



Niagara Falls Water Board Financial Management

Report of Examination

Period Covered:

January 1, 2013 – April 30, 2015

2015M-141



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State of New York Office of the State Comptroller

Division of Local Government and School Accountability

March 2016

Dear Water Board Officials:

A top priority of the Office of the State Comptroller is to help officials manage their public authorities efficiently and effectively and, by so doing, provide accountability for tax dollars spent to support public authority operations. The Comptroller oversees the fiscal affairs of public authorities statewide, as well as their compliance with relevant statutes and observance of good business practices. This fiscal oversight is accomplished, in part, through our audits, which identify opportunities for improving operations and Board governance. Audits also can identify strategies to reduce costs and to strengthen controls intended to safeguard assets.

Following is a report of our audit of the Niagara Falls Water Board, entitled Financial Management. This audit was conducted pursuant to the State Comptroller's authority as set forth in Article X, Section 5 of the State Constitution and Sections 1230-x and 2803 of the New York State Public Authorities Law.

This audit's results and recommendations are resources for Water Board officials to use in effectively managing operations and in meeting the expectations of taxpayers. If you have questions about this report, please feel free to contact the local regional office for your county, as listed at the end of this report.

Respectfully submitted,

*Office of the State Comptroller
Division of Local Government
and School Accountability*

Introduction

Background

The Niagara Falls Water Board (Water Board) and the Niagara Falls Public Water Authority (Authority) are public benefit corporations which were created in 2002 by a special act of the New York State Legislature.¹

The Water Board is governed by a five-member board (Board). Board members are appointed by the Governor, the State Senate, the State Assembly, the Mayor of the City of Niagara Falls (Mayor) and the City Council. The Water Board's day-to-day operations are supervised by an Executive Director appointed by the Board. The Director of Financial Services is responsible for overseeing the financial operations of the Water Board. The Director of Technical and Regulatory Services is responsible, along with other administrators and consultants, for preparing the Capital Improvement Plan (Plan).

The Authority is governed by a three-member board appointed by the Mayor, the State Senate and the State Assembly. The primary responsibility undertaken by the Authority has been issuing debt to finance capital projects of the Water Board.

The Water Board owns and operates the City of Niagara Falls' (City) drinking water, wastewater and storm water systems (System) and facilities. These facilities were purchased by the Water Board from the City in September 2003 with the proceeds of debt issued by the Authority. The operating budget for 2015 totaled \$29.8 million and included appropriations for the Water Authority and Water Board. Revenues are derived from the fees, rents and service charges established by the Water Board.

Objective

The objective of our audit was to determine if the Board is managing Water Board finances in accordance with the governing agreements and New York State Public Authorities Law (PAL). Our audit addressed the following related question:

- Did the Board properly separate Water Board finances from Authority finances?

Scope and Methodology

We examined the Water Board's records and reports for the period January 1, 2013 through April 30, 2015. We reviewed transactions that occurred prior to January 1, 2013 to complete our audit objective.

¹ See Laws of 2002, chapters 257 and 325, and enacting Public Authorities Law Titles 10-B and 10-C.

We also reviewed certain records and reports of the Authority related to our audit of the Water Board.

We conducted our audit in accordance with generally accepted government auditing standards (GAGAS). More information on such standards and the methodology used in performing this audit is included in Appendix B of this report. Unless otherwise indicated in this report, samples for testing were selected based on professional judgment, as it was not the intent to project the results onto the entire population. Where applicable, information is presented concerning the value and/or size of the relevant population and the sample selected for examination.

**Comments of
Water Board Officials
and Corrective Action**

The results of our audit and recommendations have been discussed with Water Board officials, and their comments, which appear in Appendix A, have been considered in preparing this report. Water Board officials agreed with our findings and plan to implement corrective action.

Within 90 days after the receipt of this final report, the Chair of the Board, as provided in New York State Executive Law Section 170, is required to report to the Governor, the State Comptroller and Leaders of the State Legislature and the fiscal committees of the State Legislature advising what steps were taken to implement the recommendations contained herein and, where recommendations were not implemented, the reasons why.

Financial Management

In addition to the special acts which created them, the framework through which Water Board and Authority finances are governed are set forth in an Acquisition Agreement,² a Financing Agreement,³ an Operations Agreement⁴ and a General Revenue Bond Resolution (Resolution).⁵ These governing documents and the enabling acts set forth specific guidelines and responsibilities for preparing the annual budget, accounting records and financial reports and for establishing the funds, reserves and accounts required by the Water Board and Authority. For example, the Financing Agreement states that the Water Board must include a provision for Board expenses⁶ in the annual budget for the ensuing fiscal year, as well as for the amount, if any, to be required to be deposited in certain other accounts. In addition, pursuant to the Financing Agreement, at least 60 days prior to the start of the fiscal year, the Authority is required to deliver to the Water Board a certified copy of the Authority's budget for the ensuing fiscal year showing its operating expenses⁷ and debt service costs for such fiscal year. Furthermore, both the Water Board and the Authority must keep, or cause to be kept, proper accounting records which contain complete and correct entries of all financial transactions relating to their respective corporate purposes and annually obtain an audit of records by a certified public accounting firm.

The Water Board's and Authority's finances are commingled to the extent that there is no clear division between the two entities. The Water Board performs essentially all the financial operations with very little involvement from the Authority. The Water Board maintains the Authority's bank accounts, and it prepares the budget and maintains accounting records for both entities. For financial reporting purposes, the Authority is presented as a blended component unit of the Water

² The Acquisition Agreement is between the Water Board and the City.

³ The Financing Agreement is between the Water Board and the Authority.

⁴ The Operations Agreement is among the Water Board, the Authority and the City.

⁵ The Resolution, dated May 1, 2003, states that it is deemed to constitute a contract among the Authority and a bank, appointed as trustee.

⁶ Water Board expenses are defined as all operating expenses, including salaries and fringe benefits; administrative, engineering, advertising, auditing, accounting and legal expenses; insurance premiums; consultants' fees; and charges and costs of improvements to the system not otherwise paid from the Water Board Construction Account.

⁷ Authority expenses are defined as salaries and fringe benefits; administrative, general, engineering, advertising, auditing, accounting and legal expenses; insurance; consultants' fees; and all other expenses necessary, incidental or convenient for the efficient operation of the Authority.

Board in the Water Board's audited financial statements.⁸ The Water Board's financial statements for the fiscal year ended December 31, 2014 commingled Water Board and Authority cash without indicating how much was attributed to each entity. Consequently, a user of the financial statements would likely incorrectly conclude that all the financial data reported pertained to the Water Board.

Local Water Fund

The enabling legislation for the Authority establishes a Local Water Fund⁹ held in the custody of the Board. According to the Financing Agreement, the Board shall establish five special accounts or sub-funds within the Local Water Fund, including the Water Board General Account, the Water Board Construction Account, the Water Board Expense Account, the Water Board Operations and Maintenance Reserve Account and the Water Board PILOT¹⁰ Payment Account. Under the Resolution, in addition to an operating fund, known as the Authority Expense Fund, the Trustee is required to maintain the Authority Debt Service Fund, the Authority Debt Service Reserve Fund and the Authority Construction Fund, among others.

According to the Financing Agreement, all revenue, including revenues derived from the fees, rents and service charges established by the Water Board, shall be promptly deposited into the Water Board General Account. Revenues in the Water Board General Account shall be kept separate and shall not be commingled with any other money in the custody of the Water Board. The Financing Agreement also indicates the priority in which disbursements from the Water Board General Account are to be applied each month:

1. Authority Debt Service Fund and Authority Expense Fund.
2. Water Board Expense Account.
3. Authority Debt Service Reserve Fund and the Water Board Operations and Maintenance Reserve.
4. Water Board PILOT Payment Account.¹¹

⁸ With respect to blending component units for financial statement presentation purposes, the Governmental Accounting Standards Board states that "because the primary government's general fund is usually the main operating fund of the reporting entity and often is a focal point for report users, its general fund should be the only general fund for the reporting entity. The general fund of a blended component unit should be reported as a special revenue fund." We note that the Authority's accounts were not reported as a special revenue fund in the Water Board's financial statements.

⁹ See PAL Section 1230-j(2)

¹⁰ Payments in Lieu of Taxes (PILOT) generally are amounts paid by the owners of certain tax-exempt parcels in an amount equal to all or a portion of the taxes that would otherwise have been levied, had the property not been tax-exempt.

¹¹ The PILOT Payment Account is used to record the annual payments to the City required by the Operations Agreement.

5. Water Board Construction Account.
6. Any surplus to the Water Board Operations and Maintenance Reserve.

We noted that revenue collected was appropriately deposited into the Water Board General Account as required. We also reviewed 71 disbursements from the Water Board General Account during 2012, 2013 and 2014 and found that revenue collected was applied in the order described in the Financing Agreement. However, the Water Board deposited more cash than needed in the Authority Debt Service Fund and commingled Water Board revenue and surplus funds with the proceeds of debt issued by the Authority in the Authority Construction Fund.

Authority Debt Service Fund

The Trustee for the Authority's Bonds is required by the Resolution to maintain the Debt Service Fund. The Authority's annual debt service payments are funded by revenue collected by the Water Board. Each month, the Water Board deposits cash¹² into the Debt Service Fund. The Trustee periodically makes principal and interest payments to bondholders as they become due, without further direction from the Authority or the Water Board.

Each fiscal year, the Board includes debt service appropriations in the adopted budget for the required annual payments. For example, for 2014 the Board budgeted \$7.7 million for debt service costs, while actual debt service costs totaled \$7.6 million. Similarly, budgeted and actual debt service costs in 2013 were \$7.4 million. However, the Water Board deposited more money than necessary into the fund to pay debt service costs. In 2014, \$7.8 million was deposited and in 2013, \$7.7 million was deposited into the fund. Moreover, an additional \$3.3 million was deposited into the fund when it was initially established in 2003. This amount was not used to pay any debt service costs and remained in the account as of December 31, 2015. Water Board officials were unsure why this extra deposit was made. The fund's cash balance was \$6.3 million as of December 31, 2015. Since debt service costs are entirely funded by appropriations included in the Water Board's annual budget, there is excess cash in this account. While we recognize that this excess cash provides additional security for bondholders and allows for cash flow, the excess not needed for cash flow could be used to fund capital projects or repairs or used to reduce the water and sewer rent rates charged to ratepayers.

Water Board officials indicate that a covenant in the Financing

¹² The minimum monthly balance to be deposited with the trustee to fund debt service costs is defined in the financing agreement as the sum of monthly accrued principal and interest on outstanding debt.

Agreement requires them to collect revenues equal to 115 percent of the debt service payments. However, the covenant does not indicate that the extra 15 percent of revenue collected must be deposited into the Debt Service Fund and accumulated over time.

Water Board Operations and Maintenance Reserve

The Water Board Operations and Maintenance Reserve is an account created to fund extraordinary repairs to the System or payments to the City if there is an insufficient amount of cash in the Water Board Expense Account. The reserve may also be used for any other purpose deemed acceptable by the Board. The Financing Agreement states that deposits into the reserve should be made from budgeted appropriations and the annual operating surplus. The balance as of December 31, 2014 was just over \$7 million.

We found that the reported operating surplus of \$4.5 million for 2013 in the Local Water Fund was not deposited into this reserve. Rather, the Water Board deposited the operating surplus into the Authority Construction Fund, which consists of Authority bond proceeds and certain other Water Board revenue (see below). The Director of Financial Services indicated that management felt there were excess funds in the Water Board Operations and Maintenance Reserve. However, we question whether the Water Board should deposit cash generated from an operating surplus into the Construction Fund, an Authority account in the custody of the trustee, because the Board was not using the fund in accordance with the governing agreements.

Water Board Construction Account and Authority Construction Fund

The Financing Agreement requires the Water Board to maintain a Construction Account (an account distinct from the Authority's Construction fund). Amounts deposited into the Water Board Construction Account should include the amount budgeted by the Water Board in the operating budget to fund projects that the Water Board undertakes without the need for financing by the Authority.

The Resolution requires the Authority to establish and maintain a Construction Fund that is held by the trustee. The fund should consist of bond proceeds and certain other money and is to be held separately from other funds and accounts. Payments from the fund shall be for capital projects funded by bond proceeds. Bond proceeds are typically considered to be a restricted asset of the issuer until spent.

Water Board officials combined the Water Board Construction Account and the Authority Construction Fund into one account that is in the custody of the Authority's trustee. The Water Board commingled the bond proceeds obtained by the Authority with other money set aside for construction projects by the Water Board. The payments the trustee made from the Authority Construction Fund at the direction of the Water Board were part of the monthly financial report to the Water Board. None of the payments were reviewed by the Authority.

From January 1, 2012 through December 31, 2014, Water Board officials deposited \$25.2 million into the Authority Construction Fund,¹³ consisting of New York Power Authority (NYPA) grant money (\$3.1 million), bond proceeds (\$10 million), flood insurance reimbursements (\$3.5 million), coverage transfer¹⁴ and surplus¹⁵ (\$8.5 million) and other miscellaneous deposits, such as interest and refunds (\$32,500). Capital expenditures during this period totaled \$20.8 million. The balance in the account was \$4.5 million as of December 31, 2014.

The Water Board's Plan lists capital projects ongoing or expected to commence in the current fiscal year and the ensuing four fiscal years, as well as projects that are envisioned for the future. The projects are categorized by Wastewater Infrastructure, Water Infrastructure and Combined Projects (both water and wastewater). The Plan indicates the anticipated funding source for each project. The Plan is typically approved by the Water Board multiple times a year as needed. Water Board officials do not track the funds that were actually used to finance the projects, but merely track the expenditures made for all projects using a spreadsheet. Each month, beginning in 2014, the total transactions are entered into the financial system.¹⁶ Therefore, there is no way to ascertain what types of funds (bond proceeds, grants or Local Water Fund money) were used to pay for each project and the sources of the remaining cash balance.

In April 2013, the Board asked the Authority to finance \$10 million "of improvements to the System." At the time of this request, the Board had \$10 million in the Local Water Fund money market account, \$15 million in grant money from NYPA which was to be used for construction projects, \$2.7 million in the Water Board Operations and Maintenance Reserve and more than \$6 million in excess funds in the Authority Debt Service Fund and Authority Debt Service Reserve Fund. As shown in the Plan, the Water Board and Authority had anticipated needing bond proceeds to fund only two projects.¹⁷

We question why the entities would agree to issue \$10 million in bonds when cash from other sources was available. The bond proceeds

¹³ The fund had a balance of approximately \$175,000 as of January 1, 2012.

¹⁴ The appropriation included in the Water Board's annual operating budget to be added to the Water Board Construction Account is known as the "coverage transfer."

¹⁵ According to the Financing Agreement, remaining surplus is to be deposited into the Water Board Operations and Maintenance Reserve.

¹⁶ Prior to 2014 capital expenditures were only entered into the general ledger at year end, in total.

¹⁷ The two projects in the Plan that were to be funded with bond proceeds were a \$1.4 million Meter Replacement Program and a \$780,000 Wastewater Treatment Plan Rehab.

were placed in the Authority Construction Fund where they were commingled with the Water Board's cash. The final cost of the two projects totaled \$2.2 million. However, since the difference between deposits and disbursements from the Authority Construction Fund was \$4.4 million, it appears that bond proceeds were used for capital projects in the Plan that were intended to be funded with revenue from sources other than debt proceeds.

It is important to properly delineate and report the financial resources of the Water Board and Authority. The governing agreements and PAL set forth specific guidelines and responsibilities to achieve this goal.

Recommendations

The Board should:

1. Ensure that Water Board and Water Authority finances are managed in accordance with the terms of the governing agreements, resolutions and statutory requirements, and are properly reported.
2. Use the excess cash in the Debt Service Fund for capital projects, for repairs or to reduce the water and sewer rent rates charged to ratepayers.
3. Analyze the cash balance in the Authority Construction Fund to determine if any cash should be transferred to the Water Board Construction Account or returned to the Water Board Operations and Maintenance Reserve.
4. Fund capital projects as documented in the approved Plan and document the source of funds (bond proceeds, grants or Local Water Fund money) that were used to pay for each project.

APPENDIX A

RESPONSE FROM WATER BOARD OFFICIALS

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



March 8, 2016

Office of the State Comptroller
Buffalo Regional Office
Jeffrey D. Mazula, Chief Examiner
295 Main Street, Suite 1032
Buffalo, New York 14203-2510

Dear Mr. Mazula:

The Niagara Falls Water Board (NFWB) submits the following in response to the recommendations of the recent Office of the State Comptroller's audit.

- 1.) Ensure that Water Board and Water Authority finances are managed in accordance with the terms of the governing agreements, resolutions and statutory requirements and properly reported.**

The Niagara Falls Water Board uses an Enterprise Fund presentation under the guidance of Governmental Accounting Standards Board No. 34 which is used to report activities for which a fee is charged to external users for goods or services. Under this reporting presentation it is not possible to report the Authority, a blended component unit, as a special revenue fund in the Board's basic financial statements. We agree with the recommendation and will discuss with our external auditors options for reporting the Authority information as supplementary information to the basic financial statements.

- 2.) Use the excess cash in the Debt Service Fund for capital projects, repairs or to reduce the water and sewer rent rates charged to ratepayers.**

We agree with the recommendation to analyze the current debt service fund, including the \$3.3m initial deposit made in 2003. If it is determined that excess cash exists that is not restricted under contractual agreements, the Board will determine use of these funds in accordance with the terms of the governing agreements.

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- 3.) Analyze the cash balance in the Authority Construction Fund to determine if any cash should be transferred to the Water Board Construction Account or returned to the Water Board Operations and Maintenance Reserve.

We agree with the recommendation. Board management will analyze the Authority Construction Fund account to only maintain bond proceeds issued by the Authority within this account.

- 4.) Fund capital projects as documented in the approved Plan and document the source of funds (bond proceeds, grants, or Local Water Fund money) that were used to pay for each project.

The Board funds capital projects consistent with the restricted use of funds as documented in approved bond resolutions and governing agreements. We agree with the recommendation and will explore alternatives to better document the funding source on an ongoing project by project basis.

We will develop a corrective action plan to address each of these areas going forward. Our corrective action plan will further evaluate and expand on the recommendations provided by the Office of the State Comptroller.

Respectfully,

Paul J. Drof
Executive Director

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APPENDIX B

AUDIT METHODOLOGY AND STANDARDS

To accomplish our audit objective and to obtain valid audit evidence, our audit procedures for financial management included the following:

- We interviewed Water Board officials to gain an understanding of the financial management of the Water Board and Authority.
- We reviewed the Water Board's and the Authority Board's minutes and policies and procedures.
- We reviewed the Water Board's and Authority's agreements and contracts governing financial management.
- We reviewed the Water Board's and Authority's bank accounts and banking activity.
- We reviewed the Water Board's and Authority's funds and reserves to determine if they were adequately funded and used appropriately and in accordance with the governing agreements and PAL.

We conducted this performance audit in accordance with GAGAS. 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.

APPENDIX C

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AND SCHOOL ACCOUNTABILITY

Andrew A. SanFilippo, Executive Deputy Comptroller
Gabriel F. Deyo, Deputy Comptroller
Tracey Hitchen Boyd, Assistant Comptroller

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