

Westfield Academy and Central School District

Financial Management

AUGUST 2018



OFFICE OF THE NEW YORK STATE COMPTROLLER
Thomas P. DiNapoli, State Comptroller

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Report Highlights

Westfield Academy and Central School District

Audit Objective

Determine whether District officials properly managed fund balance and reserves.

Key Findings

- Unrestricted fund balance exceeded the statutory limit by more than \$650,000 (4 percentage points) as of June 30, 2017.
- The Board appropriated fund balance not needed to fund operations and overestimated appropriations by a total of approximately \$2.7 million (6 percent).
- The Board did not adopt an adequate reserve fund policy and three reserves with balances totaling more than \$1 million appear to be overfunded.

Key Recommendations

- Reduce the amount of unrestricted fund balance to within the legal limit.
- Adopt budgets that include realistic estimates for expenditures.
- Adopt a more comprehensive reserve policy and review reserves to determine whether reserve balances are necessary and reasonable.

District officials generally disagreed with our recommendations. Appendix B includes our comments on issues raised in the District's response letter.

Background

Westfield Academy and Central School District (District) serves the Towns of Portland, Ripley and Westfield in Chautauqua County. The District is governed by an elected seven-member Board of Education (Board).

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. The District's Business Administrator oversees the business office and maintains financial records.

The Board, Superintendent and Business Administrator are responsible for developing a realistic budget.

Quick Facts

Enrollment	700 (approximately)
Employees	180
2017-18 Budget	\$15.9 million

Audit Period

July 1, 2014 – June 7, 2018

We extended our audit period back to July 1, 2008 to determine when reserves were established.

Financial Management

What Is Effective Financial Management?

To effectively manage a school district's financial condition, a board must adopt realistic and structurally balanced budgets based on historical data or known trends, in which recurring revenues finance recurring expenditures. In preparing the budget, a board must estimate what the school district will spend and what it will receive in revenue, how much fund balance will be available for use at fiscal year-end and what the expected tax levy will be to balance the budget. Accurate estimates help ensure that the real property tax levy is not greater than necessary.

Boards should retain both a reasonable amount of fund balance for cash flow needs and unexpected expenditures and an adequate amount of reserves for other identified or planned needs. Fund balance is the difference between revenues and expenditures accumulated over time. New York State Real Property Tax Law¹ limits the amount of unrestricted fund balance that a school district can retain to no more than 4 percent of the following year's appropriations. Any unrestricted fund balance over this percentage must be used to reduce the real property tax levy by appropriating fund balance or to fund necessary reserves.

School districts are legally allowed to reserve portions of fund balance to finance future costs (e.g., capital projects or retirement expenditures). While school districts are generally not limited as to how much money can be held in reserves, the balances should be reasonable. A board should balance the intent for accumulating money for future identified needs with the obligation to ensure that the school district's real property tax levy is not greater than necessary. To help ensure that reserve balances do not exceed the amount necessary to address long-term obligations or planned expenditures, a board should adopt a formal written policy that indicates how the reserves will be funded, how much should be accumulated in the reserves and when the money will be used to finance related costs.

Appropriations Were Overestimated and Fund Balance Exceeded the Statutory Limit

District officials need to improve budgeting practices to ensure that budgets are realistic and to address the reasonableness of fund balance. The District's fund balance policy requires the District to maintain unrestricted fund balance within the statutory limit, but District officials have allowed unrestricted fund balance to exceed the statutory limit from fiscal years 2014-15 through 2016-17 by 4 to 6 percentage points. As of June 30, 2017, unrestricted fund balance totaled nearly \$1.3 million and was 8 percent of 2017-18 budgeted appropriations, exceeding the statutory limit by more than \$650,000 (4 percentage points).

¹ New York State Real Property Tax Law Section 1318

While officials appropriated fund balance annually, the appropriated fund balance was not needed to finance operations because District officials overestimated appropriations.

We compared budgeted appropriations and estimated revenues with actual operating results for fiscal years 2014-15 through 2016-17 and found that, while revenue variances were generally reasonable (underestimated by less than 1 percent), appropriations were overestimated by more than \$2.7 million (6 percent), or an average of \$915,000 each year (Figure 1).

Figure 1: Overestimated Appropriations^a

	2014-15	2015-16	2016-17	Totals
Appropriations	\$14,676,000	\$15,035,000	\$15,852,000	\$45,563,000
Actual Expenditures	\$13,652,000	\$13,885,000	\$15,282,000	\$42,819,000
Overestimated Appropriations	\$1,024,000	\$1,150,000	\$570,000	\$2,744,000
Percentage Overestimated^b	7.5%	8.3%	3.7%	6.4%

a Includes budgeted transfers out

b Overestimated appropriations divided by actual expenditures

Because the Board overestimated appropriations, it appeared the District needed to use appropriated fund balance to close projected budget gaps. District officials appropriated more than \$1.7 million,² or \$550,000 on average, from fund balance for the last three fiscal years. However, the District realized operating surpluses totaling \$491,000 during 2014-15 and \$719,000 during 2015-16 and a much smaller operating surplus totaling \$5,000 during 2016-17 (Figure 2). As a result, the District generated a cumulative operating surplus totaling \$1.2 million from 2014-15 through 2016-17. In June 2017, District officials also transferred \$500,000 from fund balance to the capital projects fund to help finance a voter-approved capital project,³ which reduced how much total fund balance increased during the period.

2 The District appropriated \$305,000 for the 2014-15 budget.

3 The capital project was approved by the voters in June 2014.

Figure 2: Unrestricted Fund Balance at Year-End

	2014-15	2015-16	2016-17
Beginning Fund Balance	\$3,889,000	\$4,380,000	\$5,099,000
Add: Operating Results	\$491,000	\$719,000	\$5,000
Less: Transfers Out^a	\$0	\$0	\$500,000
Ending Fund Balance	\$4,380,000	\$5,099,000	\$4,604,000
Less: Reserve Funds	\$2,582,000	\$2,582,000	\$2,647,000
Less: Encumbrances	\$2,000	\$19,000	\$38,000
Less: Appropriated Fund Balance	\$320,000	\$1,071,000 ^b	\$625,000 ^c
Unrestricted Fund Balance at Year-End	\$1,476,000	\$1,427,000	\$1,294,000
Subsequent Year's Budget	\$15,035,000	\$15,852,000	\$15,882,000
Unrestricted Fund Balance as a Percentage of the Subsequent Year's Budget	10%	9%	8%

a Transfer to the capital projects fund to help finance voter approved capital project

b Includes \$500,000 appropriated for transfer to the capital projects fund

c Includes \$225,000 appropriated for transfer to the capital projects fund

Routinely adopting budgets that appropriate fund balance that will not be used can be misleading to residents because they are under the impression that surplus funds will be used to reduce taxes. In addition, annually appropriating fund balance that is not needed to finance operations is, in effect, a reservation of fund balance that is not provided for by statute and a circumvention of the statutory limit imposed on the level of unrestricted fund balance.

Because the District did not use the appropriated fund balance, it actually exceeded the 4 percent statutory limit by higher amounts than reported. When unused appropriated fund balance is added back, unrestricted fund balance exceeded the statutory limit each year by 7 to 9 percentage points (Figure 3).

Figure 3: Recalculated Unrestricted Fund Balance at Year-End

	2014-15	2015-16	2016-17
Unrestricted Fund Balance	\$1,476,000	\$1,427,000	\$1,294,000
Unused Appropriated Fund Balance^a	\$320,000	\$571,000	\$400,000
Recalculated Unrestricted Fund Balance	\$1,796,000	\$1,998,000	\$1,694,000
Subsequent Year's Budget	\$15,035,000	\$15,852,000	\$15,882,000
Percentage of Budget	12%	13%	11%

a Appropriated fund balance less amount transferred to the capital projects fund

The most significant budget variances were in employee benefits (\$1,020,000 or 10 percent), personal services (\$995,000 or 5 percent) and contractual (\$760,000 or 10 percent).

District officials were unable to provide support for the budget estimates used in the past three adopted budgets because the individuals responsible for developing these budgets were no longer working at the District. The District has experienced significant turnover in key administrative positions, including three different business officials over the audit period. Currently, the District has an interim business official and a contracted financial consultant providing business office support and assisting with budget development. The Superintendent stated the District's goal is to more accurately budget appropriations based on actual expenditure trends.

Based on the 2016-17 and 2017-18 adopted budgets, officials have taken positive steps towards maintaining unrestricted fund balance within the statutory limit and developing more realistic budget estimates. The 2016-17 and 2017-18 appropriation estimates are more reasonable than the estimates used in the prior two years. District officials also obtained voter approval to use approximately \$500,000 from unrestricted fund balance in 2016-17 and \$225,000 in 2017-18 to help finance a voter-approved capital project. As a result, fund balance will likely decrease. However, in the 2017-18 budget, estimated State aid revenues increased by approximately \$875,000 (10 percent) and District officials increased the tax levy by approximately \$91,000 (1.5 percent). Because expenditures will likely be similar to prior years and revenues have increased, the District will most likely incur another operating surplus and unrestricted fund balance will remain in excess of the statutory limit.

Given these projections and fund balance levels, the Board has continued to levy more taxes than necessary to sustain operations and may have missed opportunities to better use fund balance and reduce taxes.

The Board Did Not Adopt an Adequate Reserve Fund Policy and Reserves Were Not Reasonably Funded

Although the Board adopted a reserve fund policy, the policy did not address the maximum funding levels for each reserve, the conditions necessary for using the reserve funds to finance the related costs or the circumstances under which reserve funds would be replenished.

As of June 30, 2017, the District reported five general fund reserves (retirement contribution, insurance, unemployment insurance, tax certiorari and employee benefit accrued liability) with balances totaling approximately \$2.6 million. We analyzed the reserves for reasonableness and adherence to statutory requirements and found that three reserves with balances totaling more than \$1 million appear to be overfunded. The remaining two reserves were reasonably funded.

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- The retirement contribution reserve had a reported balance of \$612,000. The District's average annual related expenditures were \$218,000 over the last three years. However, the District did not use the reserve to fund related expenditures and instead used general fund appropriations to pay these costs. Based on this level of expenditure, the District could fund related expenditures with the reserve balance for the next three years.
 - The insurance reserve has reported a balance of approximately \$250,000 and has not been used to pay for any losses since being established in 2014. District officials told us the reserve was established and funded to cover insurance deductibles and claims not fully covered by insurance. Because there has been no activity in the reserve other than interest income, we question the need for funding the reserve at this level.
 - The unemployment insurance reserve is significantly overfunded, with a balance of \$204,000. Over the last three fiscal years, unemployment expenditures have averaged \$3,400 per year. However, based on this level of expenditure, the District could fund related expenditures with the reserve balance for nearly 60 years.

While it is a prudent practice for the District to save for future expenditures, retaining more funds than necessary in reserves may result in missed opportunities to use these funds in a manner that best benefits District taxpayers.

What Do We Recommend?

The Board and District officials should:

1. Adopt annual budgets that contain realistic estimates for appropriations based on historical trends or other known factors.
2. Ensure that the amount of unrestricted fund balance complies with the statutory limit and develop a plan to use excess unrestricted fund balance in a manner that benefits District taxpayers. Such uses include, but are not limited to:
 - Funding one-time expenditures,
 - Funding needed reserves and
 - Reducing District property taxes.
3. Adopt a more comprehensive reserve fund policy that includes how the reserves will be funded, the optimal funding levels for each reserve and the conditions under which reserves will be used to finance related costs.

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4. Review all reserves at least annually to determine whether the amounts reserved are necessary and reasonable, and use excess amounts in accordance with applicable statutes in a manner that benefits residents.

Appendix A: Response From District Officials

Westfield Academy and Central School

David J. Davison
Superintendent of Schools

203 East Main Street
Westfield, New York 14787
Phone: (716) 326-2151
FAX: (716) 326-2195

Julia Murphy
School Business Official

July 9, 2018

State of New York
Office of the State Comptroller
Attn: Mr. Jeffrey Mazula, Chief Examiner
110 State Street
Albany, NY 12236

Dear Mr. Mazula:

The Westfield Academy and Central School District (the "District") has received your draft Report of Examination (the "Report") by the Office of the State Comptroller for the period July 1, 2014 to December 15, 2017. We would like to thank the State Comptroller's auditors for their efforts and audit Report. The Board of Education, Administration and staff always welcome the opportunity for improvement while supporting its goal of providing the best educational opportunities for our students and protecting the District against financial uncertainty.

The Report indicates that the District needs to improve budgeting practices and ensure that budgets are realistic and address the reasonableness of fund balance. The Report cites that over a three-year period, the most significant budget variances were in employee benefits, personal services and contractual items. The District believes it has consistently used realistic estimates in its budgets based on historical trends, current costs, projected enrollment, estimated costs of settling expired collective bargaining agreements and annually varying fringe benefit costs that are outside the District's control.

It is important to note that while the Report indicates that the District had an operating surplus in 2016-17 of \$5,000; there was actually an operating **deficit** of approximately \$495,000 as noted in the District's financial statements audited in accordance with auditing standards generally accepted in the United States. When the District inquired about this discrepancy, the auditors indicated that they purposely excluded the operating transfers to other funds in their calculation for this year. However, in Figure 2 of the draft Report, the previous two years included the operating transfers as expenditures.

See Note 1 Page 10

Also, during the initial time period covered by the audit, the District was in the midst of negotiating contracts with the Westfield Teachers Association and the Instructional Support Staff. Both of these negotiations carried on well into the 2015 fiscal year leading to uncertainty in budget estimates in areas cited as having overestimated appropriations.

The District has also historically experienced significant cost increases due to special education students moving into the District mid-year. One high cost student can increase expenses by at least \$100,000. Therefore, the District must reasonably budget for potential changes in the number of special education

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Westfield Academy and Central School

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School Business Official

students and related contractual costs for services to guard against budget shortfalls that may impact other student programs.

District management appreciates the draft Report acknowledging that officials, over the last two years of the time period covered by the audit, have taken positive steps toward maintaining unrestricted fund balance within statutory limits and developing more realistic budgets. However, we take exception to the auditors speculating the 2017-18 expenditures will likely be similar to prior years, resulting in another operating surplus. The auditors were provided with projections through both March and June 20, 2018 that indicated expenditures are anticipated to exceed the prior year expenditures by approximately \$500,000 and the projected operating deficit was estimated to be approximately \$200,000 at the time the projections were prepared. This would reduce the unrestricted fund balance to less than seven percent of the 2018-19 budget.

See Note 2 Page 10

The District agrees that the reserve fund policy and balances should be revisited and will review policy changes and reserve balances with legal counsel and our External Auditor. These discussions will take place during the summer of 2018 and be incorporated into the District's Corrective Action Plan.

The District acknowledges that it is the duty of the Office of the State Comptroller to audit school districts in the state, and to make recommendations to improve accountability and financial practices. The District also believes that it is the duty of school districts, their governing boards and administration to maintain financial solvency and guard against unanticipated aid reductions and unfunded mandates that could result in educational program reductions that could negatively impact student learning.

Please be advised that this letter does not represent the formal Corrective Action Plan for Westfield Academy and Central School. The District will submit the plan to the Office of the State Comptroller after receipt and review of the final published audit report.

Sincerely,

David Davison

Westfield Academy and Central School Superintendent

Appendix B: OSC Comments on the District's Response

Note 1

Interfund transfers are generally not considered expenditures because they do not involve payment to an external party at the time of the transfer. The \$500,000 transferred to the capital projects fund will be expended at a future date when payment is made to a third party for capital project related expenditures.

The transfer was classified as "other financing sources and uses," not as an expenditure on the District's audited financial statements, which is consistent with our presentation. We did not present interfund transfers separately for the other two years because they were insignificant (interfund transfers totaled \$5,144 in 2014-15 and \$3,962 in 2016-17).

Note 2

We estimated 2017-18 operating results using multiyear trend analysis and financial records. The District's operating results projection differs not only from the results we projected but also significantly from historical trends. We requested support for the District's projections but officials were unable to provide adequate support or explanation for the significant increase in operating expenditures.

Appendix C: Audit Methodology and Standards

We conducted this audit 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. To achieve the audit objective and obtain valid audit evidence, our audit procedures included the following:

- We interviewed District officials and reviewed Board meeting minutes, resolutions and policies to gain an understanding of their budget process and the monitoring of fund balance and reserves.
- We analyzed fund balance in the general fund for 2014-15 through 2016-17 and assessed whether appropriated fund balance was used as budgeted. We also compared unrestricted fund balance with the next years' budget appropriations to determine whether the District was within the statutory limit.
- We performed a budget to actual review for 2014-15 through 2016-17 to assess the results of operations and budget reasonableness. We also compared the 2017-18 budget to prior years' budgets and reviewed preliminary budget estimates for 2018-19. We followed up with District officials on significant budget variances.
- We reviewed reserves to assess whether they were properly established and the reserve balances to assess whether they were reasonable in comparison to related expenditures.

We conducted this performance audit in accordance with GAGAS (generally accepted government auditing standards). 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.

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, pursuant to Section 35 of General Municipal Law, Section 2116-1(3) (c) of New York State Education Law and Section 170.12 of the Regulations of the Commissioner of Education. To the extent practicable, implementation of the CAP must begin by the end of the 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. We encourage the Board to make the CAP available for public review in the District Clerk's office.

Appendix D: Resources and Services

Regional Office Directory

www.osc.state.ny.us/localgov/regional_directory.pdf

Cost-Saving Ideas – Resources, advice and assistance on cost-saving ideas

www.osc.state.ny.us/localgov/costsavings/index.htm

Fiscal Stress Monitoring – Resources for local government officials experiencing fiscal problems

www.osc.state.ny.us/localgov/fiscalmonitoring/index.htm

Local Government Management Guides – Series of publications that include technical information and suggested practices for local government management

www.osc.state.ny.us/localgov/pubs/listacctg.htm#lmgm

Planning and Budgeting Guides – Resources for developing multiyear financial, capital, strategic and other plans

www.osc.state.ny.us/localgov/planbudget/index.htm

Protecting Sensitive Data and Other Local Government Assets – A non-technical cybersecurity guide for local government leaders

www.osc.state.ny.us/localgov/lgli/pdf/cybersecurityguide.pdf

Required Reporting – Information and resources for reports and forms that are filed with the Office of the State Comptroller

www.osc.state.ny.us/localgov/finreporting/index.htm

Research Reports/Publications – Reports on major policy issues facing local governments and State policy-makers

www.osc.state.ny.us/localgov/researchpubs/index.htm

Training – Resources for local government officials on in-person and online training opportunities on a wide range of topics

www.osc.state.ny.us/localgov/academy/index.htm

Contact

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