

City of Rye, New York
Independent Auditors' Report on Communication of
Internal Control Matters Identified in the Audit

December 31, 2009



Independent Auditors' Report on Communication of Internal Control Matters Identified in the Audit

To The Honorable Mayor,
Members of the City Council
and City Manager
City of Rye
1051 Boston Post Road
Rye, New York 10580

In planning and performing our audit of the basic financial statements of the City of Rye New York ("City") as of and for the year ended December 31, 2009, in accordance with auditing standards generally accepted in the United States of America, we considered the City's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the City's internal control. Accordingly, we do not express an opinion on the effectiveness of the City's internal control.

We have included in this letter a summary of communications with the Mayor, the Members of the City Council and the City Manager as required by generally accepted auditing standards. We are also required to communicate any control deficiencies we identified during the audit and determined to be significant deficiencies or material weaknesses. This communication is a requirement of the new Statement on Auditing Standards (SAS) 115: Communicating Internal Control Related Matters Identified in an Audit.

Our consideration of internal control was for the limited purpose of conducting your City's audit and was not designed to identify all deficiencies in internal control that might be significant deficiencies or material weaknesses, and therefore, there can be no assurance that all such deficiencies have been identified. We did not identify any deficiencies in internal control that we consider to be material weaknesses.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A significant deficiency is a deficiency, or combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

However, as indicated in the attached Addendum A, we identified certain deficiencies in internal control that we consider to be control deficiencies as well as other comments and recommendations identified in Addendum B that are opportunities for strengthening internal controls and operating efficiency.

It is important to note that control deficiencies are not necessarily issues the Mayor, the Members of the City Council and the City Manager will choose to address, however, control deficiencies may represent potential risks. Our responsibility as your auditor is to ensure that the Mayor, the Members of the City Council and the City Manager are aware of these deficiencies or weaknesses so that you can make informed business decisions on how best to respond to these risks.

This report, summary of communications and addendums are intended for the information and use of the Mayor, the Members of the City Council and the City Manager. However, this report is a matter of public record and its distribution is not limited. We will be pleased to discuss these comments in further detail at your convenience, or to assist you in implementing the recommendations.

O'Connor Davies Munns & Dobbins, LLP

O'Connor Davies Munns & Dobbins, LLP

May 21, 2010

City of Rye, New York

Summary of Communications

- Auditors' Responsibility Under Auditing Standards Generally Accepted in the United States of America
 - Unqualified opinion on financial statements
 - No change in scope of the audit
 - No material errors
 - No fraud or illegal acts identified
 - No instances/suspicion or allegations of fraud were noted during conduct of audit
- Internal Accounting Controls
 - Reviewed to extent necessary to render our opinion on the financial statements
 - No material weaknesses noted
- Significant Accounting Policies
 - Accounting policies appears appropriate
 - Significant accounting policies included in Note 1 to the financial statements
 - No changes in accounting policies during the year
- Management's Judgments and Accounting Estimates
 - Estimates used deemed adequate
- Audit Adjustments
 - No significant unrecorded adjustments
- Other Information in Documents Containing Audited Financial Statements
 - Management's Discussion and Analysis appears reasonable
- Disagreements with Management
 - None
- Unresolved Difficulties Encountered in Performing the Audit
 - None

City of Rye, New York

Summary of Communications
(Concluded)

- Consultation by Management with Other Accountants
 - None of which we were made aware
- Management Consulting Services
 - None
- Independence
 - O'Connor Davies Munns & Dobbins, LLP is independent in all respects
- Irregularities or Illegal Acts
 - Nothing to report

City of Rye, New York

Addendum A

- **Capital Projects Fund**

Lack of Financial Activity

The lack of financial activity in a capital project over an extended period of time may be an indication of the project's completion. Our review of the Capital Projects Fund indicated that, as of December 31, 2009, the Locust Avenue, CBD Traffic Signals, Peck Avenue Intersection, Recreation Master Plan and the Bowman Avenue Spillway projects were financially inactive for the entire fiscal year. These projects have combined fund balances of \$243,340. Upon determination that a capital project has been completed, the governing board should pass a resolution indicating this status and directing the disposition of the unexpended proceeds. If the unexpended balance of the project consists of monies provided from obligations or in certain instances, State or Federal grants, its use will be restricted to the payment of outstanding indebtedness. If the remaining balance consists of a return of a contribution from an operating fund, it should be returned to that fund to be used for any lawful purpose.

Recommendation

We suggest that a review of all capital projects be undertaken to determine the status of completion and the proper disposition of available funds.

State and Federal Aid Receivable

In April 2007, the City sustained extensive flood damage in several areas. As a result, the City applied for and was awarded both a federal disaster grant through the Department of Homeland Security and a federal highway planning and construction grant through the Department of Transportation that provided funding sources for the various repair and improvement projects. The City incurred the expenditures for the repairs and improvements prior to the end of the current fiscal year, but did not record an accrual for the federal grant revenues that have not as yet been received. Accordingly, an adjustment was made upon audit. In accordance with grants accounting, which requires a matching of revenues and expenditures, since the City incurred expenditures for these projects prior to the end of the fiscal year, a receivable and corresponding revenue were also recorded up to the amount of the authorized grant, so that a proper matching of revenues and expenditures would be reported. This is particularly important since federal funds in excess of \$500,000 were expended, thereby requiring the City to undergo a federal compliance audit in accordance with OMB Circular A-133.

City of Rye, New York

Addendum A

- **Capital Projects Fund (Continued)**

State and Federal Aid Receivable (Continued)

Recommendation

We recommend that the City record all grants, whether for operating or capital purposes, in the above prescribed manner.

- **Interfund Charges/Charges for Services**

We again noted that the General Fund charges the Boat Basin and Golf Club Funds for their respective share of certain overhead costs. The allocation of these costs continues to be based on information provided by an independent consultant's report prepared in 2002.

Recommendation

We suggest that the methodology for determining these interfund charges be reviewed and updated periodically to appropriately reflect changes that occur over time.

- **Cash – Payroll Account**

Generally, payroll accounts are maintained on an imprest basis. This means that the monies deposited to the payroll account should be no more than the payroll obligations for each period, and therefore the book balance in the general ledger account should be zero. Our audit indicated that the book balance for this account, reflected in the Agency Fund at year end, was \$26,317.

Recommendation

The payroll account should only be funded when necessary to cover payroll expenditures. We suggest that the City identify the reason for this balance and make the necessary adjustments.

City of Rye, New York

Addendum A

- **Accrued Liabilities/Encumbrances**

Pursuant to the Uniform System of Accounts promulgated by the Office of The State Comptroller, the accrued liabilities general ledger account should be used to record liabilities due to individuals, firms or corporations for goods and services received as of the fiscal year end. Accrued liabilities differ from encumbrances, which represent commitments for the expenditure of monies and are recorded in order to reserve applicable appropriations in governmental funds. Encumbrances are reported as reservations of fund balance, since they do not constitute expenditures or liabilities. The subsequent year's appropriations are amended so that the commitment for the goods and/or services can be satisfied when received. During our audit, we performed a test of the balances reported as encumbrances. Our tests indicated amounts encumbered related to the expired police contract. Generally speaking, payroll related items can not be encumbered at the end of the fiscal year. Therefore, since this obligation for retro active salary adjustments is based on services provided prior to the end of the fiscal year, an adjusting journal entry was proposed and recorded by management to reclass the amount from encumbrances to accrued liabilities.

Recommendation

While this adjustment had no impact on the undesignated portion of fund balance, we nevertheless suggest that these payroll type items be recorded in the above prescribed manner.

- **Golf Club Fund**

Procurement Policy – Bidding Requirements

The golf club operated by the City utilizes outside contractors, who provide for the staffing of the club's restaurant, catering hall and kitchen, as well as clerical workers, supervisors and manual laborers, as needed, for capital projects. Additionally, the Golf Club enters into operating leases for golf carts and golf course maintenance equipment. Our inquiries with Golf Club management revealed that no bids are solicited to provide for these services. In addition, we were unable to locate copies of signed contracts or, in the alternative, City Council resolutions authorizing the approval of the service providers or the terms and conditions.

City of Rye, New York

Addendum A

- **Golf Club Fund (Continued)**

Procurement Policy – Bidding Requirements (Continued)

Recommendation

It is our opinion that a competitive bidding process is required for these services, similar to other services that are provided to other City departments. At a minimum, documentation should be readily available, including a signed contract outlining the services to be performed, the rates to be charged and clearly specifying that all applicable employment laws are being followed.

Golf Pro's Contract

During our audit, we reviewed the City's contract with the pro at the Golf Club. The contract clearly outlines the financial arrangement between the City and the golf pro. The contract also includes a clause that allows the City to review and audit the books and records of the golf pro at its discretion. Upon inquiry with management, we were informed that no such review has ever taken place.

Recommendation

The City should establish procedures to periodically review the operations and the books and records of the Golf Club Pro as provided in the terms of the contractual agreement.

Inventory

We noted that there is no inventory reported on the books and records of the Golf Club Fund. Rather, purchases of inventorable items are recorded as expenses at the time of purchase.

Recommendation

We suggest that a physical inventory be taken at the Golf Club and a valuation report be generated. If the inventory amount is deemed material to the Golf Club Fund's operations, the amount should be reported on the balance sheet. A physical inventory should then be taken at least annually and the balance sheet adjusted accordingly.

City of Rye, New York

Addendum A

- **Capital Assets**

Capital Assets Inventory

The City has not performed a physical inventory of its capital assets, primarily machinery, equipment and vehicles, in many years. Based on discussions with management, the City plans to perform a capital asset inventory in 2010.

Recommendation

We recommend that the City follow through with its plan for a physical inventory of its capital assets to ensure that only those assets currently in use are reported in the books and records.

Procedures for Disposal of Capital Assets

The City did not have a formal procedure in place to ensure that disposals of capital assets are reported to the finance department as they occur. Without such a procedure, the likelihood increases that disposals are not being recorded. This often leads to a situation where capital assets that physically exist within the City and the asset listing used for accounting are completely out of synch. A simple standardized form should be developed by management and this form should include the necessary level of approval for the disposal.

- **Acquisition of Property with Grant Funds**

The City purchased property, the "Bird House Property", during 2009 for \$1,250,000. A portion of the down payment was made by a not-for-profit Corporation ("Corporation") and the balance due of \$1,086,678 was advanced by the City at closing. The City was to apply for various Federal and State grants to fund the entire cost. The not-for-profit Corporation guaranteed the City that any shortfalls of grants not received would be paid by the Corporation. Additionally, the Corporation would pay interest to the City from the time of closing to the actual receipt of grant monies. Although the purchase of the property was recorded by the City, a receivable for the various grants was not recorded. An adjusting journal entry was proposed and recorded by management. However, the adjustment included an allowance for uncollectability against a portion of these grants, since there was some doubt by management that certain of these grants would be received.

City of Rye, New York

Addendum A

- **Acquisition of Property with Grant Funds (Continued)**

Recommendation

We strongly recommend that all the grant money be aggressively pursued. Since the General Fund advanced the monies at the closing, if these grant monies are not realized in the upcoming fiscal year, a reserve of the fund balance reported in the General Fund will be required, thus negatively impacting the unreserved fund balance. Receipt of these funds will also replenish the City's cash balances, thus improving cash flow.

- **Internal Controls**

Segregation of Duties

An effective system of internal control provides for the distribution of duties among available personnel, so that no one employee controls all phases of a transaction without some independent verification by another employee. During the course of our audit and through inquiry of various department personnel, we noted that certain positions have been eliminated or have remained vacant. This limited staffing could pose a potential risk for insufficient segregation of duties.

Recommendation

Although we are aware that resources are currently tight and should not in all instances be dedicated to satisfy internal control dictates and that the cost of internal controls should not outweigh the benefits, we believe that this matter is important enough to be brought to the attention of those charged with governance.

City of Rye, New York

Addendum B

- **Future Application of Accounting Standard – Statement of the Governmental Accounting Standards Board (“GASB”) – Fund Balance Reporting and Governmental Fund Type Definitions (GASB Statement No. 54)**

In February 2009, the Governmental Accounting Standards Board (“GASB”) issued Statement No. 54, “Fund Balance Reporting and Governmental Fund Type Definitions”. This Statement is intended to improve the usefulness of information provided to users of governmental financial statements about fund balance by 1) providing clearer, more structured fund balance classifications and 2) by clarifying the definitions of existing governmental fund types.

It is said that fund balance is among the most widely and frequently used piece of information provided in local government financial statements. GASB Statement No. 54 was developed to address the diversity and lack of consistency that had developed in the reporting of this vital information. To reduce this confusion, the new standard establishes a hierarchy of fund balance classifications based primarily on the extent to which a government is bound to observe spending constraints imposed upon how resources reported in governmental funds may be used.

GASB Statement No. 54 distinguishes fund balance between amounts that are considered nonspendable (such as fund balance associated with inventories) and other amounts that are classified based on the relative strength of the constraints that control the purposes for which specific amounts can be spent. Accordingly, fund balance amounts will be reported in the following classifications:

- **Restricted** – amounts stipulated by constitution, external resource providers or through enabling legislation.
- **Committed** – amounts that can be used only for the specific purposes determined by a formal action of the government’s highest level of decision-making authority.
- **Assigned** – amounts that are intended to be used by the government for specific purposes but do not meet the criteria to be classified as restricted or committed. In governmental funds other than the General Fund, assigned fund balance represents the remaining amount that is not restricted or committed.
- **Unassigned** – amounts that are not constrained at all in the government’s General Fund and includes all spendable amounts not contained in other classifications.

GASB Statement No. 54 also clarifies the definitions of individual governmental fund types. It provides an interpretation of certain terms within the definition of special revenue fund types, while further clarifying the debt service and capital projects fund type definitions. GASB Statement No. 54 is effective for the City’s fiscal year ending December 31, 2011 with earlier implementation encouraged.