OFFICE OF THE NEW YORK STATE COMPTROLLER

DIVISION OF LOCAL GOVERNMENT
& SCHOOL ACCOUNTABILITY

Fairport Central School District

Financial Condition and Capital Improvement Project Expenditures

Report of Examination

Period Covered:

July 1, 2009 — December 11, 2012

2013M-23

Thomas P. DiNapoli

Table of Contents

State of New York
Office of the State Comptroller

Division of Local Government
and School Accountability

April 2013

Dear District Officials:

A top priority of the Office of the State Comptroller is to help local government officials manage government resources efficiently and effectively and, by so doing, provide accountability for tax dollars spent to support government operations. The Comptroller oversees the fiscal affairs of local governments statewide, as well as 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 operations and Board of Education governance. Audits also can identify strategies to reduce costs and to strengthen controls intended to safeguard local government assets.

Following is a report of our audit of the Fairport Central School District, entitled Financial Condition and Capital Improvement Project Expenditures. 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 General Municipal Law.

This audit's results and recommendations are resources for local government 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

State of New York
Office of the State Comptroller

EXECUTIVE SUMMARY

The Fairport Central School District (District) is located in the Town of Perinton, in Monroe County. The District is governed by the Board of Education (Board) which comprises seven elected members. The Board is responsible for the general management and control of the District's financial and educational affairs. The Superintendent of Schools is the chief executive officer of the District and is responsible, along with other administrative staff, for the day-to-day management of the District under the direction of the Board.

There are eight schools in operation within the District, with approximately 6,400 students and 1,170 employees. During the 2011-12 fiscal year, the District had operating expenditures[1] of approximately $102 million, funded primarily with State aid and real property taxes. The District's budgeted expenditures for the 2012-13 fiscal year are $107.2 million.

Scope and Objectives

The objectives of our audit were to examine the District's financial condition and capital improvement project expenditures for the period July 1, 2009, to December 11, 2012. Our audit addressed the following related questions:

- Has the District taken adequate action to address the reasonableness of fund balance?

- Are capital project expenditures properly supported and within the amount authorized and approved?

Audit Results

Over the last five years, the District's tax levy only had an average change of 1.09 percent. However, District officials' conservative budgeting practices generated $15.8 million[2] in net operating surpluses.[3] As a result of these operating surpluses, the accumulated fund balance would have exceeded the statutory maximum of 4 percent of the ensuing year's budget.[4] However, to reduce the fund balance

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1 Including operating transfers

2 $5 million of this total was a transfer to the capital projects fund in the 2008-09 fiscal year that was not approved by the voters.

3 The District had an operating deficit of $209,247 for the 2007-08 fiscal year and operating surpluses of $7,406,316 for 2008-09, $3,066,825 for 2009-10, $3,544,703 for 2010-11, and $2,031,473 for 2011-12.

4 The Real Property Tax Law statutory limit of unappropriated, unreserved fund balance (called "unexpended surplus funds" for fiscal years ending June 30, 2011 and beyond) increased from 3 percent of the 2007-08 fiscal year's budget to 4 percent of the 2008-09 fiscal year's budget and years thereafter.

and stay within the 4 percent limit, District officials transferred moneys to the District's reserves and have continuously increased the amount of fund balance appropriated, which has gone unused for the last four years. These budgeting practices circumvented statutory controls and resulted in taxpayers paying more than necessary to sustain District operations. As a result, the District's general fund's fund balance increased to $48,661,075 as of June 30, 2012.

We also found that the District did not solicit proposals for approximately $2.7 million in professional services for a capital improvement project (CIP), as required by the District's policy. In addition, we found that the expenditures for architectural services were not properly supported.

Comments of District Officials

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 disagreed with the findings and recommendations in our report. Appendix B includes our comments on the issues raised in the District's response letter.

Introduction

Background

The Fairport Central School District (District) is located in the Town of Perinton, in Monroe County. The District is governed by the Board of Education (Board) which comprises seven elected members. The Board is responsible for the general management and control of the District's financial and educational affairs. The Superintendent of Schools is the chief executive officer of the District and is responsible, along with other administrative staff, for the day-to-day management of the District under the direction of the Board.

There are eight schools in operation within the District, with approximately 6,400 students and 1,170 employees. During the 2011-12 fiscal year, the District had operating expenditures[5] of approximately $102 million, funded primarily with State aid and real property taxes. The District's budgeted expenditures for the 2012-13 fiscal year are $107.2 million.

Objectives

The objectives of our audit were to examine the District's financial condition and capital improvement project expenditures. Our audit addressed the following related questions:

- Has the District taken adequate action to address the reasonableness of fund balance?
- Are capital project expenditures properly supported and within the amount authorized and approved?

Scope and Methodology

We examined the District's financial condition and capital project expenditures for the period July 1, 2009, to December 11, 2012.

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 disagreed with the findings and recommendations in our report. Appendix B includes our comments on the issues raised in the District's response letter.

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[5] Including operating transfers

The Board has the responsibility to initiate corrective action. Pursuant to Section 35 of the General Municipal Law, Section 2116-a (3)(c) of the 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 responsibility for accurate and effective financial planning rests with the Board, the Superintendent, and the Business Official. District officials must ensure that budgets are prepared, adopted, and modified in a prudent manner, accurately depicting the District's financial activity while also using available resources to benefit its taxpayers. Prudent fiscal management also includes maintaining sufficient balances in reserves to address long-term obligations or planned expenditures. In doing so, District officials should adopt a policy or plan governing the use of reserve funds and ensure that residents are fully informed of all reserve funding and activity.

Over the last five years, the District's tax levy only had an average change of 1.09 percent. However, District officials' conservative budgeting practices generated $15.8 million[6] in net operating surpluses.[7] As a result of these operating surpluses, the accumulated fund balance would have exceeded the statutory maximum of 4 percent of the ensuing year's budget.[8] However, to reduce the fund balance and stay within the 4 percent limit, District officials transferred moneys to the District's reserves and have continuously increased the amount of fund balance appropriated for taxes which has gone unused for the last four years. District officials' continued use of these budgeting practices resulted in taxpayers paying more than necessary to sustain District operations. As a result, the District's general fund's fund balance increased to $48,661,075 as of June 30, 2012 (see Chart 1).

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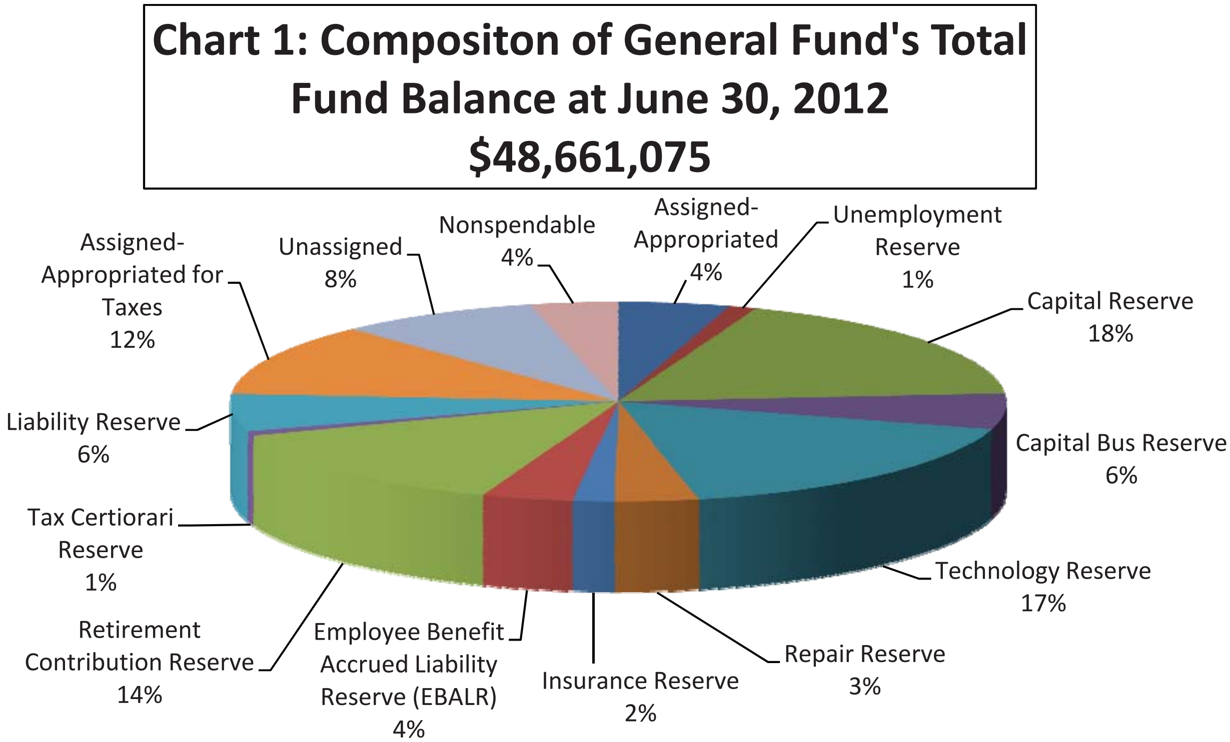
[6] $5 million of this total was a transfer to the capital projects fund in the 2008-09 fiscal year that was not approved by the voters.

[7] The District had an operating deficit of $209,247 for the 2007-08 fiscal year and operating surpluses of $7,406,316 for 2008-09, $3,066,825 for 2009-10, $3,544,703 for 2010-11, and $2,031,473 for 2011-12.

[8] The Real Property Tax Law statutory limit of unappropriated, unreserved fund balance (called "unexpended surplus funds" for fiscal years ending June 30, 2011 and beyond) increased from 3 percent of the 2007-08 fiscal year's budget to 4 percent of the 2008-09 fiscal year's budget and years thereafter.



Budgeting and Use of Fund Balance

The Board is responsible for preparing and presenting the District budget to the public for vote. In preparing the budget, the Board must estimate what the District will receive in revenue (e.g., State aid), how much fund balance will be available at fiscal year-end (some or all of which may be used to fund the ensuing year's appropriations and to balance the budget), and what the expected tax levy will be. Accurate estimates help ensure that the levy of real property taxes is not greater than necessary.

The estimation of fund balance is an integral part of the budget process. Fund balance represents resources remaining from prior fiscal years that can be used to lower property taxes for the ensuing fiscal year. A district may retain a portion of fund balance, referred to as unexpended surplus funds,[9] within the limits established by Real Property Tax Law. Districts may also establish reserves to restrict a

[9] The Governmental Accounting Standards Board (GASB) issued Statement 54, which replaces the fund balance classifications of reserved and unreserved with new classifications: nonspendable, restricted, and unrestricted (comprising committed, assigned, and unassigned funds). The requirements of Statement 54 are effective for fiscal years ending June 30, 2011 and beyond. To ease comparability between fiscal years ending before and after the implementation of Statement 54, we will use the term "unexpended surplus funds" to refer to that portion of fund balance that was classified as unreserved, unappropriated (prior to Statement 54), and is now classified as unrestricted, minus appropriated fund balance, amounts reserved for insurance recovery and tax reduction, and encumbrances included in committed and assigned fund balance (post-Statement 54).

portion of fund balance for a specific purpose, also in compliance with statutory directives.

The District reported unexpended surplus funds at a level that complied with statute. However, because the District has ended four of the last five fiscal years with an operating surplus, the appropriated fund balance included in each year's budget was not needed to finance planned expenditures. Because of the operating surpluses, little to none of the $12.8 million of appropriated fund balance was used to cover expenditures.[10] Instead, the District used excess surplus funds to finance reserves, as described later in this report.

From fiscal years 2007-08 through 2011-12, the District generated net surpluses totaling approximately $15.8 million, an average of approximately $3.2 million in each fiscal year and averaging 5.15 percent of the tax levy over the five-year period.

Reserves

Reserves may be established by the Board in accordance with applicable laws. Moneys set aside in reserves must be used only in compliance with statutory provisions which determine how reserves are established and how they may be funded, expended, and discontinued. Generally, school districts are not limited as to how much money can be held in reserves. However, reserve balances must be reasonable. Funding reserves at greater than reasonable levels contributes to real property tax levies that are higher than necessary because the excessive reserve balances are not being used to fund operations. The Board is responsible for developing a formal plan for the use of its reserves, including how and when disbursements should be made, optimal or targeted funding levels and why these levels are justified, and for ensuring that appropriate documentation is maintained to account for and monitor reserve activity and balances.

As of June 30, 2012, the District had 10 reserves in the general fund totaling approximately $34.8 million. We analyzed these reserves for reasonableness and adherence to statutory requirements, and found the funding of the capital reserve, tax certiorari reserve, employee benefit accrued liability reserve, reserve for liabilities, and insurance reserve to be reasonable. However, the reserves for retirement, unemployment insurance, repair, and capital technology, totaling approximately $17.3 million, were questionable as to the amounts required for their stated purposes and the amounts actually retained. Table 1 shows the balances in these reserves at June 30, 2012.

[10] Only $209,247 of the $1.3 million in appropriated fund balance was used for the 2007-08 fiscal year.

Table 1: Questionable General Fund Reserve Balances			
	Year Established	Balance at June 30, 2012	Expended from July 1, 2007 to June 30, 2012
Capital Technology	2005	$8,353,791	$0
Retirement Contribution	2007	$6,704,395	$0
Repair	1995	$1,696,576	$0
Unemployment Insurance	2007	$565,099	$236,587
Total		**$17,319,861**	**$236,587**

Capital Technology Reserve – The Capital Technology Reserve was established in 2005 for the purpose of financing, in whole or in part, the purchase of computer equipment, apparatus and peripherals such as printers, modems, file servers, communication devices, and required wiring of the same. The reserve was established with a 10-year term and $10 million maximum limit.

Over the first four fiscal years, the District funded the reserve with a total of $8.98 million and expended $1.5 million. The District has not funded or expended any moneys from this reserve since, even though the approved 2005 Technology Plan had a total budget of $7 million.[11] Because this plan was never completed or expended as approved by voters, the Capital Technology Reserve had a balance of $8,353,791 as of June 30, 2012 and is due to expire in 2015.

Although the District prepared a new capital technology plan in 2012 that anticipates expending $14,342,500 over the next 10 years and using this reserve as a funding source, the scope of the 2012 plan has materially changed from the 2005 plan. Therefore, District voters have not had an opportunity to accept or approve this revised plan or the use of the reserve in this new way. In fact, taxpayers who agreed to finance these expenditures in 2005 saw little benefit from their tax moneys to date because little (approximately 17 percent) was spent to upgrade technology.

Retirement Contribution Reserve – By law, this reserve can only be used to pay benefits for employees covered by the New York State and Local Retirement System. The District cannot include the cost of financing contributions for employees covered by the New York State Teachers' Retirement System. The Retirement Contribution Reserve was originally funded with $2 million during the 2007-08 fiscal year

[11] Technology purchases have been made through the operating budget.

and was funded an additional $4.7 million during 2010 and 2011. The balance of this reserve at June 30, 2012 was $6,704,395.

No moneys have been expended from the reserve since it was funded. Instead, the Board budgeted for retirement costs in the general fund and levied taxes to fund them. Annually, the District receives projected contributions and rates from the New York State and Local Retirement System. These projections are for the current and ensuing fiscal years. The current Retirement Contribution Reserve balance is approximately 2.5 times the projected retirement contribution payment for 2013.[12]

Repair Reserve – The District established this reserve in June 1995 to pay for the cost of certain repairs or capital improvements to equipment that do not recur annually. According to District officials, the reserve would only be used in emergency situations and is a "safety net" for repairs that are significant enough that funds may not be available in the District's operating budget. By making this stipulation, District officials have essentially circumvented the legal requirement for holding a public hearing prior to appropriating funds because moneys may be expended from this reserve in an emergency with only a two-thirds vote of the Board.

Since our last audit, the District has discontinued funding this reserve but has not appropriated any moneys for expenditures. The balance of the Repair Reserve as of June 30, 2012 was $1,696,576, which is 1.6 percent of the 2012-13 budgeted appropriations ($107,201,812).

Unemployment Insurance Reserve – This reserve is allowed for reimbursing the State Unemployment Insurance Fund (SUIF) for payments made to claimants where the school district has elected to use the "benefit reimbursement" method based on actual unemployment claims.

The District made payments to the SUIF totaling $236,587[13] for the five-year period July 1, 2007 through June 30, 2012, or an average of $47,317 a year. Although the District has taken steps to reduce the balance of the Unemployment Insurance reserve since our last audit,[14] the balance of the reserve was $565,099 as of June 30, 2012, which is almost 12 times the average annual expenditures.

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[12] Paid on either December 15, 2013, or February 1, 2014

[13] The NYS UI Fund expenditures were $24,144 for the 2007-08 fiscal year, $6,421 for the 2008-09 fiscal year, $74,467 for the 2009-10 fiscal year, $46,720 for the 2010-11 fiscal year and $84,835 for the 2011-12 fiscal year.

[14] The Unemployment Insurance Reserve had a balance of $753,844 at June 30, 2008, which was over 26 times the average annual expenditures of the previous five years (2003-08).

By maintaining excessive and/or unnecessary reserves, combined with ongoing budgeting practices that generate repeated operating surpluses, the Board and District officials have withheld significant funds from productive use, levied unnecessarily high taxes, and compromised the transparency of District finances to the taxpayers.

Recommendations

1. District officials should develop a plan for the use of the surplus balances in unexpended surplus funds identified in this report in a manner that benefits District taxpayers, and provides appropriate transparency through the budget process with public disclosure. Such uses could include, but are not limited to, reducing District property taxes or funding one-time expenditures.

2. The Board should review all reserves and determine if the amounts reserved are necessary, reasonable, and in compliance with statutory requirements. To the extent that they are not, transfers should be made to unrestricted fund balance, where allowed by law, or other reserves established and maintained in compliance with statutory directives.

Capital Improvement Project Expenditures

A capital project is a plan for the acquisition and/or construction of capital facilities, capital improvements and major equipment purchases. All the financial activities related to capital projects are recorded and reported in the capital projects fund. The Board is responsible for establishing procedures to properly authorize, finance, and monitor the status of individual capital projects to ensure that moneys are properly accounted for and used only for their intended purposes. Such procedures also include maintaining complete and accurate accounting records, and retaining documentation to support payments made.

In 2006, the District sought to spend a total of $76.3 million to construct new school facilities and to improve existing school facilities, including site improvements, original furnishings, equipment, machinery, apparatus, and incidental improvements. A special vote was held on February 14, 2006, but the capital improvement project (CIP) proposition was defeated. As a result of the defeated proposition, District officials decided to divide the CIP into three phases.

- Phase I, which primarily focused on roofing projects at various district buildings, was completed in May 2008 at a total cost of $5.3 million.

- Phase II was approved by District voters on May 15, 2007 in the amount of $12.6 million for improvements to two buildings – Johanna Perrin Middle School and Fairport High School. Phase II was completed by June 30, 2009 at a total cost of $12,594,397.

- Phase III was approved by voters on December 6, 2007 in the amount of $29.9 million for improvements of other District buildings. As of June 30, 2012, Phase III had expenditures of $29,524,152 and was not completed as a result of pending litigation with two contractors.

We found that the 427 proposed change orders[15] for the phases II and III, totaling approximately $1.2 million, were proper CIP expenditures and properly approved. However, we found that the District did not solicit proposals for approximately $2.7 million in CIP-related professional services, as required by the District's policy.

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[15] A change order is used to officially make changes to a signed contract for capital construction.

In addition, we found that expenditures for architectural services were not properly supported.

Procurement of Services

An effective procurement process includes confirming that vendors/consultants are eligible to provide necessary services; obtaining requests for proposals (RFPs)[16] from providers of professional services; and requiring written contracts detailing contract terms and deliverables, such as the contract period, services to be provided, and the basis for compensation for these services before services are provided to the District. Written contracts also help to protect the District in the event that contractors default on their obligations or make excessive claims.

District policy indicates that goods and services which are not required by law to be procured through competitive bidding will be procured in a manner to ensure the prudent and economical use of public moneys in the best interests of the taxpayers. Officials should assure that goods and services are procured in the most prudent and economical manner, that goods and services of desired quality are being acquired at the lowest possible price, and to protect against favoritism, improvidence, extravagance, fraud, and corruption. Board policy indicates that alternative proposals or quotations will be secured by RFPs, written or verbal quotations. Alternative proposals secured by RFPs benefit the District by providing a comparison of the qualifications and fee structure for various professional services.

Although the Board adopted a purchasing policy requiring the use of an RFP to procure professional services, the District neglected to do so for $2.7 million in professional services used for the CIP. At the beginning of the CIP, the District solicited and obtained a construction management company (CMC) for the entire CIP at a cost not to exceed $1.7 million. However, the CMC changed twice during Phase II and III without solicitation. District officials informed us that the change in CMC was a result of the project manager leaving the initially solicited company to form his own construction company. When the project manager then sold his newly formed company to his former employer to create a joint venture, the District again followed the project manager. Because District officials failed to solicit competition, the total amount paid to date for construction management services for all three phases was about $444,104 more than the original amount approved.[17]

[16] An RFP is a highly-structured document that specifies minimally acceptable functional, technical, and contractual requirements, as well as the evaluation criteria that will govern the contract award.

[17] Construction management services costs identified were $27,140 for Phase I, $596,700 for Phase II, and $1.5 million for Phase III for a total of $2,152,904.

The District also paid $404,526 to three separate vendors for capital project related professional services,[18] $70,459 for legal services, and $51,300 for financial services that were not solicited using an RFP process. Although all the contracts were approved by the Board, the District cannot be sure that they have acquired professional services in the most economical manner and in the best interest of District taxpayers.

Architectural Services and Fees

On March 19, 2008, the Board approved a contract for architectural, engineering and surveying pre-construction and construction services for Phase II. According to the contract, the scope of the Architect's basic services included six phases for each of the two buildings and each phase was assigned a percentage of the basic compensation fee.[19] According to the contract, the basic compensation fee is calculated based on a percentage (7 percent) of the total construction cost, which is defined as the total cost or estimated cost of all elements of the CIP designed or specified by the Architect. For example, if the project's construction cost is $12.3 million, the Architect's total basic compensation would be $861,000 (7 percent). This contract was also extended for Phase III and approved by the Board on January 6, 2009. However, while the same percentages were allocated to the Architect's six phases of basic services, they were contracted for a lump sum of $1,745,800.

During our audit period 81 claims were paid to the Architect totaling approximately $2,749,810, which included $2,492,121 for basic compensation fees, $218,250 for reimbursable expenses and labor, $36,989 for pre-referendum services, and $2,450 for a consultant. Because the Architect's invoices were not detailed or contained insufficient supporting documentation, we were unable to verify that the amounts charged were appropriate District expenditures and consistent with the approved contract. Specifically, while the contract provided rates for various personnel positions for architectural work, the reimbursable expense invoices did not include any rates at which employees were being charged. Without detailed invoices, we were unable to determine if the fees paid were in compliance with contract terms.

As a consequence of the failure to ensure that proper supporting documentation is submitted and verified prior to payment, District officials cannot be certain that they are paying for the agreed-upon

[18] These capital project services included construction materials testing and inspection services, geotechnical services, and environmental testing and consulting.
[19] The percentage assigned to each phase is as follows: schematic design (10 percent), design development (15 percent), construction documents (40 percent), bidding (5 percent), construction (25 percent) and closeout phase (5 percent).

services and that the services are delivered in accordance with District requirements.

Recommendations

3. The Board should ensure that District officials comply with the District's purchasing policy and award professional services contracts only after soliciting RFPs.

4. The District should ensure that professional service providers submit proper itemization and support for reimbursable expenses.

APPENDIX A

RESPONSE FROM DISTRICT OFFICIALS

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

Quality Learning & Caring...

FAIRPORT CENTRAL SCHOOL DISTRICT

Jon G. Hunter, Ed.D.
Superintendent of Schools

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March 27, 2013

Mr. Edward V. Grant Jr., Chief Examiner
Office of the State Comptroller
The Powers Building
16 West Main Street – Suite 522
Rochester, New York 14614-1608

Dear Mr. Grant:

The Fairport Central School District is in receipt of the draft report, *Financial Condition* and *Capital Improvement Project Expenditures* for the period July 1, 2009, through December 11, 2012, prepared by the Office of the State Comptroller. The Rochester, New York Office of the State Comptroller's Office reviewed the internal controls and evaluated financial oversight, cash receipts and disbursements, purchasing, payroll, and personnel services that the District has in place to safeguard assets. We are most proud to note that this report does not present a single material finding or procedural weakness in these areas.

We welcomed the opportunity to review the District's report with the local Office of the State Comptroller. Unfortunately, during our initial meeting on March 13, 2013, your staff refused to meet with us when a second board member attempted to enter the District Office conference room. We are disappointed that our efforts for transparency to discuss the report were not reciprocated. Internally, we have thoroughly reviewed and discussed the findings and recommendations of the Report and respond accordingly.

See Note 1 Page 24

We disagree with the opinions and noted certain inaccuracies with their report. We are also concerned that there seems to be a specific tone in the draft report with respect to the District's fiscal operations and financial condition. This is concerning to us. In a report such as this, we feel it is inappropriate to use inflammatory phrases based on subjective opinions. Further, it is inaccurate to report that the District accumulated funds that should be used to benefit taxpayers without specifying that the District has allocated $16.2 million since 2007-08 to reduce taxes as noted in the audited financial statements for that period of time. We are compelled and pleased to point to the fact that during the last five years the average tax levy change is only slightly higher than 1% per year, and the average tax rate change for the same period was -0.54%.

See Note 2 Page 24

See Note 3 Page 24

Response to Executive Summary

The State Comptroller states in the Audit Methodology and Standards section of the report, "Our overall goal was to assess the adequacy of the internal controls put in place by officials to safeguard District assets." The Fairport Central School District is pleased that the State Comptroller's examination identified no internal control findings, no material weaknesses, and no professional misconduct. The State Comptroller cited in its Scope and Objectives two items to address:

1. Has the District taken adequate action to address the reasonableness of fund balance?
2. Are capital project expenditures properly supported and within the amount authorized and approved?

The District's answer to both of these items is a resounding yes.

The District's Unassigned Fund Balance is within the acceptable limits of Real Property Tax Law §1318 as noted in all District annual audited Basic Financial Statements. District capital project expenditures are properly supported and within the amount authorized and approved. The District adheres to its Purchasing Policy, has an Internal Claims Auditor who audits every payment, and has not had any weaknesses cited in this area from either the internal or external District auditors. The State Comptroller has chosen to reference information outside of their July 1, 2009 to December 11, 2012 scope noted on the cover of their report. We have never seen this done in our experience with any auditors but we will oblige and respond to best serve the taxpayers' interest.

See Note 4 Page 24

The State Comptroller's Draft Report erroneously reports $15.8 million in net operating surpluses for the District over the last five years. The correct figure is $10.8 million, of which $3.8 million was liquidated by the District in following the State Comptroller's own recommendation in its 2009 report. The actual net operating figure, as generated by budgeting practices, is $7 million which calculates to $1.4 million per year or about 1.3% of the total budget. The State Comptroller has ignored a $5 million dollar transfer to benefit taxpayers by reducing the overall borrowing costs of the voter approved Phase III capital improvement projects. That item would give the District an audited operating surplus of $2,406,316 for the 2007-08 fiscal year. Their apparent confusion regarding this concept and their own scope of the current examination is not clear to us. The State Comptroller recommended liquidation of the $3.8 million allocated for retiree health insurance contributed to the operating surplus for the aforementioned period of time. New York State has not provided a means by which to allow the District to comply with these obligations. The State Comptroller has proposed legislation to establish an irrevocable trust recognizing that under current state law school districts do not have a mechanism by which to allocate funds for their largest single obligation.

See Note 5 Page 24

It is inaccurate to suggest the District has exceeded the statutory maximum allowed by Real Property Tax Law §1318 in any of the years mentioned. The District has five years of audited financial statements and state reports to demonstrate that the District has never exceeded the allowable unassigned fund balance limit. In addition, the District has appropriated $16.2 million since 2007-08 to reduce taxes by appropriating assigned fund balance to reduce taxes. It's simply not true that any 'statutory controls' were circumvented as suggested by the State Comptroller. The State Comptroller's report mentions the total fund balance has increased by June 30, 2012. A school district's total fund balance will increase when the appropriated fund balance is increased to reduce the tax burden of the community.

See Note 6 Page 24

See Note 3 Page 24

See Note 7 Page 25

The District's Phase I, Phase II, and Phase III capital project expenditures that were referenced were properly supported and within the amount authorized and approved.

In addition, we are disappointed that after a three month examination, the State Comptroller could not ascertain how many people the Fairport Central School District employs. We have 1170 employees, not the 744 listed in the State Comptrollers Executive Summary section of its report.

See Note 8 Page 25

Responses to Specific Recommendations

1. *District Officials should develop a plan to use the surplus fund balance identified in this report in a manner that benefits District taxpayers, and provide appropriate transparency through the budget process with public disclosure. Such uses could include, but are not limited to, reducing District property taxes or funding one-time expenditures.*

The District has a detailed reserve funding plan that is consistently updated throughout the budget process and was provided to the State Comptroller's auditors. The District does not have surplus Unassigned Fund Balance in any of the years mentioned and is within the acceptable limits of Real Property Tax Law §1318. The District has numerous budget workshops and community meetings throughout the budget process with public disclosure. The District strongly disagrees with the Comptroller's suggestion that the budget process does not provide appropriate transparency. The District has allocated $16.2 million since 2007-08 to reduce taxes by appropriating assigned fund balance for taxes.

Additionally, the District shared long-range plans and public presentations from the last three years with the field auditors. These presentations were shared with the Board and Community, and included detailed review of budget development, long-range financial planning, use of fund balance and reserves, and an explanation of the tax levy limit to name a few. The District presents about seven public presentations per year that target these important issues.

2. *The Board should review all reserves and determine if the amounts reserved are necessary, reasonable, and in compliance with statutory requirements. To the extent that they are not, transfers should be made to unappropriated fund balance, where allowed by law, or other reserves established and maintained in compliance with statutory directives.*

The Board of Education does review all reserves before the close of each fiscal year with a focus on long range planning. The Audit Committee reviews the financial condition of the District, including reserves, with the external auditor prior to the release of its financial statements. In addition, the external auditor presents the audited financial statements to the Board annually. The District believes that all of its reserves are necessary, reasonable, and in compliance with statutory requirements.

The Comptroller's report suggests transferring balances from the Capital Technology, Retirement Contribution, Repair, and Unemployment Insurance Reserves to unappropriated fund balance. This appears to conflict with the State Comptroller's April 2011 Fund Balance Reporting and Governmental Fund Type Definitions bulletin, which clearly states the new Governmental Accounting Standards Board issuance Statement #54 does not include the term unappropriated fund balance. For the purposes of our response, we'll make the assumption the State Comptroller is referring to the Unassigned Fund Balance which can be found in our external auditor's annual Basic Financial Statements.

The Capital Technology Reserve cannot simply be transferred to Unassigned Fund Balance as clearly outlined in The State Comptroller's Local Government Management Guide publication on Reserve Funds dated January 2010. We are puzzled by the suggestion to transfer funds from a Capital Reserve in a manner that is not allowed by their own guidelines.

See Note 9 Page 25

Technology is changing in rapid fashion and the District adapts and adjusts specific plans to meet the needs of the students, staff, and community as it sees fit. In addition, the reserve was initially funded with $7.48 million, not the incorrect amount listed in the Comptroller's report. The District has a specific plan to expend moneys from this reserve on technology to enhance teachers' ability to educate students in the most effective and efficient manner. We are pleased that funding from this reserve is available to allow this to happen. This reserve is legal, necessary, reasonable, and in compliance with The State Comptroller's Local Government Management Guide publication on Reserve Funds dated January 2010.

See Note 10 Page 25

The Retirement Contribution Reserve is used for the purpose of financing retirement contributions to the New York State Employees' Retirement System (ERS). During the period of time of the Comptroller's report, the ERS rate increased 265% with further increases projected. The District is forecasting an increased reliance on this reserve to offset rising pension costs and mitigate taxes. This reserve is legal, necessary, reasonable, and in compliance with The State Comptroller's Local Government Management Guide publication on Reserve Funds dated January 2010.

The Repair Reserve cannot simply be transferred to Unassigned Fund Balance as clearly outlined in The State Comptroller's Local Government Management Guide publication on Reserve Funds dated January 2010. We are again confused by the suggestion to transfer funds from a reserve in a manner that is not allowed by their own guidelines.

The District disagrees that any legal requirements have been circumvented regarding the use of this reserve as suggested by the Comptroller's report. The State Comptroller's Local Government Management Guide publication on Reserve Funds dated January 2010, states: "In an emergency, moneys in a repair reserve fund may be expended without giving notice and without holding a public hearing." The Comptroller's report suggests that the District would choose to expend these funds without holding a public hearing in an emergency situation, without having any factual support to make such an outrageous claim. The District is very distressed that the Comptroller's report would speculate about an event that has not yet occurred and determine a course of action by the District by saying "…essentially circumvented the legal requirement…". The District's Reserve Plan specifically states that "a public hearing is required before expending from the Repair Reserve Fund." This reserve is legal, necessary, reasonable, and in compliance with The State Comptroller's Local Government Management Guide publication on Reserve Funds dated January 2010.

See Note 11 Page 25

The Unemployment Insurance Reserve is utilized by the District to reimburse the State Unemployment Insurance Fund for payments made to claimants using the benefit reimbursement method. This reserve has been consistently utilized and the District's intention is to pay claims until the fund is depleted. The District believes having an Unemployment Reserve with a sufficient funding level to pay future claims is reasonable. The unemployment rate has been at its highest rates in twenty five years and using this reserve for its intended function is both reasonable and prudent. This reserve is legal, necessary, reasonable, and in compliance with The State Comptroller's Local Government Management Guide publication on Reserve Funds dated January 2010.

In our opinion, the conclusions on page 12 of the report are not supported by evidence but are merely subjective speculation.

These reserves are legal, necessary, reasonable, and in compliance with The State Comptroller's Local Government Management Guide publication on Reserve Funds dated January 2010. The State Comptroller's Local Government Management Guide publication on Reserve Funds dated January 2010 states:

"Reserve funds, like other savings plans, are mechanisms for accumulating cash for future capital outlays and other allowable purposes. The practice of planning ahead and systematically saving for capital acquisitions and other contingencies is considered prudent management. Planning today and saving incrementally for expected future events can help mitigate the financial impact of major, nonrecurring or unforeseen expenditures on your annual operating budget."

The State Comptroller released a bulletin in January 2013 titled Fiscal Stress Monitoring System that "…identifies local governments and school districts that are in fiscal stress, as well as those showing susceptibility to fiscal stress." The Fairport Central School District would be classified as a school "Susceptible to Fiscal Stress", according to the Comptroller's own financial indicators scoring system. Implementation of the Comptroller's recommendations will only move the District further along the spectrum of fiscal stress when using the financial indicators scoring system.

See
Note 12
Page 25

The Fairport Central District is committed to being financially strong, focused on providing a quality student learning environment, and being mindful of the community's expectations to balance cost and quality education. Our approach to long term financial planning reflects the community's commitment to education.

3. *The Board should ensure that District officials comply with the District's purchasing policy and award professional services contracts only after soliciting RFPs.*

District officials do comply with the District's purchasing policy and do solicit Requests for Proposals (RFP's) when awarding professional service contracts. The Board provides oversight in the appropriate manner through the Audit Committee and Board meetings where external and internal audit reports are presented. The District has not been cited for failing to comply with purchasing policy or soliciting RFP's in regards to capital project expenditures in any outside audit during the Comptroller's examination scope.

The report claims that the District neglected to do so for some of the professional services used during the Phase II and Phase III of the capital improvement plan. The District did complete a rigorous RFP process to select professional service providers for the initial $76.3 million project proposed for capital improvements in 2006. When the project was defeated, the District proposed smaller components of the project to the community over the next several years beginning with Phase I (roofing), Phase II, and Phase III.

After a reasonable review, the Board determined that it was in the District's best interest to keep the same consultants, who had the institutional memory and knowledge of the District's capital improvement needs, in place for the redesign and planning of the phased projects. By retaining the same consultants, the District maintained continuity and a more economical design development phase than could have been provided with new consultants. By splitting the larger project out over several phases, the timeline for completing the work was extended out several years. The extension of time resulted in increased cost to manage multiple projects over a longer period of time.

4. *The District should ensure that professional service providers submit proper itemization and support for reimbursable expenses.*

The District uses best purchasing practices and has an Internal Claims Auditor who reviews every District payment prior to release of funds for sufficient supporting payment documentation. The Phase II Owner and Architect agreement provided for a 7% fee based on construction cost. Reimbursable expenses were paid at cost. The Phase III Owner and Architect agreement set a lump sum fee of $1,745,800 for basic services. Reimbursable expenses were paid at cost. Additional services in both phases (whether charged to Owner or Contractors) were paid based upon labor rates included in each contract. Contrary to the Auditor's suggestion, invoices for additional services included a list of time and materials and were paid accordingly.

The State Comptroller should be aware that the figures used in the Capital Improvement Project Expenditure section of their report for Phase I, Phase II, and Phase III all do not match our audited Basic Financial Statements. The District proposed spending $76.3 million in 2006, not the $50.4 million cited in their report. The Phase I project total was $5.4 million not the reported $5.3 million in their report. The Phase II project total was $12,123,319, not the $12,594,397 cited in their report. The Phase III project total was $28,092,470, not the $29,524,152 cited in their report. The District did provide the correct information to the State Comptroller in the form of audited Basic Financial Statements.

See Note 13 Page 25

We appreciate the opportunity to have responded to this report. We believe our response is thorough and factual. We are both pleased and proud that the State Comptrollers three month examination found no material internal control weaknesses, no fraud, no theft, no abuse of funds, no illegal activities, no areas of noncompliance, and no professional misconduct. This reaffirms District personnel's use of best operating practices in safeguarding District assets and securing community trust in protecting taxpayer funds. The District's approach to long term financial planning has demonstrated fiscal responsibility and secured a healthy financial future that reflects the community's commitment to education.

Respectfully submitted,

Jon G. Hunter, Ed.D.
Superintendent of Schools

APPENDIX B

OSC COMMENTS ON THE DISTRICT'S RESPONSE

Note 1

Exit conferences are an extension of our audit process and held as a courtesy to District officials to give them a complete and comprehensive review of the draft audit report's contents. The conference gives officials an opportunity to clarify facts and express their concerns pertaining to our draft audit report content. OSC staff scheduled an exit conference with the District's Superintendent, Board President and Assistant Superintendent for Business on March 13, 2013 as per OSC policy. In addition, we offered to meet individually with any Board member upon their request.

Note 2

Our report accurately conveys our audit findings which are based on facts, not opinions.

Note 3

Even though the District appropriated $12.8 million of fund balance since the 2007-08 fiscal year, little to none was used to finance planned expenditures. Furthermore, an additional $5.7 million of fund balance appropriated for the 2012-13 fiscal year will also most likely not be used. As a result, the District's taxpayers have been paying more than necessary to sustain District operations.

Note 4

Auditing standards require that the results of previous audits be evaluated to determine if any corrective action recommended by the previous audits are relevant to the current audit objectives, and if so, has the local government taken action to implement the recommendations. Because our previous audit provided recommendations that were relevant to our current audit objective, OSC staff followed up and reported out on the corrective action taken or lack thereof.

Note 5

The District's net operating surplus for the five year period 2007-08 through 2011-12 was $15.8 million and not $10.8 million because the District transferred $5 million to the capital projects fund in the 2008-09 fiscal year that was not approved by the voters.

Note 6

The practice of consistently appropriating fund balance that is not needed to finance operations is, in effect, a reservation of fund balance that is neither regulated by statute nor subjected to the statutory limit for unrestricted fund balance. If the appropriated fund balance amount were combined with the unrestricted fund balance, the District would have been over the statutory limit for unrestricted fund balance.

Note 7

District officials' conservative budgeting practices generated $15.8 million in net operating surpluses. As a result of these operating surpluses, the amount of appropriated fund balance has not been used and the total accumulated fund balance has increased almost $9 million over the last five years.

Note 8

District officials provided us with updated employee figures, which we have adjusted in our report.

Note 9

Our audit report recommended that only to the extent allowable by law, transfers should be made to unrestricted fund balance or other reserves established and maintained in compliance with statutory directives.

Note 10

The reserve was established in 2005 with a 10-year term and $10 million maximum limit. Over the first four fiscal years, the District funded the reserve a total of $8.98 million.

Note 11

The District's reserve plan states that the Repair reserve is to pay for the cost of certain repairs or capital improvements to equipment that do not recur annually and that the intended use of such funds will be in an emergency situation only. Although the plan states that a public hearing is required before expending from the Repair reserve, by making this "emergency" stipulation, District officials may avoid this legal requirement without recourse from District taxpayers if they so choose.

Note 12

OSC's Fiscal Stress Monitoring System has not identified the District as susceptible to fiscal stress.

Note 13

The amounts expended for each of the CIP phases as listed in our report are correct because they include preconstruction costs, which the District expended and accounted for in the general fund instead of the capital projects fund.

APPENDIX C

AUDIT METHODOLOGY AND STANDARDS

Our overall goal was to assess the adequacy of the internal controls put in place by officials to safeguard District assets. To accomplish this, we performed an initial assessment of the internal controls so that we could design our audit to focus on those areas most at risk. Our initial assessment included evaluations of the following areas: financial oversight, cash receipts and disbursements, purchasing, payroll and personal services, and information technology.

During the initial assessment, we interviewed appropriate District officials, performed limited tests of transactions and reviewed pertinent documents, such as District policies and procedures manuals, Board minutes, and financial records and reports. In addition, we obtained information directly from the computerized financial databases and then analyzed it electronically using computer-assisted techniques. This approach provided us with additional information about the District's financial transactions as recorded in its databases. Further, we reviewed the District's internal controls and procedures over the computerized financial databases to help ensure that the information produced by such systems was reliable.

After reviewing the information gathered during our initial assessment, we determined where weaknesses existed, and evaluated those weaknesses for the risk of potential fraud, theft and/or professional misconduct. We then decided on the reported objectives and scope by selecting for audit the area most at risk. We selected the District's financial condition and capital improvement project (CIP) for further audit testing.

To accomplish the objectives of this audit:

- We reviewed Board minutes, District policies, adopted budgets for the 2008-09 through 2011-12 fiscal years, audited financial statements, and budget status reports. We analyzed budget items with significant budget-to-actual variances.
- We examined tax levy increases from 2008-09 through 2011-12. We reviewed District reserve accounts and supporting documentation to determine the appropriateness of funding levels and if proper procedures were followed for establishing those reserves.
- We inquired as to the availability of financial information, such as budgets, and reviewed the last five years of financial information submitted to the Office of the State Comptroller.
- We reviewed pertinent documents available, including applications and certificates of payment, applications for examination and approval of final plans and specifications, change orders, claims, contracts, and Board construction reports.
- We reviewed capital project vendors for Phase II and III that provided capital improvement and professional services that were paid amounts that required proper competitive solicitation per GML 103.

- We reviewed all change orders totaling $1,246,188 for Phase II and Phase III for Board approval, and randomly sampled 15 percent of the total Phase II change orders for proper approvals by project management.

- We reviewed all payments made to the CMC for Phase II and III, totaling $2,125,764, to compare construction management fees to project costs to determine if they were appropriate.

- We reviewed all payments made to the Architect for Phase II and III totaling $2,749,810 to verify if the payments were properly supported, reviewed, approved, and allowed by the contract.

We conducted this performance audit in accordance with generally accepted government auditing standards (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 objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

APPENDIX D

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