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March 1, 2013

Sean Walter, Town Supervisor
Members of the Town Board
Town of Riverhead
200 Howell Avenue
Riverhead, NY 11901

Report Number: 2012M-247

Dear Supervisor Walter and Members of the Town Board:

One of the Office of the State Comptroller's primary objectives is to identify areas where local government officials can improve their operations and provide guidance and services that will assist them in making those improvements. Our goals are to develop and promote short-term and long-term strategies to enable and encourage local government officials to reduce costs, improve service delivery, and account for and protect their entity's assets.

In accordance with these goals, we conducted an audit of the Town of Riverhead (Town), which addressed the following question:

- Is the Town's methodology for allocating administrative costs adequate?

We discussed the audit results with Town officials and considered their comments in preparing this report. The Town's response is attached to this report in Appendix A.

Summary of Findings

The Town allocates the costs of services provided by some Town operations funded by the general fund to other departments and districts accounted for in other funds. However, we found that the allocation method is not based on the cost of actual services provided. Instead, Town officials applied a flat percentage rate to each department's budget, which is not equitable because all the departments do not use the same type and degree of services. Additionally, the Town improperly included the salaries of the Supervisor and Town Clerk and included certain administrative charges – such as payroll, Justice Court, and municipal garage – in allocations to departments that did not use them. These improperly allocated amounts represented at least \$779,829 (26 percent) of the \$2,980,750 that was allocated in 2012 to 11 funds.

Background and Methodology

The Town of Riverhead (Town) is located in Suffolk County. The Town covers 201 square miles, includes nine hamlets (Aquebogue, Baiting Hollow, Calverton, Jamesport, Laurel, Manorville, Northville, Riverhead, and Wading River), and has a population of approximately 33,500.

The Town is governed by a Town Board (Board) which comprises five elected members, including the Town Supervisor (Supervisor). The Board is responsible for the general management and control of the Town's financial affairs. The Supervisor is the Town's chief fiscal officer and is responsible for daily operations. The Town Financial Administrator (Financial Administrator) is appointed by the Board and is responsible for maintaining complete and accurate accounting records and reports. The Financial Administrator must provide the Board with the information necessary to properly monitor financial activities and make prudent financial decisions.

The Town provides various services to its residents, including waste management, highway, parks and recreation, public safety, and general government support. The majority of the funding to finance these services comes from real property taxes. The town-wide general fund budget was \$42,383,100 for the 2011 fiscal year and \$43,865,900 for the 2012 fiscal year.

We analyzed the Town's administrative cost allocations for the period January 1, 2011, to September 30, 2012. We interviewed Town officials and reviewed Town spreadsheets, budgets, and financial statements. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

Audit Results

To equitably allocate general fund administrative overhead costs,¹ the Town must use an allocation method that shows a direct relationship between the services rendered to the benefiting departments and the costs allocated to them. Departments that are not accounted for in the town-wide general fund² should be charged only for actual costs incurred after the services have been provided, to the extent permitted by law. If estimates are used for the purpose of balancing a legally adopted budget, these estimates should use equitable allocation factors based on the cost of direct services provided to the departments, and should later be reconciled with actual costs incurred. Furthermore, certain costs incurred by elected officials, such as the salaries of the Supervisor and Town Clerk, who serve the public at large, are usually town-wide general fund charges and generally cannot be allocated to funds or departments with different tax bases.

¹ The costs of central services or support functions shared across Town departments

² The town-wide general fund is used to account for transactions that are charged to all areas of the Town.

To the extent that the town-wide general fund provides services to departments that are accounted for in other funds, the general fund generally is entitled to be reimbursed for those costs.³ The Town allocates services provided by the town-wide general fund departments⁴ to other funds and districts.⁵ However, Town officials have not developed an allocation plan based on the direct relationships between the services paid by the general fund and the actual services received by the benefiting departments or funds.

In the 2011 fiscal year, the town-wide general fund budget of \$42,383,100 included \$2,800,000 in revenues from other funds for allocated administrative costs (6.6 percent); in 2012 the \$43,865,900 town-wide general fund budget included \$2,980,750 in revenues (6.8 percent) from the same cost allocation process.

The methods that Town officials used for calculating administrative cost allocations were not based on the actual services being provided. Instead, Town officials calculated this allocation as a flat percentage of the total budget based on actual expenditures in the administrative cost centers for the last complete fiscal year. To illustrate, Town officials calculated the 2012 allocation by dividing the sum of the Town's actual 2010 expenditures⁶ for all cost centers by the total general fund expenditures for the year. This percentage (14.2 percent) was then applied to the 2012 budget for each department to which the costs were being allocated, as follows:

³ Clerical and administrative expenses of the town highway department are general fund, not highway fund, charges and are not subject to reimbursement from the highway fund to the general fund (see, for example, the 1985 Opinions of the State Comptroller No. 85-11, at 14).

⁴ The town-wide general fund departments (cost centers) include the Town Council, Justice Court, Supervisor, Finance and Data Processing, Auditor, Tax Receiver, Town Clerk, Purchasing, Tax Assessor, Town Attorney, Personnel, Engineering, and Municipal Garage.

⁵ The cost allocation is applied to 11 funds: highway, water, sewer, refuse and garbage, street lighting, public parking, Business Improvement District, Ambulance District, Calverton Sewer District, Scavenger Waste District, and East Creek Docking Facility.

⁶ 2010 was the last complete fiscal year at the time that the 2012 budget was prepared.

Table 1: Town Allocations to Funds Receiving Services in 2012		
Cost Center	2010 Total Expenditures	2012 Administrative Charge-Back (at 14.2 Percent) ^a
Highway	\$5,415,918	\$768,870
Water District	\$4,970,012	\$705,560
Sewer	\$2,595,211	\$368,430
Refuse and Garbage	\$4,582,940	\$650,610
Street Lighting	\$794,805	\$112,830
Public Parking	\$115,132	\$16,340
Business Improvement District ^b	\$168,129	\$23,870
Ambulance	\$ 930,567	\$132,110
East Creek	\$86,733	\$12,310
Calverton Sewer	\$313,814	\$44,550
Scavenger Waste	\$1,023,291	\$145,270
Total Interfund Revenues	\$20,996,552	\$2,980,750
(a) Rounded to nearest \$10 (b) Chargebacks for services provided for the operation of a business improvement district (BID) must be consistent with the BID Plan (General Municipal Law Section 980-j).		

This is not an adequate method of allocation because it assumes that the entire budgets of the Town's cost centers were devoted to services provided to the other (receiving) funds. In addition, it assumes that each of the receiving funds received equal shares of the services from each cost center.

Furthermore, the Town's allocation calculation for 2012 included the 2010 Supervisor's and Town Clerk's salaries (\$115,147 and \$72,386, respectively), which should generally be excluded from most department administrative costs; as a result, as much as \$94,655 was improperly distributed to the various funds. Administrative charges to departments also included payroll, regardless of whether departments actually used the Town's payroll services; for example, the public parking, Business Improvement District, and ambulance funds did not use payroll services but were charged a total of \$981 for them. Justice Court charges of \$636,625 and municipal garage charges of \$402,652 for 2010 were also included in the calculation of administrative costs, resulting in \$524,562 being improperly distributed to the 11 Town funds to which the cost allocation is applied. The Town's Financial Administrator also acknowledged that the costs allocated to the Highway Department – at least those related to payroll, purchasing, and the Town attorney (a total of \$159,631 for 2012) – need to be adjusted. As we noted previously, clerical and administrative expenses of the town highway department are general fund, not highway fund, charges and are not subject to reimbursement from the highway fund. Town officials could not provide us with documentation to show that these costs were based on a direct relationship to the department charged. In addition, Town officials do not reconcile and adjust the allocated charges to actual costs incurred for the current year.

Town officials told us they have made several changes to the allocation process for the 2013 budget. For example, Justice Court and municipal garage charges will no longer be allocated as administrative costs to departments. In addition, payroll costs will no longer be allocated to funds

that do not use the Town's payroll services, and the costs that are allocated will be based on a percentage determined by the number of employees working on payroll processing. While using a percentage of employees may be appropriate to allocate payroll and personnel costs, the Town must also develop an appropriate method to allocate the cost of other services such as finance and data processing, purchasing, legal, and engineering. An appropriate and equitable method could be based on the number of transactions, disbursements, or number of checks/abstracts processed for a particular department or fund.

Without appropriate allocation factors that take into account the direct relationship between the services provided to the benefiting department or fund and the true cost of such services, the Town may be either over-charging or under-charging for such services.⁷ Thus, the cost for such services may be inequitably charged to certain tax bases or rate payers. Further, as certain costs are not permitted or have no clear relationship to the department, different funds may bear an inequitable burden for costs that do not apply.

Recommendation

1. Town officials should continue to develop an allocation plan based on the direct relationships between the various services provided by the general fund and the actual services received by the benefiting department or fund. If estimates are used when preparing the annual budget, such estimates must be reconciled to the actual cost of services provided.

The Board has the responsibility to initiate corrective action. Pursuant to Section 35 of the General Municipal Law, a written corrective action plan (CAP) that addresses the findings and recommendation in this report should be prepared and forwarded to our office within 90 days. To the extent practicable, implementation of the CAP must begin by the end of the next fiscal year. For more information on preparing and filing your CAP, please refer to our brochure, *Responding to an OSC Audit Report*, which you received with the draft audit report. We encourage the Board to make this plan available for public review in the Town Clerk's office.

Sincerely,

Steven J. Hancox
Deputy Comptroller
Office of the State Comptroller
Division of Local Government
and School Accountability

⁷ Without methodologies for determining the true amount and cost of services provided to each department, we cannot determine the proper charge-backs that should have been allocated to specific departments.

APPENDIX A

RESPONSE FROM LOCAL OFFICIALS

The local officials' response to this audit can be found on the following pages.



TOWN OF RIVERHEAD

Sean M. Walter, Town Supervisor

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February 25, 2013

Ira McCracken, Chief Examiner
Division of Local Government and School Accountability
Office of the State Comptroller
110 State Street
Albany, NY 12236

Dear Mr. McCracken,

The Town of Riverhead requested an audit by the Office of the State Comptroller of our method of allocation of the Town's administrative chargebacks.

The Town utilized a method of administrative chargebacks based upon a percentage of expenditures of special districts. The report findings recommended that the Town allocate funds based on the cost of services provided to the special district and that the allocation show a direct relationship between the services rendered to the appropriate district. The report also recommended that the chargeback be reconciled to the actual cost of the services provided and not by an estimate.

In addition, certain costs incurred for elected officials such as salaries of the Supervisor and Town Clerk whose role is to serve the public at large are not to be included in the chargeback. Finally, administrative salaries and expenditures of the Highway Department are properly charged to the General Fund and therefore will not to be included in future administrative chargebacks.

The Town agrees with the findings of the Office of the State Comptroller. The following changes were made in the 2013 budget: exclude the charges of Justice Court and Municipal Garage as a calculation of administrative costs; exclude a chargeback for payroll costs from outside funds that do not utilize payroll services; and reduce the Highway chargeback to exclude Town Attorney.

A corrective action plan for the 2014 chargebacks will be implemented and included in the Town of Riverhead's 2014 budget. The corrective action plan is attached hereto.

Sincerely,

Sean M. Walter
Supervisor
Town of Riverhead



TOWN OF RIVERHEAD

Sean M. Walter, Town Supervisor

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CORRECTIVE ACTION PLAN

Unit Name: Town of Riverhead

Audit Report Title:

Audit Report Number: 2012M-247

Audit Recommendation:

Town officials should continue to develop an allocation plan based on direct relationships between the various services provided by the General Fund and the actual services received by the benefiting department or fund. If estimates are used when preparing the annual budget, such estimates must be reconciled to the actual cost of services provided.

Implementation Plan of Actions:

The Town of Riverhead will be charging back the following special districts: Water, Sewer, Refuse & Garbage, Street Lighting, Public Parking, Business Improvement District, Ambulance, East Creek, Calverton Sewer and Scavenger Waste. The Town will no longer assess chargebacks to the Highway Department. Fringe benefits will be added to all salaries based upon FEMA approved rates.

The Town of Riverhead's proposed allocation of administrative costs are detailed as follows:

Finance Department (Accounting, Auditing, Information Technology, Payroll and Accounts Payable Cost Center 016800):

The administrative chargeback for the total cost of the two CPAs plus related expenses will be allocated to each division (IT, Payroll and Accounts Payable) proportionately based upon the number of employees in each division.

The administrative chargeback for the total cost of the two Accountants plus related expenses will be allocated to each division (Payroll and Accounts Payable) proportionately based upon the number of employees in each division.

IT - The Town will allocate the cost of IT based upon the total expense of the IT division, dividing those costs by the number of in-service computers to give a rate per computer. The general fund would charge the special district that rate multiplied by the number of computers assigned to the specific district.

Payroll – The Town will allocate Payroll based upon the total cost of the employees and related expenses. The General Fund would divide that cost by the total number of full time “equivalent” employees to give a rate per employee. The General Fund would charge the special district the rate multiplied by the number of full time “equivalent” employees in the specific special district.

Accounts payable – The Town will allocate Accounts Payable upon the total cost of the employees and related expenses. The General Fund would divide that cost by the total number of vouchers processed to give a rate per voucher. The general fund would charge the special district the rate multiplied by the number of vouchers processed in the specific special district.

Personnel (cost center 014300) – The Town will allocate Personnel based upon the total cost of the employees and related expenses. The General Fund would divide that cost by the total number of full time “equivalent” employees to give a rate per employee. The general fund would charge the special district the rate multiplied by the number of full time “equivalent” employees in the specific special district.

Purchasing (cost center 013400) - The Town will allocate Purchasing based upon the total cost of the employees and related expenses. The General Fund would divide that cost by the total number of full time “equivalent” employees to give us a rate per employee. The general fund would charge the special district the rate multiplied by the number of purchase orders processed in the specific special district.

Tax Receiver (cost center 013300) – The Town will establish an employee related cost rate for each dollar of tax collected. This will be accomplished by taking the total expenses of the department dividing it by the total dollars of taxes collected thereby establishing a rate by tax dollar collected.

Assessor (cost center 013550) – The Town will establish an employee related cost rate for each dollar of assessed value. This will be accomplished by taking the total expenses of the department and dividing it by the combined assessed value for all districts.

Buildings & Grounds (cost center 016200) – The Town will allocate Buildings and Grounds based upon the total cost of the employees and related expenses. The General Fund would divide that cost by the total square footage of all town owned buildings to give a rate per square footage. The general fund would charge the special districts the rate multiplied by the square footage of buildings in the specific special district.

Engineering (cost center 014400) – For Engineering work related directly to Building and Grounds, the Town will allocate our Town Engineers based upon the total cost of the employees and related expenses. The General Fund would divide that cost by the total square footage of all town owned buildings to give us a rate per square foot. The general fund would charge the special district the rate multiplied by the square footage of buildings within the specific special district.

For specific projects within special districts the Town Engineer will chargeback based upon billable hours.

Town Attorney (cost center 014200) – The General Fund will bill special districts based upon actual billable hours as documented by attorneys.