

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



**Limited Financial Review
of the Franklin Square Water District**

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Comptroller

September 18, 2007

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OFFICE OF THE COMPTROLLER

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EXECUTIVE SUMMARY

Background

Nassau County has over 200 special taxing districts providing services for town residents. More than half of the special districts are run by independently elected commissioners, the rest of the districts are run directly by town officials. In 2005, the office of Nassau County Comptroller Howard Weitzman conducted audits of sanitary special districts in Nassau County. A follow-up white paper discussed problems of waste, fraud and abuse in special districts generally.¹

Following the audits of sanitary districts, Comptroller Weitzman's office undertook audits of the financial operations of four water districts in Nassau County: the Hicksville Water District in the Towns of Oyster Bay and Hempstead, the Westbury Water District in the Town of North Hempstead, and the Franklin Square and East Meadow Water Districts in the Town of Hempstead.

Water districts are governments that exist solely to provide water for residents and commercial establishments primarily in unincorporated areas of towns. District expenses are paid through local property taxes and charges for water, generally based on the gallons used as measured by water meters.

In 2006 the Franklin Square Water District (the "District") provided 754 million gallons of water to a population of approximately 20,000.² Homeowners in the District in 2006 paid an average of \$142 in taxes to the District in addition to a water charge of \$16 per quarter for the first 9,000 gallons of water and \$1.60 per additional 1,000 gallons. For a district homeowner who used 100,000 gallons per year, the average total charge for water was \$308.

The District's total expenses were \$2,079,822, and \$1,951,358 for the years ended December 31, 2005 and 2004 respectively. The District employed three elected commissioners, a Superintendent, two part time attorneys, two administrative and seven operations staff members. The District derives approximately 40% of its revenue from real property taxes, 53% from charges for water usage, with miscellaneous revenues making up the remainder.

Audit Scope and Methodology

The scope of our audit was limited to an examination of the District's administrative policies and procedures, procurement practices, operating expenses, administrative expenses and revenues for years ended December 31, 2004 and 2005.

¹ *Nassau County Special Districts: The Case for Reform* (Dec. 19, 2005), www.co.nassau.ny.us/comptroller/auditreports.html

The individual sanitary district audits can be found at the same web site.

² Franklin Square Water District "2006 Drinking Water Quality Report"

EXECUTIVE SUMMARY

Summary of Significant Audit Findings

Commissioner Compensation

Per Diem Compensation

During the audit period, New York State law set the maximum daily compensation for water district commissioners at \$80 per day. The District paid its three commissioners at the maximum rate. District spending on per diem compensation for the three commissioners was \$39,440 in 2004 and \$36,960 in 2005.

The Board had not set forth a policy requiring board members to attest to time they work or to provide written descriptions of the District business they perform. The Superintendent noted when commissioners were present in a daily log book. He listed the nature of the work performed as “inspection,” “conference,” or “teleconference.” The records did not include enough information to determine whether the services provided were not nominal, trivial or inappreciable as required by law before commissioners can be compensated. The Superintendent is the son of one of the commissioners. The son’s responsibility to record his father’s time presented a conflict of interest.

Health Insurance

As part of their compensation, the commissioners were offered fully paid medical, dental and vision insurance for a total cost of \$56,822 over the audit period.

Commissioners’ Retirement Reporting

For retirement credit purposes, the District reported to the New York State Employee’s Retirement System (“NYSERS”) that one commissioner worked five days per month in both 2004 and 2005. We could not ensure, however, that the District was correctly reporting time for the commissioner as there was no record of activities for the required monthly period or documentation on how the standard workday was established.

Improper Treatment of Attorneys as Employees

The District employed two part time attorneys during the audit period. One was the Town of Hempstead’s Town Attorney. According to Board minutes, the Town of Hempstead’s Town Attorney was hired in September 2002 for \$12,600 annually and a second attorney (the “junior attorney”) was hired in July 2004 for an annual amount of \$3,500. The District offered both attorneys fully paid health benefits. The Town Attorney took excess medical and dental coverage and the junior attorney took medical coverage. The District paid \$13,600 in total for both attorneys’ policies during the audit period. The District reported both attorneys’ time to the retirement system, even though

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the Town Attorney had a full time job with the Town of Hempstead and was also a part time attorney for Sanitary District 6 in the Town of Hempstead.

The District also assumed responsibility for paying social security and Medicare taxes for the attorneys because it treated them as employees. IRS guidelines permit the District to treat the attorneys as consultants, which would have saved taxpayer money.

The District did not adequately hold the attorneys accountable for reporting hours worked, other than a semiannual time statements submitted by the Town Attorney. These time statements showed approximately 40 hours worked, but did not include specific dates and hours, or details about the projects worked on.

Employment of Family Members

We found that the District's hiring practices gave the appearance of preferential treatment to family members. On a 2006 organization chart consisting of 15 individuals, 7 were related.

- A commissioner's son is the District Superintendent.
- The District Superintendent's nephew is a water plant attendant.
- A commissioner's daughter is an account clerk.
- The business manager's son is a water plant attendant.

Excessive Health Insurance Benefits

The District offers excess medical benefits coverage for its employees to cover the amount employees have to pay out of pocket for out of network service under the NYSHIP plan. During the audit period, the cost of the excess health insurance was \$12,473. When the District already offers non-contributory fully paid health benefits, it is excessive to also insure against payment of deductibles.

Board's Failure to Establish Formal Policies and Procedures

We found that the Board had not ensured that the District's operations properly controlled cash disbursements totaling approximately \$2.1 million per year. There were no written operating policies and procedures for many of its accounting and operating functions, such as cash receipts, disbursements, payroll and time and leave.

We also found that the District's code of ethics did not include a conflict of interest policy or mention the extent to which such conflicts are not permitted even though a number of family members were hired by the District.

Lack of Segregation of Duties

We found that job assignments did not provide an adequate segregation of duties over financial transactions. For example the Business Manager performed conflicting duties

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such as generating, approving and issuing purchase orders. Written job descriptions were vague or did not exist at all.

Lack of Time and Leave Documentation

The District did not maintain adequate time, leave and overtime records for its employees and commissioners to support wages of \$1,646,748 during the audit period. Employees were not required to attest to the time they worked, or for a supervisor to certify accuracy. The District did not require employees to submit written requests for usage of leave and employees were paid overtime based solely on entries made on a wall calendar which, in violation of New York State document retention regulations, was not retained. The District could not provide the appropriate documentation to support overtime payments of approximately \$50,000 per year.

Procurement and Cash Disbursements

Procurement

The District's procurement policy for purchases not required to be competitively bid had weaknesses and often left entire purchase decisions, or the decision on the number of bid quotes obtained, to the sole discretion of the Superintendent.

We reviewed 11 purchases between \$1,000 and \$4,999, representing 10% of those purchases, and all 11 of the purchases between \$5,000 and \$9,999. We found that the District violated its procurement procedure because there was no evidence of the Superintendent's approval for three purchases; and no purchase order at all for a \$6,300 item.

Cash Disbursements

- The District's use of vendor numbers was inaccurate. We found four instances where a vendor number identified a specific vendor but the voucher and payment were for a different vendor.
- The District did not maintain a current list of rates charged by a water testing vendor for each of the over 135 parameters tested and paid these charges without verifying their accuracy.
- We found five instances where the District paid vendor invoices without evidence that the goods had been received.

Travel, Meeting and Conference Expenses

The District did not have a policy governing travel, meeting and conferences. We tested all travel vouchers and found that two commissioners were reimbursed a total of \$516 for meals and tolls not supported by receipts. Three paid vouchers, totaling \$690, were for

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meetings attended by the commissioners, with no supporting documentation. An announcement for one of the meetings attended included golf as one of the day's activities, which is a recreational activity and should have been a personal expense of the employees.

Cell Phones

The District provided cell phones to two commissioners, the Superintendent and Business Manager. It did not promulgate a policy governing cell phone use. Commissioners, who have no operational responsibility, do not require cell phones.

Accounting for Employee Life Insurance Policies

The District's individual life insurance policy premiums were \$18,555 in 2004 and \$18,435 in 2005. The September 2004 and 2005 cash surrender values were \$215,555 and \$232,463, respectively. The District improperly categorized the insurance premium cost in its financial reports as "General Unallocated Insurance," instead of Employee Benefits. Further, the cash surrender value did not appear on its Balance Sheet; instead the cash surrender amounts were only discussed in the footnotes to the financial statements.

The matters covered in this report have been discussed with officials of the District during this audit. On July 5, 2007 we submitted a draft report to the District with a request for comments. The District's comments, received on July 23, 2007 are included as an addendum to this report (Appendix).

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AUDIT FINDINGS AND RECOMMENDATIONS

Audit Finding (1):

Commissioner Compensation

Per Diem Compensation

During the audit period commissioners were compensated at a per diem rate of \$80 per day for each day “actually and necessarily spent in the service of the district.”³ The \$80 was a flat fee, regardless of the amount of time worked each day. In order to be entitled to this compensation, the services rendered must not have been “wholly nominal and unsubstantial” or “trivial or inappreciable.”⁴

We noted a general lack of internal controls over the commissioners’ timekeeping. The commissioners are paid for attending regular board meetings and for other days when they are in attendance at the District’s offices.

The Board had not set forth any policies requiring board members to attest to time they work or to provide written descriptions of the District business performed on the days when there were no board meetings.

As shown in the table below, the combined earnings of the three commissioners were \$39,440 in 2004 and \$36,960 in 2005. Based on a review of the board minutes and professional organization meeting registration fees, we determined that the amounts for 2004 and 2005 included \$11,520 and \$10,160, respectively, for attendance at board and professional organization meetings. The remaining amounts, \$27,920 in 2004 and \$26,800 in 2005, could not be associated with meetings. Thus, the appropriateness of per diem payments totaling \$54,720 during the audit period for days when there were no board or professional organization meetings could not be determined since there was no record to show that the work performed by a commissioner was not nominal, trivial or inappreciable.

	Per Diem Compensations Paid to Commissioners								
	<u>2004</u>			<u>2005</u>			<u>Audit Period Total</u>		
	Number of Meetings	Number of Per Diems	Earnings	Number of Meetings	Number of Per Diems	Earnings	Number of Meetings	Number of Per Diems	Earnings
Board Meetings	37	111	\$8,880	33	97	\$7,760	70	208	\$16,640
Outside Meetings	15	33	\$2,640	15	30	\$2,400	30	63	\$5,040
Total Meetings	52	144	\$11,520	48	127	\$10,160	100	271	\$21,680
Other		349	\$27,920		335	\$26,800		684	\$54,720
Total		493	\$39,440		462	\$36,960		955	\$76,400

The documentation supporting the days the commissioners were paid consisted only of a notation made by the Superintendent in a daily log book of the days that each

³ See N.Y. Town Law § 214 (2005). During the period 2004 through October 23, 2005 the daily rate could not exceed \$80 per day. As of October 24, 2005, the statutory maximum was raised to \$100 per day.

⁴ See N.Y. Op. State Comptroller 90-49 (1990).

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commissioner was present and working on behalf of the District. However, the nature of the work performed was listed only as “inspection,” “conference” and “teleconference.” The log book did not include any notations about the business purpose of the meeting or conference, indications of what was inspected, or the number of hours worked. As a result, the records did not include enough information to determine whether the services provided were not nominal, trivial or inappreciable.

Commissioners’ Retirement Reporting

The District reported that one commissioner worked five days per month in both 2004 and 2005 to the New York State Employee’s Retirement System for retirement credit purposes. (The other two commissioners were already NYS retirees and were not reported.)

The New York State Employees Retirement System (“NYSERS”) requires that employers report time worked based on the number of days actually worked.⁵ For elected officials, the governing board of a municipality is directed to establish a standard workday to be used as the basis for retirement system reporting, which should not be less than six hours per day. Elected officials must keep a record of activities for a period of one month containing a daily detail of hours worked and duties performed directly related to the position, which is used as the basis for reporting time worked. To determine the number of days to be reported, NYSERS prescribes taking the total number of hours worked by the elected official, based on the record of activities, and dividing that total by the standard work day that was established by board resolution.

The District determined a standard workday to be six hours and a standard workweek to be 30 hours. We commend the District for establishing a standard workday; however we could not ensure that the District was correctly reporting time for the Commissioner. The District did not have any record of activities for the required one month period or document how the standard workday was established.

Commissioners’ Health Benefits

As part of their compensation, the commissioners, were offered fully paid medical, dental and vision insurance. The District incurred a total cost of \$56,822 for their health insurance over the audit period.

⁵ New York State Employees Retirement System Employer’s Guide. June 2004, p. 100.

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Family Relationship between Superintendent and one Commissioner

We also found that the Superintendent is the son of one of the commissioners and as such, is responsible for preparing the daily time record for the commissioner. Audit Finding 3 addresses the conflict of interest issues that arise from this situation.

Audit Recommendations:

The District should:

- a) set standards and develop specific written criteria and board approved procedures to describe when a commissioner is entitled to receive per diem compensation. Written procedures should be developed to describe the information each commissioner must attest to for each per diem payment. For example, such information would include the day, time and number of hours worked and the nature of the work performed, in sufficient enough detail to assure taxpayers that the services rendered are not nominal, trivial or inappreciable;
- b) require commissioners to prepare, sign and certify their own daily time records;
- c) terminate medical, dental and vision insurance for commissioners;
- d) establish a policy that addresses the conflict of interest between a commissioner's son filling out the father's timesheet; and
- e) document the basis for establishing the commissioner's standard workday.

Audit Finding (2):

Improper Treatment of Attorneys as Employees

Compensation

The District treated its two attorneys as District employees instead of independent contractors. The Board approved payments totaling \$30,450 to the two attorneys through the District's payroll. According to Board minutes, the Town Attorney for the Town of Hempstead was hired in September 2002 to provide legal services for an annual amount of \$12,600 (the "Town Attorney") and a second attorney (the "junior attorney") was hired as of July 2004 for an annual amount of \$3,500. Both annual amounts were to be paid in monthly installments.⁶

The District's Personnel Policy permits both attorneys, as employees of the District to receive fully paid health benefits, including medical, excess medical, dental, vision and worker's compensation. The Town Attorney took excess medical and dental coverage from the District. The junior attorney also took the medical coverage. The District paid

⁶ The Town Attorney resigned from the District as of December 2005.

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\$13,600 in total for policies for the two attorneys during the audit period, \$9,977 of which was attributable to the insurance for the junior attorney. For 2005, the junior attorney received a fee of \$3,500 and health benefits at a cost of \$7,060 to the District, which amounts to more than two times the junior attorney's annual salary.

We also found that during the audit period, for New York State pension credit purposes, the District reported the Town Attorney as having worked five days per month for the District even though he had a full time job with the Town of Hempstead and another part-time job as attorney for Sanitary District 6 in the Town of Hempstead . On December 7, 2005, the District amended its filing with the New York State and Local Retirement System to reverse four of the five days per month worked. The filing included the statement "Be advised that this employee has another full-time government position in New York State and as such no "time" credit should be given to him." As such, the District should have reversed the full five days per month that were originally filed.

In a report entitled "Nassau County Special Districts: The Case for Reform," the Comptroller's Office has critically noted that "Districts hired attorneys without following written procurement policies, without entering into written retainer agreements, and provided attorneys health and retirement benefits even though they appeared to be outside contractors, not employees."⁷ This is a wasteful practice that increases a district's costs without a legitimate business purpose.

FICA Payments, Fringe Benefits

By classifying the attorneys as employees, the District has assumed responsibility for social security and Medicare payments for the attorneys. The Internal Revenue Service (IRS) has specific criteria to determine whether an individual is an independent contractor, an employee, or both. The IRS does not require FICA payments if the individual is an independent contractor. A review of IRS topic 762, found on the IRS Web site, serves as a guideline in making this determination. We found that the facts suggest the attorneys were not employees for IRS purposes because they were not:

- required to maintain any time records;
- assigned any office space at the District; and
- required to provide any description of their day to day activities.

No duties or responsibilities were mentioned in the minutes for the junior attorney, nor did we find any documentation of the services rendered by this attorney. The District did not adequately hold the attorneys accountable for reporting hours worked. The only reporting of time worked consisted of semiannual time statements from the senior attorney. The time statements showed approximately 40 hours for reviewing bid

⁷ Office of the Nassau County Comptroller, *Nassau County Special Districts: The Case for Reform*, at 9 (2005) <http://www.nassaucountyny.gov/agencies/Comptroller/Docs/PDF/05Dec19-SpecDistRpt.pdf>.

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documents and requests for proposals, researching laws, and drafting legal notices. The time statements did not include the specific dates services were performed, the hours worked per day, or provide details about the projects worked on. We also found no evidence that bid documentation and legal notices were reviewed by counsel other than the vague description on the time statements.

Audit Recommendations:

The District should:

- a) terminate the employer-employee relationship with the attorneys, thereby eliminating the related fringe benefits expense. Instead, the District should use a competitive procurement process to obtain legal services; enter into a retainer agreement and require the attorneys to provide detailed time records to support invoices;
- b) explore the possibility of sharing legal services with the Town or other special districts within the framework of an intermunicipal cooperation agreement;⁸ and
- c) eliminate all five days per month pension credits filed for the senior attorney.

Audit Finding (3):

Employment of Family Members

We found that the District's hiring practices gave the appearance of preferential treatment to family members. On a 2006 organization chart consisting of 15 individuals, 7 were related.

- A commissioner's son is the District Superintendent.
- The District Superintendent's nephew is a water plant attendant.
- A commissioner's daughter is an account clerk.
- The business manager's son is a water plant attendant.

To the extent that family members supervise their relatives, the District's ethics policy should be expanded to address the inherent conflict of interest in that situation and provide alternative lines of reporting.

Audit Recommendations:

The District should adopt and comply with a conflict of interest policy that prohibits hiring and supervisory practices that give the appearance of preferential treatment.

⁸ Office of the Nassau County Comptroller, *Cost Saving Ideas for Special Districts in Nassau County*, at 11-12 (2006)
http://www.nassaucountyny.gov/agencies/Comptroller/Docs/PDF/Cost_Saving_Initiatives121306.pdf.

AUDIT FINDINGS AND RECOMMENDATIONS

Audit Finding (4):

Excessive Health Insurance Benefits

We found that the District was incurring excessive health insurance costs. Many municipalities in New York State, including Nassau County, the Town of Hempstead and all local school districts⁹ obtain health benefits through the New York State Health Insurance Program (“NYSHIP”). NYSHIP offers medical, mental health, hospitalization, drug and related coverage to participating employers. The benefit levels are generally recognized as generous.¹⁰ We found that in addition to the NYSHIP coverage, the District provided privately purchased excess medical benefits coverage for its employees and retirees at a cost of \$12,473 during the audit period. This excess medical benefits coverage enhanced the NYSHIP coverage for District employees for up to \$1,500 in expenses incurred by using out of network providers instead of NYSHIP participating providers. This practice is an unnecessary burden on District taxpayers since the District already offers fully paid, non-contributory health insurance.

Audit Recommendation:

The District should terminate the excessive coverage policy and no longer provide reimbursement for employees’ deductible payments for out of network providers.

Audit Finding (5):

Board’s Failure to Establish Formal Policies and Procedures

The District’s Board is responsible for establishing and ensuring compliance with a system of internal controls over financial operations. We found that the Board had not ensured that the District’s operations were controlled through the promulgation of written operating policies and procedures for many of its accounting and operating functions to control cash disbursements totaling approximately \$2.1 million per year. While the District’s policies “do not necessarily need to outline in specific detail each and every

⁹Office of the Nassau County Comptroller, *Nassau County Health Benefits Survey with Appendix (2006)*
http://www.nassaucountyny.gov/agencies/Comptroller/Docs/PDF/School_Districts_Health_Benefits_Survey.pdf

¹⁰Office of the Nassau County Comptroller, *Providing Affordable Health Benefits for County Employees and Retirees; Some Suggested Solutions (2007)*,
http://www.nassaucountyny.gov/agencies/Comptroller/NewsRelease/2007/documents/07Jul19-health_benefit_rpt.pdf

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step of a particular transaction... [they] should provide guidance to help promote and maintain accountability.”¹¹

Although the District had a procurement policy and a personnel policy, it lacked written policies and procedures for:

- cash disbursements
- cash receipts
- payroll
- time and leave
- travel, meetings and conferences
- educational expenses
- cell phones
- vehicles
- credit cards
- petty cash
- fixed assets
- system user procedures

We also found that the District’s code of ethics did not include a conflict of interest policy or mention the extent to which such conflicts are not permitted. A conflict of interest policy is particularly critical because of the number of related family members hired by the District. See Audit Finding (3).

Audit Recommendations:

The District should:

- a) develop and adopt formal written policies and procedures for the operating, financial and systems processes; and
- b) ensure that the ethical culture is clearly governed through a written code of conduct which includes a conflict of interest policy. Relationships and/or transactions that could be construed as a conflict of interest or otherwise inappropriate should be prohibited.

¹¹ Office of the State Comptroller, *A Study of Cash Internal Control Practices for Local Governments in New York State, State of New York*, at 4 (2000), <http://nysosc3.osc.state.ny.us/localgov/audits/swr/2000ps5.htm>.

AUDIT FINDINGS AND RECOMMENDATIONS

Audit Finding (6):

Lack of Segregation of Duties

A key element in an effective internal control environment is the segregation of duties, which is intended to prevent or detect unauthorized transactions or fraudulent activity. No one person should have control over 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 and written job descriptions exist that establish clear day-to-day roles and responsibilities for each employee. The job descriptions should assign functions among employees so that no single individual controls all aspects of a transaction and that there is a system of checks and balances.

The assignment of job duties did not provide adequate segregation of duties over financial transactions. For example:

- The Business Manager had authority to make purchases costing under \$1,000, however, he generated, approved and issued purchase orders for administrative or office purchases, received the goods, and entered the invoices into the accounting system. The Business Manager also prepared the monthly bank reconciliation without oversight and was the custodian of the treasurer's signature plate.
- The Business Manager was an authorized signatory on certain District credit cards. He also had custody and control over credit cards, determined which card was appropriate to use, and reconciled usage to the credit card statements. This lack of segregation of duties increased the risk of unauthorized usage.
- The District only required one signature on checks, regardless of the amount of the check.
- Written job descriptions either did not exist or were vague.

Audit Recommendations:

The District should:

- a) develop an operating manual to provide written job descriptions that clearly define duties, roles and responsibilities for all job functions, how each job function is to be performed and how incompatible functions are segregated;
- b) reassign responsibilities of the Business Manager to achieve a proper segregation of duties; and
- c) establish a policy requiring two signatures on all checks above a specified dollar limit and transfer custody of the treasurer's signature plate to a board member or the Superintendent.

AUDIT FINDINGS AND RECOMMENDATIONS

Audit Finding (7):

Lack of Time and Leave Documentation

Time Records

The District did not maintain adequate time records for its employees and commissioners to support wages of \$1,646,748 paid during the audit period. The Superintendent prepared and maintained an attendance book showing time worked for each employee as recorded by him. Full time employees were noted with a "P" for present or with leave time used. The part-time employees were noted with the number of hours worked for the day. There was no requirement for the employees to attest to the time they worked or for a supervisor to certify its accuracy. A certification process provides a segregation of duties to help ensure that employees are not paid for time not worked.

Authorization of Leave Time

The District did not require employees to submit written requests for usage of leave time. Thus, employee leave accruals may not be properly charged for leave taken and unauthorized leave time could have been taken and gone undetected.

Overtime

The authorization and reporting of overtime was not adequately controlled and documented. Employees were paid overtime monthly for "on call" duty based solely upon entries made on a wall calendar, which was not retained in accordance with New York State document retention regulations.¹² "On call" responsibilities included monitoring pumping functions and responding to emergency calls. The District could not provide the appropriate documentation to support overtime payments of approximately \$50,000 per year and employees may have been paid for overtime that was unnecessary or not worked.

Audit Recommendations:

The District should require that:

- a) employees record their beginning and ending times and sign the timesheet to acknowledge the accuracy of the information entered;
- b) the timekeeper initial the timesheet to attest to the accuracy of the employees entries;
- c) the Superintendent review and approve the timesheet by certifying the hours worked by each employee on a timesheet;
- d) employees request the use of leave entitlements in writing. The form should note the type of leave requested and should be signed and dated by the employee and the Superintendent;

¹² N.Y. Comp. Codes. R. & Regs. Tit. 8, § 185.14 (Schedule MI-1, Appx. K) (2007).

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- e) the supervisor document the dates and hours of overtime and a description of the reason for the necessity of overtime. The form should be certified by the employee and approved by the Superintendent; and
- f) all documentation supporting salaries paid be retained for six years consistent with New York State document retention regulations.

Audit Finding (8):

Procurement and Cash Disbursements

Procurement

General Municipal Law §103 requires that purchasing contracts for more than \$10,000 be awarded to the lowest bidder. GML §104-b requires that the District promulgate by resolution policy and procedures governing the procurement of goods and services which are not subject to the bidding requirements of §103. The purpose of such a procedure is to assure the prudent and economical use of public moneys in the best interest of the taxpayers of the District, to facilitate the acquisition of goods and services of maximum quality at the lowest possible cost under the circumstances, and to guard against favoritism, improvidence, extravagance, fraud and corruption. We have found that the District's policy and procedures fail to meet the goals of GML §104-b.

The District's procurement policy for purchases not required to be competitively bid had the following weaknesses:

- it left purchase contracts between \$1,000 and \$4,999 and public works contracts estimated to cost between \$1,000 and \$9,999 to the sole discretion of the Superintendent; and
- it required written or oral quotes to be obtained for purchases between \$5,000 and \$9,999 and public works contracts between \$10,000 and \$19,999, but left the number of quotes obtained to the discretion of the Superintendent and did not require documentation of the quotes to be retained.

We reviewed 11 purchases between \$1,000 and \$4,999, representing 10% of those purchases, and all 11 of the purchases between \$5,000 and \$9,999. The District did not adhere to its purchasing practices. We found no:

- evidence of the Superintendent's approval for three purchases; and
- purchase order for a \$6,300 purchase.

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Cash Disbursements

We selected an audit sample of 53 vouchers, totaling \$319,744, from general ledger accounts totaling \$1,142,099 in expenditures and tested internal controls over the cash disbursement process. The following internal control weaknesses were noted:

- The District used vendor numbers to identify vendors; however, it did not always issue unique numbers for each vendor. We found four instances where the vendor number identified a specific vendor on the vendor list but the voucher and the payment were for a different vendor not on the list. The assignment of a single vendor number to multiple vendors inhibits the District's ability to review vendor histories to prevent duplicate payments or determine the amount of business done with each vendor.
- The District's water testing vendor periodically tests water samples for over 135 parameters in each of the District's wells, as required by the New York State Department of Health. The District does not maintain a list of the current rates charged for each parameter tested and pays these charges without verifying the accuracy of the invoice amounts.
- The District paid vendor invoices without evidence that the goods had been received. We found that receiving slips were missing for four purchases and one receiving slip was not signed to evidence proper receipt by a District employee.

Audit Recommendations:

The District should:

- a) amend its procurement policy to comply with GML §104-b. The District should specify procurement requirements at all dollar thresholds;
- b) issue each vendor a unique vendor number;
- c) obtain and maintain a current list of the rates that are charged by the vendor for water testing and verify invoice rates to the rate schedule prior to invoice payment;
- d) ensure that purchase orders are completed and signed by the Superintendent for all procurements that are subject to the District's procurement policies; and
- e) ensure that receiving slips are completed and signed by an employee for all goods that are delivered. The receiving slip should be maintained and filed with the voucher and the supporting vendor invoice.

AUDIT FINDINGS AND RECOMMENDATIONS

Audit Finding (9):

Travel, Meeting and Conference Expenses

As noted in Audit Finding (5), the District does not have a policy governing travel, meeting and conferences.

During the audit period the District reimbursed \$2,888 for travel. We tested all travel vouchers and found that two commissioners were reimbursed a total of \$516 for meals and tolls which were not supported by receipts.

We also found that three vouchers totaling \$690 were paid for meetings attended by the commissioners without proper supporting documentation. One \$520 voucher for the September 10, 2004 Long Island Water Conference annual meeting, held at the Cherry Creek Golf Links, was supported by a meeting notice for the Long Island Water Conference annual meeting held on September 15, 2005 at the Timber Point Country Club. The other two vouchers were not supported by any meeting notice.

The District incurred a \$520 cost for four employees to attend the September 10, 2004 Long Island Water Conference annual meeting. The meeting announcement included golf as one of the day's activities. Recreational activities, such as golf, are a personal expense of the employees, not an expense to be born by taxpayers.

There were two occasions, totaling \$240, where the District paid for employees to attend the Nassau-Suffolk Water Commissioner's Association. There was no approval in the Board minutes to authorize attendance at the two meetings, as was the case with attendance at all other professional organization meetings attended during the audit period.

Audit Recommendations:

The District should:

- a) ensure that attendance at all professional organization meetings is pre-approved by the Board;
- b) not pay for recreational activities; and
- c) ensure that invoices and/or receipts are obtained for all disbursements and reimbursable costs. If there are no invoices disbursed for attendance at meetings the District personnel should obtain a receipt for the registration fee.

AUDIT FINDINGS AND RECOMMENDATIONS

Audit Finding (10):

Bank Reconciliations

Bank reconciliations are an important part of cash control procedures and should be performed timely so that the District can verify the amount of cash it has in each bank account and to ensure that its accounting ledgers reflect all cash transactions. We reviewed three of the District's bank reconciliations and were unable to determine that they were performed timely because they were not signed or dated by the preparer and there was no evidence of a supervisory review.

Audit Recommendations:

The District should ensure that bank reconciliations are performed in a timely manner by requiring that they be signed and dated by the preparer and by a supervisor to evidence review and approval.

Audit Finding (11):

Fixed Assets

According to the District's 2005 audited financial statements' Summary of Significant Accounting Policies, capital assets are defined by the District as assets with an initial and individual cost of \$1,000 or more and an estimated useful life in excess of one year. The District's inventory and fixed assets were originally appraised and recorded in 1993 by an independent appraisal agency. This agency maintains a Property Inventory and Accounting Cost Record (PIACR) based on information from the District regarding all additions and deletions that took place during the year. The agency issues an annual report as of every year end.

We found that disposals were not always reflected in the most recent PIACR. We randomly selected and tested ten of the 183 inventory items listed on the PIACR for the administration building and the garage. We were unable to locate a fax machine purchased in 1989 and a check signer purchased in 1978. We were told by the Superintendent that these two items had been disposed of and the District failed to report the disposals to the appraisal agency for their removal from the PIACR.

We also found that the District did not adhere to its fixed asset capitalization policy. The District uses the total acquisition cost of all items in the PIACR in reporting its capitalized assets in their financial statement. The PIACR lists include all fixed assets owned by the District regardless of the initial cost. As such, the District is not in compliance with the statement of accounting policies because it has capitalized assets with a cost of less than \$1,000, thereby overstating capital assets.

AUDIT FINDINGS AND RECOMMENDATIONS

Audit Recommendations:

The District should:

- a) report all additions and disposals for the proper recording of fixed assets;
- b) periodically compare the PIACR to actual inventory;
- c) determine if missing items have been disposed of and research others items unaccounted for; and
- d) comply with its accounting policy by including only assets with a cost of over \$1,000 for reporting capitalized assets in the financial statements.

Audit Finding (12):

District Cell Phones

The District spent \$4,684 on five cell phones during the audit period. Cell phones were issued to two of the commissioners, the Superintendent and the Business Manager, with the fifth held as a spare. As mentioned in Audit Finding (5), the District did not have a cell phone policy covering which employees should have cell phones, to define appropriate use and require District reimbursement if personal calls were made.

We found no business purpose for the two commissioners to have District cell phones.

Audit Recommendations:

The District should discontinue the use of cell phones by the commissioners.

Audit Finding (13):

Accounting for Employee Life Insurance Policies

The premiums incurred by the District to provide individual life insurance policies to its employees were \$18,555 in 2004 and \$18,435 in 2005. The September 2004 and 2005 cash surrender values were \$215,555 and \$232,463, respectively.

The District improperly categorized the insurance premium cost in its financial reports as "General Unallocated Insurance," instead of "Employee Life Insurance" under "Employee Benefits." Further, the cash surrender value did not appear on its Balance Sheet; instead the cash surrender amounts were only discussed in the footnotes to the financial statements.

AUDIT FINDINGS AND RECOMMENDATIONS

Audit Recommendations:

The District should ensure that the employee benefit costs and related assets are properly classified in the financial statements, making them more transparent to the users.

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DISTRICT'S RESPONSE AND AUDITOR'S FOLLOW-UP

(1): Commissioner Compensation

The Board understands the need for better documentation of Commissioner's time spent in the service of the District as to not give the perception of it being nominal or trivial. We believe all of the time that was referred to as other services was not nominal or trivial in any sense and was spent addressing many issues that arise during the course of business. The operation of a water district requires the active participation of its commissioners to be aware of situations with physical plant, water quality, distribution system and finances.

- a) The District is developing a policy and procedures that will address the issue of commissioner's accounting for their time in detail (date, hours, nature of work, etc.) and documenting it.
- b) As recommended all commissioners will be required to sign and certify their time records as part of the policy.
- c) The District will review its policy of providing medical benefits to commissioners.
- d) As recommended we have established a policy that addresses conflicts of interest and commissioners will have to complete their own time sheets.
- e) The District will re-document the basis for establishing the commissioner's standard workweek being we were unable to locate the original documentation.

Auditor's Follow-up Response:

We concur with the corrective action taken by the District.

(2): Improper Treatment of Attorneys as Employees

The Nassau County Civil Service Commission has approved the Counsel positions maintained by the District.

In that regard, 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. It

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DISTRICT'S RESPONSE AND AUDITOR'S FOLLOW-UP

would be a violation of Federal and State law to classify individuals who meet the criteria of being employees as independent contractors.

Hours worked by the Attorney who holds another full time position are reported to the New York State Pension System in accordance with their rules. The employee in question does not receive nor did he ever receive duplicate pension time.

Auditor's Follow-up Response:

Aspects of the relationship that indicate the attorneys were contractors under IRS regulations include:

- *There was no evidence that the District tells the attorneys when or where to work, the attorneys do not have work space at the District office, and the attorneys kept no time records.*
- *There was no evidence that District instructed the attorneys on how the work was to be performed and we found no documentation of work performed by the attorneys. The attorneys were free to work for other employers or clients and, in fact, the Town of Hempstead Town Attorney had a full time job with the Town and was also a part time employee of the Town of Hempstead Sanitary District 6 during the audit period.*

We reiterate our recommendation that the District re-evaluate whether it is cost effective to treat the attorneys as employees after taking into account the cost of fringe benefits.

(3): Employment of Family Members

The District is fully cognizant of certain employee relationships and as such maintains that no employees related or not get preferential treatment and are subject to the due process of the Board, the District and the Employment Policy of the District. Nassau County Civil Service Commission approves all hiring of personnel. Individual supervisors are not in charge of any one person and all personnel are subject to three commissioner's authority and oversight of their actions.

Audit Recommendations

As recommended the District has written and adopted by Board Resolution a comprehensive formal Code of Ethics and Conflict of Interest Policy to address all issues, which may give the appearance of preferential treatment.

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Auditor's Follow-up Response:

We concur with the corrective action to adopt a conflict of interest policy. The District should avoid the appearance of a conflict of interest in its hiring practices. The challenge of adequately segregating duties to achieve strong internal control in a District with only 15 employees, seven of whom are related, is exacerbated when employees are related to one another. The District's assurance that all employees are subject to the three commissioners' authority and oversight leaves unresolved the conflict of interest presented by the fact that the Superintendent is the son of one of the three commissioners.

(4): Excessive Health Insurance Benefits

The Board disagrees with the finding that providing an excess medical benefit as part of a compensation package is excessive because the County doesn't offer it. The coverage provides reimbursement for out of pocket expenses in cases where medical specialties are not provided for in the NYSHIP network. The plan is specifically designed for municipalities who participate in the New York State Government health plan. Subsequent to the completion of the audit, the premium was reduced by the insurance company and the District is receiving premium credits for the years 2004, 2005 and beyond due to the District's favorable experience rating lowering the premium by nearly 50% to an average of \$142.00 per person per year or \$3,273 annually for all District personnel and retirees, which we do not think is excessive.

Auditor's Follow-up Response:

We stand by our finding that this coverage is excessive. NYSHIP provides an extensive network of providers in all disciplines and reimburses for out of network treatment after payment of a deductible. We reiterate our recommendation to terminate this policy.

(5): Board's Failure to Establish Formal Policies and Procedures

The District does have well established and generally accepted procedures for internal control and does not believe there is any material weakness. An important part of internal control is the integrity of the employees, which the Board has the utmost confidence in. The procedures that have always been followed by personnel are more than adequate and will be formally written in a procedures manual. To resolve the issue the Board has acted accordingly:

Audit Recommendations

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- a) The District has written and adopted formal procedures and policies regarding credit cards, cell phones, fixed assets, time and leave, cash receipts and are in the process of completing the remaining areas for which there are no written procedure or policy.
- b) The District has established and adopted a formal code of ethics policy governing the conduct of all employees.

Auditor's Follow-up Response:

We concur with the corrective actions taken by the District.

(6): Lack of Segregation of Duties

The District fully agrees that the segregation of duties is an important part of internal controls in safeguarding the assets of the District. The audit finding fails to recognize that internal controls are based on many factors including the size of the organization. We believe we segregate duties adequately in a small office with three employees. The Business Manager is accountable to the Superintendent and the Board of Commissioners who meets regularly and oversees all financial transactions.

Auditor's Follow-up Response:

We stand by our finding that the Business Manager had too many duties. Incompatible duties provide the opportunity for theft of District assets without the knowledge of the Supervisor or Board.

Personnel have the required financial knowledge and accounting expertise and perform job functions as defined by Nassau County Civil Service Commission. The Board wants to make it clear that there were no irregularities found in the accounting records, bank reconciliations or misuse of the Treasurer's signature plate contrary to the misleading statement regarding custody of the signature plate.

Auditor's Follow-up Response:

This report does not comment on the District's employee's qualifications. We stand by our finding that internal control is weakened when the employee performing the bank reconciliation has custody of the signature plate. Employees who perform bank reconciliations should have no role in the disbursement process.

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As to credit cards, the District has strong control over the use of them and there is not any abuse or questionable charges made on them. The Business Manager is not an authorized user of a gas card and the authorized Home Depot credit card, which has never been used, has been cancelled. The District will continue to improve in areas where possible with the small size of its staff.

Auditor's Follow-up Response:

We reiterate our recommendation that the Business Manager's responsibilities be further segregated. The Business Manager is an authorized signer on the Office Max and Staples credit cards and also reconciles the credit card statements.

Audit Recommendations

- a) The District has clearly and fully defined job descriptions as per the title classification by Nassau County Civil Commission that are on file in the District office and employees perform their job functions as described.

Auditor's Follow-up Response:

Civil Service job descriptions are generic in nature and describe the functions to be performed in general terms for all employees with the same title. We recommend that the District prepare specific job descriptions detailing the duties and responsibilities for each employee.

- b) The District has segregated the duties of the Business Manager in regards to the purchasing procedures. The Superintendent will perform the authorization function, the Account Clerk or a senior service employee will perform the receiving function and the Business Manager will perform the accounting for purchases. The check-signing machine will be kept in a locked cabinet in the vault and the Superintendent will have custody of the keys.

Auditor's Follow-up Response:

We concur with the corrective actions taken by the District.

- c) The Board does not believe the policy of requiring two signatures on checks over a given amount would improve our existing controls. Every check must be attached to a voucher that must be approved and signed by 3 commissioners for authorization. All cash disbursements are approved and

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documented in the District's Minutes. The embossed signature from the check-signing machine is the only accepted signature on file with the bank for checks thereby preventing a check from being hand signed and misused.

Auditor's Follow-up Response:

We reiterate our recommendation that checks above a given amount require two signatures. The controls in place will not prevent the theft and use of checks because the Board will only review checks presented to them. The use of two signatures provides an additional level of control. If the bank pays a check that has not been properly signed, the District can pursue recovery from the bank; however this can be a time consuming and lengthy process that should be a last resort.

(7): Lack of Time and Leave Documentation

The District disagrees that there is a lack of documentation for time and leave. The Superintendent maintains an attendance book and time and leave records for all employees therefore employees are not recording their own time. The Business Manager prepares the payroll and civil service certification sheets from the attendance records. Upon completion of the payroll the Superintendent reviews paychecks and certifies the accuracy of the payroll sheets by signing and dating them, therefore providing a system of checks and balances that the payroll is correct and accurate.

Auditor's Follow-up Response:

The District's response does not address the fact that it does not require employees to record the beginning and ending work times and then attest to hours recorded. We reiterate our recommendations that timesheets be maintained and attested to by the employees and certified by the Superintendent.

Authorization of leave time was verbal, employees requested leave days in advance from the Superintendent for approval of the time off who (the Superintendent) recorded it at the time of the request in the attendance book and time and leave records of the individual therefore there was not a discrepancy that the employees were not properly charged for the leave taken.

Auditor's Follow-up Response:

Similar to above, written requests and approvals for use of leave form a record that will be useful to resolve any disputes over time used or authorizations to use time.

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Overtime paid to service employees is documented and authorized for every hour worked. Of the total overtime amount paid, \$39,153 in 2004 and \$43,224 in 2005 seventy-five percent (\$29,670 in 2004 and \$32,994 in 2005) is on a flat rate basis for the "on call" duty and pre-approved by the Board of Commissioners in order to cover the around the clock monitoring that is required. Well operators are on a rotating shift for a week at a time, which is scheduled in advance on a calendar that leaves flexibility in the schedule for vacation time or unexpected changes in an individual's availability. Any additional overtime for after hours emergency calls, such as water main breaks, are authorized by the Superintendent prior to dispatching of personnel.

All overtime is paid monthly to the servicemen. At month end all dates and hours worked for each individual are transferred from the calendar to a formal monthly overtime sheet, first by the Superintendent and a second time by the Business Manager to verify that all overtime hours are correct. From these sheets the overtime payroll is prepared. All dates and hours worked are documented on formally prepared overtime sheets and account for all hours paid without any discrepancies and were available for review. The District follows New York State documentation retention regulations for all formal records, which are retained for the required years. The referenced "wall calendar" is draft documentation of overtime and as such is not required to be retained as per N.Y. Records Retention Schedule MI-1 Payroll section 1.[291]e.

- a) Formal procedures
 - 1) The District has established the use of weekly time sheets since it was brought to our attention that it would supplement our documentation, where the employees must enter their beginning and ending times and initial each sheet acknowledging the accuracy of their hours.
 - 2) The District has implemented the practice of the Superintendent verifying the accuracy of the entries on the supplemental time sheets on a daily basis.
 - 3) The District has implemented the procedure of requiring the Superintendent to review the supplemental time sheets and initialing them.
- b) The District has created a formal request form for all leave entitlements noting the amount of time, type of leave and dates of the requested leave, again to supplement existing records. The employee and the Superintendent must sign the form.

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- c) The District has created an additional form to document overtime hours, date and description of work performed that must be signed by the employee and the Superintendent to supplement our current documentation.

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Auditor's Follow-up Response:

We concur with the corrective actions taken by the District and reiterate our recommendation that the timesheets be signed by a timekeeper as well as by the employees and Superintendent.

- d) The District has always complied with the New York State regulations requiring the retention of all records for six years. All formal documentation that is produced for payroll is retained and available.

Auditor's Follow-up Response:

The wall calendars used by the District to document overtime are a source document for payroll preparation. As such, they should be maintained for six years.

(8): Procurement and Cash Disbursements

Procurement

The District has always had a procurement policy that met the criteria of GML § 104-b and followed it as written. Purchases were made in compliance with the then current policy. Purchase orders were not required by the procurement policy but evidence of authorization at the time can be inferred by the Board's approval of vouchers to make payment on those purchases. All transactions were appropriate and obvious purchases or services for the District, documented by detailed invoices and signed claim vouchers.

Auditor's Follow-up Response:

We found that the District's procurement practices did not meet the goals of GML § 104-b because it gave too much discretion to one individual and did not require that evidence be retained of quotes received. The inference of Board approval by signing vouchers takes place after the purchase has been made. We recommend that approval take place before the District incurs any obligations.

Cash Disbursements

Due to the limitations of the software in use during the period under audit each vendor had to be assigned a vendor number in order to be entered in the system, which is not a required accounting procedure. The vendor number list was a separately maintained reference for locating the vendor on the system because they could not be searched by

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name, only by number. The last current vendor number list at the time of the audit had changed because of the fact that inactive vendors from previous years were removed from the system and replaced with new current vendors to keep the list from growing unwieldy. All documentation as to the vendor that was paid, description of the goods or services, the amounts, invoices, cancelled checks and signed vouchers matched general ledger entries without any discrepancies in the years under audit.

The rate schedule for the vendor was not on file, but rates have been unchanged for many years prior to and after the audit period and known to the staff to be correct as evidenced by all invoices for the entire period showing the same charge for the same parameter tested consistently through out. The invoices for water testing were and are checked for accuracy by the number of samples charged for against the sample requests generated by the District and for dollar amounts billed.

Audit Recommendations

- a) The District has amended its procurement policy to be more specific as to the procedure and requirements at each dollar level.
- b) The issue of unique vendor identification numbers was addressed by the installation of new accounting software in April 2006 that permanently maintains vendor accounts by name no longer requiring vendor numbers.
- c) The District requested and received the current list of rates charged by the vendor, which are the same rates as during the audit period.
- d) Purchase orders are now required for all significant purchases and must be signed by the Superintendent up to \$1000; over a \$1000 the Board must sign showing authorization.
- e) Receiving slips must be signed by an employee to show receipt of the goods and permanently maintained with the invoice.

Auditor's Follow-up Response:

We concur with the corrective actions taken by the District.

9): Travel and Meeting Expenses

- a) All attendance at professional organization meetings is pre-approved by the Board and documented in the minutes. Unfortunately one was inadvertently

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left out of the minutes and the second one referenced was recorded but noted the wrong date, which we believe, was a typographical error.

- b) The Board agrees that the annual recreational activity management attended as a part of a professional organization meeting should not be paid for by the District and will no longer pay for it.

- c) The District is developing a travel and meeting policy that will address the issues that were referenced in the audit. As part of the completed travel policy each Commissioner or employee will be required to obtain a receipt for all expenses incurred at the attendance of meetings and conferences before being entitled to reimbursement.

Auditor's Follow-up Response:

We concur with the corrective actions taken by the District.

10): Bank Reconciliations

All bank statements are reconciled on a timely basis as soon as they are received from the bank and all our documentation supports that. The bank reconciliations were reviewed by Nassau County and found to be accurate and prepared in a formal manner. There were no discrepancies between bank balances and book balances at any time. Dating and signing the bank reconciliation is not a requirement we are aware of and would not change the fact the reconciliations they were prepared timely and accurately.

Audit Recommendation

- a) The District resolved the issue of dating the reconciliations with the installation of new accounting software in April 2006, which automatically dates and time stamps the reconciliation. To document the reconciliations are being reviewed they are to be initialed by the District Treasurer.

Auditor's Follow-up Response:

We concur with the corrective actions taken by the District. We reiterate our recommendation that the preparer initial the reconciliation.

(11): Fixed Assets

The District has capitalized all assets of value with a useful life of more than one year since a detailed appraisal was performed in 1993. The Board feels that having assets of value such as power tools, or computer printers with an initial cost of less than \$1000

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inventoried is an excellent control to track assets that are purchased with taxpayer money. The 16-year-old fax machine and 28-year-old check signer were disposed of properly and not inappropriate being they were no longer useful. The removal from the inventory report was an oversight and did not affect asset values because they were fully depreciated.

The capitalization of assets under \$1000 did not agree with the stated policy but the District believes it went beyond what was required in its own policy by tracking all assets. The assertion of overstating assets we believe to be incorrect, even if their initial cost is valued under \$1000 they are assets of the District. The \$1000 figure is an arbitrary number that was set by the Board many years ago and at the discretion of the Board to change at any time to reflect there current position.

Audit Recommendations

- a) The District does report all additions and disposals of assets for the proper recording.
- b) The District agrees that a periodic review of fixed assets is a good practice to ensure the accuracy of the report and has performed an inventory of assets to verify the correctness.
- c) The District will physically review the inventory of fixed assets on a periodic basis.
- d) The Board has updated the District's Capitalization Policy to state that capital assets with a value of \$200 or more and a useful life of more than one year will be capitalized to reflect the actual practice.

Auditor's Follow-up Response:

We concur with the corrective actions taken by the District with regard to fixed assets. We stand by our recommendations regarding vehicles and disposition of fixed assets.

Failure to remove disposed assets from the fixed asset listing results in the overstatement of both the asset and the accumulated depreciation.

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(12): District Cell Phones

The District adopted a cell phone policy in February 2007 formally listing the positions authorized for issuance of a cell phone and outlining the reimbursement policy, which had been previously understood and followed. Commissioners are the highest authority in the operation of a water district so we believe it to be sound business practice to have the final authority in the decision making process available at any time.

Auditor's Follow-up Response:

We concur with the corrective actions taken by the District to implement a cell phone policy. Commissioners typically set policy for districts and guide overall operations. They do not run the day to day operations and should not require District provided cell phones.

(13): Employee Life Insurance Policies

- a) The District does not believe the life insurance premium cost was inappropriately classified as "Insurance Expense" in its financial statements. In the interest of transparency the District will expense the cost of the life insurance as an "Employee Benefit" in the future. As to presentation in the financial statements, the District fully discloses the existence of the policies, the ownership, the details of the group life insurance program and the cash value for all the policies in the notes to the financial statements. The District does not report the cash surrender value on its balance sheet for several reasons. The primary reason for not recording the cash surrender value is that it is not available to finance District operations. The District believes that reporting the Cash Surrender Value and increasing the District's total fund balance during a period of build up distorts the District's total fund balance. Also in the period an employee retires, the accounting effect of reducing the cash surrender value would also improperly distort the decrease in the District's fund balance for the period. In our opinion the presentation in the notes is proper.

Auditor's Follow-up Response:

We reiterate our recommendation that the cash surrender value of the life insurance be reflected in the District's financial statements. The government-wide financial statements are prepared on an accrual basis without regard to the timing of cash flows. As owner of the policies, the cash surrender value of the policies is an asset of the

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District. The District has no contractual obligation to continue life insurance coverage for employees and it can obtain the cash value at any time by surrendering the policies.

We concur with the corrective action taken by the District to classify the life insurance expense as employee fringe benefits.