

Town of North Castle, New York

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

December 31, 2011

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

To The Honorable Supervisor and  
Members of the Town Board  
Town of North Castle  
15 Bedford Road  
Armonk, New York 10504

In planning and performing our audit of the basic financial statements of the Town of North Castle, New York ("Town") as of and for the year ended December 31, 2011, in accordance with auditing standards generally accepted in the United States of America, we considered the Town'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 Town's internal control. Accordingly, we do not express an opinion on the effectiveness of the Town's internal control.

We have included in this letter a summary of communications with the Town Supervisor and Members of the Town Board 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 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 Town'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 a material weakness.

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 that are opportunities for strengthening internal controls and operating efficiency.

It is important to note that control deficiencies are not necessarily issues the Town Supervisor or Members of the Town Board will choose to address, however, control deficiencies may represent potential risks. Our responsibility as your auditor is to ensure that the Town Supervisor and Members of the Board of Trustees 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 Town Supervisor and Members of the Board of Trustees. 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, LLP*

O'Connor Davies, LLP  
Harrison, New York  
April 20, 2012

Town of North Castle, 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

Town of North Castle, New York

Summary of Communications

- 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

Town of North Castle, New York

Addendum A

- **General Fund**

*Balance Sheet Accounts*

At the commencement of the audit, there was no analysis performed on the balance sheet accounts. Based on audit test work performed, several adjusting journal entries were needed for various receivable and payable accounts, including accounts receivable, due from other governments and accrued liabilities. Prior to our adjusting journal entries, some of these accounts were materially misstated. It is important to reconcile subsidiary ledgers or supporting schedules to the general ledger to ensure the accuracy of financial information and minimize the risk of misstatement or misappropriation.

***Recommendation***

We suggest that all balance sheet accounts be analyzed and adjusted prior to the start of the audit. Furthermore, in order to ensure efficient reconciliation and review of accounting data, we suggest that a policy be implemented, whereby all subsidiary ledgers and/or supporting schedules are reconciled to the general ledger on a monthly basis. We also recommend that appropriate management-level personnel review the reconciliations for accuracy and document evidence of their review for audit purposes.

*Taxes Receivable*

Real property taxes represent the largest single source of revenue for the Town. As such, it is imperative that the records maintained by the Receiver of Taxes and the amounts recorded in the books and records of the Finance Department be in agreement at all times. We noted that the taxes receivable balances in the general ledger did not reconcile to the subsidiary schedules printed from the tax system. This could have resulted, for instance, from various timing issues, cutoffs or bounced checks.

***Recommendation***

We recommend that procedures be modified and that the records of the Finance Department and the Tax Receiver's office be reconciled on a monthly basis.

Town of North Castle, New York

Addendum A

- **Capital Projects Fund**

*Over- expended Budget Authorizations*

The Capital Projects Fund is established to account for financial resources to be used for the acquisition or construction of major capital facilities. Authorizations for capital projects must be approved by the Town Board prior to the actual expenditure of funds. Once the total cost of a project has been approved, the related expenditure must remain within the authorized budget. Our audit disclosed that two projects exceeded their authorizations.

***Recommendation***

We suggest that management review these projects with the Board and authorize the necessary funding.

*Accrued Liability*

During our review of the Capital Projects Fund, it was noted that the Town lacked the proper supporting documentation to substantiate an accrued liability balance of \$262,424. A strong control system over accrued liabilities includes an accurate accounting system that maintains agreement between supporting schedules and the general ledger, and effective review and follow-up on a monthly basis.

***Recommendation***

We recommend that the Town implement the proper procedures to ensure that supporting documentation is attainable for all accounts upon request.

- **Capital Projects Fund**

*Retainages Payable*

Retainages payable, which represents amounts withheld from contractors for completed work pending satisfactory approval of their phase of a construction project, should be classified as expenditures and recorded on the books simultaneously with the payment to the contractor. Our audit of the Capital Projects Fund disclosed that there is a retainage of \$50,000 on the Town's books dating back several years.

Town of North Castle, New York

Addendum A

- **Capital Projects Fund** (*Continued*)

*Retainages Payable* (Continued)

**Recommendation**

The retainages payable amounts should be recorded simultaneously with the accounts payable process to reflect the total costs of a capital project at any given time during the fiscal year. Proper procedures should be implemented to ensure the accurate recording of retainages payable.

*Lack of Activity*

A 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 there are several projects that remain open despite the lack of financial activity. 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 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 the Town examine the status of these projects and determine whether there will be any future activity and if not obtain a Board resolution to close out the projects and transfer any balances back to the applicable fund.

Governments often acquire or construct major capital facilities. Such facilities either can help the government provide service to its citizens or can serve the needs of citizens directly. In either case, a financial reporting vehicle is needed to demonstrate compliance with legal and contractual provisions and to compile certain cost data which may span several fiscal years. The Capital Projects Fund provides such a mechanism and is provided to account for the financial resources used for the acquisition or construction of major capital facilities. Many governments establish an annual capital improvement program and include the program in their annual operating budget, while others adopt project length budgets for their projects and rely on mechanisms such as bond indentures to ensure proper control over expenditures. No matter which method is chosen, governments need to ensure that budgetary compliance is demonstrated in their financial reports. Our audit disclosed that projects with a deficit fund balance are not being covered by BANS outstanding.

Town of North Castle, New York

Addendum A

- **Capital Projects Fund** (*Continued*)

*Deficit Fund Balance* (Continued)

***Recommendation***

We suggest that the Town establish the proper methodology to improve the overall financial condition of any Capital Fund projects that are currently in a deficit.

- **Special District Funds**

*Fund Balance*

A review of the Town's financial statements indicated that the assigned fund balance, in several of the Water, and Sewer Districts are substantial, and, in some cases, more than the annual operating budget of the respective district.

***Recommendation***

We suggest that the Town Board determine the appropriate level of fund balance to be retained. Since it would not be fiscally responsible to merely apply amounts determined to be in excess of that level to the subsequent year's budget, we also suggest that a multi-year financial plan be prepared to assess the most judicious use of available funds.

- **Parking fund**

*Inactive*

Our audit of this fund indicated that the fund remained financially inactive for the entire fiscal year.

***Recommendation***

We suggest that the Town analyze the balance and review the purpose of this fund so that a determination may be made as to the proper disposition of the fund. Should it be determined that the amount is no longer required to be held in the fund, a Board resolution should be approved transferring the amount to the General Fund.

Town of North Castle, New York

Addendum A

- **Highway Fund**

*FEMA*

During our audit of the Highway fund, we noted that the Town received a Federal Emergency Management Assistance grant during the year. However, all requests relating to this FEMA grant were unattainable during fieldwork because the grant information was not ready and/or auditable at the time. This deficiency may be due to a lack of coordination between the various Town departments and the Finance Department and/or lack of efficient review over accounting records.

***Recommendation***

We strongly recommend that Town institute policies and procedures that ensure that all departments notify the Finance Department immediately of all federally reimbursable expenditures that are being incurred. In this way, the Finance Department can have the proper receivables recorded and can track the status of any unpaid amounts. More importantly, these expenditures will be reported properly so that compliance with federal regulations can be validated.

- **Agency Fund**

*Accounts Receivable*

During our review of the Agency Fund we noted that the exchange account, which accounts for money collected from Town residents for engineering services, had approximately \$96,400 in receivables outstanding at year end. Our audit procedures disclosed inadequate support of this accounts receivable balance.

***Recommendation***

We suggest that the account balances be reconciled on a monthly basis to the amount reported in the general ledger. This practice serves as a check on the accuracy of the record-keeping process and maintains the accounts receivable on a more timely and accurate basis. In addition, supporting documentation should be maintained so that independent audit verification of this balance can be performed.

Town of North Castle, New York

Addendum A

- **Special Purpose Fund**

*Segregating Funds*

The Special Purpose Fund is used to account for assets held by the Town in accordance with the terms of a trust agreement. The revenue and expenditure activity for each trust agreement should be reflected in the general ledger for proper tracking. Also, as one of the requirements promulgated under the provisions of Governmental Accounting Standards Board Statement No. 34, revenue and expenditure transactions are required to be reported separately from activities reported as "Agency Funds" type activities. During our audit of the Agency Fund, we noted that the Town accounted for both agency and special purpose activities within the same fund structure. We also noted that the revenues and expenditures related to the activity of each trust are not recorded in separate revenue and expenditure account codes, requiring additional analysis to determine the nature of the transaction that took place.

***Recommendation***

For the Special Purpose fund, we suggest that a separate fund be created to track the trust activities in accordance with the above requirements and that this includes detailed revenue and expenditure codes for each trust.

*Lack of Activity*

Within the Special Purpose fund, we noted that the following accounts had no activity for 2011:

91.13	Library Trust – Michelman
91.32	Library Trust – Unrestricted
91.20	Library Trust – Salvatore
37.03	Tennis Bubble Money Trust
93.00	Rocky Ledge Trust

***Recommendation***

We recommend that the Town analyze the balances and review the purposes of these trusts. Should it be determined that these amounts are no longer required to be held in trust, a board resolution should be approved transferring these funds to the appropriate operating fund.

*Unauthorized Transfer*

During our audit of the activity in the various trust accounts, it was noted that there was a transfer made from the Recreation Subdivisions account to the Capital Projects Fund in the amount of \$254,769 for which Board authorization could not be located.

Town of North Castle, New York

Addendum A

- **Special Purpose Fund** *(Continued)*

*Unauthorized Transfer* (Continued)

***Recommendation***

We suggest that Board approval be obtained for all transfers made out of the Special Purpose Fund in order to determine that the transfer is in accordance with the terms of the trust agreement.

- **Cash & Investments**

*Old Outstanding Checks*

We noted there were several checks in the net payroll account that are outstanding for more than one year. Tracking outstanding checks is an important control procedure that ensures that all outgoing checks are accounted for.

***Recommendation***

We suggest that a periodic review of the outstanding checks lists be performed on a timely basis. In addition, we suggest that the Town modify this procedure so that checks that have been outstanding for greater than one year be written off and the amounts returned to the fund balance of the appropriate fund.

- **Capital Assets**

The establishment and maintenance of accounting records for capital assets are necessary to help assure that the Town's property, plant and equipment are not stolen, misused or subject to undue wear and tear. These records are also a necessary element in an on-going capital asset repair and preventive maintenance program and enhance efforts to obtain optimum insurance coverage levels. In the current year the Town did not analyze the capital outlay to determine the proper classifications of the current year expenditures in the on-going projects. As a result, the construction-in-progress balance was not properly reconciled as all construction-in-progress amounts remained from the prior year.

***Recommendation***

We suggest that the Town analyze construction-in-progress and capital outlay expenditures annually to ensure all capital projects are recorded with the proper treatment.

Town of North Castle, New York

Addendum A

- **Tests of Transactions**

As part of our audit of the Town's financial statements, we review, evaluate and test controls with respect to the payroll, purchasing, real property taxes, and cash receipt cycles. Our tests of transactions for the current year indicated the following area is in need of improvement.

*Journal Entries*

In addition to the numerous cash receipts and disbursements that get posted each year to the accounting records, a significant amount of journal entries are also processed by accounting personnel. These journal entries, or adjustments, can range from minor to material amounts. During our audit, it was noted that certain journal entries do not appear to be signed off and approved by supervisory personnel.

***Recommendation***

Journal entries should always be reviewed by an individual not involved in creating the entry, to ensure appropriateness and accuracy. We recommend that procedures be implemented whereby all journal entries evidence the fact of supervisory approval. The Town can set different approval parameters based upon the materiality of the adjustment.

Town of North Castle, New York

Addendum A

- **Justice Court**

*Segregation of Duties*

The Town Justices and the Town Board are responsible for the financial affairs of the Town's Justice Court. This responsibility includes the establishment of an effective system of internal control which adequately safeguards the Court's assets. An effective system of internal control encompasses the books and records for the recording of financial transactions and the systems and procedures to ensure that all transactions are executed in accordance with management's authorizations, applicable laws and State regulations. Our procedures noted that all aspects of recording and accounting for financial transactions are under the purview of one individual.

***Recommendation***

In order to improve internal controls over Justice Court assets, we recommend that consideration be given to redistributing these duties among available personnel.

*Outstanding Parking Report*

During our audit of the Town's Justice Court, we noted that the Town does not maintain a cumulative record of outstanding parking tickets. Therefore, the Town is unable to determine the number of parking tickets outstanding over a period of time.

***Recommendation***

We suggest the Town maintain a cumulative listing of all outstanding parking tickets in order to properly determine their collectability.