Office of the New York State Comptroller

Division of Local Government & School Accountability

Madrid-Waddington Central School District

Financial Condition

Report of Examination

Period Covered:

July 1, 2014 – June 30, 2015

2015M-347

Thomas P. DiNapoli

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State of New York
Office of the State Comptroller

Division of Local Government
and School Accountability

April 2016

Dear School District Officials:

A top priority of the Office of the State Comptroller is to help school district officials manage their districts 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 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 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 Madrid-Waddington Central School District, entitled Financial Condition 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 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 Madrid-Waddington Central School District (District) is located in the Towns of Lisbon, Louisville, Madrid, Potsdam and Waddington in St. Lawrence County. The District is governed by the Board of Education (Board), which is composed of 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 District's chief executive officer and is responsible, along with other administrative staff, for the District's day-to-day management under the Board's direction. The Business Official is mainly responsible for the District's finances and accounting records and reports.

The District operates one school with approximately 680 students and 120 employees. The District's budgeted appropriations for the 2015-16 fiscal year were $14.8 million, funded primarily with State aid and real property taxes.

Objective

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

- Did the Board adopt realistic budgets and ensure that the District maintained a reasonable fund balance?

Scope and Methodology

We examined the District's financial records for the period July 1, 2014 through June 30, 2015. We extended our audit scope period back through the 2012-13 fiscal year to analyze the District's historical fund balance, budget estimates and financial trends. We also expanded our scope back through July 1, 2006 and forward through September 23, 2015 to analyze the funding and use of the debt service fund.

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. Except as specified in Appendix A, District officials generally agreed with our recommendations and indicated they planned to take corrective action. Appendix B includes our comment on an issue raised in the District's response.

The Board has the responsibility to initiate corrective action. Pursuant to Section 35 of General Municipal Law, Section 2116-a (3) (c) of 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 Condition

The Board, Superintendent and Business Official are responsible for making sound financial decisions in the best interest of the District, the students it serves and the taxpayers who fund the District's programs and operations. Sound budgeting practices based on accurate estimates, along with prudent fund balance management, help ensure that sufficient funding will be available to sustain operations, address unexpected expenditures and satisfy long-term obligations and future expenditures. Fund balance represents resources remaining from prior fiscal years. A district may retain a portion of fund balance within the limits established by New York State Real Property Tax Law (law). Currently, the law limits the amount of fund balance a school district can retain to no more than 4 percent of the next year's budgetary appropriations.

The Board did not develop reasonable budgets. Over the last three fiscal years, the District spent almost $4.7 million (11 percent) less than budgeted. Because District budgets overestimated expenditures, the District did not need to make transfers to the general fund from the debt service fund as budgeted from 2012-13 through 2014-15. District officials were also unable to demonstrate why $1.8 million in fund balance (as of June 30, 2015) should be restricted in the debt service fund. By removing these excess funds from the general fund, the District, in effect, circumvented the statutory limit on fund balance and reported reasonable levels. If these excess funds were added back to the general fund, the recalculated unrestricted fund balance would be 15.5 percent of the next year's appropriation, or almost four times the legal limit.

General Fund Budgeting

In preparing a realistic budget, the Board must estimate what the District will spend and what it will receive in revenue, estimate how much fund balance will be available at year-end and determine the expected tax levy. Revenue and expenditure estimates should be developed based on prior years' operating results, past expenditure trends, anticipated future needs and available information related to projected changes in significant revenues or expenditures. Accurate estimates help ensure that the real property tax levy is not greater than necessary.

We compared the District's budgeted appropriations to actual expenditures for the last three fiscal years in the general fund and found that the District overestimated expenditures by a combined total of approximately $4.7 million, as shown in Figure 1.

Figure 1: Overestimated Expenditures				
Fiscal Year	Budgeted Appropriations	Actual Expenditures	Difference	Percentage Difference
2012-13	$13,984,990	$12,757,025	$1,227,965	9%
2013-14	$14,793,075	$12,489,135	$2,303,940	16%
2014-15	$15,323,475	$14,174,710	$1,148,765	7%
Total	$44,101,540	$39,420,870	$4,680,670	11%

District officials told us they prepared the budget conservatively to ensure a stable real property tax rate and to provide a cushion for unexpected fluctuations (for example, in utility prices and retirement contribution expenditures). Our review of District expenditures for fiscal years 2012-13 through 2014-15 showed that District officials overestimated employee benefits by $2.6 million (20 percent), services for students with disabilities by $530,000 (12 percent) and building utilities by $510,000 (46 percent).

Because actual expenditures averaged $1.56 million less than budgeted over the three-year period, the District did not need to rely on the debt service fund and appropriated reserve funds, as budgeted, to finance its operations. For the three-year audit period, the Board adopted budgets that included aggregate transfers of $2.9 million from the debt service fund. However, none of these funds were actually transferred from the debt service fund into the general fund. For example, in the 2013-14 fiscal year budget, the Superintendent and Board budgeted the transfer of $1,051,160 from the debt service fund to the general fund to help finance operations, but, in fact, none of this money was transferred to the general fund or used. Furthermore, the District inappropriately made annual transfers of excess general fund balance to the debt service fund prior to 2012-13 (see Debt Service Fund section). This practice led to the accumulation of excess funds in the debt service fund and enabled the District to report year-end unrestricted fund balance at levels that were close to or within the 4 percent legal limit.

Figure 2: Reported Unrestricted Fund Balance			
	2012-13	2013-14[a]	2014-15
Total Beginning Fund Balance	$3,116,561	$2,762,979	$3,291,912
Add: Operating Surplus/(Deficit)	($353,582)	$528,923	($698,977)
Total Ending Fund Balance	$2,762,979	$3,291,912	$2,592,935
Less: Restricted Funds (Reserves)	$1,102,571	$1,915,721	$1,342,076
Less: Appropriated Fund Balance for the Ensuing Year	$750,000	$893,357	$750,000
Total Unrestricted Funds at Year-End	$910,408	$482,834	$500,859
Ensuing Year's Budgeted Appropriations	$14,793,075	$15,323,475	$14,788,913
Reported Unrestricted Funds as Percentage of Ensuing Year's Budget	6.2%	3.2%	3.4%

[a] The total beginning fund balance includes a prior-period adjustment of ($2) and the operating surplus was adjusted by $12 to match the District's audited financial statements.

However, the District's practice of budgeting unnecessary transfers from the debt service fund has perpetuated a high debt service fund balance which has not been used to benefit taxpayers.

Debt Service Fund

The District accounts for and reports a debt service fund which is separate from the general fund. Debt service funds are not required unless segregation of resources is legally mandated. For example, school districts are required to establish a debt reserve that would be accounted for in the debt service fund if there are proceeds from the sale of property on which debt is outstanding. School districts are also required to account for and restrict unexpended bond proceeds and related interest earnings in accordance with statutory provisions. However, there is no other authority for a school district to accumulate unused general fund money in the debt service fund.

Officials did not appropriately use the debt service fund, which had a balance of more than $1.9 million as of June 30, 2015. For fiscal years 2006-07 through 2011-12, the Board passed resolutions to increase the debt service fund using year-end excess general fund balance. The debt service fund balance increased from $39,602 at the beginning of 2006-07 to $1,928,342 at the end of 2014-15. Based on our discussions with District officials and review of related documents, most of the resources in the debt service fund were transferred from fund balance available in excess of resources required for annual operations. Net transfers from the general fund to the debt service fund totaled $1,672,500 from 2006-07 to 2011-12, the last fiscal year that transfers were made.[1] Although during 2014 the District appropriately transferred $131,498 in residual bond proceeds from the capital projects fund to the debt service fund, District officials were unable to demonstrate why the remaining fund balance of $1,796,844 (as of June 30, 2015) should be restricted in the debt service fund.

The District's inappropriate practice of transferring excess general fund balance to the debt service fund in effect circumvents the 4 percent statutory limitation, withholding significant funds from productive use and compromising the transparency of District finances. If the resources in the debt service fund that are not statutorily required to be restricted in that fund were added back to the general fund, the unrestricted fund balance as of June 30, 2015 would be $2,297,703, or 15.5 percent of the next year's appropriations, as shown in Figure 3. This would be almost four times the legal limit.

[1] Transfers were made to the debt service fund every year from 2006-07 to 2011-12 except for 2009-10. The annual transfers ranged from $130,000 to $1,056,102. From 2006-07 through 2014-15, the District also reported $84,742 in interest earnings and other miscellaneous revenues in the debt service fund.

Figure 3: Recalculated Unrestricted Fund Balance

	2012-13	2013-14	2014-15
Total Unrestricted Funds at Year-End	$910,408	$482,834	$500,859
Add: Excess Debt Service Funds	$1,793,296	$1,795,673	$1,796,844
Total Recalculated Unrestricted Funds	$2,703,704	$2,278,507	$2,297,703
Ensuing Year's Budgeted Appropriations	$14,793,075	$15,323,475	$14,788,913
Recalculated Unrestricted Funds as Percentage of Ensuing Year's Budget	18.3%	14.9%	15.5%

For the 2015-16 fiscal year, the Board budgeted interfund transfers of $871,423 from the debt service fund to the general fund. By contrast with the past three completed fiscal years (2012-13 through 2014-15) when the budgeted transfers never took place, the District did transfer most of this amount ($750,000) to the general fund on September 10, 2015 to help pay $950,000 in budgeted debt service. The District is now likely to actually use these funds as planned because it has taken into account historical overestimations and budgeted more realistically and it reduced 2015-16 appropriations by $534,000 (3 percent).

We encourage District officials to maintain realistic budget appropriations and use debt service funds as budgeted.

Recommendations

The Board should:

1. Adopt budgets with realistic estimates of anticipated expenditures and revenues.

2. Determine the source of moneys in the debt reserve fund and return all moneys to the general fund that are not statutorily required to be restricted in the debt service fund.

3. Develop a plan to use the moneys transferred from the debt service fund to the general fund in a manner that benefits District residents. Such uses could include, but are not limited to:

   - Paying off debt.

   - Financing one-time expenditures.

   - Funding legally established, necessary reserves.

   - Reducing real property taxes.

APPENDIX A

RESPONSE FROM DISTRICT OFFICIALS

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

Madrid-Waddington Central School

Lynn M. Roy, Superintendent

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April 1, 2016

Rebecca Wilcox, Chief Examiner
Office of the State Comptroller
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333 E. Washington Street
Syracuse, New York 13202-1428

Dear Ms. Wilcox:

The Madrid-Waddington Central School District is in receipt of the Draft Financial Condition Report of Examination for the period of July 1, 2014 to June 30, 2015. We would like to commend the audit personnel for their professionalism and courtesy in undertaking their responsibilities and interactions with District staff. The District is pleased that the extensive work of auditors from your office resulted in no findings of fraud, waste or abuse. Please allow this letter to serve as the District's response to the audit findings.

While the District does not dispute the findings of the report, we feel that any report that fails to cite the volatile economic climate in which the District has been forced to operate is incomplete at best. Since the State imposed the "Gap Elimination Adjustment" the resulting cumulative loss in revenue to our District amounted to over $2,646,099. Additionally, state aid was frozen for four years resulting in a comprehensive loss of foundation aid of over $700,000. These reductions, coupled with the imposed Tax Levy Cap and legislated intimidation of loss of State Aid linked to negotiations of APPR agreements, created an unprecedented hostile financial environment in which to build responsible budgets.

See Note 1 Page 11

The District has prepared budgets guided by two fundamental principles. The first is the sustainment of educational programs for our District's children. The second is to be fiscally responsible to our community by providing budget and tax rate stability over time. We agree that sound budgeting, along with managing of fund balance and reserves, supports the Districts goals to maintain high quality educational programs, manage emergencies, address unexpected expenses and satisfy long term financial obligations. The District faces many unknown factors when projecting expenditures at the time of budget development.

As cited in your report, the District expended less than budgeted in Employee Benefits, specifically Health Insurance. Due to the unpredictability of Health Insurance utilization, the District, with positive directive from its external auditors, felt it fiscally responsible to annually budget the entire cost of the Employee Health Insurance, since this constitutes a huge fiscal liability. This cost included the premium expenditure as well as the District's self-funded Health Reimbursement and

Savings Accounts. These unused funds from the District's HRA and HSA accounts are part of what the comptroller calls an annual "overestimation" of expenditures. Special Education and Utilities costs are also budget line items with great volatility thereby requiring conservative estimates.

All District transactions take place in public session and the district takes great pains to ensure transparency. The District created a reserve financial plan, which is reviewed and updated by the Board of Education. Transfers to the reserves occurred in accordance with resolutions passed annually in a public session of a board meeting. The District's transfer of money into the Debt Service Fund was confirmed and condoned by the District's external auditors.

Additionally, the District has received strong community support for our budgets. In spite of the caustic environment, Board of Education minutes confirm that tax levy reduction occurred in 2009-10, by $150,000; $107,617 in 2012-13. The Tax Levy had an average growth of only 2.21 % over a 9 year period. For the same time periods, the District's tax rate was reduced by 9.46 % in 2009-10 with subsequent decreases of -3.52% in 2010-11; - .71% in 11-12; and -.14% in 2012-2013. This represents an average of -1.99% in tax rate over 9 years. It should also be noted that the District has remained within or below the tax cap since it was signed into law.

Furthermore, the State Comptroller's Fiscal Health Monitoring, to which the District is subject, contains a scoring system that reflects negatively on the use of reserves and fund balance through the budgeting of operating deficits and reflects positively on the maintenance of higher levels of both undesignated and total fund balances as a percentage of expenditures. The District has received a status of "No designation" as determined by this annual measurement system, for the last three years. However, the most recent 2015 determination of fiscal stress indicates that we are just below "susceptible to fiscal stress" by 1.7% due to operation deficits of gross expenditures exceeding gross revenues.

This designation along with other factors contributed to the District's strong "**AA**" bond rating by Standards and Poor's, which will assist it in securing low interest rates that benefit District taxpayers when looking to borrow for future projects.

The District concurs with the Comptroller's assertion that funds were inaccurately deposited into the Debt Service Fund. However, the District believes that the accrual of these reserve funds was fiscally prudent budgeting. A Corrective Action Plan demonstrating appropriate allocation and utilization of these funds will be presented for approval to the Board of Education on April 18, 2016 and immediately forwarded to the Comptroller's office upon completion.

As always we thank the Office of the State Comptroller for their insight and expertise. It is extremely helpful to have a critical lens focused on our work, and it will only serve to enhance the way we do business.

Sincerely,

Lynn M. Roy

APPENDIX B

OSC COMMENT ON THE DISTRICT'S RESPONSE

Note 1

Our audit is complete in addressing whether the Board adopted reasonable budgets and adequately managed the District's financial condition. Although budgetary decisions may have been influenced by the economic climate, the Board should ensure that the fund balance remains within the provisions established by law.

APPENDIX C

AUDIT METHODOLOGY AND STANDARDS

To accomplish our objective, we interviewed District officials and employees, tested selected records and examined pertinent documents for the period July 1, 2014 through June 30, 2015. To analyze the District's historical fund balance, budget estimates and financial trends, we extended our audit scope period back through the 2012-13 fiscal year. To analyze the funding and use of the debt service fund, we expanded the audit scope period back through July 1, 2006 and forward through September 23, 2015. Our examination included the following procedures:

- We interviewed District officials and reviewed the Board meeting minutes, resolutions and the policy manual to gain an understanding of the process and procedures over the District's financial management.

- We reviewed the results of operations in the general fund for fiscal years 2012-13 through 2014-15.

- We calculated the unrestricted fund balance in the general fund as a percentage of the ensuing year's appropriations to determine if the District was within the statutory limitation during fiscal years 2012-13 through 2014-15.

- We analyzed the trend in total fund balance, including the use of appropriated fund balance, in the general fund for the fiscal years 2012-13 through 2014-15. We compared the appropriated fund balance to the same year's operating results to determine if the appropriated fund balance was actually used.

- We compared the budgeted revenues and appropriations to the actual revenues and expenditures for the general fund for fiscal years 2012-13 through 2014-15 to determine if the District's budgets were reasonable.

- We reviewed the trend of real property tax rates, levies and assessments for fiscal years 2012-13 through 2015-16.

- We analyzed the District's use and funding of reserves during fiscal years 2012-13 through 2014-15 to determine if the funds were properly authorized and planned for. We reviewed reserve balances and compared them to the related reserve liabilities, when applicable, to evaluate the reasonableness of reserve amounts.

- We analyzed the debt service fund balances and activities from the 2006-07 fiscal year through September 23, 2015 to determine if the debt service fund balance was reasonable.

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 D

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