



# Watertown City School District Financial Condition

## Report of Examination

Period Covered:

July 1, 2014 – October 31, 2015

2016M-85



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**

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 Watertown City 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 Watertown City School District (District) is located in Jefferson County and lies within the City of Watertown and the Towns of Le Ray, Pamela, Rutland and Watertown. 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 District 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 District operates eight schools with approximately 4,000 students and 740 employees. The District's 2014-15 general fund expenditures were approximately \$58.5 million, which were funded primarily with State aid and real property taxes. The 2015-16 budgeted appropriations are approximately \$68.4 million.

## Objective

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

- Did the Board and District management develop realistic budgets and adequately manage the District's financial condition?

## Scope and Methodology

We examined the District's financial records for the period July 1, 2014 through October 31, 2015. We extended our audit scope period back through the 2012-13 fiscal year to analyze historical fund balance, budget estimates and financial trends.

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 agreed with the findings in the report. Appendix B includes our comment on one issue 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 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 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 residents 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 occurrences and satisfy long-term obligations and future expenditures. Fund balance represents resources remaining from prior fiscal years. School districts 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 budgeted appropriations.

Reserve funds may be established by the Board in accordance with applicable laws to provide financing for specific purposes. Prudent fiscal management includes establishing reserves needed to address long-term obligations or planned future expenditures. The Board should fund reserves appropriately, monitor reserve amounts and use them as intended for planned expenditures. When District officials establish a reserve, it is important they develop a formal policy for its use, including how and when disbursements should be made, optimal or targeted funding levels and why these levels are justified. When conditions warrant (subject to legal requirements), the Board should reduce reserve funds to reasonable levels or liquidate and discontinue a reserve fund that is no longer needed or whose purpose has been achieved.

The District has overestimated appropriations in the adopted budgets by about an average of 14 percent annually over the past three years. As a result, a significant portion of the fund balance appropriated in the general fund was not needed to finance operations and unassigned fund balance has exceeded the 4 percent legal limit each of the last three fiscal years. The District has reduced the reported level of year-end unassigned fund balance from 9.3 percent of the ensuing year's budget at the end of 2012-13 to 6.9 percent at the end of 2014-15, but when the unused appropriated fund balance is added back, the recalculated unassigned fund balance exceeds 20 percent of the next year's appropriations for each of the three years.<sup>1</sup> In addition, the District's tax certiorari reserve is overfunded by approximately

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<sup>1</sup> The recalculated fund balance at the end of 2014-15 is an estimate because the amount of fund balance actually needed for the current 2015-16 fiscal year is unknown at this time.

\$567,000 and, based on historic costs, the unemployment insurance reserve has enough funds to cover 37 years of expenditures.

Budgeting and Fund Balance – District officials overestimated appropriations when they prepared and adopted budgets for fiscal years 2012-13 through 2014-15. We compared the District’s general fund budgeted revenues and appropriations with actual results of operations for this period. The District’s revenue estimates were generally close to the actual revenues received. However, officials presented, and the Board approved, budgets which overestimated appropriations for this period. As a result, for each year the District spent an average of approximately \$9.2 million less than planned and consistently budgeted for the use of about an average of \$10.9 million of fund balance and reserves,<sup>2</sup> most of which was not needed. The District’s budget variances for expenditures are shown in Figure 1.

Fiscal Year	Appropriations	Expenditures	Difference	Percentage Difference
2012-13	\$64,594,377	\$56,052,711	\$8,541,666	13.22%
2013-14	\$66,243,377	\$57,053,164	\$9,190,213	13.87%
2014-15	\$68,229,146	\$58,455,418	\$9,773,728	14.32%
<b>Total</b>	<b>\$199,066,900</b>	<b>\$171,561,293</b>	<b>\$27,505,607</b>	<b>13.8%</b>

The majority of overestimated expenditures during this period were for teacher salaries (\$9.9 million or 36 percent), employee benefits (\$5.7 million or 21 percent), instructional expenditures (\$4.3 million or 16 percent) and general support expenditures (\$2.9 million or 11 percent).<sup>3</sup> District officials told us that they budget in a conservative manner in an effort to provide the District with a cushion in the event that expenditures are higher during the year than actual expenditures in prior years. For example, District officials stated that if additional children, especially those with special needs, move into the District during the year, the District may need to hire additional teaching staff and purchase additional materials. And, with additional staff, there would be higher employee benefit costs.

District officials appropriated approximately \$32.8 million<sup>4</sup> of fund balance and reserves over the past three years (averaging about

<sup>2</sup> The District appropriated fund balance each year. It also appropriated \$347,379 of reserves for fiscal year 2012-13.

<sup>3</sup> Instructional and general support includes a variety of expenditures such as Board of Cooperative Education Services, utilities, materials and supplies.

<sup>4</sup> The District appropriated fund balance of \$9,927,196 and reserves of \$347,379 for use in the 2012-13 budget, totaling \$10,274,575. It also appropriated fund balance of \$11,000,506 for 2013-14 and \$11,559,368 for 2014-15.

\$10.9 million each year), which should have resulted in operating deficits and reduced fund balance at year-end. However, due to the overestimation of appropriations, the District experienced much smaller operating deficits than budgeted and most of the appropriated fund balance was not needed (Figure 2).

<b>Figure 2: Unassigned Fund Balance at Year-End</b>			
	<b>2012-13</b>	<b>2013-14</b>	<b>2014-15</b>
Total Beginning Fund Balance <sup>a</sup>	\$23,964,286	\$21,976,700	\$21,850,459
Less: Operating Deficit	(\$1,983,324)	(\$126,244)	(\$694,811)
Total Ending Fund Balance	\$21,980,962	\$21,850,456	\$21,155,648
Less: Restricted Fund Balance (Reserves)	\$4,775,091	\$4,782,621	\$4,799,797
Less: Appropriated Fund Balance for the Ensuing Year	\$11,000,506	\$11,559,368	\$11,559,368
Less: Encumbrances	\$48,263	\$29,028	\$43,168
Unassigned Fund Balance at Year-End	\$6,157,102	\$5,479,439	\$4,753,315
Ensuing Year's Budgeted Appropriations	\$66,243,377	\$68,229,146	\$68,443,146
Reported Unassigned Fund Balance as a Percentage of Ensuing Year's Budgets	9.3%	8.0%	6.9%
<sup>a</sup> Includes prior period adjustments			

Over the past three years, the District's reported unassigned fund balance at year-end exceeded the 4 percent statutory limit. In addition, the unused appropriated fund balance would remain as unassigned fund balance at year-end. We added back the unused appropriated fund balance each year to the reported unassigned fund balance to recalculate the District's actual unassigned fund balance at year-end. The District's recalculated unassigned fund balance significantly exceeded the statutory limit, at 25.7 and 24 percent of the ensuing year's appropriations at the end of the 2012-13 and 2013-14 fiscal years, respectively. During 2014-15, the District appropriated nearly \$11.6 million for the 2015-16 budget. However, based on the 2015-16 projected year-end operating results provided by the District, it is estimated that the District will need to use about \$1 million of the appropriated fund balance. Therefore, we expect the District's recalculated unassigned fund balance to continue to exceed 20 percent of the next year's appropriations (Figure 3).

**Figure 3: Unused Fund Balance**

	2012-13	2013-14	2014-15
Total Unassigned Funds at Year-End	\$6,157,102	\$5,479,439	\$4,753,315
Add: Appropriated Fund Balance Not Used to Fund Ensuing Year's Budget	\$10,874,262	\$10,864,557	\$10,509,368 <sup>a</sup>
Total Recalculated Unassigned Funds	\$17,031,364	\$16,343,996	\$15,262,683
Recalculated Unassigned Funds as Percentage of Ensuing Year's Budget	25.7%	24.0%	22.3%
<sup>a</sup> Estimated			

The result of these budgeting practices made it appear that the District needed to both raise taxes and use fund balance to close projected budget gaps. However, the District's budgets resulted in much smaller than budgeted operating deficits in each of the three years reviewed. The District increased the tax levy about 7.5 percent from \$14.3 million in 2012-13 to \$15.4 million in 2015-16. Had District officials used more realistic budget estimates, they could have possibly reduced the tax levy.

Reserves – As of June 30, 2015, the District had eight reserves totaling approximately \$4.8 million for liability (\$1.4 million), tax certiorari (\$1.2 million), retirement contributions (\$734,786), compensated absences (\$607,075), unemployment insurance payment (\$588,175), insurance (\$188,327), repairs (\$37,117) and property loss (\$32,216). We analyzed these reserves for reasonableness and adherence to statutory requirements. Even though six of these reserves<sup>5</sup> were reasonably funded, the Board has not developed a written policy that states the optimal funding level for the reserves and the conditions under which reserves will be used. In addition, we found that two of the reserves are overfunded.

- Education Law authorizes school districts to establish a tax certiorari reserve fund to pay judgments and claims resulting from tax certiorari proceedings. Funds held in such a reserve may not exceed the amount that might reasonably be deemed necessary to meet anticipated judgments and claims arising out of such proceedings. Any amounts not used to pay judgments and claims must be returned to the general fund within four years of deposit into this reserve.

Although the District's tax certiorari reserve had a reported balance at the end of the 2014-15 fiscal year of approximately \$1.2 million, the list of pending tax certiorari claims, as provided to us by District officials, only totaled approximately

<sup>5</sup> Liability, retirement contributions, compensated absences, insurance, repairs and property loss

\$636,000. Therefore, the tax certiorari reserve is overfunded by at least \$567,000. District officials told us they maintained a balance in the tax certiorari reserve in excess of known claims in case the District is required to pay yet unknown judgments resulting from future property revaluations. However, there is no authority to pre-emptively fund this reserve for future property revaluations.

- General Municipal Law authorizes school districts to create an unemployment insurance reserve to reimburse the State Unemployment Insurance Fund for payments made to claimants. This reserve had a reported balance at June 30, 2015 of \$588,175. During the last three fiscal years, the District spent an average of \$15,634 per year on unemployment claims but did not use reserve funds to pay the claims. Based on this average cost per year, the District's current reserve balance could fund unemployment insurance claims for approximately 37 years. Although this reserve has not increased over the last few years (other than interest), District officials told us they felt comfortable with the amount in the reserve because their intent is to use the funds in the event the District ever needs to make significant layoffs.

By maintaining an excessive unassigned fund balance and excess funds in reserves, and not using the fund balance appropriated in adopted budgets, District officials are withholding significant funds from productive use and may be levying more taxes than necessary to sustain District operations. District officials told us they will consider options to reduce fund balance and reserves. They will also try to use more realistic estimates of appropriations and appropriated fund balance in the budgets.

## Recommendations

The Board should:

1. Develop realistic estimates of appropriations and the use of fund balance in the annual budget.
2. Ensure that the amount of the District's fund balance is in compliance with statutory limits and reduce the amount of fund balance in a manner that benefits District residents. Such uses could include, but are not limited to, reducing District property taxes, increasing necessary reserves, paying off debt and financing one-time expenditures.

The Board and District officials should:

3. Evaluate potential claims to determine the appropriate amounts that will be needed in the tax certiorari reserve and return the remaining moneys to the unrestricted fund balance in the general fund.
4. Develop a formal reserve fund policy that outlines targeted funding levels and indicates when reserve balances will be used to finance related costs.
5. Ensure that reserve fund balances are maintained at reasonable levels and take appropriate action, in accordance with statute, to reduce reserves with excess funds.

## **APPENDIX A**

### **RESPONSE FROM DISTRICT OFFICIALS**

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

# WATERTOWN CITY SCHOOL DISTRICT

TERRY N. FRALICK  
Superintendent of Schools

MARY-MARGARET ZEHR  
Assistant Superintendent for Instruction

JASON RING  
Assistant Superintendent for Personnel

DALE M. MORROW  
Fiscal Officer I

DONNA A. WILLIAMS  
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May 10, 2016

Rebecca Wilcox, Chief Examiner  
State Office Building, Room 409  
333 E. Washington Street  
Syracuse, NY 13202-1428

RE: Watertown City School District's Response to Financial Condition Report of Examination

Dear Ms. Wilcox:

Watertown City School District is in receipt of the Draft Financial Condition Report of Examination for the period of July 1, 2014 to October 31, 2015.

The District is pleased that this extensive examination has resulted in no findings of a material weakness, fraud, waste or abuse. As such, the focus of the referenced examination was our Financial Condition, which resulted in recommendations regarding our budgeting practices, fund balance, and reserve accounts.

The District will develop and then implement a Corrective Action Plan to address the findings in the report.

To date the Watertown City School District has addressed the following needs as noted. During the 2015-16 School Year, the Watertown City School District has utilized Unappropriated Fund Balance to provide several teacher aides in Kindergarten classrooms, as well as a full-time Social Studies Teacher, and a full-time Science Teacher in Watertown High School.

See  
Note 1  
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In addition, the Watertown City School District has allocated Unappropriated Fund Balance to renovate the former Army Reserve Center (facility acquisition) in order to house the tutoring program, the STEM program, and the district-wide Buildings and Grounds operations.

1351 Washington Street, Watertown, NY 13601-4593 – (315) 785-3700; Fax: (315) 785-6855  
"School and Community Working Together"

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We would like to thank the Office of the State Comptroller for their expertise and professionalism.

Sincerely,

Terry N. Fralick  
Superintendent

## **APPENDIX B**

### **OSC COMMENT ON THE DISTRICT'S RESPONSE**

#### Note 1

School districts budgets are subject to voter approval and districts must keep expenditures within legally authorized appropriations. The use of unappropriated fund balance suggests the total appropriations will be increased. To the extent 2015-16 appropriations were overestimated, it is permissible to make budget transfers and use the appropriated fund balance that was approved in the 2015-16 budget.

## APPENDIX C

### AUDIT METHODOLOGY AND STANDARDS

To accomplish our objective, our examination included the following procedures:

- We interviewed District officials to gain an understanding of their budget development process and monitoring procedures and to determine whether the District adopted long-term financial and capital plans and a reserve fund policy.
- We compared the revenues and appropriations in the original adopted budgets to the actual revenues and expenditures in the general fund for fiscal years 2012-13 through 2014-15 to determine if budgeted revenues and appropriations were realistic.
- We reviewed actual expenditures for fiscal years 2012-13 through 2014-15 in order to determine which expenditure types contributed the most to the District's budget-to-actual variances. We interviewed District officials to identify reasons for significant budget variances.
- We analyzed the use of appropriated fund balance in the general fund for fiscal years 2012-13 through 2014-15. We also compared the unassigned fund balance to the next year's budgeted appropriations to determine if the District was within the statutory 4 percent limitation.
- We reviewed tax warrants to identify the trend in the real property tax levy for fiscal years 2012-13 through 2015-16.
- We reviewed reserve balances for fiscal years 2012-13 through 2014-15 and compared them to related expenditures during the same time period, when applicable, to evaluate the reasonableness of reserve amounts.

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.

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