

**SUFFOLK COUNTY SUPREME COURT  
SPECIAL GRAND JURY 1F**

**NOVEMBER 30, 2009  
TERM XII**

**GRAND JURY REPORT  
CPL 190.85(1)(C)**

**Dated: May 27, 2010**

**SUPREME COURT SPECIAL GRAND JURY 1F  
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**PRELIMINARY STATEMENT**

The Suffolk County Supreme Court Special Grand Jury 1F, Term XII, was empanelled on November 30, 2009, to investigate the financial condition of the town of East Hampton from 2003 to present.

As a result of this investigation, the following report has been adopted pursuant to New York State Criminal Procedure Law Section 190.85(1)(C), and is respectfully submitted to the Court.

## INTRODUCTION

The Grand Jury heard seventeen witnesses and received ninety-two exhibits consisting of thousands of pages of evidence regarding the financial condition of the Town of East Hampton from 2003 to the present.

The Town of East Hampton (Town) is located in Southeastern Suffolk County. The Town, which covers approximately 74 square miles, includes two villages (East Hampton and Sag Harbor) and four hamlets (Amagansett, Montauk, Springs, and Wainscott) and has a population of approximately 20,000.

The Town of East Hampton is governed by the Town Board (Board) which comprises five elected members, the Town Supervisor (Supervisor) and four council members. The Board is responsible for the general management and control of the Town's financial affairs. The Supervisor is the chief fiscal officer of the Town and is responsible for the Town's daily operations, including reporting to the Board.

The Town provides various services to its residents, including sanitation, highway, parks, airport, public safety and general government support. The majority of the funding to finance these services comes from real property taxes, fees and the State aid.<sup>1</sup>

The Grand Jury finds that a rapid collapse of the Town of East Hampton's financial condition occurred between 2003 and 2009.

The Town of East Hampton had a reported General Fund surplus at the end of 2003 of \$4,397,714.<sup>2</sup> As of the date of this report the Town of East Hampton has incurred deficits of in excess of 30 million dollars. The Town's debt will have to be

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<sup>1</sup> Grand Jury Exhibit #38 at p. 7

<sup>2</sup> Grand Jury Exhibit #38 at p. 11

**bonded through deficit financing approved by the New York State Legislature at great cost to Town of East Hampton taxpayers.**

**The Grand Jury finds that the following factors caused the financial decline of the Town of East Hampton:**

- 1. Steadily increasing costs to the Town of East Hampton for many expenses, in particular, employee benefits, salaries and retirement cost.**
- 2. Town Officials, for political expediency, refused to raise taxes or cut expenses to match the Town's budget.**
- 3. Town officials failed to implement the controls recommended by independent auditors regarding legitimizing budgeting practices, keeping of financial records, tracking of capital projects and fixed assets.**
- 4. The improper use of over fifteen million dollars of Community Preservation Funds was hidden from the Town Board and the public.**
- 5. Funds from Bond Anticipation Notes were obtained by false representations as to the Town's financial status and were used for purposes other than those stated in the notes.**
- 6. Funds obtained for Capital Projects were improperly used to pay General Fund expenses.**

#### **I. INCREASING COSTS TO THE TOWN OF EAST HAMPTON**

**The Town of East Hampton began to incur increasing expenses, particularly with respect to employee benefits from 2004 onward.**

**Expenditures for employee benefits included health insurance premiums,**

social security, and retirement contributions. These expenditures were consistently increasing. Employee benefit expenditures for the Town-Outside Village Fund increased from 2004 to 2005 by over \$450,000.00; from 2005 to 2006 by over \$1.2 million and from 2006 to 2007 by over \$700,000.00. Similarly, Police Department Personal Services increased from 2004 to 2005 by over \$400,000.00, from 2005 to 2006 by over \$300,000.00, and from 2006 to 2007 by nearly \$500,000.00.<sup>3</sup>

Unfortunately, rather than acknowledging and properly budgeting for them, these increasing expenses were met by the Town's practice of under appropriating money despite the cost increases. From 2004 through 2007 underestimated appropriations for employee benefits totaled \$2,532,670.00 in the Town-Outside Village Fund and for the same period \$3,323,631.00 for Police Department Personal Services.<sup>4</sup> These employee benefits alone constitute nearly six million dollars of under budgeted expenses.

## **II. FAILURE TO SPEND WITHIN BUDGETED PARAMETERS**

The Grand Jury received evidence and heard testimony regarding the Town of East Hampton's failure to conduct its affairs within its adopted budget. The Grand Jury notes that municipalities often spend beyond the amount budgeted each year. However, the circumstances and stated reasons for East Hampton's failure to act responsibly are alarming to this Grand Jury.

Each year, a tentative budget is prepared for the following year and must be submitted to the Board by September 30<sup>th</sup>. A preliminary budget hearing is held

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<sup>3</sup> Grand Jury Exhibit #38 at p.12

<sup>4</sup> Grand Jury Exhibit #38 at p. 12

and the public is given an opportunity to comment on the proposed budget. The Board then makes any final adjustments and by resolution adopts the budget. The Board by law is required to adopt the budget by November 20<sup>th</sup>.

A summary of the Town's proposed Tentative Budgets and Adopted Budgets was received into evidence as a chart marked Exhibit #83. The chart illustrates the tax rate change for both the Town-Outside Village Fund (Outside) and the Town-Inside Village Fund (Inside) proposed in the Tentative Budget column and the budget the Board adopted in the Adopted Budget column.

In 2003, the Tentative Budget was for a  $-.071\%$  tax rate change in the Outside Fund and a  $-.0733\%$  decrease in taxes in the Inside Fund. The budget adopted by the Board was a  $-.038\%$  decrease in taxes for the Outside Fund and a  $-.079\%$  decrease in taxes for the Inside Fund. Similarly, the 2004 Tentative Budget proposed a tax rate decrease of  $-4.66\%$  in taxes in the Outside Fund and  $-7.037\%$  decrease in taxes in the Inside Fund. The budget adopted by the Board was  $-.013\%$  tax rate decrease in taxes the Outside Fund and a  $-6.732\%$  decrease in taxes in the Inside Fund.

The Grand Jury heard testimony that an analysis was performed in 2004 calculating the 2005 budget and what adjustment to the tax rate was needed to meet that budget. It was determined that a tax increase of over 25% was needed.

Although the 2005 Tentative Budget proposed a tax rate increase of  $25.694\%$  in the Outside Fund and a  $33.770\%$  increase in the Inside Fund, the Adopted Budget by the Board for the Outside Fund was only a  $8.987\%$  increase in taxes and  $11.250\%$  increase in taxes for the Inside Fund. Throughout the following years,

specifically, 2006, 2007 and 2008, the changes in the tax rate in the Tentative Budgets were significantly lower than the tax rate changes in the Adopted Budgets by the Board.

The Grand Jury heard testimony from Town Employee A, Town Employee B and Town Employee C regarding why taxes were not raised as needed. Each witness testified consistently that taxes were not raised to meet expected costs in order to preserve elected positions. The stated concern was that if taxes were raised substantially, then those facing election might be voted out. The failure to conduct the Town's affairs within the budget contributed significantly to the Town's deficit.

The Grand Jury further finds while Town Officials refused to raise taxes as needed, they also chose not to cut spending as required.

### **III. FAILURE TO IMPLEMENT RECOMMENDED CONTROLS**

#### **A. Former Auditor's Recommendations.**

The Town's auditors made several recommendations in its 2003 Audit Report dated November, 2004.<sup>5</sup> It included the following areas of concern:

1. **Management oversight of budget - The annual operating budget represents an orderly financial plan for the operation of Town activities. The appropriations in it represent choices by the Board of Trustees as to the allocation of Town resources to specific purposes. Any expenditures beyond those budgeted had to be approved by the board and paid with available funds from another legal source. The Town was warned that over-expending the Town budget without prior board approval was "in violation of various laws and regulations."**

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<sup>5</sup> Grand Jury Exhibit #42

**The Town's auditors urged:**

**“The Town Employee C and the Board of Trustees should establish procedures to effectively monitor the Town's budget. Their monitoring should ensure that Town appropriations are not over expended. In addition, the Board of Trustees should take steps to better control expenditures. When it becomes apparent that the level of appropriations provided in the adopted budget will not be sufficient, or when the anticipated financing sources for those appropriations will not be realized, the Board of Trustees should take action to provide additional financing, reallocate appropriations or reduce appropriations to make up for unexpected budget shortfall.”**

**2. Improve monthly closing procedures of books and records – the Town's auditors noted that the Town's books and records were not being properly closed on a monthly basis resulting in the Town's accounting records not being maintained timely and accurately. The auditors recommended that:**

**“We further recommend that the Town establish a formal monthly closing calendar listing all the items needed to close the books, the people responsible for providing the information to the accounting department, and the date on which the information is needed. The recurring journal entries needed for the close should be among the items required. Since the purpose of the Board of Trustees is to provide oversight and guidance for the Town, information about the Town's actual results of operations is critical to the Board's ability to make informed decisions and meet its obligations to guide the Town.”**

**3. Capital Projects – The Town's auditors noted that capital projects were being tracked manually and urged the use of existing or new software to accurately track expenditures of capital projects.**

**4. Fixed Assets – Government Accounting Standards Board (GASB) Statement #34 was issued in June of 1999 and required state and local governments to begin reporting all financial transactions, including the value of their infrastructure or fixed assets in their annual financial reports on an accrual or continuing accounting basis. The GASB rules allowed the Town to defer reporting of infrastructure assets until the year ending December 31, 2004. The auditors found:**

**“During our audit we noted that the Town does not have an adequate system in place to properly record, classify, or update fixed assets records for additions, deletions, and transfers including infrastructure type assets.”**

**and recommended:**

**“We recommend that the Town develop an internal control system of policies and procedures in order to properly account for all fixed assets transactions. This system should include procedures for accounting for additions, deletions, transfers and periodic physical counts of fixed assets in accordance with accounting principles generally accepted in the United States of America, and the recommendations contained in the Fiscal Management Guide for Local Governments, issued by the Office of the NYS Comptroller.”**

**These and other material accounting principles were not implemented as recommended as of the 2008 draft audits for the Town. The Grand Jury finds that failure to follow the recommendations of the auditors for at least five years contributed significantly to the financial decline of the Town.**

**The Grand Jury received evidence and heard testimony regarding the findings of the Office of the New York State Comptroller regarding the Town of East Hampton’s finances.**

**The Grand Jury heard testimony from a representative of the New York State Comptroller’s Office and received the New York State Comptroller’s Report on the Town of East Hampton’s financial condition and internal controls from January 1, 2007 to March 31, 2008 in evidence. <sup>6</sup>**

**The Grand Jury notes that the State Comptroller’s finding regarding poor management by Town officials mirrors the recommendations of the Town’s auditors that were disregarded.**

**The State Comptroller concluded that because of the Board’s poor budgeting**

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<sup>6</sup> Grand Jury Exhibit #38

**and imprudent fiscal management, the Town's financial condition has deteriorated and that it has had to resort to deficit financing at a significant cost to taxpayers.**

**The New York State Comptroller's statement of the cause of the financial decline included:**

**"This decline in the Town's financial condition occurred because the Board and Town officials engaged in poor budgeting practices, including failing to appropriate adequate funding for expenses, and then routinely over-expending the appropriations. Rather than taking necessary steps to match revenues to expenses, the Board and Town officials tried to finance budgets by appropriating unavailable fund balance, which further increased deficits. In addition, Town officials did not provide, and the Board did not demand, accurate and timely financial information to prepare sound budgets and to monitor spending."**

**Specifically, the New York State Comptroller found that Town officials claimed non existing fund balances and then under budgeted for mounting actual costs. The report found:**

**"The effect of appropriating non-existent fund balance and poor budget estimates was a significant decline in the general fund balance (unappropriated fund balance) from a surplus of about \$4.5 million at December 31, 2003, to a deficit of \$3 million at December 31, 2007 – a decline of \$7.5 million over this four year period."**

**Town officials were expressly warned against such use of fund balance and inaccurate budgeting by its auditors.**

**The New York State Comptroller concluded that the failure by Town officials to make timely and sufficient financial information available contributed to the Town's financial decline. The report concluded:**

**"The Board needs timely and sufficient financial data to make informed decisions about financial management of the Town, including preparing the annual budget, monitoring revenues and expenditures, and modifying the budget during the fiscal year. However, we found that Board members did not receive, or demand, adequate financial information from Town officials, and did not receive timely reporting on the Town's financial condition from the Town's independent public accountant..."**

**The absence of complete, accurate and up-to-date financial data has seriously**

hampered the Board's ability to develop sound budgets and to monitor revenues and expenditures against budgeted amounts. The availability of such information, and the Board's diligent use of it, are all the more critical now, given the Town's deteriorating financial condition, and the Board's need to actively manage the Town's current budgetary commitments using limited cash resources."

The Grand Jury also finds that Town officials disregarded the independent auditor's recommendations regarding capital projects. The New York State Comptroller's Report concluded:

"The Town's accounting for capital projects is also very poor. Town officials did not realize they had improperly charged \$480,000 in expenditures for the Montauk Playhouse Reconstruction project to the Justice Court Building project. Therefore, the Playhouse project is \$330,000 over-budget, and the Town expended bond proceeds intended for one project for another project. Further, the Town has no assurance that \$1.47 million in payments for Justice Court project work were valid because it has no documentation to support the claims."

The Town's independent auditors warned Town officials in 2004 that GASB rules required the accurate tracking of fixed assets.<sup>7</sup> The Grand Jury finds that Town officials failed to track fixed assets as required and recommended.

The Single Audit Report for the year 2005 was not provided to the Town until October of 2007. The auditors noted:

"OMB Circular A-133 at Section 320(a) states that the reporting package (which includes the audit reports) must be submitted no later than 30 days after the reports are received from the auditors but no later than nine months after the end of the audit period. The Federal Audit Clearinghouse considers the submission requirement complete when it has received both the data collection form (which may be submitted electronically) and the reporting package."

The Town's financial year is the same as the calendar year. As such, the independent audited reports must be completed by September of the following calendar year. Yet the 2005 Town Audit was not released until September of 2007 some 12 months after the permitted completion time. The independent auditors

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<sup>7</sup> Grand Jury Exhibit #42 at p.47

explained in the 2005 report:

**“The Town did not meet the required September 30, 2005 filing deadline for the audited financial statements. This delay was attributable to additional time needed by the Town and the fixed asset appraisal company, hired by the Town, to complete the update of the fixed assets and infrastructure records in accordance with the provisions of Governmental Accounting Standards Board Statement No. 34, Basic Financial Statements – and Management’s Discussion and Analysis – for State and Local Governments.**

**GASB 34 was adopted by the Town for the year ended December 31, 2003 and required significant changes in the format and content of the basic financial statements. Prior to 2003, fixed asset records were not maintained in the detail required by GASB 34. During 2005, the Town designated a full time individual to accumulate the information needed to properly account for fixed asset records and work with the fixed asset appraisal company to update the reporting. As a result, the records and reporting has been improved. The Town is also taking steps to be able to process fixed assets records and the required reporting internally which should make the reporting more timely in the future.”**

**The failure to comply with the recommendations of the independent auditors regarding the tracking of fixed assets caused the delay of the 2005 audit. As a result from September 2005 through September 2007, the Town operated without audited financial information.**

#### **IV. IMPROPER USE OF COMMUNITY PRESERVATION FUNDS**

**The Grand Jury received evidence and heard testimony regarding the improper use of Community Preservation Funds (hereinafter “CPF”). In June of 2009 the Office of the New York State Comptroller issued a report on the use of Community Preservation Fund.<sup>8</sup> The report provided the following background:**

**“The State Legislature enacted Chapter 114 of the laws of 1998 which authorized the creation of the Peconic Bay Community Preservation Fund (CPF). This legislation, contained within Town Law Section 64-e, authorized each of the Suffolk County Towns of East Hampton, Riverhead, Shelter Island, Southampton, and Southold to establish such a fund by local law.**

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<sup>8</sup> Grand Jury Exhibit #31

The CPF's overall goal is to preserve open land and farmland in the five Towns, a goal which includes purchasing open space and environmentally-sensitive lands. The CPF is financed by a 2 percent real estate transfer tax. In 2006, voters in all five Townships approved a referendum to extend the collection of this tax from 2020 to 2030. Proceeds of this transfer tax are disbursed to the Town in which the transaction takes place for the Town's acquisition of land, development rights, and other interests in property for conservation purposes. Towns are allowed to use CPF funds (not more than 10 percent) for management and stewardship of acquired property and to make payments in lieu of taxes (PILOT's) to eligible fire, fire protection, and ambulance districts within the Central Pine Barrens area.

Since the creation of the Peconic Bay CPF in 1998, the fund has generated approximately \$516 million for land preservation in the Peconic Bay Region, and Towns have acquired approximately 7,400 acres of open space, farmland, parks, and historic sites for preservation purposes.”<sup>9</sup>

On August 4, 1998 the Town of East Hampton passed Local Law Number 26-1998 which established Chapter 112 of the Town Code “Community Preservation.” Said law contained the same language of the New York State statute mentioned above. The Town Code described the proper use of the Community Preservation Fund.

Both statutes defined “Community Preservation” as:

“COMMUNITY PRESERVATION – Includes all of the following:

- A. Establishment of parks, nature preserves or recreational areas.
- B. Preservation of open space, including agricultural lands.
- C. Preservation of lands of exceptional scenic value.
- D. Preservation of freshwater and saltwater marshes or other wetlands.
- E. Preservation of aquifer recharge areas.
- F. Preservation of undeveloped beach lands or shore lands.
- G. Establishment of wildlife refuges for the purpose of maintaining native animal species diversity, including the protection of habitat essential to the recovery of rare, threatened or endangered species.
- H. Preservation of pine barrens consisting of such biota as pitch pine and scrub oak.
- I. Preservation of unique or threatened ecological areas.
  
- J. Preservation of brooks or streams and riverine areas in natural, free-flowing condition.
- K. Preservation of forested lands.

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<sup>9</sup> Office of the New York State Comptroller, Peconic Bay Community Preservation Fund Report p.3.

- L. Preservation of public access to lands for public use, including stream rights and waterways.**
- M. Preservation of historic places and properties listed on the New York State Register of Historic Places and/or protected under a local historic preservation ordinance or local law.**
- N. Undertaking any of the aforementioned in furtherance of the establishment of a greenbelt.”<sup>10</sup>**

**The Town Code permits the use of CPF monies for the purposes stated above.**

**The statute also prohibits the use of funds as follows:**

**“In no event shall moneys deposited in the fund be transferred into any other account”<sup>11</sup>**

**The Grand Jury heard testimony from several witnesses that in December of 2006 the Town did not have sufficient fund balances to pay for closing costs for the purchase of property, payroll and other expenses. The Grand Jury finds the following course of events as the truthful and reliable version of what occurred in December of 2006.**

**Town Employee A and Town Employee C conferred with Town Employee E as to how to pay the expenses for which the Town had insufficient funds. Town Employee E was told by Town Employee C to use CPF money to pay the expenses.**

**Town Employee D learned of the planned use of CPF Funds for non CPF expenses. Town Employee D told Town Employee A, Town Employee C and Town Employee E that CPF Funds could not be used as planned and that different funding sources would have to be accessed. No CPF Funds were used improperly in this December, 2006 scenario.**

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<sup>10</sup> East Hampton Town Code Section 112-1-20.

<sup>11</sup> East Hampton Town Code Section 112-1-30(D).

Thereafter, Town Employee D met with Town Employee A, Town Employee C, Town Employee E and Town Employee F and advised them all that CPF Funds could be used for CPF purposes only and that CPF Funds could not be transferred or loaned to any other funds.

During the time period between July 2007 and November 2007 Town Employee C caused the use of approximately \$8,000,000 of CPF money to be advanced to other funds to pay for non-CPF expenses. The Town Board, Town Employee A, Town Employee D, Town Employee F and the public were unaware of these CPF expenditures.

The second half of the year 2007 was a particularly dark period with respect to the availability of usual accounting tools. The Town had been without final audited figures since September, 2005. In July of 2007, the Town employee who prepared some form of monthly financial reports ended his employment with the Town. No one was tasked with his role of doing bank reconciliation, updating the Town's ledger and computer system. The Town was conducting its finances without any of the most fundamental accounting measures in place.

It is in this extreme set of circumstances that the Town's outside auditors at the time began to perform some bookkeeping function. Late in 2007 the Town's auditors discovered the improper use of CPF Funds described above. In December of 2007 the Town's outside auditors sought an emergency meeting with Town Employee A and Town Employee C. The requested meeting did not take place until January 2008.

Upon learning of the outside auditors objections to the use of CPF Funds in

the second half of 2007, Town Employee A directed the immediate repayment of those monies to the CPF and approximately \$8,000,000 was repaid to the fund without interest. Later, interest was retroactively calculated and paid.

The Town Board, Town Employee D, Town Employee F and the public did not learn of the 2007 use of CPF Funds described above until March of 2008.

The New York State Comptroller conducted a review of the use of CPF Funds by all of the east end Towns in Suffolk County. The Comptroller's report found:

“We identified that East Hampton has used millions of dollars of CPF monies for inappropriate purposes. For example, CPF monies were advanced to other Town funds to maintain operations, used to buy land for non-preservation purposes, and used to reimburse the general fund for costs reportedly incurred on behalf of the CPF. As a result, CPF funds were used for unallowable or improper purposes.”<sup>12</sup>

The Grand Jury heard testimony from the current independent auditor for the Town of East Hampton who conducted an audit of all CPF expenditures from the funds inception onward. This work was performed after the State Comptroller's report on CPF.

The current auditors similarly found that in 2007 the Town of East Hampton improperly spent \$9,118,569.31 of CPF Funds on non CPF expenses. Their review found that in 2008 \$8,647,546.45 was reimbursed to the CPF as described above.<sup>13</sup>

However, these auditors, conducting a review of greater detail than performed previously, concluded that as of the end of fiscal year 2009 the CPF is still owed \$8,641,698.95.

The bulk of this newly discovered improper use of CPF Funds comes from a series of transactions that occurred in 2006. Specifically, in 2006 the Town of East

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<sup>12</sup> Peconic Bay Community Preservation Fund p 7-8.

<sup>13</sup> Grand Jury Exhibit #80

Hampton received \$10,000,000 from bonds obtained for the repayment of Bond Anticipation Notes sold to fund land preservation. The auditors found that \$8,230,915.49 of those funds never made it to CPF accounts, but were improperly used for other purposes unrelated to CPF.

The Grand Jury finds that the aforementioned abuse of the Community Preservation Fund has contributed significantly to the Town's financial problems.

## **V. BOND ANTICIPATION NOTES**

In 2007 the Town of East Hampton obtained four Bond Anticipation Notes (hereafter BANS). A BAN dated June 6, 2007 was obtained in the amount of \$5,689,000<sup>14</sup>; August 31, 2007 in the amount of \$6,583,000<sup>15</sup>; November 9, 2007 in the amount of \$8,214,000<sup>16</sup> and November 29, 2007 in the amount of \$3,000,000<sup>17</sup>.

Bond Anticipation Notes are accompanied by Official Statements. The Official Statement is a document prepared to induce investors to lend money pursuant to the terms of the BAN. The document contains representations as to the Town's financial condition, which is a critical risk factor weighed by potential investors. The Grand Jury heard testimony that the poor financial condition of a municipality may prevent an investor from lending money at all or it might cause an investor to increase the interest rate offered.

The Grand Jury heard testimony from the Town of East Hampton's financial advisor who prepared the Official Statements. The financial advisor

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<sup>14</sup> Grand Jury Exhibit #21

<sup>15</sup> Grand Jury Exhibit #22

<sup>16</sup> Grand Jury Exhibit #23

<sup>17</sup> Grand Jury Exhibit #24

**described how the Official Statements were created.**

**Information regarding the Town finances was obtained by the financial advisor from Town Employee C. Usually, audited figures would be included in the Official Statement to describe the state of the Town's finances. However, as set forth above, the last audit of the Town was received in September of 2005 relating to fiscal year 2004. The completed audit for the year 2005 was not available until September of 2007.**

**The June and August Official Statements contained representations as to 2005 finances that were from the unaudited Annual Update Document sent to the State of New York. Under the Section "Recent Operating Results", the claim is made that the Town's General Fund had a fund balance of \$4,266,000 and that the Part Town Fund had a balance of \$171,573.**

**However, Town Employee C was aware of very different information. Specifically, in September of 2006 the Town's auditors provided Town Employee C with a draft of the audit for 2005. The draft stated that General Fund balance was only \$1,950,041 and that the Part Town Fund had a deficit of \$1,444,408. This information was not provided to the financial advisor. Nor was the fact that \$8.2 million dollars had been improperly taken from CPF in 2006 to cover General Fund expenses.**

**In August, 2007 Town Employee C began writing checks for millions of dollars from the CPF Fund to cover unreported General Fund deficits. This use of CPF Funds was not revealed in the two November Official Statements.**

The 2005 Independent Audit was released in September, 2007.<sup>18</sup> The final figures showed a General Fund balance of \$4,142,352 and a Part Town Fund deficit of \$940,253. So significant was this information that Moody's lowered the Town's bond rating from Aa1 to A2.<sup>19</sup>

The Grand Jury heard testimony that funds obtained from these BANS and other securities were commingled with other funds and spent for purposes other than those stated in the Official Statement.

The Grand Jury heard testimony regarding the descriptions of pending litigation in Official Statements. A municipality must advise investors of pending litigation that might impact the Town's finances or its ability to repay loans. Two methods of reporting such litigation were supposed to be employed in 2007. First, the Official Statement would contain a representation that the Town Attorney had given an opinion as to pending litigation. Second, the investor would receive an Attorney's Certification at the closing that expressed an opinion by the Town Attorney regarding pending litigation.

Each of the aforementioned Official Statements contained the following statement:

#### LITIGATION

“Various notices of claim have been filed with the Town. The allegations set forth in the claims relate to various circumstances including personal injury, condemnation proceedings, civil rights violations and administrative determinations by Town officials. Certain claims asset money damages while others seek a specific action or forbearance on the part of the Town.

In the opinion of the Town Attorney, the resolution of such various other claims presently pending against the Town will not have an adverse material effect on the

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<sup>18</sup> Grand Jury Exhibit #44

<sup>19</sup> Grand Jury Exhibit #78

**Town's financial position. Such matters are immaterial or adequately covered by existing insurance coverage. Pursuant to the Local finance Law, the Town is authorized to issue debt to finance judgments and claims, if necessary."**

**The Town Attorney testified that she was never consulted about the four Official Statements and never gave the opinion in the statement above.**

**The Grand Jury heard testimony from the Town's Bond Counsel who was responsible for conducting the closings on the BANS. Bond Counsel testified that in error, no Attorney's Certifications were obtained or provided at the closings on the four BANS.**

**The Grand Jury finds that the claim in the Official Statement that the Town Attorney expressed an opinion is false. The usual methods used to ensure accurate information regarding litigation failed to the detriment of the Town of East Hampton and investors.**

## **VI. CAPITAL PROJECT FUNDS**

**The Grand Jury heard testimony from the Town's current auditors regarding Capital Project Funds. The preliminary findings of the auditors is that in many cases money received from Bonds for Capital Projects was used for General Fund expenses, not the purposes stated in the Bonds.**

**The auditors have concluded that approximately \$4,000,000 are owed from the General Fund to various Capital Projects.**

**The Grand Jury finds that the practice of using Capital Project money for General Fund purposes is improper and contributed to the financial decline of the Town of East Hampton.**

## CONCLUSION

The Grand Jury makes the following conclusions based upon the stated findings of fact:

The Town of East Hampton's financial condition was propelled into a state of crisis between 2003 and 2009 by Town Employees who destroyed the financial health of the Town. Trained professional accountants and lawyers gave critical advice regarding the Town's finances which was disregarded by certain Town employees to the detriment of Town of East Hampton residents.

The Grand Jury concludes that while Town of East Hampton faced mounting expenses, Town Officials failed to act responsibly to address the Town's fiscal issues. The Grand Jury finds that the Town's economy was thriving during the period in question but Town Officials failed to either raise taxes as needed or cut spending as required to function within the budget. Failure to tax and spend responsibly was motivated by concerns about political survival.

The Grand Jury concludes that the Town's current debt in excess of \$30,000,000 dollars was further generated by a willful disregard of the most basic accounting principles. By January 2009 no general ledger was being maintained. Fixed assets were not listed and appraised in 2005. Bank reconciliations were not performed for the eighteen months between July 2007 and January 2008. Monthly reports were not prepared after July of 2007. The Town had to function for two years without audited financial reports. In sum there was a complete collapse of fiscal management.

**The public and the Town Board were not made aware of illegal use of Community Preservation Funds. The irresponsible budgeting practices created a cash flow crisis that was solved in part by secretly and illegally accessing Community Preservation Funds. As of this report, the Community Preservation Fund is owed over \$8,000,000 dollars from the general fund.**

**The cash flow crisis was further hidden by the improper use of bonded funds obtained for Capital Projects. Capital Project Funds were commingled and approximately \$4,000,000 is owed by the General Fund to various Capital Projects.**

**Official Statements in support of Bond Anticipation Notes contained false information as to the Town's financial health and whether the Town Attorney had issued an opinion regarding pending litigation.**

**The Grand Jury finds the abuse of the bonding process particularly disturbing. While the Town is urged to engage in responsible budgeting practices, the need to preserve the Town's ability to engage in bonding is paramount. The Town must act diligently to keep its name and representations trustworthy.**

**The Grand Jury concludes that the Town Board should enact legislation creating liability and accountability for officials who delegate authority blindly.**

**The Grand Jury concludes that the preparation and disclosure of Official Statements for securities is of critical importance to accurate financial disclosure. The Grand Jury recommends that as a result of this investigation, the Supervisor be compelled to share a completed Official Statement with the town Board and the Town Attorney prior to its use. Furthermore, the Town Board should adopt legislation which would authorize the removal of the Supervisor from his office for**

**failure to know the truth of representations made in Official Statements. These requirements combined create a framework for the making of accurate and reliable representations as to the Town's finances in the future.**

**Town government should be an incubator of honesty and transparency. The fiscal powers of the executive and legislative branches of government should be well defined. The Grand Jury herein makes recommendations to compel the disclosure of accurate Town financial documents between the Supervisor and the Town Board. The public also should be provided with comprehensive information on past, current, and projected fiscal activity and major fiscal risks.**

**The Town of East Hampton has incurred significant debt because of the budgeting and expenditure practices described. The Grand Jury recommends that the Town of East Hampton form a committee to explore the potential need of balanced budget laws that would provide for maximum allowable deficits which, if missed, would trigger automatic across the board spending cuts.**

**Town of East Hampton taxpayers will now be saddled with costly deficit financing as a result of gross fiscal mismanagement. The Grand Jury concludes that safeguards recommended by the New York State Comptroller, the Town's independent auditors and this Grand Jury must be implemented earnestly to avoid the further financial destruction of the Town of East Hampton's finances.**

## RECOMMENDATIONS

Based upon the stated findings of fact and all of the evidence heretofore had before this Grand Jury and in order to protect the financial status of the Town of East Hampton and the best interest of the citizens of the Town of East Hampton; NOW THEREFORE, by the authority vested in this Grand Jury by Criminal Procedure Law; Section 190.85(1)(c); the following legislative, executive, and administrative actions are recommended in the public interest:

### LEGISLATIVE

1. The Town of East Hampton must accurately prepare a budget and conduct its affairs within the adopted budget parameter.
2. The Town of East Hampton must not make expenditures without first having an appropriation in place.
3. The Town Board of Trustees must establish procedures to effectively monitor the Town's budget.
4. The Town of East Hampton must implement recommendations made by independent auditors in management letters and notes.
5. The Town of East Hampton must require the employment of a qualified individual with an accounting degree who has experience in municipal finance.
6. The hiring of the accountant must be approved by a majority vote of the Town Board of Trustees.

- 7. The Town of East Hampton must adopt a law requiring that such an accountant position be maintained at all times and without lapse at change of administrations.**
- 8. The Town of East Hampton must create internal controls over Community Preservation Fund expenditures and receipts including accurate tracking of revenues, land acquisitions, salaries and stewardship expenses.**
- 9. Monthly reports must be made to the Town Board regarding the status of CPF accounts.**
- 10. The Town of East Hampton must require an annual stand alone audit of the CPF by an independent auditor to be funded as a stewardship expense.**
- 11. The Town Attorney must be kept apprised of the nature of CPF expenditures to ensure compliance with Town law.**
- 12. The CPF must be maintained in a separate account free from being commingled with other funds.**
- 13. The Town of East Hampton must develop an internal control system of policies and procedures in order to properly account for all fixed asset transactions.**
- 14. The Town of East Hampton fixed asset system must include procedures for accounting for additions, deletions, transfers and periodic physical counts of fixed assets in accordance with accounting principles generally accepted in the United States of America, and the recommendations contained in the Fiscal Management Guide for Local Governments, issued by the Office of the New York State Comptroller.**

- 15. The Town of East Hampton must adopt a procedure to require notification to the Town Board and Town Attorney of the contents of an Official Statement in support of all BANS, BONDS, RANS, TANS or other securities prior to the use or release of the Official Statement.**
- 16. The Town must adopt a statute which authorizes the removal of the Town Supervisor who signs an Official Statement in a security offering that contains false statements or representations and when the Supervisor (i) knew the truth; (ii) with reasonable effort could have known the truth; (iii) made no reasonable effort to ascertain the truth; or (iv) did not have knowledge concerning the representations of statements made.**
- 17. In instances where no Official Statement is needed for the acquisition of securities, the Town Board and Town Attorney must be notified in writing of the security sought.**
- 18. The Town Attorney must be consulted and give an opinion as to the status of pending litigation as part of the preparation of Official Statements.**
- 19. The Town of East Hampton must ensure that funds obtained from BANS, BONDS and other securities are used only for the stated purposes.**
- 20. The Town of East Hampton must assign a staff person the duties of collecting and providing information needed for the Official Statements.**
- 21. The Town of East Hampton must assign a staff employee the task of tracking the progress of Capital Projects.**
- 22. The Town of East Hampton must adopt a procedure to account for each Capital Project separately.**

23. **The Town of East Hampton must provide monthly reports of the status of Capital Projects to the Town Board.**
24. **Town Board members must be given unfettered access to Town financial records, including but not limited to Capital Project expenditures.**
25. **The Town of East Hampton must create a committee to review whether the Town should propose legislation commonly known as a “Balanced Budget Law” which would provide for maximum allowable deficits which if missed would trigger automatic across the board spending cuts.**

#### **EXECUTIVE**

1. **The Supervisor of the Town of East Hampton must introduce legislation consistent with the legislative recommendations in this report or, in the alternative, he must support legislation introduced by others. The Supervisor of the Town of East Hampton must commit appropriate budgetary resources necessary to implement the legislative recommendations.**

#### **ADMINISTRATIVE**

1. **Town of East Hampton departments affected by the changes implied in the legislative recommendations must be given the necessary authority to adopt administrative rules and regulations necessary for the effective implementation and execution of the legislative recommendations.**