



# Walkill Central School District Financial Management

## Report of Examination

Period Covered:

July 1, 2010 — June 30, 2015

2015M-294



Thomas P. DiNapoli

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# State of New York Office of the State Comptroller

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## **Division of Local Government and School Accountability**

February 2016

Dear 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 Wallkill 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 Wallkill Central School District (District) is located in Ulster County and is approximately 84 square miles. The District includes portions of the Towns of Newburgh, Montgomery, Gardiner, Plattekill and Shawangunk. The District is governed by the Board of Education (Board), which is composed of nine elected members. The Board is responsible for working with District officials to approve the budget and present it to the public. The Board President acts as the chief financial officer. The Superintendent of Schools is the chief executive officer and has the responsibility, along with other administrative staff, for the District's day-to-day management under the Board's direction. The Assistant Superintendent for Support Services is responsible for major phases of the District's business activity including the budget.

The District operates five schools with approximately 3,000 students and 450 full-and part-time employees. The District's budgeted general fund appropriations for the 2014-15 fiscal year were \$69 million, which were funded primarily with real property taxes and State aid.

## Objective

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

- Did District officials ensure budget estimates were reasonable, fund balance was maintained in accordance with statutory requirements and reserves were maintained at reasonable levels?

## Scope and Methodology

We examined the District's financial management for the period July 1, 2010 through June 30, 2015.

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 generally agreed with our recommendations and indicated they planned to take corrective action. Appendix B includes our comments on the issues raised in the District's response letter.

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

The Board is responsible for making sound financial decisions that are in the best interests 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<sup>1</sup> management, help ensure the real property tax levy is not greater than necessary. According to New York State Real Property Tax Law (RPTL), the amount of fund balance that the District can retain may not be more than 4 percent of the ensuing fiscal year's budget. Districts may use the remaining resources to fund the next year's operations or establish reserves to restrict a reasonable portion of fund balance for a specific purpose. Ideally, school districts should fund reserves through the budget process to ensure transparency.

From 2010-11 through 2014-15, District officials adopted budgets for expenditures that resulted in operating surpluses each year. They also appropriated between \$2 and \$3.8 million of fund balance each year that they did not use because of operating surpluses. As a result, total fund balance increased to \$18 million as of June 30, 2015. Furthermore, District officials overfunded reserves by \$12.8 million as of June 30, 2015. With the inclusion of the unused appropriated fund balance and overfunded reserves, the total fund balance actually ranged from \$9 million to \$17.3 million, or between 14 and 24 percent of the ensuing years' budgets, in excess of the 4 percent allowed. District officials funded reserves by transferring surplus funds at year-end rather than through the budget process.

## Budgeting Practices

District officials are responsible for preparing and adopting reasonable budgets based on historical or known trends for appropriations and revenues. It is essential that District officials use the most current and accurate information to ensure that budgeted appropriations are reasonable.

We reviewed the District's general fund budget for 2010-11 through 2014-15 and found that District officials overestimated expenditures by a total of \$26 million (8 percent), as shown in Figure 1. Certain line items made up the majority of the overestimations for the five-year period. For example, the District expended less than budgeted for salaries (\$8.4 million, or 2.5 percent), contract/other services (\$8.4 million, or 2.5 percent) and employee benefits (\$7.9 million or 2.4 percent). District officials could have estimated these expenditures more realistically by using available information, such as actual prior year costs, before preparing the budget.

<sup>1</sup> Fund balance represents resources remaining from prior fiscal years.

**Figure 1: Overestimated Expenditures**

	2010-11	2011-12	2012-13	2013-14	2014-15	Five-Year Total
Appropriations	\$63,874,681	\$64,233,020	\$65,335,416	\$67,287,056	\$69,205,164	<b>\$329,935,337</b>
Actual Expenditures	\$58,630,682	\$59,494,620	\$60,167,291	\$61,820,862	\$63,400,252	<b>\$303,513,707</b>
Overestimated Expenditures	\$5,243,999	\$4,738,400	\$5,168,125	\$5,466,194	\$5,804,912	<b>\$26,421,630</b>
Percentage	8%	7%	8%	8%	8%	<b>8%</b>

District officials told us they feel they are budgeting correctly to smooth out spikes in unpredictable costs and decreases in revenues from State aid. District officials told us that they review actual expenditures and trends while preparing the budget. However, the results indicate otherwise. As a result, the Board adopted inflated budgets each year, which led to excessive fund balance levels and possibly lost opportunities to reduce tax levies.

### Fund Balance

A district may retain a portion of fund balance but must do so within the limits established by RPTL. The amount of unrestricted fund balance that the District can retain may not be more than 4 percent of the ensuing fiscal year's budget. The District may use the remaining resources to fund the next year's budget or to establish reserves for a specific purpose.

From 2010-11 through 2014-15, District officials appropriated between \$2 million and \$3.8 million each year. The amounts appropriated were not used in any of the five years because expenditures were overestimated; thus, the District had an operating surplus in all five years.

**Figure 2: Fund Balance**

	2010-11	2011-12	2012-13	2013-14	2014-15
Beginning Fund Balance	\$8,194,874	\$9,366,090	\$10,507,398	\$12,905,043	\$15,000,128
Less: Prior Period Adjustment	\$89,141				
Operating Surplus	\$1,260,357	\$1,141,308	\$2,397,645	\$2,095,085	\$3,043,083
Year-End Fund Balance	\$9,366,090	\$10,507,398	\$12,905,043	\$15,000,128	\$18,043,211
Less: Restricted Fund Balance	\$2,977,337	\$4,902,609	\$7,742,788	\$9,689,984	\$13,310,523
Less: Appropriated Fund Balance	\$3,800,000	\$3,000,000	\$2,500,000	\$2,500,000	\$2,000,000
Less: Encumbrances	\$28,753	\$45,228	\$25,839	\$54,934	\$170,427
Unrestricted Fund Balance at Year-End	\$2,560,000	\$2,559,561	\$2,636,416	\$2,755,210	\$2,562,261
Unrestricted Fund Balance at Year-End as a Percentage of Ensnung Year's Budget	4%	4%	4%	4%	4%

At the end of 2014-15, the District’s recalculated unrestricted fund balance was approximately \$17 million, or 24 percent of the 2015-16 budget. This occurred because District officials consistently overestimated expenditures, which resulted in increasing levels of fund balance.

With the inclusion of the unused appropriated fund balance and overfunded reserves (as discussed later in this report), the total fund balance was actually in excess of the 4 percent allowed, ranging between 14 and 24 percent of the ensuing year’s budget, as shown in Figure 3.

<b>Figure 3: Recalculated Unrestricted Fund Balance</b>					
	<b>2010-11</b>	<b>2011-12</b>	<b>2012-13</b>	<b>2013-14</b>	<b>2014-15</b>
Unrestricted Fund Balance at Year-End	\$2,560,000	\$2,559,561	\$2,636,416	\$2,755,210	\$2,562,261
Add: Appropriated Fund Balance Not Used To Fund Ensuing Year's Budget	\$3,800,000	\$3,000,000	\$2,500,000	\$2,500,000	\$2,000,000
Add: Excess Reserves	\$2,656,578	\$4,516,368	\$7,612,477	\$9,559,641	\$12,763,376
Total Recalculated Unrestricted Fund Balance	\$9,016,578	\$10,075,929	\$12,748,893	\$14,814,851	\$17,325,637
Unrestricted Fund Balance as a Percentage of the Ensuing Year's Budgeted Appropriations	14%	15%	19%	21%	24%

As a result of the significant increase in fund balance as shown in Figure 3, District officials have missed opportunities to reduce real property taxes. Furthermore, adopting inflated budget estimates for expenditures and appropriating fund balance that will not actually be used to finance operations diminishes the transparency of the budget process.

## **Reserves**

Fund balance may be restricted for particular purposes or appropriated to reduce the real property tax levy. When District officials establish reserve funds for specific purposes, it is important that they develop a plan for funding the reserves and determine how much should be accumulated and how and when the funds will be used to finance related costs. School districts should fund reserves in a transparent manner and 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.

District officials maintain six reserve funds totaling \$13.2 million. Although District officials had appropriated reserve funds for use in 2012-13 through 2014-15, the reserve funds were never used because District officials had budgeted for the corresponding expenditures in operating funds. We reviewed Board resolutions establishing the

reserves and funding methods for the top three reserve funds at the end of 2014-15 totaling \$12,763,375: retirement contribution, workers' compensation and unemployment insurance. While each reserve appears to be properly established, the District generally transfers surplus funds at year-end to fund the reserves instead of funding the reserves in the budget, which is the ideal form of transparency for taxpayers.

Furthermore, even though District officials have available reserves, they budget for and levy taxes to fund retirement, workers' compensation and unemployment expenditures, paying for these expenditures from the annual operating budget. For example, for 2014-15, the District budget included \$900,000 for the New York State and Local Retirement System and \$250,000 for workers' compensation, even though the District had \$5 million in the retirement contribution reserve and \$2 million in the workers' compensation reserve prior<sup>2</sup> to the creation of the 2014-15 budget. It is unclear why these reserves are necessary when District officials routinely budget for these expenditures.

We calculated that, for 2014-15, the District was retaining \$12.7 million in reserves that appeared to be excessive, as illustrated in Figure 4.

	2010-11	2011-12	2012-13	2013-14	2014-15
Retirement Contribution Reserve	\$1,556,578	\$2,866,368	\$5,047,677	\$6,737,054	\$9,187,054
Workers' Compensation Reserve	\$750,000	\$1,250,000	\$2,067,515	\$2,342,268	\$3,102,252
Unemployment Reserve	\$350,000	\$400,000	\$497,285	\$480,319	\$474,070
<b>Total Excess Reserves</b>	<b>\$2,656,578</b>	<b>\$4,516,368</b>	<b>\$7,612,477</b>	<b>\$9,559,641</b>	<b>\$12,763,376</b>

District officials have consistently adopted budgets that generated operating surpluses. District officials have chosen to retain excess funds in the reserves rather than return them to the taxpayers.

## Recommendations

The Board should:

1. Develop budget projections for appropriations that consider prior years' financial results and only appropriate the amount of fund balance that is actually needed to cover expenditures.
2. Review reserves to determine if the amounts reserved are justified, necessary and reasonable. To the extent that they are not, reserves should be properly reduced.

<sup>2</sup> These were the reserve balances at fiscal year-end 2013 that were available when the 2014-15 budget was voted on during 2013-14.

3. Develop a plan to use the surplus fund balance identified in this report in a manner that benefits District taxpayers.

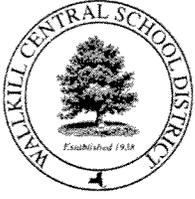
## **APPENDIX A**

### **RESPONSE FROM DISTRICT OFFICIALS**

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

The District's response letter refers to attachments that support the response letter. Because the District's response letter provides sufficient detail of its actions, we did not include the attachments in Appendix A.

The District's response letter refers to a page number that appeared in the draft report. The page numbers have changed during the formatting of this final report.



Kevin Castle  
Superintendent of Schools

Yvonne Herrington  
Assistant Superintendent for Educational Services

Brian Devincenzi  
Assistant Superintendent for Support Services

*The Board of Education of the Wallkill Central School District and its Administration, thank the Office of State Comptroller's Division of Local Government and School Accountability for the opportunity to respond to the Financial Management Report of Examination conducted by your office's auditing team. We would like to commend the audit team for their professionalism and courtesy in undertaking their responsibilities and interacting with District personnel throughout the entire audit process.*

*However, we wish to share our concerns about some of the auditing team's findings, in particular, its conclusion that the District has adopted inflated budget estimates and overfunded reserves, its assertion that the District's budgeting process lacks transparency and its determination that the District needs to issue a corrective action plan.*

*The District's budgeting process has been fiscally sound, consistent with recommendations that the State Comptroller developed and subject to scrutiny at Board presentations before being approved by its residents. All of the reserve funds established and financed by the Board of Education comply with State law. In short, we believe that our budgeting process represents a commitment to improve fiscal management consistent with the mission of the Division of Local Government and School Accountability.*

See  
Note 1  
Page 13

*As background, in 2006 the District received a letter from the Office of Audit Services, which highlighted the need to establish reserves and increase fund balance, establish controls to prevent future operating deficits and carefully monitor revenues and expenditures (see Appendix A). The District responded by addressing the areas of concern and began to look to gain the skills, knowledge and tools to be able to take corrective steps.*

See  
Note 2  
Page 13

*The District attended trainings offered by the Comptroller's Office. Based on these trainings and the multi-year financial planning guide supplied by the Comptroller's Office a number of working documents were developed that continue to be used to address the District's short and long-term planning including: budget forecasting, health insurance spreadsheet, TRS tracking spreadsheet, transportation spreadsheets, salaries tracking spreadsheet, BOCES spreadsheet, utilities tracking/fuel consumption spreadsheet, special education spreadsheet, enrollment spreadsheet, retirement forecasting spreadsheet, cash flow spreadsheet, debt service and the reserve financial plan (see Appendices B - N). The workshops and training guides assisted the District in its efforts to improve the financial condition of the District as can be seen by the District's most recent Fiscal Stress Report (see Appendix O). Without implementing the suggestions in the multi-year planning guide supplied by the Comptroller's Office, the District was heading down a path of potential insolvency. These tools have allowed the District to manage its financial condition on a monthly and annual basis; thus, resulting in stabilizing its budget.*

*We agree that sound budgeting, along with managing of fund balance and reserves, supports the District's goal that sufficient funding will be available 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 it develops the budget. As cited in your report,*

*the District expended less than budgeted in salaries and health insurance. Over the period from 2010-11 through 2014-15 the District had sixty-eight (68) teachers take unpaid leave under the FMLA. The District budgets for the salaries of each individual teacher, but cannot predict with certainty when a teacher may request unpaid leave under the FMLA. As for health insurance, the District received a premium holiday during the 2011-12, 2012-13 and 2013-14 school years. This premium holiday cannot be budgeted, as it is unknown at the time when budgets are developed and ultimately approved. The District also has to forecast out projected increases as rates are not finalized at the time of budget adoption. More specifically, two of the District's insurance plans operate on a calendar year basis (January through December), therefore requiring the District to estimate the uncertain rate increases for the second half of the District's fiscal year (January through June).*

See  
Note 3  
Page 13

*As a result of this planning, the District has been able to manage expenses, increase fund balance, establish reserves and create "fund equity," a concept that the Comptroller emphasizes in its multi-year financial planning management guide (see Appendix P). When the District established reserve funds, based on an operating surplus, the District created a reserve financial plan, which is annually reviewed and updated. Money held in a reserve can only be expended for the purpose of the reserve. The District has properly transferred surplus monies, as evidenced by the positive external audit reports the District has received, to these reserve accounts in accordance with resolutions passed annually in a public session of a board meeting. The funding of the reserves are discussed at board meetings and during audit committee meetings. By establishing the reserves and a long-term reserve plan along with fund balance the District is choosing to purposefully spend them down over a period of time to allow for long-term flexibility during a time when revenue has been restricted, reduced and increasingly unpredictable.*

See  
Note 1  
Page 13

*The reserve funds established by the District comply in all respects with State law. The District has not violated any law or regulation in the amounts that have been deposited into these reserve funds. Also, contrary to the State Comptroller's opinion that the amounts deposited in the reserve funds are "excess" and constitute a part of "recalculated unrestricted fund balance" (see State Comptroller Report, figure 3, page 8), all of the monies transferred into these reserve fund accounts are part of "restricted fund balance," according to GASB Statement Number 54, which the State Comptroller has explained school districts must honor in its financial reporting requirements (see Appendix Q).*

See  
Note 4  
Page 13

*In 2008-09, the District received \$27,404,715 in State aid which equated to 45% of the budget. In 2011-12, the District received \$23,300,000 in State aid which equated to 36% of the budget. In 2015-16 the District is supposed to receive approximately the same amount of State aid that it received in 2008-09 (see Appendices R & S).*

*Despite State aid being nominally the same today as it was seven years ago, the District's expenses have continued to increase. In fact, from 2010 through 2015, the District has lost over \$16,000,000 due to the GAP Elimination Adjustment and over \$22,000,000 due to the loss in Foundation Aid under the original formula. In totality, the District has lost \$38,886,861 in funding owed to the District (see Appendix T). Absent the prudent planning of reserves and fund balance, this District would not have been able to survive a reduction of this magnitude on top of the enacted tax cap that has been in place for four (4) years. During these challenging fiscal times, the District has strategically used its fund balance and reserves to fill a revenue gap to maintain high-quality educational programs, avoid closing school buildings, and maintain instructional staff.*

See  
Note 5  
Page 13

*Additionally, the District has received strong community support for our budgets, has limited the average budget increase over the last five years to 2.1%, has maintained the average tax levy increase at 3.4% and has remained within or below the tax cap since the cap was signed into law (see Appendix U). The District's ability to navigate a steady fiscal course through these tough financial times was due to prudent foresight by*

See  
Note 1  
Page 13

*the Board of Education, through the creation of a multi-year financial plan consistent with the State Comptroller's guidance, the establishment and funding of reserves and an increase in fund balance. Without these developments, the District would not have been able to maintain the high-quality educational programs and highly-qualified instructional staff, who positively influence the student achievement in the classroom, as demonstrated through the increase in our graduation rate (see Appendix V).*

*A "fiscally healthy district" is able to endure short-term financial pressures, revenue shortfalls – i.e. – reduction in State aid (see Appendix W). The District has received a status of "No designation" as determined by the State Comptroller's Fiscal Health Monitoring System that distinguishes the District from others whose status was determined to be "Susceptible to Fiscal Stress," "Moderate Fiscal Stress," or "Significant Fiscal Stress" (see Appendix O). This designation along with other factors contributed to the District's strong bond rating of AA 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 has been proactive in all areas that surround the fiscal health of the District. It has established budgets with realistic estimates of expenditures before adoption. The budget process is a collaborative effort of the Board of Education and building administration, which begins in October and continues through the Spring. As detailed in the Board of Education committee reports given each month, the District consistently provides updates to the Board and the community about the budget process (see Appendix X). The District uses forecasting spreadsheets to look at specific budget codes, for example health insurance, and prior year actuals when developing the spending plan. The District also holds budget presentations throughout the Spring to inform the community about its spending plan, sends out budget newsletters and posts information on the website (see Appendix Y).*

*The Wallkill Central School District is dedicated to the efficient and effective use of taxpayer approved resources. It has acted within the limits of the law when establishing reserves, funding reserves, and increasing fund balance, consistent with the guidance the State Comptroller has recommended. When financial decisions are made, the District looks at the impact on the students, community and staff and works to balance to meet the needs of all. We appreciate and welcome recommendations and feedback from our internal and external auditors, as well as the Office of the State Comptroller, to help assist us in the overall management of the District and in serving the best interests of the Wallkill community.*

*Joséph LoCicero  
Board of Education President*

*Kevin Castle  
Superintendent of Schools*

*Brian Devincenzi  
Assistant Superintendent for  
Support Services*

## APPENDIX B

### OSC COMMENTS ON THE DISTRICT'S RESPONSE

#### Note 1

The District's budget overestimated expenditures by a total of \$26 million over the last five years. With the inclusion of unused appropriated fund balance and overfunded reserves, the total fund balance was effectively in excess of the 4 percent allowed, ranging between 14 and 24 percent of the ensuing years' budgets. Our report does not state that reserve funds did not comply with State law but states that the District was retaining \$12.7 million in reserves that appeared to be excessive.

#### Note 2

The Office of Audit Services is part of the New York State Education Department and is not part of the Office of the State Comptroller.

#### Note 3

The District expended less than budgeted for salaries by \$8.4 million and employee benefits by \$7.9 million. We believe that District officials could have estimated these expenditures more realistically by using available information, such as actual prior year costs.

#### Note 4

The District maintains available reserves to fund retirement contribution, workers' compensation and unemployment expenditures, but routinely budgets for and levy taxes to pay for these expenditures from the annual operating budget. While Governmental Accounting Standards Board (GASB) Statement No. 54 does establish fund balance classifications, we did not state that monies transferred into reserve fund accounts are not part of restricted fund balance. We stated that District officials have chosen to retain excess funds in the reserves rather than return them to the taxpayers.

#### Note 5

During the past five years, the District has experienced operating surpluses totaling \$9.9 million and increased excess reserves by \$10.1 million, bringing the total fund balance to \$17.3 million. There was no use of fund balance or reserves during this period to fill a revenue gap.

## APPENDIX C

### AUDIT METHODOLOGY AND STANDARDS

The objective of our audit was to review the financial management of the District. To achieve our objective and obtain valid audit evidence, we performed the following audit procedures:

- We interviewed District officials, emailed Board members and reviewed documentation to determine the policies and procedures surrounding financial management.
- We reviewed the general fund's results of operations and analyzed changes in fund balance for the period July 1, 2010 through June 30, 2015.
- We compared adopted budgets to operating results to determine if budget assumptions were reasonable.
- We reviewed the appropriation of fund balance and reserves from July 1, 2010 through June 30, 2015.
- We reviewed expenditures and created a pivot table based on the District's budget categories to identify significant expenditures and analyze trends.
- We tested the reliability of the accounting records by comparing the District's independently audited financial statements to the annual financial reports filed with the Office of the State Comptroller. In addition, we reviewed Board minutes to determine if adopted budget amounts in the records were accurate.
- We reviewed budget and revenue status reports.
- We reviewed meeting minutes and interviewed officials to determine whether the District's management was involved in financial matters. We also determined whether management received and reviewed financial reports, analyzed the need for and establishment of reserves and otherwise monitored the District's financial condition.
- We reviewed Board minutes and resolutions to assess the establishment of reserve funds. We reviewed the reserve balances for reasonableness.

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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