

**VILLAGE OF DANSVILLE,
LIVINGSTON COUNTY, NEW YORK**

**Communication of Matters Related to Internal Control
Over Financial Reporting and Other Matters
February 27, 2012**

Bonadio & Co., LLP
Certified Public Accountants

February 27, 2012

To the Village Board of the
Village of Dansville, Livingston County, New York:

In planning and performing our audit of the accompanying balance sheet - all fund types and account groups - statutory basis of the Village of Dansville, Livingston County, New York (the Village) as of and for the year ended May 31, 2011, in accordance with auditing standards generally accepted in the United States, we considered the Village's internal control over financial reporting (internal control) as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Village's internal control. Accordingly, we do not express an opinion on the effectiveness of the Village's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph 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. However, as discussed on the following pages, we identified certain 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.

In our report, we have identified items that have been classified as material weaknesses in internal control. This conclusion was reached based on their significance to the financial statements taken as a whole, their inter-reliance and counter-dependence, and the fact that most, if not all, of the errors were not identified by management or employees performing their assigned functions.

This communication is intended solely for the information and use of management, the Village Board, and others within the Village, and is not intended to be and should not be used by anyone other than these specified parties.

171 Sully's Trail
Pittsford, NY 14534
p (585) 381-1000
f (585) 381-3131

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www.bonadio.com

VILLAGE OF DANSVILLE, LIVINGSTON COUNTY, NEW YORK

COMMUNICATION OF MATTERS RELATED TO INTERNAL CONTROL OVER FINANCIAL REPORTING AND OTHER MATTERS FEBRUARY 27, 2012

INTERNAL CONTROL RELATED MATTERS

We have identified the following control deficiencies that we consider to be material weaknesses:

1. ACCOUNTING POLICIES AND PROCEDURES MANUAL

Observation

During the course of our audits, we noted that the Village does not have an updated policy and procedures manual detailing the daily functions performed by the finance department, as well as other critical functions within the Village.

Recommendation

We recommend that the Village focus on preparing an accounting policy and procedures manual. This manual should contain all procedures performed to maintain and operate all accounting functions. A detailed and comprehensive manual is extremely important in the event of employee turnover or job changes to ensure that the continuity of the financial function and internal control environment is maintained. The manual should summarize tasks in logical categories such as daily, weekly, monthly, quarterly and annual tasks. Within each category, information regarding critical due dates, Federal, State or local compliance requirements and similar items should be included, as well the position within the Village responsible for accomplishing that task. We can provide the Village with a template policy from which they can use to tailor specifically to the Village's needs.

2. INTER-FUND BALANCES

Observation

In reviewing the balance of inter-fund due to/from accounts, we noted that the Village was not able to provide sufficient support for the composition of each of the amounts on a fund by fund basis. In total, the inter-fund activity was in balance. Historically, the Village's contracted CPA firm provided the Clerk-Treasurer with detailed information about the activity from one year to the next within each fund using information obtained from the Village's records. This information was maintained for fiscal 2011. As outlined in the NYS Office of the State Comptroller report dated April 2011, the repayment of inter-fund advances is required under General Municipal Law within the year the monies were advanced. The ability of these funds to repay these amounts has been an issue for a number of years.

Recommendation

We recommend that the Village review the annual general ledger information for as many years as practical to determine how much of the inter-fund activity represents known advances. Secondly, a plan of repayment should be formally established and approved by the Village Board. Going forward, these advances need to be better managed and accounted for so that the Village can comply with all laws and regulations. We understand that the Village has engaged a third-party consultant to perform a water and sewer rate study. Going forward, properly calculated water and sewer rates should allow for any inter-fund transfers from these funds to be repaid in the year advanced.

INTERNAL CONTROL RELATED MATTERS (Continued)

We have identified the following control deficiencies that we consider to be significant deficiencies:

3. PAYROLL

Observation

We noted that the Deputy Clerk is currently responsible for preparing payroll input, reviewing the payroll journals from the payroll system, finalizing each payroll for employees and amounts, and determining the necessary bank transfer from operating. In addition, the Deputy Clerk inputs changes to employee status, such as adding new employees and deleting terminated employees. Currently, payroll is processed on a weekly basis. Payroll is the most significant, on-going cost to the Village and as such poses the greatest potential risk of loss to the Village. Currently, the time tracking system does not accurately report time spent on various Village functions (i.e., Water, Sewer, General Fund).

Recommendation

We understand that segregation of duties is an issue through all finance functions because of the size of the Village's accounting office. However, having one person perform essentially every payroll step significantly increases the risk of an error or irregularity going undetected. We strongly suggest that some of these functions be segregated among other employees to protect the assets of the Village. Additionally, we recommend that the Village transition from a weekly to a bi-weekly or bi-monthly payroll cycle to reduce the administrative burdens of the Village Finance office. In addition, this would free up the duties of the Deputy Clerk to perform other administrative functions as identified. The net payroll cost to the Village will be unchanged as a result of a change of this nature. Time tracking should be done at a level that appropriately captures the level of effort across each Village function. If necessary, the Village should redesign their timecards to incorporate the allocation of hours to different functions within the Village. Doing so will allow the Village to better capture the time and effort related to key functions and better determine necessary budgets, fees, and tax rates. Lastly, the Village should consider transitioning all employees to direct deposit and electronically posted pay stubs to eliminate the excess costs and time associated with purchasing check stock and envelopes, stuffing envelopes with pay stubs, reconciling outstanding checks on the bank statement, and replacing lost checks.

4. FIXED ASSETS

Observation

Currently, the Village does not have an accurate listing of fixed assets that reconciles to the totals included in their NYS Annual Update Document (AUD). As a result the Village cannot produce an accurate listing of all owned fixed assets. Such a list would assist the Village in assuring that adequate insurance is being maintained and that assets no longer owned are not being insured.

Recommendation

We strongly recommend the Village develop an accurate and up-to-date listing of fixed assets. When completed this list should include, at a minimum, the following information: asset description, location, ID tag (if desired), cost, and date purchased. This information will assist the Village when considering future capital budget needs by identifying the age of assets and therefore when a replace item may be needed.

INTERNAL CONTROL RELATED MATTERS (Continued)

5. SEGREGATION OF DUTIES

Observation

The Village Board is elected to oversee the operations of the Village and has fiduciary responsibility for ensuring the activities are appropriate. Although the Board does not directly oversee the day-to-day operations of the Village, it is responsible for the overall review and decision-making relating to organizational matters. In larger organizations, internal control is typically linked directly to an appropriate level of segregation of duties. The size of the Village's key departments does not allow for adequate segregation of duties for all critical functions. Historically, the Board has not been actively involved with internal control related matters, which are critical to ensure the accuracy and appropriateness of accounting records.

Recommendation

We understand that there are limitations to the Village's ability to implement an ideal set of internal controls that would include the appropriate level of segregation of duties due to the limited number of staff. We also understand that it is not feasible for the Board to become a primary part of those controls. The State of New York, as well as generally accepted auditing standards, has stressed the importance of strong Board governance. We recommend that the Village Board, or a committee thereof, review the existing policies and procedures, as well as review the Village's overall risks related to fraud, misappropriation or other loss, to assess the appropriate level of Board involvement going forward. From this review, additional procedures should be developed, documented and implemented.

6. SEGREGATION OF DUTIES OVER CASH RECEIPTS

Observation

We noted that there was a lack of segregation of duties surrounding cash receipts, especially in the Water department, where one person is primarily responsible for collecting funds, depositing them, and crediting a customer account.

Recommendation

The objective of internal controls over cash receipts is to ensure control over amounts received at the time of receipt. Separating these closely related functions in the cash receipts system of the Village will result in much greater internal control. To achieve this control, certain duties involving receipts should be handled by more than one member of the Village's personnel. Ideally, the following procedures should be enacted to ensure efficient internal control:

- One employee should open the mail, make a control list of all receipts, and restrictively endorse all items received. This would prevent any unauthorized endorsement should the checks be misplaced or lost before being deposited.
- The receipts should then go to another employee for further processing and deposit to the bank on a timely basis. The lack of timely deposits poses a risk to the Village.
- Then, someone who does not otherwise handle receipts should compare the deposit slips to the list of receipts to ensure that all funds reflected on the receipts were deposited. If in agreement, that person should then record those amounts in the general ledger.

In addition, the Village could consider using a lockbox procedure to reduce the time needed by Village staff to process checks. This will also add a layer of control over this procedure as the bank would be receiving and posting the checks directly.

INTERNAL CONTROL RELATED MATTERS (Continued)

7. VILLAGE CONTRACTS

Observation

We identified that the Village had many contractual arrangements for which there was not an updated contract in place. These included the agreement with the Town of North Dansville for office space, as well as agreements with the Ambulance and Fire Services.

Additionally, the Village annually provides funding relating to a summer festival. Activities for this festival are managed by an individual outside of the employment of the Village; however, much of the funding comes through the Village and is paid directly to this individual to coordinate all of the activities. No contract exists with this individual that outlines each party's responsibilities for performance and/or remedies in the event of a breach of those duties. In addition, the Village does not issue IRS Form-1099 for non-employee compensation for providing these services.

Recommendation

To protect the Village and to eliminate potential problems that can arise from outdated or oral agreements, we recommend that written agreements be prepared and signed in all instances where the Village is contracting with another party for services. Each agreement should name the parties involved and list the terms of the agreement. Ideally, the Village and legal counsel should develop a standard contract to be used in these situations that should only be modified with the express consent of counsel. Furthermore, a schedule of terms should be maintained so that contracts can all be kept current prior to their term expirations. Lastly, for any service contracts with unincorporated parties, all necessary tax forms should be completed and filed by the Village.

8. BUDGET OBSERVATIONS

Observation

The Village has a legally adopted budget which is approved by the Board each year. During the year, budget line transfers are not processed or requested. We noted that for the past two years, all budget line transfers are processed at one time at year-end. From this process it is clear that the Village is not currently using actual to budget variance analysis as an effective management tool. As a result, it is more difficult to properly control spending during the year and will often result in budget overruns. The Village needs to be reviewing budget resolutions on a timely basis.

Recommendation

We recommend that the Village closely monitor its expenditures by analyzing actual results to budget at least quarterly, but ideally on a monthly basis. Budgets are meant to provide guidance and instill discipline for management of the Village. Budgets can, and do, change through the year; however, we recommend that those changes be documented and provided to the Village Board on a timely basis.

By tracking budget amendments and transfers, management will be readily able to document why it has deviated from its Board approved budget, will maintain its discipline over expenditures, and be able to use that information for future budgeting purposes.

INTERNAL CONTROL RELATED MATTERS (Continued)

We have identified the following as deficiencies in internal control that we consider to be neither a material weakness nor a significant deficiency:

9. MANDATORY VACATION POLICY

Observation

The Village does not currently have a mandatory vacation policy in place for staff with finance responsibilities. Therefore, no requirements exist for individuals to be separated from their day-to-day duties for an extended period of time and another individual perform those functions in their absence.

Recommendation

The lack of a mandatory vacation policy poses a significant risk to the Village. Requiring cross-training and the performance of an individual's duties while on vacation is in itself a great internal control and deterrent to improper behavior. Although we are unaware of any inappropriate transactions, our audit is not designed to specifically test for these items. Additionally, all individuals, regardless of title or position should be held accountable for their time as their employment represents a contractual relationship between the Village and the employee.

10. UNIFORM ALLOWANCES

Observation

Under the current police union contract, there is a provision that all full-time officers, excluding plain-clothes officers, will receive an annual uniform allowance which is currently set at \$550 through May 31, 2012. The contract further stipulates that any unused allowance can be carried over to the subsequent year's uniform allowance. These carry-overs are being tracked manually outside of the Village's general ledger system. Furthermore, money unspent each year is not charged against that year, nor is the money set aside for future payment of these allotments. Therefore, from a budgetary perspective, the Village is unable to adequately control this spending against its annual tax levy.

Under Internal Revenue Service regulations, allowances are to be treated as taxable compensation unless the reimbursement meets the definition of an accountable plan. An accountable plan exists when reimbursement is predicated on the submission of specific receipts that justify the purchase being made.

Recommendation

We recommend that the Village consider whether changes to the existing uniform allowance provision needs to be made during the next contract. Until such time as the policy is amended, the Village should transfer any unused uniform allowances to the Agency account and record that as a charge against that fiscal year's budget. Going forward this will ensure that amounts unspent from prior years do not impact the current year budget. The Village needs to determine whether allowing any carry-over of unused balances is necessary, whether unused amounts will be paid out as compensation, or if the current policy is still warranted given the current budgetary issues facing the Village.

INTERNAL CONTROL RELATED MATTERS (Continued)

11. DEBT AGREEMENTS

Observation

Currently the Village has six outstanding general obligation bonds. However, the Village was unable to locate the actual bond agreements related to each of these bonds. Therefore, we were unable to ascertain what debt covenants, or requirements, might exist relating to these bonds. In addition, the Village has several bond anticipation notes outstanding with original issue dates that are more than five years prior to May 31, 2011.

Recommendation

We recommend that the Village attempt to obtain the actual signed agreements relating to these bonds, and that going forward they develop a mechanism to ensure that all necessary supporting documentation is maintained in the Village records. Such information should include the Village authorizations to enter into the debt arrangement (resolutions, etc.), actual debt agreements, repayment schedules, and any other relevant information. We also recommend that the Village review its compliance with all forms of outstanding debt obligations.

12. EMPLOYEE SICK TIME BANK

Observation

Certain contracts allow for the carryover of accumulated sick time to be used in the future to fund post-retirement health care costs. Once the determination has been made to award the unused sick time, those funds technically would not be considered funds of the Village. Under the current practice, the funds are retained in the Village's general fund balance and operating cash account.

Recommendation

We recommend that the Village transfer the value of the earned sick time at the date of award from the general fund and into the agency fund or recorded in a reserve (GML 6-p) until such time as it's used by the retiree. At that point any payout of the sick time would not have an impact on the current year budget. Additionally, the amount deposited to the sick time bank, and ultimately accruing to the employee should be based on the salary being earned at the time of the transfer, not at the time of final payout. This will help to limit the costs to the Village when employees hold out for payment of their sick time until they reach their highest level of hourly compensation.

13. CONTROLS OVER INFORMATION TECHNOLOGY

Observation

In connection with our audit, we reviewed the information technology process and controls to determine the risks, if any, related to the financial reporting process of the Village. In connection with our assessment, we identified areas where deficiencies in controls existed however, due to the sensitive nature of the findings and their significance to the Village, we have communicated them to management and we will not repeat them in this letter.

Recommendation

We recommend that the Village review our observations and develop a process by which to begin addressing those areas that are deemed to be the most critical or time sensitive. When dealing with information technology related controls, it is important to remember that it is an ever-changing environment both from the perspective of the threats that exist, and from the tools available to combat those threats. Furthermore, the costs to implement every control will typically outweigh benefits derived from implementation and; therefore, it is important to consider the entirety of the information technology and manual controls that may be in existence and develop appropriate procedures to best put them in place to protect the Village.

OTHER MATTERS FOR THE CONSIDERATION OF MANAGEMENT

14. WATER/SEWER BILLING

Observation

While performing tests over the billing for water and sewer charges within the Village, it was noted that base charges are billed in advance, whereas usage is billed at the end of the period. In situations where an existing customer moves and a new customer moves in, there is no adjustment to the bills to account for the unused base charge by the departing customer. At the same time, the new customer has no obligation for base charges until the next billing cycle.

Recommendation

We recommend that all of the billing be converted to billing for charges based on the actual usage for the period, plus a base charge related to that same period. In this process base charges would be billed at the end of the billing cycle, along with actual per gallon usage, and any final meter reads would allocate the base charge accordingly to that customer on a per diem basis. Additionally, we recommend that the Village establish a new customer charge of \$5-\$10 for every new account that is opened.

Observation

The current billing system would be considered a legacy system in that it was created internally and is not supported by a software company from a back-up or user need perspective. In fact, the system was created by the former Village Administrator.

Recommendation

We recommend that the Village consider exploring opportunities to integrate the water and sewer billing with the current general ledger reporting software. This will make financial recording more efficient and allow for automatic updates of the billing and collection information related to water and sewer billing. Additionally, it will provide for more cross-training between the water and sewer billing process and the other Village financial functions.

15. CAPITAL ASSET DISPOSITION POLICY

Observation

We observed that the Village does not have a formal policy to ensure that capital assets are disposed of properly, whether by destruction, sale, scrap, or trade-in.

Recommendation

Although there is not a large volume of capital assets at the Village, we recommend that a formal policy be implemented to ensure the proper reporting of capital asset dispositions. This policy should specify the necessary level of approvals for disposal based on the value of the asset. We suggest that a simple yet standardized form be developed to provide adequate approvals for disposal and other pertinent information as documentation of disposal of significant assets. Implementing this policy would protect the Village from loss, waste, or fraud relating to the disposal of capital assets.

OTHER MATTERS FOR THE CONSIDERATION OF MANAGEMENT (Continued)

16. COMPENSATORY TIME ACCRUALS

Observation

The Village does not have a written policy surrounding the carryover of unused compensatory time to the following year. The ability to carryover this amount appears to be arbitrary and determined on a case by case basis.

Recommendation

We recommend that the Village establish a written policy relating to the ability to carryover any unused compensatory time from one year to the next and ensure that the policies are enforced consistently throughout the Village. The policy should include provisions for limiting the amount of annual carryover, and should provide for preauthorization before any compensatory time is worked by the employee. The unused time banks should also be tracked within the payroll system and be supported by appropriately signed and approved timecards for each employee as to the time earned and used. Such a policy will help to minimize the Village's potential future costs and help minimize the impact to taxpayers.

17. CAPITAL EXPENDITURES

Observation

We noted that some of the activity being recorded in the non-current governmental assets fund group may not all meet the criteria to be considered a capital asset. Generally, the definition of a capital asset includes those assets whose cost exceed a specific threshold as established by the Village, and have an initial useful life extending beyond one year. The current practice of the Village has been to take all activity recorded in the .2 accounts and record that as a capital item.

Recommendation

We recommend that the Village review its current practices in this area, and to establish a capitalization threshold for recording capital assets. Furthermore, when preparing the Annual Update Document for NYS, only those .2 expenditures that exceed the capitalization threshold should be recorded in the non-current governmental assets fund group.