



West Hempstead Water District Life Insurance

Report of Examination

Period Covered:

January 1, 2015 — July 31, 2016

2016M-393



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State of New York Office of the State Comptroller

Division of Local Government and School Accountability

March 2017

Dear Water District Officials:

A top priority of the Office of the State Comptroller is to help local government officials manage government resources efficiently and effectively and, by so doing, provide accountability for tax dollars spent to support government operations. The Comptroller oversees the fiscal affairs of local governments statewide, as well as districts' 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 of Commissioners governance. Audits also can identify strategies to reduce district costs and to strengthen controls intended to safeguard district assets.

Following is a report of our audit of the West Hempstead Water District, entitled Life Insurance. This audit was conducted 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.

This audit's results and recommendations are resources for local government officials to use in effectively managing operations and in meeting the expectations of their constituents. 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 West Hempstead Water District (District) is located in the Town of Hempstead in Nassau County and serves the hamlets of West Hempstead, Franklin Square and Garden City South. The District is governed by an elected three-member Board of Commissioners (Board) composed of a Chairman, Secretary and Treasurer. The District Superintendent is responsible for the general management of District operations under the Board's direction. The Board, as a whole, is responsible for overseeing the District's investments and fringe benefits.

The District's total revenue for the 2015 fiscal year was approximately \$4.1 million, which was generated primarily from water usage charges and real property taxes. The District's 2015 expenditures totaled approximately \$3.5 million.

Objective

The objective of our audit was to examine the District's provision of life insurance policies as a fringe benefit. Our audit addressed the following related question:

- Is the provision of individual life insurance policies to the Board and employees appropriate?

Scope and Methodology

We examined the District's provision of life insurance policies as a fringe benefit for the period January 1, 2015 through July 31, 2016.

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 are included in Appendix C 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 District Officials and Corrective Action

The results of our audit and recommendation have been discussed with District officials, and their comments, which appear in Appendix A, have been considered in preparing this report. District officials disagreed with some aspects of our finding. Appendix B includes our comments on issues raised in the District's response.

The Board has the responsibility to initiate corrective action. A written corrective action plan (CAP) that addresses the findings and

recommendation in this report must be prepared and forwarded to our office within 90 days, pursuant to Section 35 of General Municipal Law. For more information on preparing and filing your CAP, please refer to our brochure, *Responding to an OSC Audit Report*, which you received with the draft audit report. We encourage the Board to make this plan available for public review in the Secretary's office.

Life Insurance

General Municipal Law (GML) and New York State Insurance Law (Insurance Law) provide the authority for a board of commissioners of a water district, by resolution, to provide its officers and employees with group life insurance as a fringe benefit. There is no similar authority for a water district to provide individual whole life insurance policies for its officers or employees by board resolution outside of a collective bargaining agreement (CBA).

The District's CBA states that the District will provide and pay the annual premiums for a \$40,000 "life insurance death benefit" for each represented full-time employee, with the District as "owner" of the policy. Each policy has a cash surrender value, which increases over the life of the policy. The Board passed a resolution extending the same life insurance benefits in the District's CBA to managerial employees who are not covered under the District's CBA and passed a resolution for a similar benefit to the Board.

Upon retirement, District managerial employees with life insurance coverage from the District pursuant to the Board resolution generally can either transfer ownership of the life insurance policy from the District to the employee upon payment of the cash surrender value of the policy or have the District continue ownership of the policy with the District paying all premiums. Upon completing nine years of service with the District, a Board member can either transfer ownership of the life insurance policy from the District upon payment of the cash surrender value of the policy or have the District continue ownership of the policy with the District paying all premiums.

The District currently holds individual whole life insurance policies with face values totaling \$280,000 for seven employees, officers and former officers who were provided these benefits by Board resolution (three managerial employees, three current Board members and one former Board member). As of December 31, 2015, these policies had a combined cash surrender value of \$119,871. Because GML only authorizes group life insurance for officers and employees of a water district, the District is not authorized to offer individual life insurance policies for its managerial employees and Board members by Board resolution. Also, to the extent these policies have a cash surrender feature with the cash value payable to the District as owner, this may constitute an unauthorized investment of District funds.¹ The District paid over \$16,600 in premiums during our audit period for individual

¹ Section 11 of GML sets forth the permissible investment vehicles for the water district and does not include life insurance policies.

whole life insurance coverage for the seven individuals, even though there was statutory authority only to provide group life insurance.

Recommendation

1. The Board should review the insurance policies it currently holds and consult with its counsel to take steps to ensure that all insurance policies are permissible under GML.

APPENDIX A

RESPONSE FROM DISTRICT OFFICIALS

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



www.westhempsteadwater.org

January 27, 2017

Mr. Ira McCracken, Chief Examiner
Division of Local Government and School Accountability
NYS Office Building, Room 3A10
Veterans Memorial Highway
Hauppauge, New York 11788-5533

Dear Mr. McCracken:

The Board of Commissioners of the West Hempstead Water District (“District”) acknowledges receipt of the preliminary draft findings of your full financial audit of the District. As stated in your initial July 19, 2016 letter, the audit focused “on policies and procedures related to the internal controls of the District” and covered the period from “January 1, 2015 to July 31, 2016”.

Prior to the commencement of the audit the District provided encrypted information from our financial accounting system through your Electronic Filing Data Exchange system, including all cash disbursements and payroll activities for our most recent completed fiscal year. At the entrance conference, the District provided its “minutes, annual financial reports, budgets, records, policies” and numerous other documents in full compliance with the request of the Office of the State Comptroller (“OSC”).

During the actual audit this past summer, our Secretary to the Board of Commissioners Frederick L. Kurz and Superintendent Robert P. York worked closely with your audit staff, we commend them for their diligence and professionalism. The Board deeply appreciates their constructive comments regarding the District’s operations.

Turning to the audit itself, the Board of Commissioners were very pleased that OSC made no audit findings and/or recommendations regarding the District’s accounting records or internal control policies. While the audit covered every facet of the District’s financial operations, the preliminary findings raised only one question for review, *“Is the provision of individual life insurance policies to the Board of Commissioners and employees appropriate?”*

In accordance with this solitary issue, OSC made one recommendation requesting that the Board of Commissioners review the insurance policies it currently holds and consult with its counsel to take steps to ensure that all insurance policies are permissible under the New York State General Municipal Law. (“GML”) After reviewing the facts of this matter and the group insurance criteria set forth in the GML and New York State Insurance Law with our attorney and insurance broker, we believe that the group life insurance policy the District owns for the benefit of the Board of Commissioners and the employees is appropriate and authorized pursuant to GML Section 93.

575 BIRCH STREET WEST HEMPSTEAD, NEW YORK 11552 TEL. 516.483.1180 FAX 516.483.3880

The OSC refers to the District life insurance as “individual policies”. This is an inaccurate categorization of the District’s life insurance policies. The District undoubtedly does not retain individual life insurance policies for its employees or its commissioners. The District is the policyholder of a group life insurance policy whereby employees and commissioners are the certificate holders.

See
Note 1
Page 9

Insurance Law Section 1113(a) (1) defines life insurance as every insurance upon the lives of human beings, and every insurance appertaining thereto. Life insurance policies or contracts have been construed by insurers to take any of a number of *forms*, none of which are specifically referenced in the Insurance Law, or GML. The most common forms are term insurance, whole life insurance and universal life insurance. Group life insurance is a *form* of insurance covering certain groups specified in the Insurance Law, which is written under a policy issued to the policyholder and a certificate evidencing the insurance is issued to a certificate holder. Section 4216 of the Insurance Law defines “Group life insurance” as that *form* of life insurance which covers any of the classes of employees and officers (“groups”) that may be insured. The Employees and the Board of Commissioners of the District are such a permitted group

See
Note 1
Page 9

We also respectfully submit the assertion that the cash surrender value feature of the policies is an inappropriate investment, is also incorrect. The cash surrender value is not an “investment”. The District purchased whole life insurance policies for its employees giving to them the additional benefit of having permanent rather than term life policies. That purchase was not an investment. The fact that whole life policies over the span of an employee’s career are more cost effective for the District than the purchase of term life constitutes prudent purchasing, not investing. The life insurance policies are a contractual employee benefit. The District cannot surrender the policies at will to access the cash value.

See
Note 2
Page 9

The policies in question do have a cash surrender value payable to the District but that should not be viewed as an investment. A District investment should be an instrument that the district could control, but the District cannot control the cash surrender values nor the dividends that are generated by the policy.

See
Note 3
Page 9

Our opinion is that the group life insurance purchased by the District for its employees is authorized by law and in all respects proper.

Despite the fact that we believe our current insurance is authorized by GML Section 93, we are investigating alternative insurance and the costs associated thereof. Our initial inquiries indicate that term insurance would be more costly for the district.

~~Sincerely,~~

C. J. Sparacio
Chairman of the Board

cc: Members of the Board of Commissioners
Robert P. York, District Superintendent
Frederick L. Kurz, Secretary to the Board

APPENDIX B

OSC COMMENTS ON THE DISTRICT'S RESPONSE

Note 1

We agree that NYS Insurance Law defines “group life insurance” as a form of life insurance covering certain specified groups. However, the definition also states that the coverage is written under “a policy issued to the policyholder...” The District did not provide evidence of a “group policy” (“master policy”). Instead, the District provided only separate documents for each District employee or Commissioner, designated, on the face of each one, as a whole life “policy,” with its own policy date, policy number and cash value, with no mention of a group policy. In addition, the District’s bill from the insurance company does not mention a group life insurance policy but instead lists each separate policy number with an amount due for each.

Note 2

While the District may not have intended its purchase of these policies as an investment, the policies have characteristics of an investment in that they provide for a cash surrender value, payable to the District, and for annual dividends.

Note 3

The fact that the District does not “control” the cash surrender values or dividends does not mean that they are therefore not an investment. For example, the investing local government does not “control” the market value of investment vehicles (e.g., obligations of the United States) permitted under GML Section 11. Officials must invest public funds in a manner that complies with statutory requirements and safeguards public funds. As stated in our report, GML sets forth the permissible investment vehicles for the District and does not include individual life insurance policies.

APPENDIX C

AUDIT METHODOLOGY AND STANDARDS

To achieve our audit objective and obtain valid evidence, we performed the following procedures:

- We reviewed the District's CBA and Board resolutions, GML Section 93 and Insurance Law pertaining to life insurance benefits.
- We obtained and reviewed the 2015 and 2016 life insurance bills to determine which individuals received life insurance benefits.
- We reviewed individual life insurance policies to determine the type of life insurance, coverage amount and number of policies the District had for each recipient.
- We obtained the employment status of the insurance recipients and their current or last positions at the District and determined whether the recipients were covered under the District's CBA.
- We obtained the December 31, 2015 cash value statement to determine the cash value of individual policies as of that date. We used the 2015 and 2016 insurance bills to determine premiums paid by the District for each recipient within our audit period.

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.

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