



# Cincinnatus Central School District

## Fund Balance and Reserves

### Report of Examination

Period Covered:

July 1, 2012 — April 17, 2014

2014M-191



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**

October 2014

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 Cincinnatus Central School District, entitled Fund Balance and Reserves. 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 Cincinnatus Central School District (District) provides education to children residing in eight towns in Cortland County, five towns in Chenango County and one town in Broome County. The District is governed by a seven-member Board of Education (Board) which is responsible for the general management and control of the District's financial and educational affairs. The Superintendent is the chief executive officer and is responsible, along with the Business Manager, for daily operations and the development and administration of the budget under the Board's direction. The Business Manager function is provided by the Onondaga-Cortland-Madison Board of Cooperative Educational Services (BOCES).

The District operates one school which has about 645 students and 190 employees. The District's general fund budgeted appropriations for the 2014-15 fiscal year are \$14.6 million, funded primarily with State aid and real property taxes.

The Office of the State Comptroller's Fiscal Stress Monitoring System<sup>1</sup> monitors local governments for indications of fiscal stress, such as declining liquidity and available unrestricted cash. The District was identified as being susceptible to fiscal stress largely because the District's cash available to fund operations had declined to approximately \$28,000 as of June 30, 2013, or less than 3 percent of the average monthly expenditures of the District.

## Objective

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

- Did the Board ensure that fund balance was within legal limits and reserves were properly planned for and funded?

## Scope and Methodology

We examined the District's financial condition for the period July 1, 2012 through April 17, 2014. We extended our audit scope back through July 1, 2010 and forward to June 30, 2014 to review certain budgetary practices and reserve fund 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 is included in Appendix B of this report.

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<sup>1</sup> For more information on the Fiscal Stress Monitoring System, see the OSC website at: <http://osc.state.ny.us/localgov/fiscalmonitoring/index.htm>

**Comments of  
District Officials and  
Corrective Action**

The results of our audit and recommendations have been discussed with District officials and their comments, which appear in Appendix A, have been considered in preparing this report. District officials generally agreed with our findings and recommendations and indicated they plan to take corrective action.

The Board has the responsibility to initiate corrective action. Pursuant to Section 35 of the New York State General Municipal Law, Section 2116-a (3) (c) of the 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.

## Fund Balance and Reserves

The responsibility for accurate and effective financial budgeting and planning rests with the Board and the Superintendent. A district may retain a portion of fund balance, referred to as unexpended surplus funds, but must do so within the legal limits established by the New York State Real Property Tax Law (Real Property Tax Law).<sup>2</sup> A district can also reserve portions of fund balance to finance future costs for a variety of specified purposes. District officials should plan for the funding and use of these reserves.

The Board did not effectively manage fund balance and reserves. District budgets from fiscal years 2010-11 through 2012-13 included the planned use of fund balance averaging \$495,000 per year; however, less than \$51,000 was actually used. In addition, the District did not plan for the funding or use of reserves, but instead transferred excess surplus moneys to reserves to avoid exceeding the fund balance statutory limit. Regardless, the District's fund balance exceeded the statutory limit for two out of the last three years. Furthermore, District officials overfunded four of the District's seven reserve funds. By accumulating funds without a clear plan for the future intended use, District officials have made tax levies higher than necessary. While fund balance is greater than necessary, the Office of the State Comptroller's Fiscal Stress Monitoring System identified the District as susceptible to fiscal stress in 2013, primarily due to the decrease in available cash to fund operations.

### Fund Balance

District officials adopted budgets that included plans to use fund balance totaling almost \$1.5 million between the fiscal years ended 2010-11 and 2012-13. Instead, the District used less than \$51,000 of this planned amount because the District overestimated expenditures by almost \$1.8 million during the same period.

**Figure 1: Overestimated Appropriations**

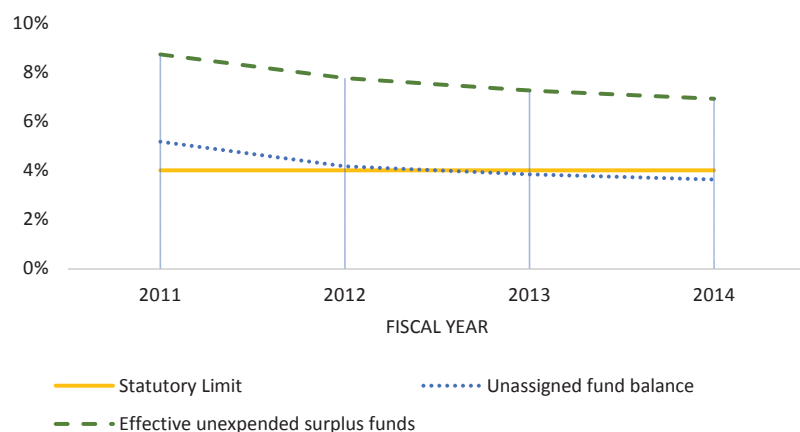
Fiscal Year	Budgeted Appropriations	Actual Expenditures	Difference
2010-11	\$13,752,301	\$13,168,220	\$584,081
2011-12	\$13,485,703	\$12,725,856	\$759,847
2012-13	\$13,356,258	\$12,901,639	\$454,619
<b>Totals</b>	<b>\$ 40,594,262</b>	<b>\$38,795,715</b>	<b>\$1,798,547</b>
3-year Average	<b>\$ 13,531,421</b>	<b>\$12,931,905</b>	\$599,516

<sup>2</sup> Real Property Tax Law limits the amount of unexpended surplus funds that can be legally retained by District officials to no more than 4 percent of the next fiscal year's budgeted appropriations.

These overestimations were primarily in the categories of employee benefits (\$1.2 million), instructional salaries (\$228,500) and BOCES services (\$220,000). Estimates for these personal service costs, including employee benefits, should be readily attainable as they are based on employment contracts. Furthermore, while the Board adopted a budget for the 2013-14 fiscal year that included the use of \$480,000 in fund balance, the District's expenditures for fiscal year ending June 30, 2014 were approximately \$685,000 less than appropriated. The 2014-15 budget continues the trend of appropriating \$480,000 in fund balance and includes an increase in expenditures over the amounts budgeted for 2013-14, which is more than \$545,000 or nearly 4 percent.

For the fiscal years ended June 30, 2011 to 2013, the District's unassigned fund balance exceeded the 4 percent statutory limit for two out of the three years reviewed,<sup>3</sup> and the District's effective unexpended surplus funds<sup>4</sup> exceeded the 4 percent limit each year. For the fiscal year ended June 30, 2014, the District's unassigned fund balance was within the statutory limit. However, if the District experiences another operating surplus in 2014-15, the effective unexpended surplus funds for fiscal year ended June 30, 2014 will exceed the 4 percent limit.

Figure 2: Ratio of Fund Balance to Succeeding Year's Budgeted Appropriations



## Reserves

Between the fiscal years ended 2010 through 2013, District officials more than doubled the balances of the District's reserves by setting aside an aggregate of \$742,000 in additional money in the reserves. According to the Board meeting minutes, the Board approved these

<sup>3</sup> Unassigned fund balance exceeded the 4 percent limit by \$158,291 (1.2 percent) and \$23,061 (0.2 percent) for the fiscal years ended June 30, 2011 and June 30, 2012.

<sup>4</sup> The District's effective unexpended surplus funds were calculated by increasing unexpended surplus funds by the amount of unused appropriated fund balance.



transfers to keep the amount of unreserved fund balance below the statutory limit. However, District officials have accumulated excessive balances in many of the District's reserves. As of June 30, 2013, the District had seven reserves in the general fund totaling more than \$1.3 million. While the Capital, Employee Benefits for Accrued Liabilities and Repair reserves were reasonably funded, the balances in the remaining reserves were excessive, as follows:

- **Retirement Contributions Reserve** – This reserve is used to pay the District's retirement contribution to the New York State and Local Retirement System (NYSLRS). The District's average annual NYSLRS expenditure for the past three years was \$137,029. Instead of using this reserve for eligible expenditures, District officials budgeted for and paid these claims each fiscal year directly from the general fund. The reserve balance as of June 30, 2013 was \$688,185 –five times the current annual contribution.
- **Unemployment Insurance Reserve** – School districts use this reserve to pay unemployment insurance claims under the “benefit reimbursement” method.<sup>5</sup> The District had an average annual unemployment insurance expenditure for the past three years of \$24,969. Instead of using this reserve for eligible expenditures, District officials budgeted for and paid these claims each fiscal year directly from the general fund. The \$190,138 reserve balance as of June 30, 2013 would cover more than seven years of average annual expenditures.
- **Tax Certiorari Reserve** – School districts can use this reserve for the payment of judgments and claims for tax certiorari proceedings<sup>6</sup> for the tax roll in the specific year in which District officials deposited the money. This reserve may not exceed the amount which officials might reasonably deem necessary to meet anticipated judgments. The reserve had a balance of \$100,912 at June 30, 2013. According to District officials, the District had no tax certiorari proceedings pending as of June 30, 2013. Therefore, the reserve is overfunded by the full amount.

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<sup>5</sup> The New York State Labor Law's Benefit Reimbursement option allows employers to reimburse the Unemployment Insurance Fund for benefits paid to their former employees instead of paying on a contribution basis.

<sup>6</sup> A tax certiorari is a legal proceeding whereby a taxpayer who has been denied a reduction in property tax assessment by a local assessment review board or small claims procedure challenges the assessment on the grounds of excessiveness, inequality, illegality or misclassification.



- Workers' Compensation Reserve – Districts may establish this fund to pay compensation and benefits, medical, hospital or other expenditures authorized by applicable statutes. The District had average annual workers' compensation expenditure for the past three years of \$57,244. District officials budgeted for and paid these claims each fiscal year directly from the general fund. The \$50,000 reserve balance as of June 30, 2013 would cover approximately one year of average annual expenditures.

District officials use a multiyear budget plan, and told us that they budget conservatively each year to provide funds for the impact of unforeseen expenditures such as increases in special education expenditures or reductions in State aid. The District's multiyear plan did not include provisions for the use of reserves, including how and when disbursements should be made or optimal or targeted funding levels and why these levels are justified. In addition, the plan assumes the repeated use of unassigned fund balance totaling \$480,000 each year and is based upon budgeted historical data instead of actual results. Moreover, special education costs have remained relatively steady and only slightly increased as a percentage of total general fund expenditures during our audit scope period. Also, the District did receive \$1.1 million less in State aid in 2012 than it did in 2010, but still continued to accumulate fund balance by adding more than \$568,000 to its reserves. Budgeting conservatively or retaining a financial cushion to provide for economic fluctuations and unforeseen events is a prudent practice. However, accumulating large reserve balances and continuing to adopt conservative budgets results in unnecessarily high tax rates.

While fund balance is greater than necessary the District was identified as susceptible to fiscal stress primarily due to the decrease in available cash to fund operations. However, this was caused by moving a large amount of money into reserves and not by a decrease in total cash on hand. A total of \$742,000 has been transferred to restricted cash balances since the fiscal year ended June 30, 2010. This restriction of available operating cash caused cash shortfalls that required District officials to intentionally hold certain checks payable to vendors for several months beginning in June 2013 to avoid cash overdrafts.

## Recommendations

The Board should:

1. Ensure that the amount of the District's unexpended surplus fund balance is in compliance with Real Property Tax Law statutory limits and reduce the amount of unexpended surplus fund balance in a manner that benefits District taxpayers. Such uses could

include, but are not limited to, using surplus funds as a financing source, funding one-time expenditures or funding appropriate reserves.

2. Develop more realistic budgets based on prior year's actual results and anticipated operations and avoid raising more real property taxes than necessary.
3. Review all reserve balances and transfer excess funds to unrestricted fund balance, where allowed by law, or other reserves established and maintained in compliance with statutory directives.
4. Develop and implement a comprehensive, multiyear financial strategy that includes realistic plans on the use of appropriated fund balance and the optimal or targeted funding and using of reserve funds.

## **APPENDIX A**

### **RESPONSE FROM DISTRICT OFFICIALS**

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



**Cincinnati Central School District**

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shubbard@cc.cnyric.org

September 29, 2014

Office of the State Comptroller  
Attn: H. Todd Eames, Chief Examiner  
State Office Building, Suite 1702  
44 Hawley Street  
Binghamton, New York 13901-4417

**RE: 2014M-191 Audit Response**

Dear Mr. Eames,

The Cincinnati Central School District is in receipt of the draft report of the NYS Office of the State Comptroller's (OSC) audit entitled Fund Balance and Reserves, for the period covering July 1, 2012 – April 17, 2014. The district shall develop a Corrective Action Plan (CAP), submit said plan to our Board of Education for approval, and file the CAP with OSC and the Commissioner of Education no later than ninety (90) days after the release of the final audit report, per statutory requirements.

We agree with the recommendation that the Board should *"Ensure that the amount of the district's unexpended surplus fund balance is in compliance with Real Property Tax Law statutory limits."* As a matter of fact, based upon the OCS audit and our exit interview, held on September 12, 2014, both our 2012-2013 and 2013-2014 fiscal year's unassigned fund balances were below the four (4) percent statutory limit.

We also agree with the recommendation, in part, that the Board should *"Develop more realistic budgets based upon prior year's actual results and anticipated operations..."* In fact, during the development of our school budgets we use actual expenses as our starting point. However, we also understand keenly the difficult task of estimating costs while prudently planning for the possibility of unanticipated expenses, i.e. high cost placements. Additionally, it is important to note that our 2012-2013 and 2013-2014 school budgets over estimated expenses by amounts of \$454,618 (3.4%) and \$442,809 (3.15%), respectfully, which resulted in unassigned fund balances in accordance with statutory limits that did not exceed the allowable 4% limit for either year. As stewards of the district's financial health, careful planning for unanticipated expenses, within statutory limits, without overburdening our tax payers, is a reasonable course of action. We certainly will continue to use our actual expenses and budget trend data as our starting point when developing future school budgets.

Lastly, we agree with the recommendation that the Board should *"Develop and implement a comprehensive, multi-year financial strategy that includes realistic plans on the use of appropriated fund balance and the optimal or targeted funding and using reserve funds."* Our Board annually receives and reviews our five-year budget plan that estimates expenses and revenue and projects future financial conditions, including use of reserves as a potential revenue source. It is through the use of this plan that we understand clearly the possible negative outcome of the use of reserves as a one-time solution to cover unforeseen loss of revenue/state aid and unanticipated expenses. Our

CAP will include such a plan with the understanding that the current economic climate, the implementation of the 2% Tax Levy Limit, and the Gap Elimination Adjustment (GEA) legislation, which has resulted in Cincinnati School's loss of \$2,385,858 in state aid since the 2010-2011 school year, requires extreme caution in using reserves as a one-time revenue source.

Again, we recognize receipt of the draft report of the NYS OSC audit entitled Fund Balance and Reserves for the period covering July 1, 2012 – April 17, 2014, respect the value of the report, and take very seriously our responsibility to provide an exemplary education for all Cincinnati School children during what has proven to be a most historic and volatile economic climate since the 2008-2009 school year.

Respectfully,

Steven V. Hubbard  
Superintendent of Schools

Cc: Board of Education  
Troy Bilodeau, Business Administrator

*Cincinnati Central – Striving to meet children's needs, awaken their minds, and touch their hearts.*

## **APPENDIX B**

### **AUDIT METHODOLOGY AND STANDARDS**

To accomplish our objective, we interviewed appropriate District officials, tested selected records and examined pertinent documents for the period of July 1, 2012, through April 17, 2014. To analyze trends in the District's financial condition, budgeting practices and reserve balances, we extended our audit scope period back through July 1, 2010 and forward to June 30, 2014. Our examination included the following:

- We interviewed District officials to gain an understanding of the budgeting process, including their processes for monitoring and developing the budget and their planning for the funding and use of reserves.
- We compared the adopted budgeted appropriations by account and object code to actual expenditures for the general fund for fiscal years 2010-11 through 2012-13 to determine if budget estimates were reasonable. We also examined budget line items.
- We evaluated the selected budgeted appropriations for 2013-14 and 2014-15 for reasonableness by comparing to actual results from fiscal 2012-13.
- We calculated the general fund's results of operations by comparing actual revenues to actual expenditures for fiscal years 2010-11 through 2013-14 and compared the results to the amount of appropriated fund balance to determine the amount of fund balance used and compliance with statutory requirements.
- We analyzed reserves to determine if they were properly established, supported and reasonably funded as of June 30, 2013.
- We compared the amount of restricted cash to the reserve balances for the fiscal years ended June 30, 2011 through June 30, 2013.
- We reviewed bank reconciliations and statements for July 2012 through September 2012 and July 2013 and September 2013 to determine if checks were held and not mailed.
- We reviewed the District's fiscal stress indicator calculation as of June 30, 2013 and recalculated the score after adjusting for the effect on cash for amounts transferred to reserves and for checks held.
- We evaluated the five-year budget projection provided to the Board to determine the basis for the projection and if the projection includes planning for the funding and/or use of fund balance and reserves.

We conducted this performance audit in accordance with GAGAS. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis

for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.



## **APPENDIX C**

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