

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

**December 31, 2010**



## 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, 2010, 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.

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 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. 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.

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.

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  
June 20, 2011

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

- **General Fund**

*Fund Balance – Workers' Compensation Reserve*

Effective January 2009, the City was no longer self-insured for workers' compensation claims. Up until that time, the City had established a reserve for workers' compensation benefits in the General Fund pursuant to Section 6-J of General Municipal Law to fund its self-insured program.

***Recommendation***

We recommend that since the City is no longer self-insured, that the funds be 1) either transferred to another reserve or 2) be applied to budgetary appropriations in a future year in accordance with the provisions of Section 6-J of the General Municipal Law. However, an amount should be retained in this reserve representing outstanding claims filed while the City was self-insured prior to January 2009.

- **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 in 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 \$24,373.

City of Rye, New York

Addendum A

- **Cash (Continued)**

***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.

- **Golf Club Fund**

*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.

- **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 2011.

***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.

City of Rye, New York

Addendum B

- **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.**

## City of Rye, New York

### Addendum B

- **Fund Balance**

One element in the evaluation of a municipal government's creditworthiness is the level of fund balance retained. The amount of fund balance retained among governmental entities varies depending upon fiscal policy and statutory requirements. The opinion among the majority of financial oversight bodies is that the larger the fund balance retained, the stronger the financial condition. Governments, however, cannot employ fiscal policies which only serve the dictates of the financial community. A government's fiscal policy must establish a delicate balance among responsibility to provide services, taxpayer affordability and the government's long-term fiscal objectives. Fund balance generally should be retained at a level that relates to the economically sensitive revenues and expenditures included in the budget. An assessment of contingencies should also be a determinant in developing a desired fund balance level. The City's unreserved and undesignated fund balance of approximately \$2.8 million reported in the General Fund at December 31, 2010 represents slightly more than 9% of the 2011 operating budget. In accordance with the City's "Operating Position Policy", the City will maintain the unreserved, undesignated fund balance of the General Fund at a level at least equal to 5% of the total General Fund appropriations. While the December 31, 2010 fund balance level appears strong, certain external elements could adversely effect the fund balance in the near term, including 1) economic volatility associated with sales and mortgage taxes, 2) the potential for additional cuts in State aid given the ongoing fiscal crisis faced by New York State, 3) the large spikes in contribution rates to be paid to the New York State Retirement Systems in the upcoming fiscal year, 4) the financial impact from expired municipal employee contracts, 5) the continuing rise in health insurance costs as well as 6) the recent enactment of the New York State property tax cap legislation. These matters will require the City to consider a variety of options in balancing future budgets, while at the same time maintaining the required level of undesignated fund balance.

A further complication for the City's capital needs is its charter bonded debt limits. In accordance with its Charter, the City Council can authorize the issuance of debt not exceeding 5% of the average gross annual budgets for the preceding three years. Debt exceeding 5% but not in excess of 10% is subject to a permissive referendum. Debt in excess of 10% requires approval of the voting public in a general or special election. Over the past several years, the City has been able to fund Capital projects from a combination of operating fund monies from the General Fund, State and Federal assistance and indebtedness at no greater amounts than required by permissive referendum. However, given the above economic factors and the City's needs for capital improvements, it may be necessary for the City to seek a mandatory referendum to fund capital projects in the near future, since the operating resources may need to be redirected to cover operating needs.

City of Rye, New York

Addendum B

- **Fund Balance (Continued)**

***Recommendation***

We recommend that the administration continue to prepare a multi-year plan, which assesses the need for resources, including the appropriation of fund balance. The preparation of such a plan is a sound financial practice that enables the City to set a course for sound financial health. We also believe it would be prudent for the City to re-evaluate its fund balance retention policy in order to ensure stability in the City's tax rate as well as its overall financial condition.

- **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.