district does not:

- require employees to record their time worked at the district even though the employees are paid on an hourly basis:
 - we observed most operations workers start their day at 7am and finish their day around 12:30 pm. In effect, based on a 25-hour work week, sanitation workers have an average hourly rate of \$36.28 per hour and supervisors have an average hourly rate of \$52.01;
- have any written policies on processing overtime payments and cannot confirm that employees were paid overtime appropriately because no time records are maintained for employees. For example:
 - There was no apparent justification for more than 50% of the General Supervisor's overtime. This employee was paid \$6,553.05 in 2003 and \$6,042.99 in 2004 for overtime;
- maintain evidence of charging employees for leave time when the employee leaves before the end of the required work day or arrives late for the start of the work day;
- have established administrative leave policies;

Findings and Recommendations

- have a written description or board resolution of the work day for employees not covered by a CBA; and
- uniformly apply its practice of giving employees a compensatory day off for helping to administer the Commissioner elections. Not all employees were given the compensatory day even though they had worked during the commissioner elections. Others were allowed to carry the time over to the following year, which is not the district's practice. In addition, the district should ensure that this method of administering elections is appropriate.

Audit Recommendations:

The district should consult with labor counsel about extending or combining routes, or adding additional routes to employee's workload to justify payment to employees for an eight-hour work day. The district should also consult with counsel to determine the appropriate procedures for administering its elections.

The district should enact written policies and procedures which include:

- 1) keeping a daily record of the hours worked by all employees of the district to determine the employee's regular and overtime hours, as well as maintain accurate records of employee leave balances;
- 2) requiring employees to record hours worked through the use of a time clock for operations employees and timesheets for office staff;
- 3) formal work rules regarding the work week for nonunion members;
- 4) uniformly apply its practice of giving a compensatory day off for commissioner election day off if deemed an appropriate practice;
- 5) an explanation of employee benefits, defined in either the collective bargaining agreement or by Board resolution for nonunion employees; and
- 6) a requirement that all payments for overtime are preceded by appropriate supervisory approvals and are supported by adequate documentation indicating the reason for the overtime and number of hours worked.

Findings and Recommendations

Audit Finding (9):

Appropriateness of Fund Balance

The Office of the NYS Comptroller conducted a study of unreserved and unappropriated fund balances in selected water, fire and sewer districts in Nassau County for the period January 1, 1998 through December 31, 2000. The study indicated that “recent changes in state Law and prudent budgeting practices allow a “reasonable” amount of unreserved fund balance to be retained to ensure the orderly operation of the district and continued provision of services.”

The fund balance restricted for working capital was \$2,845,000 in both 2003 and 2004 and is used to fund the District’s day to day operations for the period beginning January 1st until the District receives its first tax revenue that is generally received in February. This amount appears adequate to meet the reasonable and prudent budgeting practices mentioned in the state study.

The additional *unrestricted* reserves of \$3,004,544 and \$2,283,183 in 2003 and 2004 respectively might be considered excessive when measured against NYS recommendations.

Audit Recommendation:

The district should review whether the unrestricted reserve fund balance is excessive and whether it is necessary to maintain the current level of unrestricted reserve fund balance. Some portion of it could be returned to the taxpayers in the form of a lower tax levy.

Findings and Recommendations

Audit Finding (10):

Role of External Auditor

Government Auditing Standards, Amendment No. 3 (Standard), *Independence* [issued January 25, 2002] requires that audit organizations take a “substance over form” approach and consider the nature and significance of the services provided by the external auditor and carefully consider the need to avoid situations that could lead reasonable third parties to conclude that the auditor is not able to maintain independence in conducting audits. Some nonaudit services are prohibited, while others are permitted, but permitted nonaudit services must be based on management’s information, understanding and approval in order to maintain auditor’s independence.

The district has been using the same external auditor since the late 1980’s. The district does not have a contract with the auditor and the latest engagement letter is from the year 2000.

We found that the district relies too heavily on the external auditor for nonaudit services in a way that impairs the auditor’s independence. The auditor performs prohibited bookkeeping and recordkeeping functions throughout the year, developing the information that is the basis for the audited financial statements. For example:

- The auditor develops and maintains the district’s fixed asset listing.

The auditor also performs permitted nonaudit services but management apparently does not have the accounting knowledge to make an informed judgment to review, approve and take responsibility for these transactions. For example the auditor:

- recommends budget transfers; and
- calculates monthly and year end accruals for posting by the computer consultant.

In addition, when an independent auditor performs permitted nonaudit services, management's representation letter must include an acknowledgement of the auditor's role in this regard. Management’s representation letter does not include such an acknowledgement.

We also noted that the district does not have a policy to rotate its auditor.

Audit Recommendations:

The district should:

- 1) employ personnel with adequate expertise to coordinate and understand the audit work performed and oversee and evaluate the nonaudit services provided;
- 2) adopt a policy to rotate its external auditor periodically; and

Findings and Recommendations

- 3) require that the engagement letter and management representation letter cover all audit and nonaudit services to be performed by the auditor. The roles of district's management and the auditor with respect to nonaudit services should be clearly defined to prevent a lack of independence on the part of the external auditor.

Audit Finding (11):

Bank Reconciliations

The district does not have any policies and procedures for the reconciliation of its three bank accounts. "Performing bank reconciliations is an important and integral part of any financial management system. When these reconciliations are not being performed it creates a significant internal control and financial system weakness."⁷ We found that:

- bank reconciliations are prepared by the district's computer consultant without any oversight and that errors are not being caught or rectified on a timely basis;
- one of the three bank accounts is reconciled to the check book and not the general ledger; this process would not detect misstatements in the district's financial statements;
- cancelled checks are not reviewed for proper endorsement. Bank statements include images of only the front of the cleared checks. The inability of the district to view endorsements on the checks issued and cleared minimized the district's ability to identify errors and irregularities and increases the district's exposure to fraud.

Audit Recommendations:

The district should develop written procedures for periodic bank reconciliations to ensure that:

- 1) bank statements are reconciled to the general ledger;
- 2) the bank statements include images of the back of checks in order to review check endorsements; and
- 3) bank reconciliations are reviewed by a supervisor.

⁷ A Report of A Study of Cash Internal Control Practices for Local Governments in New York State, pg. 8

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District's Response:

Thank you for the opportunity to respond to the draft findings and recommendations concerning the above-referenced audit.

At the outset it should be noted that footnote 1 on page ii of the executive summary is incorrect in that the Nassau County Civil Divisions Act was amended in 1982 to provide for six (6) commissioners in Sanitary District No. 6.

Cost Analysis of Operations:

The report indicates that the district has 50 refuse disposal routes. The district in fact has 50 refuse collection routes and 30 recycling routes for a total of 80 routes. It should also be noted that the district provides regular refuse pickup three (3) times a week, recycling pickup once a week, a yard waste pickup once a week and a special bulk collection pickup by appointment. The district differs from other districts in that it operates on a six-day, Monday through Saturday schedule.

Based on the foregoing we believe that a fair analysis of costs reveals that the per-pick up cost to the residents of Sanitary District No. 6 compares favorably with that of other municipalities throughout Nassau County.

Auditor's Follow-up Response:

The fact remains that other districts provide satisfactory service at a much lower cost. We note that many other districts that provide the same, or a higher level of service, at substantially less cost.

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District's Response:

Administrative, Financial and Operating Practices:

The district complies with all applicable State and Local Laws as to procurement, conflict of interest rules and other policies. Over the two-year period covered by the audit, one error regarding a failure to be reimbursed for medical benefits paid to an employee was uncovered. The employee has been contacted and the district will be reimbursed.

The District has contacted North Fork Bank to insure that the front and back of all cancelled checks are given to the district. This is contrary to the banks policy but they are accommodating the District. The account in question is the District's New York State Retirement Account and only one check per month is written from that account to the New York State Pension System.

The District's Operating Account is reconciled and the front and back of each check is received and inspected.

The District utilizes an automated gasoline system referred to as the Gas Boy System. The system is in use and we respectfully request that the next-to-last paragraph on page iii suggesting that it is not is inaccurate.

Auditor's Follow-up Response:

We stand by our finding that the district lacked written policies and procedures covering most aspects of the district's operations, including a Conflict of Interest policy. We concur with the corrective action taken by the district with respect to obtaining both sides of the cancelled checks.

We concur that the district uses the gas boy system; however its monitoring features for vehicle and fuel usage were not properly used by management. We found that the system's reporting module was malfunctioning for six months during the audit period and that no controls existed over manual overrides to the system. In addition, the gas boy system reports we reviewed had multiple errors such as incorrect odometer readings, and multiple vehicles reported as one vehicle under the same number for reporting purposes.

The District did not respond to our finding that there was a lack of segregation of duties which concentrated key duties over cash receipts, cash disbursements, record keeping and custody with one individual. Also, the District did not respond to our finding that it appears to practice favoritism in providing benefits for certain part time employees such as attorneys, commissioners and community service and employee assistance representatives.

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District's Response:

Procurement Practices:

We respectfully disagree with these findings. The purchases of truck parts are from the authorized sole-source Dealers and Distributors for factory parts. The District complies in all respects with GML Section 103 concerning competitive bidding.

The terms of agreements with Outside Counsel are memorialized by the Resolutions passed by the Board of Commissioners hiring them. Consultants submit bills which are reviewed by the Board before being paid.

In accordance with your suggestion written documentation of all quotes is now required. In addition, the employee who orders materials will not be the individual who accepts delivery of same. While this rule has been in effect for some time, the District realizes that there have been times when this was not the case.

The computer consultant had previously worked for the district as an employee of a prior consultant and her work product was well known to the Board of Commissioners. Her resume is on file. The former Secretary to the Board, who started at the District in 1961 is retained at a salary of \$300 per month since his institutional memory and knowledge of the District is invaluable.

The District complies with the Internal Revenue Service Rules and Definitions concerning the definitions of employee and the rules emanating there from. For example the district substantially controls the time, place and work hours of its staff attorneys while also requiring them to personally render the services to be provided.

Auditor's Follow-up Response:

We made a number of requests of the district for copies of pertinent state contracts with respect to the purchases exceeding \$10,000. The district did not provide copies of the contracts or evidence that the vendors had sole-source status. The purchases that we reviewed included items other than truck parts and there was no evidence of compliance with either the district's procurement policy or General Municipal Law 103. We concur with the corrective action proposed by the district regarding the retention of quotes and the segregation of duties over ordering and receipt of goods.

Board resolutions or vendor invoices should not take the place of retainer agreements for legal counsel. We made several requests for a resume for the district's current computer consultant; however the district did not provide it. We note that the current consultant was the wife of the former consultant and not just an employee.

We reiterate our finding that the district has expended \$72,000 since 1985, apparently for "institutional memory". The district was unable to provide any work product or

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District's Response and Auditor's Follow-up

documentation or record of the nature and frequency of the services provided by the former Secretary to the Board to justify the expenditure of \$72,000.

There is no evidence to support the District's contention that it substantially controls the time, place and work hours of its staff attorneys since the attorneys maintain private practices or other full time employment, do not maintain office space, and are not accountable for their time spent on district business.

We also reiterate our findings that there was no evidence to support the \$12,000 per year expenditure for the lobbyist or the additional charges by the District's external auditor.

Although we concur with the district's corrective actions regarding retention of quotes and receiving procedures, the district did not address the weaknesses noted regarding its purchasing process. We reiterate our recommendations that the district improve controls over the purchasing process.

District's Response:

Payroll Processing, Time and Leave:

The District takes attendance at 7:00 am each morning. The employee's are assigned and a copy of their assignment is sent to the payroll department. The sheet lists all employees assigned to trucks, those absent, those late and those on excused leave.

The District uses a Modified Task System for collections. When all of the routes have completed their collections and the district has been picked up the crews are released for the day. This system is used throughout the industry. It is used by the Town of Oyster Bay, Town of Hempstead, Sanitary Districts 1, 2, 6, 7, The Villages of Garden City, Hempstead, Rockville Centre, Lynbrook, Valley Stream, Malverne, Mineola, Westbury, New Hyde Park and Floral Park just to name a few. This system is also used in private sector.

This system promotes productivity. In the year 2003 the District paid out a total of \$1,001.28 in overtime to the Sanitation and Recycling employees. In 2004 the District paid out a total of \$248.09 in overtime to those divisions.

Overall in the years 2003 and 2004 overtime cost had risen due to the illness of a mechanic supervisor who was out of work for ten (10) months. The assistant mechanic supervisor was also out for approximately six (6) weeks due to surgery.

Overtime is given mostly to deal with weather emergencies (plowing our facility) and dealing with Holiday collections. The General Supervisor receives overtime to handle weather and other related emergencies that may arise.

We agree with your recommendations to monitor overtime. We have since implemented an overtime authorization policy including a form that states the reason for

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overtime, the employee name and hours worked. The form requires the approval of the Secretary to the Board of Commissioners.

All seasonal employees fill out termination slips, which state their last date of work and the reason for leaving. Seasonal employees who stay until the end of the season receive letters of termination. Full-time employees are terminated by Board resolution and are notified in writing.

Auditor's Follow-up Response:

The district's response does not address the lack of time records for approximately 40 supervisory and administrative employees. We stand by our recommendation that the district should require all employees to record their time daily, including starting and ending times, in order to provide more accurate oversight of district operations.

Since sanitation workers are working only four or five hours a day, the district should consult with labor counsel about extending or combining routes.

Sanitation workers should not incur overtime because they are paid for eight hours to perform five hours work. We concur with the corrective actions taken to monitor and control overtime.

Our finding does not relate to the notice of termination to the employees, but rather with the lack of a written communication to the payroll and benefits areas of the district.

The district did not address our finding that an attorney who missed 26% of Board meetings received full pay even though it is part of his job description.

District's Response:

Appropriateness of Fund Balance:

The unreserved fund balance as of December 31, 2004 represents 10% of the 2005 budget appropriations. The District monitors the unreserved fund balance and feels that the current balance is prudent and reasonable in order to ensure the orderly operation of the district and continued provision of services.

Role of External Auditor:

The report states that it appears that the independence of the External Auditor has been impaired as it relates to the issuance of audited financial statements. To clarify, the additional non-audit services which are provided to "develop and monitor the district's fixed asset listing" was and is compiled using asset information provided by the district's management and from the independent third-party appraiser. Annually the District hires an independent appraiser to physically identify all district assets and identify changes and

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account for additions and deletions. This report is used as a basis for the fixed asset schedule and for insurance purposes.

The fixed asset schedule, which is maintained by the auditor, is not a component of the budgetary financial records of the District. The results of this schedule are used for disclosure purposes as a reconciling item in order to be in compliance with the newly implemented (2003) disclosures mandated by GASB #34. He does not have any managerial input regarding this schedule or the disclosures. The function is purely mechanical in nature - that is calculating and annual depreciation expense and accumulated depreciation values.

With respect to annual accruals, these accruals for unpaid expenses at year-end are recommended to the Treasurer; and, if he approves, they are entered into the general ledger. The external auditor has no control over his approval or rejection of his recommendations nor does he actually post entries into the general ledger.

Regarding the recommendations of budget transfers to the Board - they are just that, recommendations. The Board ultimately votes for or against the recommendations; the auditor has no control over the outcome of their actions.

With respect to the inclusion of non-audit services in the representation letter, we agree with the Comptroller's finding; this was the only time that the auditor performed non-audit services for the district. In the future a clearly written engagement letter of all non-audit services to be performed along with the roles of the District and the auditor will be obtained in order to prevent third parties from questioning the independence issue.

Based on the facts and circumstances noted above, we respectfully disagree with this section of the audit.

Auditor's Follow-up Response:

We stand by our finding regarding the role of the external auditor. We found that management lacked an understanding of journal entries and referred many of our questions directly to the outside auditor. We concur with the district's decision to include the provision of non-audit services in the engagement letter.

District's Response:

Lack of Written Policies or Procedures:

The invoices describing the products ordered are signed and submitted for disbursement. Two Sanitary Commissioners counter-sign each invoice, making certain that the amount; product description and authorized signature appear on the invoice. This procedure is followed at the end of every two-week period.

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The disbursements are added up and deducted from the reconciled statement of the previous two-week period. The reconciled statement not only contains the invoice and payroll disbursements but it also indicates the amount of interest received from the balances, which the district maintains in bank accounts.

We emphatically disagree with the general statement that the District has no policies or guidelines with respect to items listed at the top of page 7. All of the expenses paid by the district are legal and proper. While the District agrees that there are some deficiencies in internal control, all disbursements of funds were proper. We also note that no district commissioner or employee has a district credit card. While dinner meetings are proper and permissible under the Law, the District has a strict rule against same and the money has been repaid to the District. While a legal charge, the \$38.50 spent on a lunch and admission to an aquarium has also been repaid.

\$187.50 for "limousine service" was not for limousine service. It was for transportation to and from an airport for a duly approved seminar. A regular livery vehicle and not a limousine was used.

As to the \$1,790 in "Lunches and Dinners", these were for attendance at various conferences as follows:

- 2004 American Public Works Awards Dinner where the District received a service award from the NY Metro Chapter. Six (6) Commissioners, the Secretary to the Board, the General Supervisor and the Treasurer attended. The cost was \$60.00 per person (\$540);

- In 2004 and 2003 District Commissioners attended the Installation Dinner for the Long Island Sanitation Officials. The Secretary to the Board was installed as a member of the Board of Directors and the General Supervisor was installed as Secretary of the organization. In 2004 ten (10) members attended at a cost of \$65 per person (\$650). In 2003 eight (8) members attended at a cost of \$60 per person (\$480);

- In 2004 two (2) Safety Supervisors and the employee who processes the workers compensation claims attended a conference on Workers Compensation at a cost of \$47.78 (\$15.93) per person.

- In June of 2003 the Secretary to the Board attended the Waste Exp. Conference. The cost of the registration, transportation and lodging were paid for by the District.

Auditor's Follow-up Response:

We stand by our finding that there are no written policies and procedures relating to the financial management and oversight of the district. Although the district has informal practices, policies and procedures should be in writing and be approved by the Board of Commissioners in order to provide clear guidelines for employees to follow. The district does have a Home Depot credit card which is used by employees of the district.

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District's Response:

Personal Use of District Vehicles:

The four (4) employees who are authorized to take their vehicles home are on call to respond to any district emergency. The vehicles are not for personal use. They are used to commute to and from work on district business. The fuel usage and mileage is tracked by our computerized gas boy fuel system.

Auditor's Follow-up Response:

We stand by our finding that the district does not have a policy or Board Resolution regarding the use of district vehicles, and that the district does not impute income to employees using vehicles for commuting use as required by the Internal Revenue Service (IRS). The district was not using the gas boy system to monitor fuel use.

District's Response:

The foregoing is an initial response to your departments audit findings. We note that the entire audit is voluminous and contains many specific recommendations that the Sanitary District No. 6 will implement in the near future.

Thank you again for this opportunity to respond to this audit.