VILLAGE OF RYE BROOK

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

MAY 31, 2007

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

To The Honorable Mayor and
Board of Trustees
Village of Rye Brook
938 King Street
Rye Brook, New York 10573

In planning and performing our audit of the basic financial statements of the Village of Rye Brook, New York (the "Village") as of and for the year ended May 31, 2007, in accordance with auditing standards generally accepted in the United States of America, we considered the Village'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 Village's internal control. Accordingly, we do not express an opinion on the effectiveness of the Village's internal control.

We have included in this letter a summary of communications required by generally accepted auditing standards. We are also required to communicate in writing any control deficiencies identified during the audit that are considered to be significant deficiencies identified during the audit that are considered to be significant deficiencies and/or material weaknesses. This communication is a requirement of the auditing standard, **Statement on Auditing Standards (SAS) 112: Communicating Internal Control Related Matters Identified in an Audit.**

Our consideration of internal control was for the limited purpose of conducting your Village's audit and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did identify certain other deficiencies that we consider to be control deficiencies that are defined and discussed below. **We did not identify an deficiencies internal control that we consider to be material weaknesses as defined below.**

It is important to note that control deficiencies are not necessarily issues management and the Board of Trustees will choose to address, however, control deficiencies may represent potential risks. Our responsibility as your auditors is to ensure that management and 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.

A control deficiency 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 misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the Village's ability to initiate, authorize, record, process or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the Village's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the Village's internal control.

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.

This report, addendums and management responses and summary of communications are intended for the information and use of management and 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.

Bennett Kielson Storch DeSantis

The Government Services Division of
O'Connor Davies Munns & Dobbins, LLP
October 4, 2007

Village of Rye Brook, New York

Addendum A

A. Cash

At the time of our audit, we noted several checks in the General Fund Payroll account, and General Fund Regular Checking account that have been outstanding in excess of one year.

Recommendation

We recommend checks outstanding for greater than one year should be written off by the Village and, if necessary, stop payment notices should be sent to the bank.

Management's Response:

Management will review the checks outstanding for greater than one year. The Treasurer's Office and will attempt to contact the payees before writing off the checks.

B. Modified Accrual Based Accounting

There were several general ledger accounts containing prior year accruals which were not adjusted during the year or at year-end. For example, the real property taxes receivable, franchise fees receivable and PILOT taxes receivable. We also noted discrepancies where the balance sheet accounts had the correct balance but the related revenue accounts had to be adjusted. For example, the mortgage taxes and sales tax accounts. In effect, the Village records most receipts and expenditures on the cash basis of accounting, when in fact its financial reports use the modified accrual basis of accounting. As a result, internally generated financial statements prepared throughout the year may not accurately reflect the financial accounts of the Village. This finding is a repeat finding of a comment made during our previous year's audit. We noted that the Village did improve in this area but several adjustments were needed.

B. Modified Accrual Based Accounting *(continued)*

Recommendation

We recommend that the Village maintain its books and records on the modified accrual basis during the year. Such a policy will allow the Village to more accurately present internally generated financial information, which in turn would lead to more accurate budget preparation.

Management's Response:

Management will continue to improve maintaining its books and records on the modified accrual basis of accounting. Management will meet with staff to review the procedures for receipts and disbursements. The Treasurer will analyze the accounts at the end of the fiscal year.

C. Improve Monthly Closing Procedures

During the audit, we recommended twenty-six adjusting journal entries. Although this amount is slightly less than those recommended in 2006, the effect of such entries caused a decrease of revenue over expenses of approximately $246,000 in the general fund and $430,000 in the capital fund. The $246,000 net decrease in the general fund was caused primarily by an adjusting journal to record an accrual for medical and dental benefits while the $430,000 net decrease in the capital fund was caused primarily by entries to record retainage payable and bond anticipation note transfers to the general fund. Substantially all of the other entries were to correct bookkeeping mispostings or to make accruals and other adjustments that should have been made by the accounting department.

Recommendation

We recommend that a review and evaluation of transactions and proper monthly closing procedures would expedite the year-end closing.

Management's Response:

The Treasurer will review accounts on a monthly basis. The Treasurer and Deputy Treasurer will develop a checklist detailing the closing procedures. The checklist will indicate who will perform each procedure and when completion of each procedure is due.

D. Fixed Assets

The Village did not reconcile its fixed asset ledger with the report generated by their fixed asset appraisers. We also noted that retainage percentages, which represent amounts withheld from contractors for completed work pending satisfactory approval of their phase of a construction project, were not being recorded.

Recommendation

We recommend that management reconcile at least on a quarterly basis the fixed asset ledger to the fixed asset ledger prepared by the appraiser. We also recommend that retainage on construction contracts be recorded simultaneously with the payments made to the contractor.

Management's Response:

Management will make improvements to record and reconcile fixed assets construction retainage on a quarterly basis. The Treasurer and Deputy Treasurer will research on-line additions/deletions of fixed assets with our appraisal company.

E. Trust and Agency Funds

The Trust and Agency Fund is provided to account for assets held by the Village in a trustee capacity or an agent for individuals, private organizations, other governmental units or other funds. Our audit of the Trust and Agency Fund disclosed the following:

2) 1) Several old advance deposit accounts in the Environmental Impact Fund for professional services have both debit and credit balances, which have been outstanding for more than one year. The Village should investigate the status of these amounts. We have also noted that accounts set up in this fund in the last couple of years do not have debit balances and are currently

active, indicating that the Village has not made disbursements on behalf of developers without having received adequate funding in advance.

Recommendation

We recommend all of the above amounts being held by the Village should be reviewed. We have also noted that this is a repeat comment from last year and prior year's audits. While we noted that progress has been made in this area, the Village should attempt to analyze all accounts in this fund in order to ascertain their final disposition. The balances in developers' accounts should be reviewed to determine if the developer is owed a refund. If a refund is due, the monies should be returned to the developer. If monies are owed to the Village, management should attempt to contact the developer to collect monies owed. However, controls have been in place for several years ensuring that the village does not pay environmental fees to consultants unless funds are received by the developers. Many of the accounts in question have not had activity in several years. Perhaps the Village should seek a legal opinion to determine if any of the Trust and Aging Funds can be returned to the Village's general fund.

Management's Response:

Management reviewed small balances in several developers' accounts and closed the accounts. The Treasurer will continue to review developers' accounts to determine the proper disposition of these funds. Management has instituted new procedures to enhance collections in coordination with legal counsel.

F. Fund Balance

There is much discussion concerning the appropriate level of fund balance a municipality should retain. It is generally acknowledged by the financial community that no one amount or percentage is appropriate for every municipality. Generally, fund balance should be retained at a level that directly correlates with the economically sensitive revenues and expenditures. An assessment of an exposure to contingencies should also be a factor. Unique characteristics of the government's operation must also be quantified. A review of the Village's financial statements indicates that the General Fund undesignated fund balance is $2,311,366. The Village should continue its policy of reviewing its existing fund balances and determine if they are at a sufficient level to meet its day to day operations and to provide a cushion for any unexpected contingencies. A multi-year financial plan, in addition to the existing capital plan, would enable the Village to assess the most judicious use of available funds.

Management's Response:

Management will continue its policy of reviewing its existing fund balances and determining if they are at a sufficient level to meet the day to day operations and to provide a cushion for any unexpected contingencies.

INFORMATIONAL ITEMS

A. Continuing Emphasis on Governance

The Village has established guidelines and policies that address the principles of governance for a municipality. As management is aware, recent years have seen a heightened awareness in government regarding the responsibilities of governing boards. Accordingly, we bring to your attention the following considerations:

Document Retention - The time period for which a Village's routine accounting and financial documents should be retained needs to be establish so that important documentation could be kept at hand, in the context of the cost-benefit considerations of storing such information over time. In today's environment, regulators and other interested parties may be concerned, for a variety of reasons, about the availability of the Village's historical accounting and financial information. Accordingly, it is important now that the Board of Trustees formally assigns to a specific representative the sole authority to delete, destroy, or discard the Village's documents, based on the established policy's guidelines for the type of documentation to be maintained and the time frame for maintaining it.

Providing Access for Employee Comments and Concerns - This is a area frequently referred to as the "whistleblowers' provision", although the term "whistleblower" may sometimes have negative connotations in the public's mind that are not intended here. The intention is to provide a Village's officers and

A. Continuing Emphasis on Governance *(continued)*

employees with a mechanism that will permit them to communicate any concerns they may have regarding the organization, such as, but not limited to, what they may consider to be inappropriate behavior or actions by management. It is essential to this process that any communications from employees are completely confidential – to protect them from potential reprisals – and that their comments are received directly by the governing board or its audit committee, perhaps through an independent third party. The Village should continue its emphasis on governance.

Management's Response:

The Village has a records management committee and the Village Administrator/Clerk is the Records Management Officer. The Village follows the Record Retention and Disposition Schedule MU-1 issued by the State Education Department to determine how long financial documents must be kept.

The Village of Rye Brook has a Code of Ethics in Chapter 24 of its Village Code which includes procedures for an Ethics Board, whose members are appointed by the Village Board. Management will discuss with the Village Board whether they would like to consider any additional procedures in this area.

Addendum B

B. Statement of the Governmental Accounting Standards Board – Accounting and Financial Reporting for Employers for Post-Employment Benefits Other than Pensions

As part of the total compensation offered to attract and retain the services of qualified employees, many state and local governmental employers, in addition to pensions, provide other post-employment benefits (OPEB). OPEB includes post-employment healthcare, as well as other forms of post-employment benefits when provided separately from a pension plan. The Government Accounting Standards Board has issued Statement No. 45 Financial Reporting for Post Employment Benefit Plans other than Pension Plans which establishes standards for the measurement, recognition, and display of OPEB expenses/expenditures and related liabilities in the financial reports of state and local governmental employers.

Post-employment benefits (OPEB) are part of an exchange of salaries and benefits for employee services rendered, and are taken after the employee's services have ended. From an accrual accounting perspective, the cost of OPEB should be associated with the periods in which the exchange occurs, rather than with the periods, often many years later, when benefits are paid or provided. However, in current practice, most OPEB plans are financed on a pay-as-you-go basis, and financial statements generally do not report financial effects of OPEB until the promised benefits are paid. As a result, current financial reporting

B. Statement of the Governmental Accounting Standards Board – Accounting and Financial Reporting for Employers for Post-Employment Benefits Other than Pensions *(continued)*

generally fails to recognize the cost of the benefits in periods when the related services are received by the employer, provide information about the actuarial accrued liabilities for promised benefits associated with past services and whether and to what extent those benefits have been funded and provide information useful in assessing potential demands on the employer's future cash flows. The Statement would improve the relevance and usefulness of financial reporting by (a) requiring systematic, accrual basis measurement and recognition of OPEB expense over a period that approximates employees' years of service and (b) providing information about actuarial accrued liabilities associated with OPEB and whether and to what extent progress is being made in funding the plan.

OPEB expenditures for governmental funds should be recognized on the modified accrual basis. The amount recognized should be equal to the amount contributed to the plan or expected to be liquidated with expendable available resources. Essentially, there is no change from current practice for governmental funds. However, for proprietary and government-wide financial statements, the accrual basis must be used. The accrual method will require the calculations to be made using actuarial computations and will result in the

B. Statement of the Governmental Accounting Standards Board – Accounting and Financial Reporting for Employers for Post-Employment Benefits Other than Pensions *(continued)*

recognition of a present value liability which measures the value of OPEB benefits earned by employees during their tenure with the government and likely to be paid upon retirement. It should be apparent that this calculation will result in substantial amounts, due to the current employee cost of such benefits and their escalating costs. It should also be emphasized that there is no requirement to fund these benefits with current resources. The Statement merely requires the reporting of the value of the benefit primarily in the government-wide financial statements. The computations are extremely complex and the use of an actuary will invariably be required.

The Statement permits prospective implementation, that is, employers would be permitted to set the beginning net OPEB obligation at zero as of the beginning of the initial year. Implementation occurs in three phases based on the government's phase for implementing GASB's Statement No. 34, Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments. This Statement is effective for periods beginning after December 15, 2007 for phase 2 governments.

Addendum B

Management's Response:

Management is in the process of gathering information needed by the actuarial company. To properly record the OPEB obligation as required in 2008-2009.

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This report is intended for the information of management and 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.

- 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, frauds, or illegal acts identified
    - No immaterial frauds 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

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