

Rochester Board of Education  
Audit Committee Meeting  
December 4, 2018

**Attendance:** Commissioner LeBron (Chair), Elliott, Hallmark, Powell, Sheppard, Powell, and President White. Distinguished Educator, Dr. Aquino, Superintendent Deane-Williams, Deputy Superintendent of Administration Elizabeth Mascitti-Miller, Chief Financial Officer, Everton Sewell, Director of Accounting, Cerri Cupples, Principal Accountant, John Mahaney, Chief of operations, Michael Schmidt. Board Staff: Ms. Henry-Wheeler and Mr. Brown from Office of Auditor General.

Commissioner LeBron convened the meeting at 5:07 PM.

**I. Freed Maxick Presentation:** Kathryn Barrett presented a summary of the external audit performed for the fiscal year ended June 30, 2018. She reviewed the Audit Plan and stated there was nothing that caused them to deviate from it. She had unmodified opinions on the financial statements, as well as the single audit which is the highest level of assurance an auditor can provide regarding the financial information within this CAFR. There was a qualified opinion for the extracurricular activities. She reviewed the Government-wide Financial Highlights emphasizing the true liability of over \$800M for retiree health insurance to be paid over many years which is a big impact on the District's net position. Ms. Barrett reviewed the Fund Basis Financial statements. She emphasized that the District used \$16.2M out of \$20M budgeted which reduced the District's fund balance to \$49.6M. The deficit was associated with increases in contractual salaries, charter school payments, increasing staffing and supporting underperforming schools.

Charter school costs increased by \$500 per student (4%) and students enrolled at charters increased by 8.4%. For 18/19 cost per student is increasing by almost \$600 per student (4.5%) and enrollment is increasing by another 7.6%. The District gets some of this back through State aid but not all of it. Ms. Barrett stated that we have had two years where total fund balance has declined as a percentage of subsequent year's budget stating that total fund balanced has decreased \$21.2M since June 30, 2016. The unassigned fund balance decreased \$2.6M and the committed fund balance was reduced by \$19.4M related to Other Post Employment Benefits (OPEB) and workers compensation. Commissioner Lebron inquired whether the plan is to put the money back, since we took money from the account. Mr. Sewell explained in addition to the reserve, we have to budget every year for the full amount of workers comp expenditures and OPEB payments in that year. If an extraordinary event comes up, then we can use the reserve and replenish it. Commissioner Lebron stated that if we didn't reduce the committed fund balance by \$19.4M we would have had a deficiency of \$13M in the unassigned fund balance. Ms. Powell inquired if when workers compensation cases are settled, do we perform any kind of budget amendments or take funds out of the workers comp restricted fund because we don't need those funds anymore? Mr. Sewell stated the adjustment is based on actuarial numbers and we have not been adjusting it. This year, we budgeted \$4.8M and will underspend that. Three years ago, we evaluated settling claims rather than carrying a long term liability. At this point, chances of going into that fund are very slim because we budget for it in the current year. There was discussion about the amount of money to be maintained in unassigned fund balance and how the bond council evaluates and rates entities with fund balances.

Rochester Board of Education  
Audit Committee Meeting  
December 4, 2018

In order to maintain sufficient unassigned fund balance if not above 5%, we would have to replenish at 1% per year, and we would have to show efficiencies, reductions, and increase revenues and restructure operations differently. Commissioner Lebron stated that this means cuts and Ms. Barrett stated its more about controlling costs without necessarily making cuts that would impact students. Dr. Aquino asked if controlling costs is enough and Ms. Barrett gave an example where in 2016 the District was able to generate a \$4M surplus. Ms. Barrett presented a benchmark of unassigned fund balance for three large city districts. Commissioner Lebron inquired about why Buffalo had unassigned fund balances greater than 15% and Mr. Sewell stated that the limits are set by Board policy for RCSD.

Ms. Barrett commented on the structural deficit and trends through year 2021. According to our published budget out to 2019, there is a \$20M operating deficit for 2019, \$51.7M for 2020. If revenues and expenses occur according to budget, by 2020 we will have unreserved fund balance deficit of \$35M and total fund balance will be in deficit of \$17M. After 2019, budgetary increases appear in the 4.5 to 4.8% range. In 2020, if we increase only to 3%, and perform 2.5% increases thereafter, assuming the revenues come in; by 2021, you will have positive fund balance. So it does not take a lot to positively impact the fund balance. Dr. Aquino inquired what the big percentage increases were going forward. Mr. Sewell responded that they ranged from 2.5 to 3.4%. For CPI, we are using 2.5% right now. Dr. Aquino spoke about the lack of community understanding and to make sure there is a plan and communication of the reality very soon. Mr. Sewell stated the gap will be disclosed in the near future. Ms. Barrett spoke about other financial highlights including FMP and its incremental impact on District cash flow, and unappropriated fund balance. She spoke about the \$830M OPEB liability, that it will continue to grow and its impact on the budget. Commissioner Lebron inquired about the \$4.4M increase is debt service. Mr. Schmidt stated the estimated cost of school related projects for phase 3 would be about \$600M and used a conservative estimate to anticipate the local share of about \$87M. Commissioner Powell added there is another option relative to capital improvement borrowing. The city does not want us to exceed the 3.5% of the tax base we are legally allowed to levy and apportion to us. They put several restrictions on our spending. If we can talk to the City about lifting those restrictions, we should have those conversations. The reasons are; A funds are not reimbursable, we borrow funds for capital improvement that actually belong to the city and will go back to the city when we are done using the city's borrowing authority, and we will get reimbursed. So given the choice of spending A fund general education dollars on buildings, you are in direct competition with teachers and salaries and everything else we spend A funds on verses increasing our ability to borrow against the tax levy. I pick the tax levy. Mr. Schmidt stated Commissioner Powell was correct but clarified that he was only commenting on what he could control. Mr. Sewell added that the borrowing is also contingent on both city and district building improvements which the district receives aid for. Hence the city does have a say into what projects get done as well. Also if a project is under FMP, we cannot spend CIP money at that site. Mr. Sewell clarified that the \$87M, components of phase 3 will be budgeted for approved pieces that are to be completed in the year budgeted. Projects can span 7 or 8 years. We don't put it all on the books because in government we are obligated to budget every year like a cash basis.

Rochester Board of Education  
Audit Committee Meeting  
December 4, 2018

Mr. Schmidt stated this will be part of the presentation to Finance committee on the 13<sup>th</sup>. If we don't do it where we are reimbursed for the work, then all of the maintenance work comes out of our local share. However this way, we are getting a significant amount of money back reimbursed. The challenge is that the costs only escalate going forward. Ms. Sheppard commented that the \$87M is not locked in and had another concern on timing. Mr. Schmidt stated the 13<sup>th</sup> is based on the Board calendar, the resolution to the Board on the 20<sup>th</sup> is so that we could support the legislative calendar in the spring. The push was to hit the legislation when it opens in January. Commissioner Sheppard inquired about the plan and messaging for the community. Mr. Schmidt concurred that in light of the cash flow situation and known projects, the city CFO will be at our Finance and Joint School Construction Board meeting. Commissioner Powell stated that the important thing Mr. Schmidt needs to accomplish is to get the legislative package in. Ms. Sheppard stated that if we are talking about long term planning and we are trying to project cash needs, we need to be more mindful about planning ahead of time. It has to do with negotiation of contracts, if we are going to be giving or taking away, and it's all relevant. We cannot continue to wait until the last minute until our hands are tied. Commissioner Lebron stated it is relevant because we are seeing numbers that don't look good for us. We need to own it, acknowledge it, and understand the potential relationship of Mr. Schmidt's numbers to these numbers. The CAFR addresses significant issues as well.

**II. Executive Session – Confidential Discussion with External Auditor – Freed Maxick**

There were no confidential matters to discuss.

**III. Outstanding Questions on CAFR:** Dr. Aquino asked if we had considered the true net loss of students that go to charter school, if we excluded the expenses of educating those students if they had remained in the District. He added that we would have to pay for teachers for those additional students which would be cost. It's not truly \$16M. Mr. Sewell explained that we looked at the age groups and grade levels, the amount we are taking out across each of the grade levels warranted some adjustment in FTE, but not enough to say it offset that cost. We did an analysis about two to three years ago to see where the students were coming from and what grade level. Mr. Aquino emphasized that there is a cost for losing students to charter school, but it was usually over exaggerated in terms of the amount, so he had requested that the fixed costs be included if the students remained. Mr. Sewell stated he will do analysis. Commissioner Powell stated one of the biggest risk factors of the charter schools is that we must have space available should the charter close as the Edison charter did and over 1,000 students were affected. We will never be able to completely shrink our footprint in response to charter schools due to the way NYS law is structured. They can close voluntarily, or not renew their charter after 5 years, and we have to be able to absorb them. The FTE issue is a case of not being able to get economies of scale when one kid from any class from a particular building. The bigger issue is that we have to maintain capacity over all in our buildings to absorb them back. Dr. Aquino confirmed that we have about 6,000 students that go to charter schools, and we figure average class size which is not a perfect ratio, adjustments have to be made, however right now those adjustments are not always made.

Rochester Board of Education  
Audit Committee Meeting  
December 4, 2018

Instructional expenses increased by approximately \$20.7M, some \$16M expenses increased due to capital outlay and depreciation, so those are in the category of instructional expenses for teaching? Ms. Cupples responded that it provides the long term liability government wide. There are certain items we don't include in our short term budgetary basis. This is one of those items. We do an allocation amongst programs. Mr. Mahaney stated that we categorize expense by the type of assets we are creating. We take all of the capital outlay expenditures, look at our fixed asset system, and figure out the proportionate expenditures. In this case it would be for classrooms in school buildings and comes across as an instructional expense for depreciation and capital outlays and that's where it comes from. Why it went up to \$20M this year, the increase was the phase 2 FMP program the instructional buildings had an increase in capital outlay over the prior year. All functional expenditures are allocated and if there is a steady state of expenditure you won't see a variance in the current year. Dr. Aquino wanted to know if this would reflect programmatic changes and was told no. **ACTION:** Commissioner Lebron stated her question #3 was not addressed and asked how we will address the shortfall of \$330M. She wanted the question answered with a plan. Commissioner Lebron stated for her question #25, she is not seeing what dollar amount was spent on the Path Forward. Yet the CAFR states we overspent \$16.2M consisting of charters, FTEs, and Path Forward. I specifically asked for a breakdown in each of those categories. Teacher salaries were increased by \$10.8M, Employee benefits increased by \$6.2M, increased charter by \$8.3M, it does not add up to \$16.2M and does not address what was specifically spent on the Path Forward. I would like that number clarified. Mr. Sewell will provide the numbers in a table and break down according to categories listed in the CAFR. Commissioner Elliott inquired about the decision to reduce the Federal Government commodities utilization. It seems like we had a revenue decrease of about \$300k but that is due to not utilizing the Federal surplus commodities? Ms. Cupples will get back to her. Mr. Sewell stated there are certain vendors that we have to purchase from. \$289K was disallowed by the program. Mr. Sewell stated he would go back to see what pieces were disallowed. Commissioner Lebron inquired about the consultants expenditures and if they are part of the \$23.8M and Mr. Sewell stated they are included in the \$23.8M. President White stated if East at the end of the year has unspent monies of the 23.8M, it gets flushed back into the system, but not during the year. Commissioner Elliott inquired how much East has returned to the District. Mr. Sewell stated anywhere from \$2M to \$2.5M of unspent money. However the budget will always say \$23.8 by contract. We cannot reduce their number of FTE's and therefore established a teacher reserve. Commissioner Sheppard inquired about grant disallowances. Mr. Sewell stated that this has to do with Extended School Year (ESY). What hit this year's budget for ESY is money that had been coming in for the past 2 years. We are supposed to be reimbursed at an 80% rate. So we bill them for 80% and 20% hits our general fund. There is sometimes a delay, since this sat out there for two years and then they came back and said this amount is disallowed. It was \$700K and \$200K from 15/16 that just came back in as a receivable and they disallowing this from two years ago. Commissioner Sheppard stated that would be helpful because it suggests that grant monitors are not doing what they need to do, missing deadlines for paperwork to be handed in, and receipts are not matching with invoices. Ms. Cupples stated there are many reasons why things go wrong. The invoice may not make it to AP timely.

Rochester Board of Education  
Audit Committee Meeting  
December 4, 2018

We are rolling out tracking software so we can monitor where the problem areas are and then address them. If you pull ESY out, we have an improvement. Mr. Sewell stated the goal for the Grants Director evaluation was a 50% year over year reduction in grants disallowance. Commissioner Lebron inquired what we were being denied for. Did we try to submit reimbursements for a staff person not allowed? **ACTION:** Mr. Sewell stated he would submit his response on the disallowed costs. He wants to see why we did not get the 80% anticipated. Commissioner Sheppard requested that if monies are not on the same cycle, they be separated out, otherwise it is confusing when monies are rolling over or not. Mr. Sewell stated that we budget for monies that are coming in during that year and there are pieces that are lagging from some grants that get rolled over. Mr. Sewell, working with Commissioner Powell will establish a format to best create clear reporting. Dr. Aquino asked if we exclude ESY, what is the magnitude of the problem and the improvement. Ms. Cupples stated the problem is not that we are spending monies that are disallowed, but that it's primarily a timing issue. The magnitude of the problem is relative to the deficit. Last years was \$300K-\$400K. We need to start holding the line up on the front end. Commissioner Elliot asked if the Budget and Finance departments are dysfunctional. We are not operating at an optimal level. Mr. Sewell stated there are several processes where there are challenges. We have the OSC audit that talks about Procurement and Payroll problems. Sometimes invoices are sent to the person who ordered the service and they don't get it to the AP department to be paid on time. Many times we close out a grant thinking all of the invoices are in and then get invoices later to the point where sometimes we reopen the grant when we can. We broadcast time frames for when POs and invoices have to be complete but we have experienced where there are times that they are outside of that window. As a result, we have incurred a liability. Commissioner Elliott suggested Mr. Sewell needed to be more forceful or hold them accountable. The Auditor General stated we really need to see consequences for not complying with standards that have been set. We have a decent control environment established within the financial house but what happens is that they are only followed in the financial house. We are implementing a Direct Pay component of Concur that currently supports our travel. Claim vouchers will now go through Concur. This is online and better than the existing paper process. We have not known for 10-12 years how to capture some of those claim vouchers. Now we will capture them starting in January. Commissioner Lebron added that she believes we do a terrible job working with our Community Based Organization's (CBO) and how we provide contract services to them. We wait until the last minute to approve contracts. Second I would add, you are at the back end and our obligation is to hold the Superintendent accountable, then the Chiefs, Managers and staff. We were audited and dinged for the same procedural issues. Dr. Aquino stated the district has historically perpetuated a culture that does not promote accountability. This does not only pertain to finance or accounting but is throughout the system. The fact that someone says I'm new and don't know is totally unacceptable. Ignorance is not an excuse. That shows there is no direct accountability from the manager or supervisor to mentor and induct the person in terms of the process and the system allows people to break the rules. The workarounds should not be allowed. Commissioner Lebron spoke about the culture of working around. President White commented about the clear protocols and disciplinary practices associated with withholding peoples pay and you cannot just take it away.

Rochester Board of Education  
Audit Committee Meeting  
December 4, 2018

We are in the process of negotiating new contracts and hiring a new Superintendent. That superintendent may change the cabinet. This is our opportunity to have a conversation with them and their direct reports about accountability and how it might look differently. But right now, Barbara has a contract that says how she can be held accountable and it does not include the possibility of how we can hold money back from her or any of her designees. But, we are about to hire a new Superintendent which represents an opportunity to have conversations about accountability. Midlevel managers need to start writing people up if they don't comply. How many times are people written up for non-compliance? We call it constructive progressive discipline. I bet all the people doing this are not being held accountable in their current contracts. If I was to ask Anissa to perform an audit of how many times those people are written up for doing that, it would not be that much. The Auditor General responded that it would be a fast audit. That's because there are no consequences even under existing contracts. Dr. Aquino stated we have an opportunity to negotiate new contracts, however this goes beyond just the hiring of the new Superintendent. Superintendent Dean-Williams inherited this culture because you are talking about this going back to 2015 and my reports states that this did not begin two years ago. You can have a new superintendent but this is going to take a collective effort, implementing and demanding at all layers to have systems of accountability, whatever those are. People are going to be upset and come to the Board. This is what I meant about a total reset. When you have practices that are not working, in governance, in teaching and learning, in special education, in accountability, in organizational structure, in human capital; you have all of the areas of a system that are not working. You really need to think about a total reset in terms of shifting those practices. I want to caution you that when bringing in a new Superintendent, you are going to be able to implement a system of accountability. President White stated most employees like to get raises and most employees don't like getting things put in their files. I'll bet there is no accountability and it's a quick audit. And if we were to ask Anissa to take a look, I'll bet 9 times out of 10 nobody is written up. Commissioner Lebron added that at the last audit meeting, we had a similar conversation around accountability and our Claims Auditors were told not to approve anything on things where proper procedure was not followed. I asked that they notify the board when these things came up. In that meeting Superintendent Williams stated names were being identified and rolled up to the Chiefs, Deputies, and Superintendent. I asked for an understanding of how many people were in that rollup and process and never got it. I just wanted to say that they identified some kind of system for accountability. Whether or not accountability is happening, I have no idea. The other piece I'd like to comment on is that yes we are in negotiations on new contracts; I don't know what kind of flexibility we are going to have. We cannot afford more than 3%. We have 3.6% contractual obligation raises to RTA. We cannot afford it. I don't know what kind of flexibility we will have with them. I want to put that on the record. Superintendent Williams stated we are not going to disagree on accountability. We do want to be cautious while holding people accountable, to procedures and routines that are overly redundant. And some of our cage busters that refuse to follow procedures because they believe they are not in the best interest of the district; I think they need to be heard. So I would invite opportunities to talk to one or two of the people who routinely cage bust and ask them why they are not following the time lines and rules.

Rochester Board of Education  
Audit Committee Meeting  
December 4, 2018

If there are rules, regulations and protocols that don't make sense, it's incumbent on managers and midlevel managers to figure out what those systems are, and eliminate them. It's holding people accountable in systems that are not functional. Dr. Aquino stated all departments should look at the standard operating procedures, a prioritization plan and leverage those that are most important and need to be addressed immediately because they are creating the most damage to the system. Finance and student safety you really want to prioritize. Commissioner Sheppard stated I feel like what I just heard was another get around. People cannot just not do what we tell them to do. Even if a process or procedure is redundant or not working in your favor, you don't get the option to not do what we tell you to do. I appreciate you want to listen to staff but now it is two years later. You don't get an option. That's what accountability is. Commissioner Lebron stated she agreed with everything Commissioner Sheppard stated. President White stated that one challenge will be the Tri-borough amendment. If any of the unions say no to the less than 3%, the law says that it stays at the rate they are currently at throughout the negotiations. Commissioner Lebron stated then we will have to make cuts if we have to fund the raises of 3.6%. We can keep more people at a lower percentage or we cut teachers. We won't have a choice on this matter. Our kids deserve to be adequately funded for their schools.

**IV. Motion to Forward the CAFR to Board for Approval:** Commissioner Lebron requested a motion to move the CAFR to the full Board. Motion was made by Commissioner Elliott and approved by all present.

The meeting adjourned at 7:53PM.