OFFICE OF THE NEW YORK STATE COMPTROLLER

DIVISION OF LOCAL GOVERNMENT
& SCHOOL ACCOUNTABILITY

Wayne Central School District

Financial Management

Report of Examination

Period Covered:

July 1, 2009 — April 30, 2012

2012M-229

Thomas P. DiNapoli

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State of New York
Office of the State Comptroller

Division of Local Government
and School Accountability

March 2013

Dear District Officials:

A top priority of the Office of the State Comptroller is to help school district officials manage government resources efficiently and effectively and, by so doing, provide accountability for tax dollars spent to support district operations. The Comptroller oversees the fiscal affairs of districts statewide, as well as 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 district operations and Board of Education 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 Wayne Central School District, entitled Financial Management. 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 General Municipal Law.

This audit's results and recommendations are resources for district 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 Wayne Central School District (District) is located in the Towns of Ontario, Macedon, Walworth, and Williamson in Wayne County, and in Penfield and Webster in Monroe County. The District is governed by the Board of Education (Board) which comprises nine elected members. The Board is responsible for the general management and control of the District's financial and educational affairs. The Superintendent of Schools (Superintendent) is the chief executive officer of the District and is responsible, along with other administrative staff, for the day-to-day management of the District under the direction of the Board. The Assistant Superintendent for Business is responsible for preparing the budget, and is designated by the Board as the purchasing agent and is responsible for approving all purchases.

There are five schools in operation within the District, with approximately 2,400 students and 650 employees. The District's budgeted expenditures for the 2011-12 fiscal year are $41.3 million, which are funded primarily with State aid, sales tax, real property taxes, and grants.

Objective

The objective of our audit was to evaluate the District's financial operations. Our audit addressed the following related question:

- Did the Board provide adequate oversight and management of the District's budget and financial operations?

Scope and Methodology

We examined the Board's financial management of the District's financial condition for the period July 1, 2009 to April 30, 2012. To analyze the District's fund balance, budgeting, and financial trends, we extended the audit period back to the 2007-08 fiscal year.

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.

Comments of District Officials and Corrective Action

The results of our audit and recommendations 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 of our findings and indicated they will take limited corrective action. Appendix B contains our comments on issues raised in the District's response.

The Board has the responsibility to initiate corrective action. Pursuant to Section 35 of the General Municipal Law, Section 2116-a (3)(c) of the Education Law and Section 170.12 of the Regulations of the Commissioner of Education, 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, with a copy forwarded to the Commissioner of Education. To the extent practicable, implementation of the CAP must begin by the end of the next 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. The Board should make the CAP available for public review in the District Clerk's office.

Financial Management

A school district's financial condition is a factor in determining its ability to provide educational services to students. The responsibility for accurate and effective financial planning rests with the Board, the Superintendent, and the Assistant Superintendent for Business. District officials must manage the District's finances in a prudent manner, accurately depicting and reporting the District's financial activity while also using available resources to ensure that the tax burden is not greater than necessary. To fulfill this responsibility, it is essential that officials develop reasonable budgets and manage fund balance responsibly and in accordance with statute. Real Property Tax Law limits the amount of unexpended surplus funds[1] that can be legally retained by District officials to no more than 4 percent[2] of the next fiscal year's budget. Districts may also establish reserves to restrict a portion of fund balance for a specific purpose, but must do so in compliance with statutory directives. This is a matter of transparency so that District residents can have accurate information when voting on the budget, and is also a matter of fiscal responsibility to ensure that excess moneys are not extracted from District taxpayers.

We found that the Board and District officials have not fulfilled their fiduciary responsibility. Over the last five years, District officials consistently underestimated revenues and overestimated expenditures in the adopted budgets by a total of $20.5 million. As a result, the District had operating surpluses totaling $13.8 million, which caused the accumulated fund balance to exceed the statutory maximum of 4 percent of the ensuing year's budget. To make it appear that the fund balance was within statutory limits, District officials: appropriated

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[1] The Governmental Accounting Standards Board (GASB) issued Statement 54, which replaces the fund balance classifications of reserved and unreserved with new classifications: non-spendable, restricted, and unrestricted (comprising committed, assigned, and unassigned funds). The requirements of Statement 54 are effective for fiscal years ending June 30, 2011 and beyond. To ease comparability between fiscal years ending before and after the implementation of Statement 54, we will use the term 'unexpended surplus funds' to refer to that portion of fund balance that was classified as unreserved, unappropriated (prior to Statement 54), and is now classified as unrestricted, minus appropriated fund balance, amounts reserved for insurance recovery and tax reduction, and encumbrances included in committed and assigned fund balance (post-Statement 54).

[2] Under GASB Statement 54, the 4 percent limitation should be applied to unrestricted fund balance (i.e., the total of the committed, assigned, and unassigned classifications), minus appropriated fund balance, amounts reserved for insurance recovery, amounts reserved for tax reduction, and encumbrances included in committed and assigned fund balance. Funds properly retained under other sections of law (i.e., reserve funds established pursuant to Education Law or General Municipal Law) are also excluded from the 4 percent limitation.

$4.6 million in fund balance that was not needed to fund the budget, created fake encumbrances (by at least $3.1 million for the 2009-10 and 2010-11 years); and transferred approximately $14 million to the District's reserves with no documented plan or justification for their excessive funding levels. In routinely using these inappropriate practices, District officials have, in effect, circumvented the 4 percent fund balance limit, levied more real property taxes than necessary, and retained large amounts of taxpayer dollars without full disclosure and transparency.

Budgeting Practices

The Board is responsible for preparing and presenting the District budget to the public for approval. In preparing the budget, the Board is responsible for estimating revenue and expenditures, how much fund balance will be available at fiscal year-end (some or all of which may be used to fund the ensuing year's appropriations and reduce the tax levy) and, to balance the budget, what the expected tax levy will be. Accurate estimates help ensure that the levy of real property taxes is not greater than necessary.

Revenue and Expenditure Estimates – It is important for revenue and expenditure estimates to be developed based on prior years' operating results, past expenditure trends and anticipated future needs, and available information from outside sources related to projected changes in significant revenues or commodity prices. Unrealistic budget estimates are misleading to District voters and taxpayers, and can significantly impact the District's year end fund balance and financial condition.

District officials consistently presented, and the Board consistently approved, misleading and inaccurate budgets, which generated additional surplus funds each year. We compared the District's general fund budgeted revenues and expenditures with actual results of operations for the last five fiscal years, as shown in Table 1. For the 2007-08 through 2011-12[3] fiscal years, District officials underestimated revenues by a total of more than $5.4 million and overestimated expenditures by a total of more than $15 million. These budgetary surpluses, which totaled more than $20 million over five years, generated operating surpluses which District officials routinely used to fund reserves instead of using it to reduce real property taxes.

[3] After we had completed fieldwork, we requested and reviewed draft audited financial statements for the 2011-12 fiscal year, and included 2011-12 amounts in our tables for an up-to-date perspective.

Table 1: Budget to Actual						
Fiscal Year	**2007-08**	**2008-09**	**2009-10**	**2010-11**	**2011-12**	**Total**
Actual Revenues[a]	$22,348,157	$22,064,281	$22,824,180	$21,260,386	$20,389,515	$108,886,519
Budgeted Revenues[a]	$20,091,415	$21,320,580	$21,330,917	$20,599,236	$20,132,698	$103,474,846
Revenue Variance	$2,256,742	$743,701	$1,493,263	$661,150	$256,817	$5,411,673
Appropriations[b]	$39,572,415	$40,920,580	$40,970,917	$41,312,955	$41,378,845	$204,155,712
Actual Expenditures	$36,641,458	$36,561,857	$37,967,504	$39,582,380	$38,350,470	$189,103,669
Expenditure Variance	$2,930,957	$4,358,723	$3,003,413	$1,730,575	$3,028,375	$15,052,043
Total Variance	$5,187,699	$5,102,424	$4,496,676	$2,391,725	$3,285,192	$20,463,716
Tax Levy	$18,581,000	$18,700,000	$18,740,000	$18,999,000	$19,299,000	$94,319,000

[a] We did not include real property taxes in our analysis of budgeted and actual revenues, as school districts generally receive all taxes levied. For perspective, we provided the tax levy per the adopted budget.
[b] Does not include encumbrances (commitments for payments related to unperformed contracts for goods or services).

The under-estimated revenues and over-estimated expenditures were generally spread throughout the budget. A significant example is serial bond principal and interest payments, which were over-estimated by $3.7 million over the last five years. The Assistant Superintendent for Business told us that District officials intentionally built a cushion into the budget, rather than decreasing the bond payment budget as the District retired debt. He also stated that the large variances between budgeted amounts and actual results of operations were, in part, planned by the District to provide funding for a capital project proposed to voters in March 2010. Instead of following the transparent process of seeking voter approval for funding capital projects, District officials used various budgeting tactics to accumulate significant amounts of taxpayer dollars with the intention of using the funds for a capital project, which in the end, was rejected by voters.

Fund Balance – The estimation of fund balance is an integral part of the budget process. Fund balance represents resources remaining from prior fiscal years that can be assigned[4] as a funding source in the budget or retained as unassigned. Any fund balance in excess of 4 percent of the ensuing year's budget must be used to lower property taxes, or transferred to reserve funds that are reasonable and in compliance with statutory directives. When fund balance is assigned as a funding source, it reduces the fund balance included in the 4 percent calculation. The expectation is that there will be a planned operating deficit in the ensuing fiscal year, financed by the amount of the assigned fund balance. It is important that District officials not assign fund balance that will not be used, in an effort to circumvent the statutory limit.

[4] Prior to June 2011, assigned fund balance was referred to as appropriated fund balance. In addition, unassigned fund balance was referred to as unappropriated fund balance. The terminology was changed pursuant to GASB 54.

The District has assigned fund balance totaling $4.6 million in its adopted budgets for the last five years, which should have resulted in planned operating deficits. In reality, the budgets resulted in operating surpluses each year, totaling $13.8 million.

Table 2: Operating Results and Surplus Funds

Fiscal Year	2007-08	2008-09	2009-10	2010 -11	2011 -12	Total
Assigned Fund Balance[a]	$900,000	$900,000	$900,000	$900,000	$1,000,000	$4,600,000
Unassigned Fund Balance	$1,636,823	$1,638,837	$1,652,518	$1,655,154	$1,686,229	
Actual Revenues	$40,925,756	$40,762,008	$41,460,991	$40,222,135	$39,615,216	$202,986,106
Actual Expenditures	$36,641,458	$36,561,857	$37,967,504	$39,582,380	$38,350,470	$189,103,669
Operating Surplus	$4,284,298	$4,200,151	$3,493,487	$639,755	$1,264,746	$13,882,437

[a] Designated for subsequent year's expenditures

As a result, none of the assigned fund balance for any of the five fiscal years was used to cover expenditures. In effect, this circumvented the 4 percent statutory fund balance limit. Furthermore, even after assigning fund balance that was never used, the unassigned fund balance still exceeded the 4 percent maximum allowed by law. To reduce the fund balance to the 4 percent maximum, District officials transferred unassigned fund balance to the District's reserves. As discussed in the following section, the transfers resulted in the reserves being overfunded, in effect, further circumventing the 4 percent limit. The Board did not include the transfers to the reserves in the budgets, and again, the use of this money was not transparent.

Based on our review of the District's adopted 2012-13 budget, with appropriations of $42.1 million, estimated revenues of $39.8 million (including a tax levy of $19.8 million) and $900,000[5] in appropriated fund balance and $1.5 million in appropriated reserves, it appears the District has continued its pattern of misleading budget practices. Therefore, the District will likely generate an operating surplus for 2012-13 similar to those of the previous five fiscal years.

Encumbrances

Encumbrances are obligations in the form of unfilled purchase orders (POs) or unfulfilled contracts. An appropriation is reserved at the time orders are placed or contracts approved, prior to the actual expenditure of funds. Encumbrances that exist at the end of the fiscal year may be carried over to the next year, but must represent valid commitments for specific future expenditures, and should not be established simply as a means of reducing available year-end

[5] While the adopted 2012-13 budget included a fund balance appropriation of $900,000, the District's draft audited financial statements reported $1,000,000 appropriated fund balance as of June 30, 2012.

fund balance. Encumbrances that are established without a genuine purchase or contractual commitment inflate assigned fund balance and circumvent the budget process.

The District significantly increased its reported encumbrances for the 2009-10 and 2010-11 fiscal years as shown in Table 3. Due to the risk that over-stated encumbrances could portray a lower available fund balance and thus result in a higher tax levy, we requested a list of all recorded year-end encumbrances for both years, and reviewed supporting documentation for the most material open POs, which accounted for 80 percent of the reported encumbrances for each year.

Table 3: Encumbrances				
FY 2007-08	**FY 2008-09**	**FY 2009-10**	**FY 2010 -11**	**FY 2011 -12**
$558,570	$404,847	$2,401,316	$2,182,796	$1,121,337
Encumbrances Tested for Documentation of Valid POs and Purchases				
Fiscal Year	**Number Tested**	**Total Amount of Tested POs**	**Number Unsupported**	**Unsupported Amount**
2009-10	28	$1,909,521	15	$1,670,088
2010-11	34	$1,747,339	20	$1,467,915
Total	62	$3,656,860	35	$3,138,003

We reviewed a total of 62 POs[6] included in the reported encumbrances for the two years, and found that 35 POs, totaling over $3.1 million, or 86 percent of the total tested, were not valid encumbrances.

For example, the District generated two POs on June 30, 2011, one encumbering $435,000 for a purchase from a single vendor for "… netbook and desktop and monitors, per district replacement plan," and another encumbering $210,000 for a purchase from a different vendor for "Desktop computer replacements in classrooms." The District provided no supporting invoices and did not make any payments to the listed vendors for the listed computer equipment. Both POs indicated that the quantity ordered was "1," and had handwritten notes at the top which said "Do Not Mail." Both POs also contained handwritten notes to decrease the encumbrance by small amounts, and transfer those amounts to cover real POs for purchases made from a different vendor in the ensuing year.

The materiality of the invalid POs encumbered at year-end makes clear the District's intent to inflate the ensuing year's appropriations and the assigned fund balance, and mask the true financial position and plans of the District. This improper recognition of encumbrances caused unexpended surplus funds to be significantly understated. Had District officials assigned fund balance only for valid and supported encumbrances, the unexpended surplus funds would have exceeded the statutory limit of 4 percent of the ensuing year's appropriations, at

[6] We tested 28 of 199 open POs for 2009-10 and 34 of 151 open POs for 2010-11.

8 percent for both the 2009-10 and 2010-11 fiscal years. This excessive fund balance, in effect, represents excess taxes levied against District taxpayers.

The District's external auditor informed District officials and the Board's audit committee that encumbrances were over-stated. The external auditor also included a finding in its management letter for the last three fiscal years, regarding year end encumbrances that were liquidated after year-end without purchases made against them. The Assistant Superintendent for Business, with the Board's approval, deliberately ignored the external auditor's recommendations, and continued to record fictitious encumbrances, in order to retain more fund balance than allowed by statute. During the course of our fieldwork the Assistant Superintendent was very open about the various measures District officials used to circumvent the legal limit on fund balance. Recording entries for encumbrances that do not exist is clearly unethical and should not be tolerated by the Board.

Reserves

Reserve funds may be established by Board action, pursuant to various laws, and are used to provide financing only for specific purposes, such as unemployment insurance and workers compensation payments. The statutes under which the reserves are established determine how the reserves may be funded, expended or discontinued. Generally, school districts are not limited as to how much money can be held in reserves, but should maintain reserve balances that are reasonable. Funding reserves at greater than reasonable levels essentially results in real property tax levies that are higher than necessary because the excessive reserve balances are not being used to fund operations.

The Board is responsible for developing a formal plan for the use of its reserves, including how and when disbursements should be made, optimal or targeted funding levels, and procedures for ensuring that appropriate documentation is maintained to account for and monitor reserve activity and balances. Ideally, the Board should include amounts to be placed in reserve funds in the annual budget to inform voters of the Board's plan for funding reserves, and should not routinely fund reserves with excess fund balance at year-end. If the Board decides to make unbudgeted transfers to reserves, it must authorize them by a resolution which specifies the amounts and the reserves to be increased, to promote visibility of the Board's actions to taxpayers.

Over the past five years, District officials made it appear that the unassigned fund balance was within legal limits by using a portion of their annual operating surpluses to fund various reserves. As of June 30, 2011, the District had seven reserves in the general fund with reported balances totaling approximately $18.1 million, which had increased by more than $5.65 million since June 30, 2008. The District transferred an additional $3.4 million into reserves after completion of the 2011-12 fiscal year, including a newly created worker's compensation reserve, initially funded with $225,000.

Table 4: Reserve Funds					
Reserve / Fiscal Year	**2007-08**	**2008-09**	**2009-10**	**2010 -11**	**2011-12**
Insurance	$2,592,165	$6,864,095	$5,011,265	$6,287,189	$6,895,845
Liability	$893,560	$903,751	$1,132,082	$1,241,127	$1,246,561
Retirement	$773,897	$780,957	$985,033	$1,239,330	$2,042,622
Unemployment Insurance	$383,206	$345,076	$401,114	$400,297	$842,373
Employee Benefit Accrued Liability	$248,784	$245,518	$240,657	$172,995	$169,996
Capital	$5,308,176	$5,308,176	$5,398,123	$5,423,145	$1,440,611[a]
Capital – Bus Purchase	$2,293,309	$1,791,147	$3,894,798	$3,379,991	$2,903,311
Workers Compensation					$225,000
Total	**$12,493,097**	**$16,238,720**	**$17,063,072**	**$18,144,074**	**$15,766,319**
[a] The District transferred $4 million from its capital reserve to the capital projects fund to pay expenditures related to a voter approved capital project.					

In the fall of each year, the Assistant Superintendent for Business prepares a memo to the Superintendent detailing the District's financial position as of the prior June 30th fiscal year end, and recommending amounts for the Board to approve as transfers "of excess fund balance to reserve funds to bring the District to the 4 percent legal limit for unappropriated fund balance." Furthermore, we reviewed various District correspondence and documents that clearly demonstrate the District's blatant disregard for the statutorily authorized uses of the various reserve funds. For example, the September 2009 memo stated that the District met its financial goals established during the budget process, which included being in a position at year end to add money to reserve funds to help fund an upcoming capital project. The memo recommended the transfer of the entire $4.3 million in excess fund balance to the insurance reserve, stating that the amount would be available for the 2010 capital project,[7] but could not be transferred to the more appropriate capital reserve, which was already funded at the voter approved maximum. Furthermore, while the proposed 2010 project was later voted down by the taxpayers, the District's project proposal newsletter described its plan to use all of the District's reserve balances (estimated to be $17 million by project time) to fund the project, regardless of the fact that only the capital reserve may legally be used to pay for capital project expenditures.

[7] As discussed further below, capital projects expenditures are not allowable uses of insurance reserve moneys.

The Board did not include in its adopted budgets any transfers of surplus funds to the District's reserves. Therefore, these unbudgeted transfers to fund reserves were made well after the fiscal years ended, without prior communication to and approval by the voters. Although the Board passed resolutions for funding the reserves, the Board has not adopted a policy or plan regarding accumulating and using moneys in the reserves to ensure that the amounts are necessary, reasonable and in compliance with statutory requirements. Furthermore, District officials did not provide any calculations and/or justifications for the funding levels of the various reserves, and used reserve fund moneys for purposes not allowed by applicable statutes, as follows:

Insurance Reserve – This type of reserve is authorized by GML to fund certain losses, claims, actions, or judgments which would not be covered by insurance, and the annual allocation to the reserve is limited to 5 percent of the adopted budget. The District purchases liability insurance to limit the need for substantial reserves to fund insurance claims, and has not expended moneys from this reserve for its statutory purpose during the last five years. District officials have instead used the insurance reserve as a savings account for future capital or operating needs and transferred to it much of the District's excess fund balance at the end of each year. For example, at the end of the 2008-09 year, the District transferred its excess fund balance (more than $4.2 million) into this reserve. However, in December 2009 after the external auditor found that the District had exceeded the allowable annual contribution by over $2.2 million, the Board passed a resolution to move this excess amount back into the general fund balance. The excessive allocation of fund balance to the insurance reserve provided a mechanism for the District to stay below the statutory fund balance limit, as of June 30, 2009.The District transferred over $7.1 million[8] to the insurance reserve over the last five years.

Also, despite the restricted use of this reserve fund for judgments and claims, the District appropriated $847,147 and $1,103,523 from the reserve as funding sources in its adopted budgets for the 2011-12 and 2012-13 fiscal years, respectively.[9] The District has no authority to reallocate insurance reserve moneys to the general fund balance or for operating expenses. If these funds are not used to pay for uninsured losses, they can be transferred only to another legal reserve as authorized by GML. In addition, the District's purported use of the reserve to fund its recent budgets does not reduce the over-funded reserve, due to the sizeable transfers to fund that reserve in the same years, as well as the positive variances built into the annual budgets.

[8] The Board authorized transfers totaling $9.3 million, reduced by the $2.2 million reallocation to the general fund in December 2009.
[9] Actual transfers exceeded those budgeted and totaled $907,147 and $1,498,855 respectively.

Liability Reserve – Education Law[10] authorizes school districts to establish and maintain reserves, not to exceed three percent of the annual budget, to cover property loss and liability claims to reduce a district's insurance costs. The District allocated more than $830,000 in excess fund balance to this reserve over the last three years. Despite the legal restrictions placed on this reserve, District officials have improperly used it to pay for legal fees and court-ordered tax refunds associated with assessment challenges, totaling more than $500,000 during the last four years. The largest payments from this reserve included $387,000 in June 2011 and $105,000 in October 2011, both for court ordered refunds of taxes assessed. These payments were not an appropriate use of moneys from the liability reserve in accordance with law.[11]

Retirement Reserve – GML restricts the use of this reserve to payments to the New York State and Local Retirement System (NYSLRS). While the District has funded this reserve with excess fund balance totaling $1.8 million in four of the last five years, the Board consistently budgeted for and paid these contributions each fiscal year directly from the general fund. In effect, the Board levied real property taxes to make these annual contributions while also increasing the reserve, with the most significant increase after the 2011-12 year, by $1 million. The District had not used this reserve to fund retirement contributions, until it appropriated $200,000 and $350,000 in the 2011-12 and 2012-13 budgets, respectively. However, at the beginning of these same budget years, the District increased the reserve by $250,000 and $1 million respectively. Absent a plan for the orderly use of this reserve, instead of tax levy to fund NYSLRS contributions, its balance is excessive.

Unemployment Insurance Reserve – General Municipal Law (GML) authorizes districts to create a reserve to reimburse the State Unemployment Insurance Fund for payments made to claimants. The District has transferred over $800,000[12] of excess fund balance to this reserve in the last three years. The District made payments out of this reserve, totaling $435,000 over the last five years, on a quarterly basis as bills came due from the State. Based on the average annual expenditures of $87,000, the District has enough money in this reserve to cover approximately 10 years of expenditures. This balance is excessive, absent a formalized Board plan explaining the need and rationale for such a funding level.

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[10] Education Law §1709 (8-c)

[11] Although the District has authority (Section 3651 (1-a) of Education Law) to establish a tax certiorari reserve fund to pay for anticipated tax assessment claims, subject to statutory requirements, it has not established one, and has no authority to use a liability reserve for this purpose instead.

[12] $600,000 of which was allocated at the end of the 2011-12 fiscal year.

Failure to formally plan for the funding and use of reserve funds, in accordance with statutory restrictions, and to clearly and accurately communicate to voters both those plans and the actual use of reserve funds, raises concerns about the due diligence exercised by the Board and District officials in managing District resources.

As discussed throughout this report, District officials have intentionally adopted budgets that generated significant operating surpluses. District officials have chosen to retain the excess funds rather than return them to the taxpayers, and have done so with a lack of transparency in the budget process. As a result the Board and District officials failed in their fiduciary responsibilities to District taxpayers. During our audit period the District transferred over $14 million of the District's operating surpluses into reserve funds without transparency to the voters. It is clear that the District was funding reserves and creating fictitious encumbrances in an attempt to retain additional funds while making it appear that fund balance was within the statutory limit. Had the District reported these moneys as general fund unexpended surplus funds, real property taxes could have been reduced.

Recommendations

1. The Board and District officials should develop realistic revenue, expenditure, and fund balance estimates for the annual budget.

2. District officials should not create fictitious encumbrances and should ensure that year-end encumbrances are valid and supported.

3. District officials should develop comprehensive policies and procedures related to the establishment and use of reserve funds.

4. The Board and District officials should review all reserves and determine if the amounts reserved are necessary, reasonable and in compliance with statutory requirements.

5. District officials should include both the funding and use of all reserves in their adopted budget plan each year to provide transparency for the District's voters.

6. District officials should develop a plan for the use of the surplus balances in unexpended surplus funds and in the District's reserve funds identified in this report in a manner that benefits District taxpayers. Such uses could include, but are not limited to, paying off debt, financing one-time expenditures, reducing District property taxes, and increasing necessary reserves in accordance with established and reasonable plans and statutory requirements.

APPENDIX A

RESPONSE FROM DISTRICT OFFICIALS

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

WAYNE CENTRAL SCHOOL DISTRICT

February 7, 2013

Edward V. Grant, Chief Examiner
Office of the State Comptroller
The Powers Building
16 West Main Street, Suite 522
Rochester, NY 14614

Dear Mr. Grant and Taxpayers of the Wayne Central School District;

The Wayne Central School District is in receipt of the draft audit report *Financial Management* for the period July 1, 2009 through April 30, 2012, prepared by the Office of the State Comptroller. On behalf of the Board of Education and the District's administration, we would like to thank the local field staff of the Comptroller's Office. They were professional and courteous in conducting their duties associated with this audit.

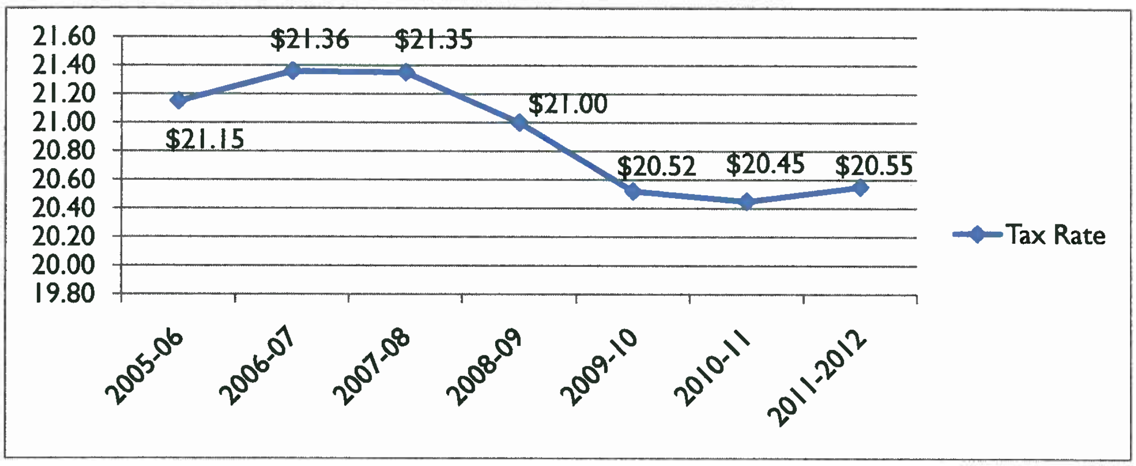
It has been and will continue to be the primary goal of the Wayne Central School District to provide our students with a world class education in a cost effective manner. In doing so, the district leadership carefully considers our community's ability to fund the education program that we offer our students. In recognizing our role and fiduciary responsibility when dealing with public taxpayer dollars, district leadership has always taken a conservative approach to budgeting and financial management. This conservative approach has allowed our district to consistently meet our primary goal of a world class education for our students in a cost effective manner.

It is to this end that the District will respond to the findings and recommendations included in this audit report. Wayne Central has always welcomed the opportunity to review and strengthen our financial management practices and oversight. In 2009, six of 200 internal control reports (3%) issued on school districts, from the Office of the State Comptroller, contained positive findings in the areas of purchasing, payroll, and cash disbursements. Wayne Central was one of the six districts to receive these positive findings, thus confirming the District's commitment to strong financial management. Further evidence is the school district's credit rating assigned in August of 2012, of **Aa3** by Moody's Investor Services and **AA-** by Standard & Poor's credit rating agencies, for a $9,250,000 Refunding Bond series. This is the second highest credit rating available to school districts. The **Aa3** and **AA-** rating is defined by the credit rating agencies as "An obligor has a VERY STRONG capacity to meet its financial commitments. It differs from the highest rated obligors only in small degree." This is the same strong rating the District received in 2009 from both Moody's and Standard & Poor's.

See Note 1 Page 24

The District is pleased that the OSC draft report does not suggest any malfeasance or legal impropriety with respect to our general business operations. We work closely with our outside independent financial advisors to review our management practices and oversight procedures. The District has reviewed the findings and recommendations of this audit, and will take corrective action in certain areas. These will be outlined in our Corrective Action Plan.

However, the audit report contains a number of conclusions and broad statements that we believe reflect subjective opinions of the Comptroller's Office with respect to the District's financial management specifically as they relate to financial planning, reserve funds, and fund balance management. The elected Board of Education and the District's administration firmly believe that our overall approach to financial management is consistent with our legal authority, and is consistent with our fiduciary responsibility to our taxpayers. This approach has allowed us to lead our District through the worst financial crisis in State history, without the loss of program or services to our students. This has all been accomplished while reducing our tax rate from $21.15/thousand in 2005-2006, to $20.55/thousand in 2011-2012.



We are concerned that the overall tone of the audit report is inconsistent with the philosophy set forth by the Comptroller's Office itself in their guidance document *Local Government Management Guide on Reserve Funds*, and also their document labeled *Multiyear Financial Planning Guide*.

The following is taken directly from the State Comptroller's Guide on *Reserve Funds*, page 1, first paragraph reads

> *"Saving for future projects, acquisitions and other allowable purposes is an important planning consideration for local governments and school districts. Reserve funds provide a mechanism for legally saving money to finance all or part of future infrastructure, equipment, and other requirements. Reserve funds can also provide a degree of financial stability by reducing reliance on indebtedness to finance capital projects and acquisitions. In uncertain economic times, reserve funds can also provide officials with a welcomed budgetary option that can help mitigate the need to cut services or raise taxes. In good times, money not needed for current purposes often can be set aside in reserves for future use."*

The District finds the findings in this report under the heading of Financial Management, contradictory to the guidance that the State Comptroller's Office provides in their own management guide. The District did exactly as instructed in this management guide, only to be criticized for our actions in this audit report, by this same office.

See Note 2 Page 24

The District had a long range financial plan in place that presented a capital project referendum to the voters in March 2010 for a $47,422,000 project that would have consolidated three elementary schools into one and closed the other two buildings. The proposed project would have saved district taxpayers one million dollars a year in staffing costs. This project was presented to the voters as a no cost increase project, as the financial plan for the project called for the District to use $17 million dollars in reserve funds to pay for the local share of the project. The financial plan for this project was put in place starting with the 2007/2008 school year. This information was fully disclosed to district residents throughout the planning process for the project, and also in a district newsletter dated February 2010, which was dedicated solely to providing information about the proposed project, including the complete financial plan. Table 1 in the audit report shows Budget to Actual variances for a five-year period beginning with the 2007/2008 school year. The first three years of the table coincide with the financial plan for the Capital Project Vote. The District added $5,000,000 to our reserves during this time period, while decreasing our tax rate each of the three years. The tax rate decreased $0.01 in 2007-2008 (or 0.0%), $0.35 in 2008-2009 (1.6%), $0.48 in 2009-2010 (2.3%), and $0.07 (0.3%) in 2010-2011. The total tax rate decrease from 2006-2007 to 2010-2011 was 4.3%. The District fully disputes the allegations on page 6 of the OSC audit report which state that the District appropriated money that was not needed for the budget, had no justification for what the Comptroller's Office references as excessive funding, and also circumvented the 4% fund balance limit. None of these allegations appear in any of the District's external audit reports for this time frame, with the exception of exceeding the 4% fund balance limit. This did occur during the 2008-2009 year due to transfer to a reserve which exceeded the legal limit for that particular reserve. This error was discovered by the District's External Auditor and brought to the attention of District Officials after the books were closed for that school year. The problem was corrected prior to the next audit. The correction was made in conjunction with a recommendation from the District's External Auditor.

See Note 3 Page 24

See Note 4 Page 24

The OSC audit report also criticizes the budgeting practices of the district, stating that District Officials underestimated revenues by a total of more than $5.4 million over a five-year period, while creating misleading and inaccurate budgets. What the OSC audit report fails to mention is that during this same time period, the District decreased our tax rate each of the five years referenced by this report, while still setting aside money for the upcoming Capital Project Vote of 2010. Once again, this was done in accordance with the financial plan put in place to present a no cost increase Capital Project to our residents. The District would counter the report findings by stating that the budgets did exactly as planned, reducing the tax burden on district residents, while saving for a Capital Project to avoid borrowing costs, which in the long run also reduce the tax burden. This practice is consistent with the State Comptroller's Guide on *Reserve Funds*. As the chart below clearly illustrates the revenue variances are aligned with the District's financial plan

See Note 5 Page 24

beginning in 2007-2008 and ending in 2009-2010 for the Capital Project of 2010. As you can see the revenue variances decreased dramatically after the Capital Project Vote of 2010 was unsuccessful.

Year	Actual Revenues	Estimated Revenues	Variance	Percentage
2007-08	$22,348,157	$20,091,415	$2,256,742	11.2%
2008-09	$22,064,281	$21,320,580	$743,701	3.4%
2009-10	$22,824,180	$21,330,917	$1,493,263	7%
2010-11	$21,260,386	$20,599,236	$661,150	3.2%
2011-12	$20,389,515	$20,132,698	$256,817	1.3%

In the past twenty years, the State Budget has been adopted on time only twice. This means that school districts are required to put their school budgets before voters, prior to having final revenue estimates provided in the State Budget. The District has always used the revenue estimates contained in the Governor's Executive Budget proposal for our revenue projections, yet are being criticized for being too conservative. The Wayne Board can only estimate revenues and costs based on the best available information at the time the estimates must be made. If final State Budget revenue estimates for school districts come in higher than the Governor's Proposal, it is impossible for a district to budget these higher revenues when they are received from the State after our residents have already voted on our proposed budgets.

See Note 6 Page 24

Once again the findings in this report contradict the guidance to school districts contained in the State Comptroller's Office handbook titled *Multiyear Financial Planning*. Referencing page 6 in this handbook,

> *"Although it is good to be as accurate as possible, it is best to err on the side of being conservative. If history shows weakness in a source of revenue, interpret signs of economic recovery with caution."*

Once again, the District is being criticized in this report for doing that exact thing, using conservative revenue estimates during the worst financial crisis in the history of the State of New York. The chart below shows the revenue variances for a five year period. These variances align with the District's approach to conservative budgeting and fiscal management. As you will notice the percentage range of 0.6% to 5.7% are within acceptable District standards.

See Note 7 Page 24

Year	Budget	Revenue Variance	Percentage
2007-08	$39,572,415	$2,256,742	5.7%
2008-09	$40,920,580	$743,701	1.8%
2009-10	$40,970,917	$1,493,263	3.6%
2010-11	$41,312,956	$661,150	1.6%

2011-12	$41,378,845	$256,817	0.6%

It is important to note that the District received $1,600,000 in stimulus funds from the Federal Government during the 2009-2010 and 2010-2011 school years. The first half of that money was received after the District had already adopted our 2009-2010 budget and could not be factored into our revenue projections for that year. Secondly, this is considered one-time revenue, since it would not be available after the second year. Referencing the *Multiyear Financial Planning Guide* from the State Comptroller's Office, page 9 states,

> *"OSC recommends using revenues from unexpected windfalls or other non-recurring sources for one-time needs or to build reserves, rather than spend them on recurring expenses."*

The District did that exact thing with the stimulus funds, used them to fund reserves, yet received criticism for doing that in this report. Once again, the OSC audit report findings, contradict the OSC recommendations contained in their own handbooks.

See Note 8 Page 25

The OSC audit report also criticizes the District for not decreasing the bond payment budget as the District retired debt. It was shared during the audit, that the Capital Project Financial Plan had the District replacing retiring debt service payments that were already included in the existing budget, with new debt payments, thus allowing the District to finance $3,769,000 of new debt, without any increase to the existing budget or increased tax burden on taxpayers. The level debt concept was approved by the Board of Education, and shared with district residents throughout the planning process for the 2010 Capital Project, yet the District has been criticized in this report for not being truthful and transparent to our voters. It is also worthy to note that since the 2010 Project was not accepted by district residents, the District reduced the debt service budget in the 2011-2012 budget, and has continued to do so in succeeding budgets (2012-2013), as debt has been retired from previous projects.

See Note 9 Page 25

The OSC audit report alleges that the District uses year-end encumbrances to circumvent the budget process. The District does not agree with this statement since the examples cited in the report were actually done as part of the next year's budget process, were presented to the Board of Education and the public during budget presentations, and were done to offset unprecedented cuts in State Aid to the District of over $2,000,000 or approximately 4.8% of the District's total budget. This is actually a strategy the District has used to continue to fund technology purchases during the State of New York's recent financial crisis. The OSC audit report claims this was done to mask the true financial position and plans of the District, when in reality; it was done to protect the financial position of the District and continue to meet student needs during the State of New York's financial crisis.

See Note 10 Page 25

In the area of reserves, page 12 of the OSC audit report cites the District in the use of the Liability Reserve to pay court ordered tax refunds and legal fees associated with those assessment challenges. It is important to note that the District's External Auditor has not cited the District for this practice. On page 26 of the State Comptroller's handbook titled *Reserves*, the legal title

See Note 11 Page 25

for this reserve is Property Loss Reserve and Liability Reserve Fund. The stated purpose of the reserve included in the handbook says,

"To establish and maintain a program of reserves to cover property loss and liability claims."

It does not state that the liability claims have to be associated with property loss. Since the establishment of this reserve over twenty years ago, the District has always used it to pay liability claims and has never been cited by our External Auditors. During the OSC Exit Conference, the local field staff of the Comptroller's Office stated that a Tax Certiorari Reserve would have been more appropriate for these court-ordered tax refunds. However, the District's position as supported by the District's External Auditor recognizes that the Property Loss Reserve and Liability Reserve Fund provide more flexibility. This is another example of how the District provided adequate oversight by selecting a reserve that provided more flexibility so that taxpayer funds were not locked up in a reserve with limited use.

The OSC audit report also cites the District for overfunding our Unemployment Reserve. The OSC audit report uses a five year average for unemployment claims of $87,000 and states that the District has enough money in this reserve to cover approximately ten years of expenditures. The OSC audit report states the balance in the reserve is excessive. The District disagrees with this assessment. Looking at past unemployment expenses is not a realistic approach to fiscal management given the current economic uncertainties. Should the District be forced to have massive layoffs like many neighboring districts, our District would have significant increases to our unemployment expenses. The Comptroller's Office used a five year average to calculate the annual projected expenses. The District disagrees with their methodology of using a five year average, when the District paid $160,000 in unemployment claims for the 2011-2012 school year. The District used our most current exposure levels to fund this reserve, not a five year average methodology, which fails to recognize the federal government extending unemployment benefits to 19 months. This extension, which the District has no control over, has a direct bearing on our exposure in the area of unemployment claims. Using the current level of expense, the District could fund four years of unemployment claims at their current levels, not ten years of expenditures as claimed by the OSC audit report. The District believes this reserve balance is warranted and was appropriately funded in accordance with General Municipal Law. We feel it is prudent and fiscally responsible to have this reserve at its current funding level. Furthermore, the District's External Auditor has not presented a finding that states that the Unemployment Reserve is over funded.

It is also important to note that since the unsuccessful Capital Project Vote of 2010, the District has used our reserves to offset tax rate increases for our taxpayers. The District used $1.1 million in 2011-2012, is using $1.4 million in 2012-2013, and will be using reserves once again in the formulation of the 2013-2014 budget to offset large losses in State Aid financing to fund public education, and to maintain important educational opportunities for the students of Wayne Central. Also the District had a successful Capital Project Vote in December of 2011 in which the financial plan calls for the District to use $4 million from the Capital Reserve. This is further evidence of the District using reserves to benefit our taxpayers.

See Note 12 Page 25

In reviewing the six recommendations included on page 13 & 14 of the audit report, the District offers this response:

1. Recommendation - The Board and District Officials should develop realistic revenue, expenditure, and fund balance estimates for the annual budget.
   District Response – The District always uses realistic and conservative estimates in our budget development.

2. Recommendation – District Officials should not create fictitious encumbrances and should ensure that year-end encumbrances are valid and supported.
   District Response – Managing fund balance at year-end is an important resource to school districts during these troubled financial times.

3. Recommendation - District Officials should develop comprehensive policies and procedures related to the establishment and use of reserve funds.
   District Response – Any reserve funds that have been established for the District have been done in conjunction with counsel from the District's External Auditor. When we asked the Office of the State Comptroller for a sample policy for reserves, they could not provide one. When we asked them of a district that they have audited who has developed one, they did not know of any that existed, even though this is a frequent comment in their audits.

See Note 13 Page 25

4. Recommendation – The Board and District Officials should review all reserves and determine if the amounts reserved are necessary, reasonable and in compliance with statutory requirements.
   District Response – The District reviews our reserves on an annual basis with our External Auditor for reasonable funding levels and compliance. The District has never been cited by our External Auditor for non-compliance or over funding.

5. Recommendation – District Officials should include both the funding and use of reserves in their adopted budget plan each year to provide transparency for the District voters.
   District Response – The use of reserves is part of the budget planning process since the 2011-2012 budget development. All reserves are reviewed during budget development, stating their legal purpose, their current balance, prior use, and any anticipated upcoming use of the reserves to fund district initiatives.

6. Recommendation – District Officials should develop a plan for the use of surplus balances in unexpended surplus funds and in the District's reserve funds identified in this report in a manner that benefits District taxpayers. Such uses could include, but are not limited to, paying off debt, financing one-time expenditures, reducing District property taxes, and increasing necessary reserves.

District Response – The District finds this recommendation very contradictory, since the District has used reserves to reduce property taxes, financing one-time expenditures and increasing necessary reserves, but have been cited for doing each of these things as recommended.

As expressed throughout the report, the District does not believe that the purpose of the Comptroller's Audit should be to substitute their judgment for that of the Board of Education and its administration in terms of overall financial management for the District. Thus, while the District respectfully acknowledges the perspectives of the Comptroller's Office in this regard, it is our view that the District's work on these matters through long range financial planning, prudent and conservative budgeting practices, and our daily commitment to the mission of our school district, which is to provide a world class education for our students in a cost effective manner for district residents, has resulted in controlling costs for the District's taxpayers over time, has put the District in a secure financial position for the future, and maintained quality program and student success at competitive costs, all during the most challenging fiscal time in the history of New York State.

Respectfully submitted,

Renee Garrett
Superintendent of Schools

Gregory J. Atseff
Assistant Superintendent for Business

Jeffrey Schultz
President, Board of Education

Debra Hibbard
Vice President. Board of Education

Jerry Champagne
Board of Education Member

Joyce Lyke
Board of Education Member

Karen Moore
Board of Education Member

Tom Nicholson
Board of Education Member

Dom Raz
Board of Education Member

Matt Prinsen
Board of Education Member

APPENDIX B

OSC COMMENTS ON THE DISTRICT'S RESPONSE

Note 1

The purpose of bond rating services is to analyze the risk posed to investors of an entity's indebtedness. They are not concerned if excess taxpayer funds are being accumulated. Our audit analyzed the District's finances on behalf of the taxpayer.

Note 2

The *Local Management Guide on Reserve Funds* goes on to state on page 2, "Reserve funds should not be merely a 'parking lot' for excess cash or fund balance. Local governments and school districts should balance the desirability of accumulating reserves for future needs with the obligation to make sure taxpayers are not overburdened by these practices." The District's budgetary practices have led us to conclude that, rather than exercising prudent management, the District is accumulating excess cash at the expense of tax relief for its residents.

Note 3

The District had these moneys in various reserves that were established for reasons other than the noted capital project; thus, not all of this money would have been legally available to use for the project.

Note 4

The fund balance appropriated as a funding source was not used for its budgeted purpose. Since the fund balance was not needed to fund operations, this practice provided a method to circumvent the legal requirement that only 4 percent of unassigned fund balance be retained by the District.

Note 5

There was no appropriation in the budget for a transfer to capital reserves which would provide for a planned transfer to the reserve; instead district officials transferred money from operating surplus at year end.

Note 6

During the period from when the spending plan is approved by the voters (May) and when the tax levy is finally established (August), certain information such as refined State aid estimates and a more accurate fund balance amount becomes available as the District's accounting records are closed for the fiscal year ending June 30. Therefore, there is time to make necessary adjustments to State aid and fund balance estimates before levying taxes unnecessarily. It should also be noted that since the 2005-2006 fiscal year, the New York State budget has been adopted later than April 9th only once.[13]

Note 7

While a conservative approach to budgeting has its merits, it must be reevaluated in light of repeated surpluses that have resulted in reserves exceeding documented needs.

[13] The budget for the 2010-2011fiscal year was adopted on August 3, 2010.

Note 8

Both the Recovery Act (Public Law 111-5) and U. S. Department of Education guidance issued in April 2009 stated that grant recipients should spend the funds quickly but wisely.[14] The intent was not to finance reserves for some uncertain future expenditure.

Note 9

The District's "level debt concept" essentially charges current taxpayers for nonexistent debt. Debt service payments are known by the District in advance of preparing the budget and should only have minimal variances, if any, when the payment is made.

Note 10

Our finding accurately describes the District's failure to follow Generally Accepted Accounting Principles in its recording of encumbrances. The result of these fictitious encumbrances was to improperly report fund balance so it would appear to be in compliance with statute. The District's assertion that the encumbrances were recorded as part of the next year's budget process confirms that the encumbrances were not in accord with Generally Accepted Accounting Principles.

Note 11

Our legal staff has reviewed the point raised and indicated that the purpose of the liability reserve is to provide an alternative to the purchase of insurance to cover liability claims. Tax certiorari claims are not the type of insurable liability risks that would fall within the category of claims intended to be covered under a section 1709(8-c) liability reserve. Our conclusion is further supported by the enactment in 1988 of Education Law §3651(1-a), which expressly authorized school districts to establish reserve funds specifically for tax certiorari judgments and claims without voter approval. If the District would like further clarification on the proper use of this reserve they should direct their attorney to contact OSC Legal Services.

Note 12

The Board has not developed a written policy that communicates to taxpayers why the money is being set aside, the Board's financial objectives for the reserves, optimal funding levels, and conditions under which the assets will be used.

Note 13

The *Local Management Guide on Reserve Funds* provides the concepts and background information to allow the District to formulate a reserve fund policy. If additional resources are required, an Internet search on the topic will return dozens of examples of policies that can be tailored to the District's needs.

[14] Specific U.S. Department of Education guidance and communications is generally available at the Department's Recovery Act Web site at http://www.ed.gov/recovery.

APPENDIX C

AUDIT METHODOLOGY AND STANDARDS

To accomplish our objective, we interviewed appropriate District officials and employees, tested selected records, and examined pertinent documents for the period July 1, 2009 through April 30, 2012. To analyze the District's historical appropriation of fund balance and funding of reserves, we extended the audit period back to fiscal year 2008.

Our examination included the following:

- We interviewed District officials and employees to gain an understanding of District operations.
- We reviewed District policies and procedures.
- We obtained an understanding of the District's internal control environment and specific controls that are significant to the District's budget process.
- We reviewed recent audits, management letters, and relevant reports, including corrective action plans, if available.
- We analyzed revenue and expenditure trends and budget-to-actual comparisons for the operating funds for the period 2007-08 through 2011-12.
- We reviewed and analyzed reported fund balance levels in comparison to amounts appropriated in adopted budgets.
- We reviewed ST-3 filings and extensions as submitted to the Office of the State Comptroller to determine if they were timely, accurate, and complete. We also analyzed ST-3s for fund balance reasonableness.
- We reviewed Board minutes from July 2009 through February 2012 for actions relevant to budgeting and financial condition.

We conducted this performance audit in accordance with generally accepted government auditing standards (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 D

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