Office of the New York State Comptroller

Division of Local Government & School Accountability

North Rose-Wolcott Central School District

Financial Management

Report of Examination

Period Covered:

July 1, 2014 – January 4, 2016

2016M-22

Thomas P. DiNapoli

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State of New York
Office of the State Comptroller

Division of Local Government and School Accountability

June 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 North Rose-Wolcott 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 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 North Rose-Wolcott Central School District (District) is located in the Towns of Butler, Huron, Lyons, Rose, Savannah, Sodus and Wolcott in Wayne County. The District is governed by the Board of Education (Board), which is composed of seven 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)[1] is the District's chief executive officer and is responsible, along with other administrative staff, for the day-to-day management of the District under the Board's direction. The Business Administrator is responsible for overseeing the District's non-instructional operations, including the financial operations, under the direction of the Superintendent and the Board.

The District operates three schools (an elementary, middle and high school) with approximately 1,200 students and 340 full- and part-time employees. During the 2014-15 fiscal year, the District had operating general fund expenditures of approximately $26.6 million, funded primarily with State aid and real property taxes. The District's budgeted general fund appropriations for the 2015-16 fiscal year are approximately $26.6 million.

Objective

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

- Have District officials adequately managed the District's financial condition by ensuring that reserves are appropriately maintained and by using long-term planning?

Scope and Methodology

We evaluated the District's financial management for the period July 1, 2014 through January 4, 2016. We extended the scope period back to July 1, 2012 to review reserve fund activity.

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 B 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

[1] The current Superintendent was appointed effective January 2015.

generally agreed with our recommendations and indicated that they have taken, or plan to take, corrective action.

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

District officials are accountable to taxpayers for the use of District resources and, therefore, effectively planning and managing District operations. Prudent fiscal management includes maintaining sufficient and appropriate balances in reserve funds to address long-term obligations or planned future expenditures and developing a detailed policy or plan to properly maintain these funds. Funding reserves at greater than reasonable levels can contribute to real property tax levies that are higher than necessary because excessive reserve balances are not being used to fund operations. Further, District officials should develop comprehensive multiyear financial and capital plans that estimate the future costs of ongoing services, upcoming expenditures and capital needs. Sound policies and procedures, prudent fund balance management and multiyear planning help ensure that sufficient funding is available to sustain operations, address unexpected occurrences and satisfy long-term obligations and capital needs.

District officials have not adequately managed the District's financial condition by maintaining reserve fund balances at reasonable levels and developing long-term plans. There is no written plan that details the appropriate and necessary levels for reserve funds and prescribes how the reserve fund balances are to be monitored, analyzed and maintained. As a result, four of the District's 11 reserve funds, totaling more than $6.8 million, may be overfunded or unnecessary. Additionally, District officials have not developed formal multiyear financial or capital plans, which would greatly benefit the District in meeting its current and future obligations and preparing for potentially adverse economic and environmental challenges.

Reserves

Reserve funds may be established by the Board in accordance with applicable laws to provide financing for specific purposes. Money set aside in reserves must be used in compliance with statutory provisions that determine how reserves are established and how they may be funded, expended and discontinued. Generally, school districts are not limited as to how much money can be held in reserves. However, reserve balances should be reasonable. Therefore, a written plan or policy should detail the reserve's purpose, how it is to be funded, how much should be accumulated and how and when the moneys will be used to finance related costs. In addition to guiding District officials, such a plan informs District residents about the use of their tax dollars. The Board should also periodically assess reserve fund balances to determine whether the amounts accumulated are reasonable and necessary. When conditions warrant, the Board should reduce reserve funds to reasonable levels or liquidate and discontinue a reserve fund that is no longer needed, in accordance with statutory requirements.

District officials have not formally established written policies or plans governing reserve funds. As of June 30, 2015, the District had 11 reserves in the general fund totaling approximately $12.5 million, equal to 85 percent of the total fund balance and 47 percent of budgeted appropriations for the 2015-16 fiscal year. Four reserves are capital reserves authorized by voter approval for a specific purpose and funding levels as outlined in budget propositions. District officials have not developed any written criteria to properly monitor the reasonableness of the remaining seven reserve balances and have not analyzed these reserve funds to determine if the balances are necessary and appropriate. We determined that four reserves with balances totaling $6.84 million may be overfunded or unnecessary.

Figure 1: Questionable General Fund Reserve Balances at Fiscal Year-End

Reserve	2012-13	2013-14	2014-15
Insurance Reserve	$3,828,954	$3,827,960	$3,826,678
Retirement Contribution Reserve	$2,080,569	$1,855,288	$1,856,413
Liability Reserve	$660,887	$646,325	$570,894
Unemployment Insurance Reserve	$599,144	$592,012	$587,847
Total	**$7,169,554**	**$6,921,585**	**$6,841,832**

Insurance Reserve – This reserve was established under New York State General Municipal Law (GML) on June 25, 2003 to fund certain uninsured losses, claims, actions or judgements for which the District is authorized or required to purchase or maintain insurance. The District maintains adequate insurance coverage, including an umbrella policy, to limit the need for substantial reserves to fund insurance claims. With the exception of allocated interest, the District has not funded this reserve in the last three fiscal years. During the last two fiscal years, the District has used approximately $7,100 from this reserve to cover certain expenditures related to uninsured claims or losses, while maintaining a balance of $3.8 million. We question the necessity of this reserve. If the Board determines that this reserve is no longer necessary, moneys remaining in this reserve may be transferred to other reserve funds as legally authorized.

Retirement Contribution Reserve – This reserve was established under GML on June 22, 2010. By law, this reserve can only be used to pay retirement contributions for employees covered by the New York State and Local Retirement System. The District cannot include the cost of financing contributions for employees covered by the New York State Teachers' Retirement System. As of June 30, 2015, this reserve's balance of approximately $1.9 million was almost five times the District's average annual retirement contribution expenditures of $395,000. The District initially funded this reserve in 2012-13, and any increases in funding were due to allocated interest. Further, the District typically budgeted for retirement costs in the general fund, paying a small portion of those expenditures (19 percent) by transfers from the reserve and the remainder primarily by levied taxes. Therefore, we question the balance in this reserve. The Board should authorize the transfer of the unnecessary portion of the funds in the reserve to another reserve as authorized by law.

Liability Reserve – This reserve was established under New York State Education Law (Education Law) on June 25, 2003 to cover property loss and liability claims. With the exception of allocated interest, the District has not funded this reserve during the last three fiscal years. During the last two fiscal years (2013-14 and 2014-15), the District used approximately $90,800 to cover certain claims, equal to 16 percent of the June 30, 2015 balance of $570,893. In addition, the District maintains adequate liability insurance coverage that would limit the need for excess funds being held in this reserve. Given the limited use of this reserve, we question its reasonableness.

Unemployment Insurance Reserve – This reserve was established under GML to reimburse the State Unemployment Insurance Fund (SUIF) for payments made to claimants. The District could not provide documentation for the formal establishment of this reserve. The reserve balance of $587,847 as of June 30, 2015 represents 46 years of a typical annual SUIF expenditure,[2] or enough to cover 53 employees at the current maximum reimbursement rate.[3] In the last three fiscal years, the District has not funded this reserve (except for allocated interest) and has used $12,056 from it (32 percent of the $38,197 in total expenditures). In general, the District budgeted for SUIF expenditures in the general fund and levies taxes to fund them; therefore, we question the balance in this reserve. If, at the end of any fiscal year, the money in the fund exceeds amounts required to be paid, the Board, within 60 days of the close of the fiscal year, may elect to transfer all or part of the excess amount to certain other reserve funds, or apply all or part of the excess to the budget appropriation of the next succeeding fiscal year.

Because District officials have not formally established reserve plans or policies or analyzed reserve fund balances to determine whether they are reasonable, the balances of certain reserves are potentially

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2 The District's SUIF expenditures for the last three fiscal years were $26,953 in 2012-13, $7,532 in 2013-14 and $3,712 in 2014-15. Therefore, the average annual expenditures were about $12,700.

3 $11,050, or $425 per week for 26 weeks

overfunded and unnecessary. Therefore, excess District funds have remained idle rather than being used to benefit residents.

Multiyear Planning

It is important for District officials to develop comprehensive multiyear financial and capital plans that project operating and capital needs and financing sources over a three- to five-year period. Such planning allows District officials to identify emerging revenue and expenditure trends, set long-term priorities and goals and avoid large fluctuations in tax rates. Multiyear plans also allow District officials to assess the effect and merits of alternative approaches to address financial issues such as the use of unrestricted fund balance to finance operations and the accumulation of money in reserve funds. Long-term financial plans work in conjunction with Board policies and procedures to provide guidance to employees on the District's financial priorities and goals. District officials must monitor and update long-term plans on an ongoing basis to ensure that decisions are guided by the most accurate information available.

District officials have not developed formal, written multiyear financial or capital plans, although they discuss capital improvements and maintenance regularly and have a building condition survey completed every five years. According to the District's most recent building condition survey, completed in the fall of 2015, the estimated costs to address the issues identified total approximately $57 million. Ideally, a documented multiyear plan will detail the timeline for completion of the items identified and project how the District will fund these improvements.

The failure to develop and adopt adequate multiyear plans limits the District's ability to effectively manage its finances. Accordingly, the District risks not being adequately prepared for adverse economic or environmental changes. Adequate multiyear planning is increasingly important due to recent legislation that limits the ability of school districts to finance their operations through tax increases. Consequently, District officials must consider future needs and available revenue streams in their strategic planning.

Recommendations

The Board and District officials should:

1. Adopt a comprehensive reserve fund plan that addresses the purpose, accumulation and use of reserve funds.

2. Analyze reserve fund levels against the plan for reasonableness and take appropriate action, in accordance with statute, to reduce reserves with excess funds. This can include making statutorily allowed transfers between reserves to align with long-term needs, discontinuing reserves in compliance with

legal restrictions, and/or using excess funds to reduce the tax levy.

3. Develop and adopt a sustainable multiyear financial and capital plan for a three- to five-year period, and make appropriate adjustments to address any ongoing economic or environmental factors.

APPENDIX A

RESPONSE FROM DISTRICT OFFICIALS

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

COUGAR PRIDE

NORTH ROSE - WOLCOTT CENTRAL SCHOOL DISTRICT

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Robert Magin
School Business Administrator

Stephan Vigliotti
Superintendent

Melanie Stevenson
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May 10, 2016

Edward V. Grant Jr., Chief Examiner
Office of the State Comptroller
Division of Local Government and School Accountability
Rochester Regional Office
The Powers Building
16 West Main Street, Suite 522
Rochester, New York 14614-1608

Dear Mr. Grant,

The North Rose-Wolcott Central School District is in receipt of the draft audit report of financial condition for the period July 1, 2014-January 4, 2016 with extended scope period back to July 1, 2012 to review reserve fund activity. The Board of Education and the District Administration of the school district would like to begin by thanking the examiners for their patience and help through the process.

We are pleased to note that *no fraud or mismanagement* was identified through this process. The report noted that the " *Prudent fiscal management includes maintaining sufficient and appropriate balances in reserve funds to address long-term obligations or planned future expenditures, and developing a detailed policy or plan to properly maintain these funds.*" We are pleased that we share the same philosophy with the Comptroller's office.

The Board of Education and the District Administration work diligently to plan budgets, to estimate actual expenditures and revenues, to anticipate future drastic cuts in school aid, to establish reserves to meet long-term obligations, to balance recurring expenditures with recurring revenue sources as well as decreases in those revenues, to maintain all programs that benefit children, and to anticipate long-term economic changes. We also agree with the Comptroller's definition of financial condition and are proud that we have taken these roles seriously. We are pleased that the District has received unmodified external audits with no significant deficiencies or material weaknesses.

State aid predictability is critical for a school district. Yet, since 2010-2011 to the present the district's anticipated Foundation Aid funding has been seriously underfunded by -$5,331,338, -$6,001,703, -$5,914,730, -$5,767,230, -$2,745,264, and -$1,606,625 for a total over that period of time of -$27,366,890. In fact, the district's 2014-2015 Foundation Aid amount only exceeds the 2008-2009 amount by a mere $262,098 ($11,316,241 - $11,054,143); this is a period of six years. The district's Foundation Aid was also frozen at 2008-09 levels until 2012-13; a period of four years.

To make the prediction of state aid predictability more complicated, the Gap Elimination Adjustment (GEA) has been problematic. Since 2010-2011 to the present the district's GEA has totaled -$5,477,825 (that is,-$1,347,839, -$1,745,223, -$1,350,237, -$792,133, -$237,640, and -$4,753 respectively). These reductions have a particularly negative impact on this district compared to wealthier counterparts.

Because of the unpredictability of state aid, which accounts for over 60% of our total revenue, we have had to rely on appropriating reserves and fund balance at various levels in order to maintain a balanced budget and tax levy.

In addition to your findings, we have also considered those of our external independent auditor, and additional recommendations we have received from a facilitator and consultant with regard to the development of a Long Range Financial Plan for the district. This response also incorporates our corrective action plan as outlined below.

Recommendation 1: Adopt a comprehensive reserve fund plan that addresses the purpose, accumulation, and use of reserve funds.

We are currently in the process of developing a written reserve fund plan. Preliminary work will go through the Board of Education's Audit Committee and Budget Committee. The final plan will be presented to the entire Board of Education for adoption no later than June 30, 2016. This plan will outline the purpose, use, and appropriate funding level for all reserve funds. We will incorporate information from your office, our consultant, our external independent audit firm and our insurance agent in determining these funding levels.

Recommendation 2: Analyze reserve fund levels against the plan for reasonableness and take appropriate action in accordance with statute, to reduce reserves with excess funds. This can include making statutorily allowed transfers between reserves to align with long-term needs, discontinuing reserves in compliance with legal restrictions, and/or using excess funds to reduce the tax levy.

Our work with our financial consultant began in early 2015. Since that time we have continued to analyze reserve fund levels and have made various adjustments.

- In January of 2016 the Insurance Reserve was discontinued and the funds were transferred to the Capital Building Reserve, the Capital Bus Reserve, and the Workers' Compensation Reserve, based on guidance provided in General Municipal Law, Education Law, regulation and suggestions gleaned from the Office of the State Comptroller as provided in *Reserve Funds, Local Government Management Guide*. Division of Local Government and School Accountability, Office of the State Comptroller, 2010.

- We will continue to analyze the Retirement Contribution Reserve. It is our plan to appropriate funds from this reserve on an annual basis and replenish as funds become available.

- We are currently examining the Liability Reserve to establish appropriate funding levels. We will be assisted in this examination by our external auditor and our insurance agent. Our goal is to have a funding level that is appropriate when considering potential losses and claims in conjunction with our insurance coverage. Board of Education Action will be taken no later than June 30, 2016 to align funding in this reserve with our adopted plan.

- Our Unemployment Insurance Reserve is currently being examined for appropriate funding levels. We do anticipate a significant increase in our unemployment costs beginning in the 2016 – 2017 school year. The Board of Education will adjust the funding level of this reserve in accordance with their reserve fund plan no later than June 30, 2016.

Recommendation 3: Develop and adopt a sustainable multi-year financial and capital plan for a three- to five-year period, and make appropriate adjustments to address any ongoing economic or environmental factors.

Our financial facilitator and consultant presented our five-year plan, after an exhaustive review of district financial practices, to the Board of Education on April 12, 2016. The Board of Education will take action to adopt our plan no later than June 30, 2016.

In addition, our Building Condition Survey was completed in August of 2015 and identified potential capital needs in excess of $55 million. This was the basis for our Organizational Study Committee that met from December of 2015 to April of 2016. This committee was comprised of community members working with third-party facilitators. Recommendations from the committee and facilitators will be presented to the Board of Education in June of 2016. The Board of Education will begin work in July of 2016 to develop a multi-year capital plan. It is anticipated that this plan will be adopted by June 30, 2017.

Once again, we thank you for your professionalism and for the suggestions. We will use this as an opportunity to re-examine our long range fiscal plan and to continue to plan for the future unanticipated needs.

Sincerely,

Edward Magin, President
Board of Education

Stephan Vigliotti
Superintendent

Robert Magin
School Business Administrator

APPENDIX B

AUDIT METHODOLOGY AND STANDARDS

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

- We interviewed District officials and employees to gain an understanding of the District's financial operations, including reserve funds and multiyear planning.

- We reviewed Board minutes and policies related to reserve funds and long-term planning.

- We reviewed the District's reserve funds for fiscal years 2012-13 through 2014-15, including related expenditures, to determine if reserves were properly and legally established and if they were being funded or used and if the reserve balances were reasonable and necessary.

We conducted this performance audit in accordance with GAGAS. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

APPENDIX C

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