

Waterloo Central School District

Financial Condition Management

OCTOBER 2019



OFFICE OF THE NEW YORK STATE COMPTROLLER
Thomas P. DiNapoli, State Comptroller

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Report Highlights

Waterloo Central School District

Audit Objective

Determine whether the Board and District officials adequately managed the District's financial condition.

Key Findings

District officials:

- Consistently adopted budgets that in total overestimated appropriations by \$9.3 million for 2015-16 through 2017-18.
- Approved more than \$9.3 million in unbudgeted year-end transfers to reserves and the capital projects fund.
- Maintained six reserves with balances totaling \$9.6 million as of June 30, 2018, that were potentially overfunded or unnecessary.

Key Recommendations

The Board and District officials should:

- Provide transparency by developing and adopting budgets that include reasonable estimates of appropriations.
- Comply with the statutory limit for fund balance and use surplus funds as a financing source for one-time expenditures, paying down debt or reducing property taxes.

District officials generally agreed with our recommendations and indicated they planned to initiate corrective action. Appendix B includes our comment on an issue raised in the District's response letter.

Background

The Waterloo Central School District (District) serves the Towns of Waterloo, Fayette, Seneca Falls, Junius and Tyre in Seneca County. The District is governed by an elected nine-member Board of Education (Board) which is responsible for the general management and control of the District's financial affairs.

The Superintendent of Schools is the chief executive officer and is responsible, along with other administrative staff, for the District's day-to-day management under the Board's direction. The Board appointed a Business Administrator, who is responsible for all aspects of the District's business and financial activities, including budgeting.

Quick Facts

Student Enrollment	1,592
2018-19 General Fund Appropriations	\$39.9 million
Total Balance of Reserve Funds as of June 30, 2018	\$20.4 million

Audit Period

July 1, 2015 – March 1, 2019

We extended our scope period forward through May 31, 2019, to review the 2019-20 adopted budget.

Financial Management

What is Effective Financial Condition Management?

To effectively manage a district's financial position, a board should adopt realistic and structurally balanced budgets based on historical data or known trends, in which recurring revenues finance recurring expenditures and reasonable levels of fund balance, are maintained. To provide for cash flow and unanticipated events, a district may retain a portion of fund balance, referred to as unrestricted fund balance. District officials should ensure that unrestricted fund balance does not exceed the amount allowed by New York State Law,¹ which currently limits unrestricted fund balance to no more than 4 percent of the following year's budget. Any unrestricted fund balance that exceeds the statutory limit should be used to pay for one-time expenditures, fund needed reserves, pay down debt or reduce the real property tax levy.

District officials are legally allowed to establish reserves for certain future purposes (e.g., retirement and tax certiorari). District officials should adopt a policy for the funding and use of reserves that balances the desire to accumulate funds for future needs with the obligation to make sure real property taxes are not higher than necessary. Ideally, amounts to be placed in reserves should be included in the annual budget to ensure taxpayers are aware of the board's intent to fund reserves in the upcoming year.²

A debt service fund is used to account for the accumulation of resources to pay principal and interest on long-term debt.³ Districts are also required to account for and restrict unexpended bond proceeds and related interest earnings in accordance with statutory provisions. Officials should use the money in this fund to make the related debt service payments. In addition, it is important for district officials to develop comprehensive multiyear financial and capital plans to estimate the future costs of ongoing services and future needs and plan for various methods or resources to finance them.

The Board Did Not Adopt Realistic Budgets and Was Not Transparent When Funding Reserves

The Board and District officials need to improve budgeting practices to ensure that budgets are realistic and avoid generating excessive surpluses. We compared appropriations and estimated revenues with actual operating results for 2015-16 through 2017-18. We found that overall District officials budgeted reasonably in most years for revenues; however, appropriations were overestimated by \$9.3 million (8.9 percent) during this period.

1 New York State Real Property Tax Law, Section 1318

2 Refer to our publication Reserve Funds available at www.osc.state.ny.us/localgov/pubs/lgmg/reservefunds.pdf

3 For example, a debt service fund must be established and maintained to account for the proceeds of a capital asset's sale that has outstanding debt or if State or federal aid is received for a capital improvement for which there is outstanding debt.

Figure 1: Overestimated Appropriations

	2015-16	2016-17	2017-18	Totals
Appropriations	\$37,541,922	\$38,240,492	\$38,974,398	\$114,756,812
Actual Expenditures^a	\$33,561,323	\$35,124,542	\$36,682,695	\$105,368,560
Overestimated Appropriations	\$3,980,599	\$3,115,950	\$2,291,703	\$9,388,252
Percentage Overestimated^b	11.9%	8.9%	6.2%	8.9%

a Less unbudgeted interfund transfers

b Calculated by dividing overestimated appropriations by actual expenditures

The most significant variances were in programs-students with disabilities (\$4.2 million or 21 percent), teaching-regular school (\$1.9 million or 8 percent), operation of plant (\$1.2 million or 23 percent) and hospital/medical/dental insurance (\$1.1 million or 11 percent). Although estimates for salaries should be readily attainable because they are based on employment contracts, the Business Administrator informed us that she generally budgets for an extra teacher in each instructional code and includes an additional \$1 million annually for programs-students with disabilities because the District does not know how many special needs students will be enrolled or the associated costs for the upcoming year.

As a result of the operating surpluses, District officials made unbudgeted year-end transfers to reserves of \$3.4 million and to the capital project fund of approximately \$5.9 million to keep the unrestricted fund balance under the 4 percent statutory limit.

We reviewed the 2018-19 appropriations and compared them to historical trends and year-to-date operating results⁴ and found the District is continuing its historical pattern of overestimating appropriations, which will likely result in an operating surplus at the end of the current year and the additional accumulation of fund balance in excess of the District's needs. We also reviewed the approved 2019-20 budget and noted it included a tax levy decrease of 0.80 percent. However, we did note that while estimated revenues appear reasonable, District officials continued the past practice of overestimating appropriations, based upon historical trends, which is likely to result in another operating surplus.

Budgeting practices that annually overestimate appropriations and officials' decisions to make unbudgeted year-end transfers instead of appropriating excessive unrestricted fund balance can result in real property tax levies that are higher than necessary and budgets that are not effective tools for financial management. Presenting complete budget information to taxpayers allows them the opportunity to make informed decisions when voting on the budget.

4 Through March 27, 2019

The Board Overfunded and Did Not Use Reserves

Although the Board adopted a reserve fund policy, the policy did not address optimal funding levels, conditions necessary for use or how and when reserve funds would be replenished. Additionally, the reserve fund policy does not include an analysis that projects expenditures to support the balances in all the reserve funds. In order to stay within the 4 percent fund balance limit, District officials made unbudgeted transfers of surplus funds to reserves at the end of the fiscal year. As a result, general fund reserves increased by \$2.3 million over the last three completed fiscal years. As of June 30, 2018, the District reported a debt service reserve and 10 general fund reserves⁵ with balances totaling \$20.4 million, or 51 percent of the District's annual budget.

We found six reserves, with balances totaling \$9.6 million (47 percent of total reserves) as of June 30, 2018, are potentially overfunded or unnecessary. Specifically:

- Debt Service Reserve⁶ - The \$4.1 million balance as of June 30, 2018 has been accumulating interest for more than 10 years. This reserve is related to prior capital projects. District officials could not provide the exact projects the debt service fund was established for and the balance has not been used to pay down current debt. Therefore, the balance should be added back to the unrestricted fund balance in the general fund in accordance with regulations.
- Retirement Contribution Reserve - Recent legislation amended New York State (NYS) General Municipal Law (GML)⁷ allowing the District to eventually fund a sub-account within this reserve for contributions to the NYS Teachers' Retirement System (TRS) of up to 10 percent of the of the prior year's total compensation or salaries of all teachers who are members of the TRS. Accounting for this new legislation, once fully implemented and funded by the Board, the District's TRS sub-account would have been capped for the current year at \$1,125,242. The remaining \$2.8 million currently in this reserve is sufficient to cover over seven years of full retirement costs with the NYS and Local Retirement System (a separate system), which averaged about \$369,000 over the last three years. Historically, District officials have not used this reserve to fund retirement contributions. Instead, they consistently budget for this expenditure to be fully funded through the District's annual budget appropriations. Therefore, we question the need for this reserve to be funded at this level.

5 The reserves included retirement, workers' compensation, unemployment, tax certiorari, insurance, liability, employee benefit accrued liability, capital, capital-bus and repair.

6 Refer to the report section entitled, "Funds Were Improperly Restricted in the Debt Service Fund" for additional discussion.

7 New York State General Municipal Law Section 6-r

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- Workers' Compensation Reserve - The balance of this reserve as of June 30, 2018 was \$432,712, which could cover the District's annual workers' compensation costs for 2.4 years.⁸ This reserve has not been used in the past three years as District officials have budgeted for and paid these costs from the general fund. Therefore, we question the need for this reserve fund at this level.
 - Unemployment Insurance Reserve –The District's established reserve plan states it shall cover the cost of 20 employees at \$405 per week for the maximum benefit period of 26 weeks.⁹ We noted that the District's reserve plan is inconsistent with current law, which as of October 1, 2018, allows for a maximum benefit of \$450 per week for 26 weeks.¹⁰ Allowing for the current maximum benefit the District's 20-employee limit would be \$234,000. The District made payments to the NYS Unemployment Insurance Fund from 2015-16 through 2017-18, which averaged \$14,000 annually. The reserve balance of \$393,222 as of June 30, 2018 exceeds the District's established plan for this reserve by \$159,222 and furthermore is sufficient to cover 28 years of the District's average annual unemployment costs. Therefore, we question the need for funding this reserve at this level.
 - Insurance Reserve - This reserve is available for the payment of any loss, claim, action or judgment for which the District is authorized or required to purchase insurance, except those already covered by another existing reserve fund. As of June 30, 2018, the reserve fund balance totaled \$381,436. Due to the inactivity in this reserve for the past three fiscal years, we question if this reserve is necessary.
 - Liability Insurance Reserve - The District established this reserve to protect itself from unresolved land claims and occasional lawsuits that put the District at risk. As of June 30, 2018, the reserve balance totaled \$345,469. The District has not used this reserve in the last three years and has an insurance reserve and a tax certiorari reserve, which may also be used to cover similar expenditures. Therefore, we question if this reserve is necessary.

While it is prudent to plan and provide for unforeseen circumstances, overfunding and/or not using reserves for their intended purpose results in property taxes being higher than necessary because the funds are not being used to fund operations.

8 Based on the District's three year average annual expenditures of \$184,000

9 A total of \$10,530 per employee, or \$210,600 total

10 The NYS unemployment maximum benefit as of April 9, 2019 is \$11,700, or \$450 per week for 26 weeks.

Funds Were Improperly Restricted in the Debt Service Fund

The District accounts for and reports a debt reserve in the debt service fund, which is separate from the general fund. As of June 30, 2018, this reserve had a reported balance of \$4.1 million. While certain funds are required by law to be set aside and used to pay related debt, District officials told us that these funds were not related to current outstanding debt. Instead, they are from interest on previous bond issues that were paid off at least 10 years ago and, therefore, are not required to be legally restricted. In addition, the District's debt service expenditures averaged about \$6 million annually for 2015-16 through 2017-18. However, the District did not use the debt service reserve to pay these costs, which were budgeted for and paid from the general fund.

Without a valid legal requirement to restrict these funds, District officials do not have the statutory authority to establish a reserve or otherwise set aside surplus fund balance in the debt service fund. Therefore, these funds should be added to unrestricted fund balance in the general fund. When these funds are added back to the surplus fund balance at the end of the 2018-19 fiscal year, the unrestricted fund balance would have exceeded the statutory limit by 10 percentage points.

The Board Did Not Adopt Adequate Multiyear Financial and Capital Plans

The Board did not develop or adopt comprehensive, multiyear financial and capital plans. Such plans for a three- to five-year period would be useful tools for the Board to address the fund balance in the general and capital reserve¹¹ funds and to outline the Board's intentions for financing future capital improvements and maintaining the existing infrastructure. The lack of detailed multiyear plans inhibits District officials' ability to effectively manage District finances and address future needs. As the District moves forward, well-designed written multiyear plans can assist the Board and District officials in making timely and informed decisions about programs and operations and help them effectively manage fund balance in the best interest of District taxpayers.

¹¹ \$9,643,000 as of June 30, 2018

What Do We Recommend?

The Board and District officials should:

1. Provide transparency by developing and adopting budgets that include reasonable estimates for appropriations.
2. Develop a plan to comply with the statutory limit of unrestricted fund balance. Surplus funds can be used as a financing source for:
 - Funding one-time expenditures.
 - Funding needed reserves.
 - Paying off debt.
 - Reducing District property taxes.
3. Adopt a more comprehensive reserve fund policy that includes how the reserves will be funded, the optimal funding levels for each reserve, the conditions under which reserves will be used to finance related costs, and how excess amounts may be used in accordance with applicable statutes in a manner that benefits taxpayers.
4. Transfer money improperly residing in the debt service fund to unrestricted fund balance in the general fund.
5. Develop and adopt comprehensive multiyear financial and capital plans for a three- to five-year period, to be used in conjunction with the annual budget process. These plans should be monitored and updated on an ongoing basis.

Appendix A: Response From District Officials



Waterloo Central School District

Terri Bavis, Superintendent of Schools
Joanne Slauson, Business Administrator
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September 5, 2019

Edward V. Grant, Chief Examiner
The Powers Building
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Rochester, N.Y. 13614-1608

Dear Mr. Grant;

The Waterloo Central School District has received and reviewed the draft Financial Condition Report Examination (2019M-137) for the audit period July 1, 2015 to May 31, 2019. On behalf of WCSD's Board of Education and administrative team, we sincerely appreciate the hard work and professionalism exhibited by the audit team while they were in Waterloo. This letter includes both the district's response to the report and the corrective action plan. The action plan was reviewed by the Board of Education Finance Committee on September 4, 2019 and as anticipated to be approved by our Board of Education on September 16, 2019.

WCSD's Board of Education always seeks to balance its ongoing commitment to be fiscally responsible stewards of our stakeholders' tax dollars, while simultaneously continuing to provide a strong educational program for our students. Concurrently, the district must abide by evolving financial constraints from state and federal laws, regulations, mandates and requirements. The Waterloo Board of Education spends many months developing sound budgets and fiscal practices that balance the priorities of the school district community.

We were pleased to receive your comments that overall District officials budgeted reasonably in most years for revenues. The district also appreciates the auditor's understanding that it is prudent to plan and provide for unseen circumstances. We wholly agree with this statement.

Please allow this letter to serve as the District's response to the Draft Audit's findings.

Based on the Comptroller's recommendations, WCSD will execute the following action plan:

1. Continue to provide transparent budgets that include reasonable estimates for appropriations. The Waterloo Central School District has annually developed and shared the budget process in open session. When the final budget for the next school year is developed in February and March there are many contingencies and unknowns for which the Board of Education must plan. Some of these contingencies may not be known until well into the budget year. These contingencies may occur at any time and may be significant. To be fiscally responsible, we must plan for the potential unknown. The district plans for as many contingencies as possible, with the realization that many increases will not only be for the current year, but may impact the district many years into the future based on student needs unknown to us at the time the budget is developed. Additionally, revenues can also be potentially unknown at the time of budget adoption. State aid, BOCES aid and PILOTS are not always known when working through the budget development process.

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2. The district will continue to comply with the statutory limit of unrestricted balance funds, appropriately use surplus funds for one-time expenditures, continue to fund needed reserves, continue to pay off debt and when possible, as in the 2019-20 budget, to reduce district property taxes. The District and WCSD Board will continue to review all balances for reasonableness and ensure continued compliance with the law. District property taxes were reduced by 0.8% in the 2019-20 WCSD Budget. In the past years the district has conservatively kept the tax levy increase low to slowly decrease the unrestricted fund balance. In 2017-2018 the increase was .36%, 2018-2019 .99% and in 2019-2020 the tax levy was decreased by .80%. The WCSD Board of Education Finance Committee has longitudinally analyzed the impact of a tax levy decrease in conjunction with the tax cap restriction, to avoid the need for the public to approve a budget that is above the tax cap calculation. The Waterloo School District understands and is sympathetic to the hardship that increased taxes cause for our community. The interest of the WCSD Board is to keep tax rates consistent in the future. Thoughtfully planned budgets allow for building strong reserves.
 3. The Board is very responsible in monitoring the district spending and reserves. The Board of Education and Board Finance Committee will continue to enhance our current documents, creating a more comprehensive reserve plan. We feel we have handled our reserve funds properly and carefully in the past, resulting in an A1 Bond rating from Moody's Investor's Service. This enables us to borrow, when needed, at favorable interest rates, which is a benefit to our taxpayers. The Board of Education and Board Finance Committee will work collaboratively with our financial advisors to continue to plan for future utilization of funds.
 4. The Board of Education and the Board Finance Committee will use the debt service fund to support the debt service payments based on a written plan, spanning the next ten years. The use of this debt service will minimize the impact to the tax cap calculation and maximize the long-term financial health of the district.
 5. The district will continue to develop, adopt and update comprehensive multiyear financial and capital plans for three, five, and ten-year periods to be considered in the annual budget development process. We are currently in the process of developing a ten-year plan for funding capital projects and incorporating the use of the debt service fund to finance these projects. This will provide us with the opportunity of a zero impact to the community when undertaking capital project work.

See Note 1 Page 10

We appreciate the Office of the Comptroller's review of the District's financial condition management. We continue to look for ways to maintain the quality of our educational programs and to continually improve our budget and financial processes, which allows us to be fiscally responsible to our community.

Sincerely,

Ellen Hughes
Board of Education

Terri Bavis
Superintendent

Appendix B: OSC Comment on the District's Response

Note 1

Because the balance of the debt service fund is not related to current outstanding debt, there is no valid legal requirement to restrict these funds. These funds are available for operations and should be added to unrestricted fund balance in the general fund. Current debt service funds should not be used to support unrelated payments on future bond issues.

Appendix C: Audit Methodology and Standards

We conducted this audit pursuant to Article V, Section 1 of the State Constitution and the State Comptroller's authority as set forth in Article 3 of the New York State General Municipal Law. To achieve the audit objective and obtain valid audit evidence, our audit procedures included the following:

- We interviewed District officials and reviewed policies and procedures to gain an understanding of the budgeting and financial management process and procedures, including the rationale for determining the levels to maintain for unrestricted fund balance and reserves.
- We compared budget estimates to actual results for 2015-16 through 2017-18. We also compared the 2018-19 adopted budget to determine whether any significant changes had been made to the District's budgeting practices. Additionally, we reviewed the 2019-2020 adopted budget to determine its effect on the tax levy and compliance with the tax cap limit.
- We calculated operating results for the past three years and assessed if reserves were used as budgeted.
- We calculated unrestricted fund balance as a percentage of the next year's appropriations to assess District compliance with statute.
- We analyzed the debt service fund balance and activity to determine amounts that accounted for the balance and whether the fund was used to make debt payments.
- We reviewed and analyzed reserve fund balances to determine whether reserves were properly established and whether reserve balances were reasonable, properly supported and/or being used as intended.
- We recalculated unrestricted fund balance as a percentage of the next year's appropriations after adding back unused appropriated fund balance, the inappropriate debt service reserve and the overfunded/unnecessary reserve funds.

We conducted this performance audit in accordance with GAGAS (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.

A written corrective action plan (CAP) that addresses the findings and recommendations in this report must be prepared and provided to our office within 90 days, pursuant to Section 35 of General Municipal Law, Section 2116-1(3) (c) of New York State Education Law and Section 170.12 of the Regulations of the Commissioner of Education. To the extent practicable, implementation of the CAP must begin by the end of the 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 the CAP available for public review in the Clerk's office.

Appendix D: Resources and Services

Regional Office Directory

www.osc.state.ny.us/localgov/regional_directory.pdf

Cost-Saving Ideas – Resources, advice and assistance on cost-saving ideas

www.osc.state.ny.us/localgov/costsavings/index.htm

Fiscal Stress Monitoring – Resources for local government officials experiencing fiscal problems

www.osc.state.ny.us/localgov/fiscalmonitoring/index.htm

Local Government Management Guides – Series of publications that include technical information and suggested practices for local government management

www.osc.state.ny.us/localgov/pubs/listacctg.htm#lmgm

Planning and Budgeting Guides – Resources for developing multiyear financial, capital, strategic and other plans

www.osc.state.ny.us/localgov/planbudget/index.htm

Protecting Sensitive Data and Other Local Government Assets – A non-technical cybersecurity guide for local government leaders

www.osc.state.ny.us/localgov/pubs/cyber-security-guide.pdf

Required Reporting – Information and resources for reports and forms that are filed with the Office of the State Comptroller

www.osc.state.ny.us/localgov/finreporting/index.htm

Research Reports/Publications – Reports on major policy issues facing local governments and State policy-makers

www.osc.state.ny.us/localgov/researchpubs/index.htm

Training – Resources for local government officials on in-person and online training opportunities on a wide range of topics

www.osc.state.ny.us/localgov/academy/index.htm

Contact

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