Office of the New York State Comptroller

Division of Local Government
& School Accountability

Tri-Valley Central School District

Budgeting

Report of Examination

Period Covered:

July 1, 2012 — January 15, 2014

2014M-94

Thomas P. DiNapoli

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State of New York
Office of the State Comptroller

**Division of Local Government
and School Accountability**

August 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 Tri-Valley Central School District, entitled Budgeting. 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 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 Tri-Valley Central School District (District) is located in the Towns of Neversink, Fallsburg and Liberty in Sullivan County, and the Towns of Denning, Wawarsing and Rochester in Ulster County. The District is governed by the Board of Education (Board) which comprises nine elected members. The Board is responsible for the general management and control of the District's financial and educational affairs. The Superintendent of Schools (Superintendent) is the 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 two schools in operation within the District, with approximately 1,100 students and 210 employees. The District's budgeted appropriations for the 2013-14 fiscal year were $30 million which were funded primarily with State aid and real property taxes.

Objective

The objective of our audit was to examine the District's budgeting practices. Our audit addressed the following related question:

- Did the Board adopt reasonable budgets?

Scope and Methodology

We examined the financial condition of the District for the period July 1, 2012 through January 15, 2014. We expanded our scope back to the 2008-09 fiscal year to analyze the District's fund balance, budgeting practices and financial trends.

We conducted our audit in accordance with generally accepted government auditing standards (GAGAS). More information on such standards and the methodology used in performing this audit is included in Appendix B of this report.

Comments of District Officials and Corrective Action

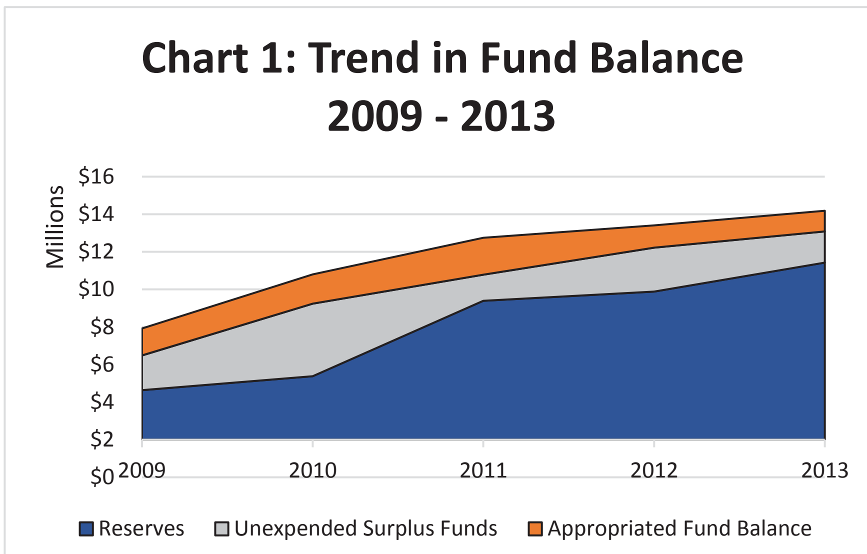
The results of our audit and recommendations have been discussed with District officials and their comments, which appear in Appendix A, have been considered in preparing this report. District officials generally agreed with our recommendations and indicated they planned to initiate corrective action.

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.

Budgeting

The District's financial condition is a primary factor in determining its ability to continue providing public educational services for students within the District. The Board, Superintendent and Assistant Superintendent for Business are accountable to taxpayers for the use of District resources. They are responsible for effective financial planning and management of District operations, including the preparation, adoption and monitoring of budgets based on reasonable assessments of anticipated resources and fund appropriations. District officials are also responsible for ensuring that the District's property tax levy is based on reasonable District needs and does not overburden taxpayers.

The Board did not adopt reasonable budgets. Budgeted expenditures were significantly higher than needed. As a result, the District's reported fund balance[1] increased from approximately $8 million for the fiscal year ended 2009 to more than $14 million as of the fiscal year ended 2013.



[1] 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).

This significant increase in fund balance was caused by the District spending an aggregate of about $13.3 million less than budgeted. Over the five-year period, over budgeted items include: grades K-3, regular and special education teachers' salaries, by $3.5 million; teacher retirement by $1 million and health insurance by $3 million. The District also increased the real property tax levy by an aggregate of approximately $1.2 million, or about 1.6 percent annually.

According to District officials, much of this operational surplus was planned to address the onset of large potential liabilities related to contract negotiations. Beginning in the 2008-09 fiscal year, the District was subject to very large claims to reduce the assessed value of properties within the District. In addition, one of the District's collective bargaining agreements expired twice, both times for more than a year. This left the District open to significant liabilities if the assessed values were reduced or if retroactive salaries needed to be paid upon the settlement of the collective bargaining agreements.

Tax Certiorari Claims – Real-property taxpayers who disagree with their properties' assessed value may file a grievance in an attempt to have their properties' assessed value reduced. The City of New York has filed such grievances each year since the 2008-09 fiscal year for properties where their reservoirs are located. In some years, the requested reduction is for more than 90 percent of its current assessed value.

Table 1: Potential Reduction in Assessed Value

Fiscal Year	Current Assessed value	Proposed Assessed Value	Potential Liability to District
2008-09	$18,326,250	$10,000,000	$3,511,600
2009-10	$18,326,250	$1,875,000	$7,190,102
2010-11	$18,326,250	$1,500,000	$7,502,234
2011-12	$18,326,250	$1,500,000	$7,642,071
2012-13	$18,326,250	$1,500,000	$7,872,605
2013-14	$18,326,250	$1,500,000	$7,969,463
Total			**$41,688,075**

These claims represent a potential liability of more than $41 million, and an average of more than 10 percent of the District's total assessed value.

The District was initially notified of the tax certiorari claims from the City of New York during the 2008-09 fiscal year, resulting in a potential $3.5 million liability. At the time, the District had less than $1 million in a Tax Certiorari Reserve that could be used to offset some of the initial claims. In each of the successive years, as the City of New York made additional claims, the Board authorized additional funding of the reserve bringing it to nearly $9 million as of the fiscal year ended 2013. The tax certiorari proceedings are still unresolved.

While balances in this reserve fund seem reasonable and the District plans to use the reserve for its intended purposes, it is essential that the District be publicly accountable by creating a formal plan for funding the reserve.

<u>Collective Bargaining Agreement</u> – The District's contract with the Tri-Valley Teachers' Association expired June 30, 2008 without a new contract in place. The next collective bargaining agreement expired on June 30, 2012, again with no successor agreement in place. The settlement of the successor agreements took as long as 18 months after the contracts had expired. District officials told us that in each year the collective bargaining agreements remained unsettled, they included provisions for salary increases in the District's adopted budgets. The potential liability can compound each year, and after several years, could impact the fiscal health of the District. Teachers' salaries totaled more than $7 million per year, and each percentage point represents about $70,000. A 3 percent annual increase over four years, compounded, could represent a retroactive salary liability of nearly $900,000.

District administrators and the Board recognized the potential liability of the expired collective bargaining agreements. Accordingly, they increased appropriations in years without a contract to accommodate possible liabilities resulting from contract negotiations. The District ultimately did not have to pay any retroactive salary increases from negotiations from either of the collective bargaining agreements and, therefore, experienced accumulated operating surplus of $5.3 million.

While it was prudent for District officials to plan for potential liabilities, they did not develop a plan for the use of the surplus funds that may become available if the liabilities were not realized. If the tax certiorari proceedings conclude in the District's favor, the Board and administration may be faced with significant surplus funds. Education Law requires that any moneys not expended for the tax roll in the year the funds are deposited to the tax certiorari reserve, or which will not be reasonably required to pay judgments or claims, should be returned to the general fund on or before the first day of the fourth fiscal year following deposit to the fund.

Recommendations

District officials should develop:

1. Realistic budgets that are consistent with the District's actual revenues and expenditures, including funding reserves.

2. Formal contingency plans for the use of surplus funds that may be available if potential liabilities are not realized.

APPENDIX A

RESPONSE FROM DISTRICT OFFICIALS

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

Tri-Valley Central School
34 Moore Hill Road
Grahamsville, NY 12740

Thomas W. Palmer
Superintendent
(845) 985-2296, ext. 5102
Fax (845) 985-0310

Lisa M. Raymond
Assistant Superintendent for Business
(845) 985-2296, ext. 5202
Fax (845) 985-0310

July 21, 2014

Via E-mail (.pdf) only to muni-binghamton@osc.state.ny.us

Mr. Todd Eames, Chief Examiner
Division of Local Government and School Accountability
Office of the State Comptroller
State Office Building, Room 1702
44 Hawley Street
Binghamton, New York 13901-4417

Re: ***Response to Report of Examination / Corrective Action Plan***
July 1, 2012 – January 15, 2014

Dear Mr. Eames:

On behalf of the Tri-Valley Central School District (the "District"), please accept this letter as the District's formal response to, and corrective action plan for, the findings and recommendations contained in your draft Report of Examination, conveyed to us by e-mail dated June 13, 2014.

First and foremost, we wanted to take this opportunity to thank you and your staff for the diligence and professionalism exhibited during the course of the examination. Specifically, we extend our gratitude to your on-site examiners who approached the process with thoroughness and tenacity, but were willing to work cooperatively with our employees to minimize disruptions to our day-to-day operations. We also appreciate your office's willingness to discuss the details of the draft findings during the Exit Interview held on June 19, 2014. As a result of that meeting, we were able to better understand our obligations under this process and focus ourselves on providing you relevant information in this response.

As we discussed at the Exit Interview, the District is in complete agreement that sound budgeting and fiscal compliance are central goals of the Board of Education which help the District that limited resources are protected and preserved. Moreover, the Board of Education, the Administration, and the District's school attorneys have reviewed the draft report and we agree with and accept the findings and recommendations contained therein. As such, we do not intend to dispute or challenge any of the factual findings or recommendations set forth in the report. Indeed, our primary goal for this correspondence is to offer additional information about the corrective steps the District has already undertaken. Accordingly, we address our comments to the draft report on a section-by-section basis.

INTRODUCTION

We have no substantive comments on the Introduction except to note that we believe that the description of the audit and its scope and objectives, contained in the Appendix on "Audit Methodology and Standards" (Appendix B in the Draft) is a more detailed and fully-informative statement of the objectives of the audit and the scope of examination. We believe the language in Appendix B conveys a fuller sense of the thoroughness and expansiveness with which your staff approached the examination.

We acknowledge the District's obligation to draft and implement a corrective action plan in accordance with your final report and we hope that our efforts, as itemized in this response, will be deemed to meet this obligation. We intend that this response will be treated as our Corrective Action Plan and if further action is needed, please let us know.

BUDGETING

The District acknowledges the duties owed by the Board of Education, Superintendent, and Assistant Superintendent to the District's taxpayers, specifically their obligations for financial planning, budgeting, and management of operations. Notwithstanding the criticisms raised in the report, we believe we have met those obligations, albeit it on a more conservative basis than your office deems appropriate.

As described in the audit report, "fund balance" is comprised of three categories of funds currently being held by the District: "Reserves," "Unexpended Surplus Funds," and "Appropriated Fund Balance."

It is the District's position – which appears to be confirmed by the Report – that it has properly accounted for its Reserves and is using reserve funds properly and only when necessary. The District established three types of Reserve Funds:

- An Unemployment Reserve Fund, to pay for U.I. claims as they arise. Annually the District makes withdraws from this account to cover the claims it has received.

- A Workers Compensation Reserve Fund, because the District is self-insured for workers compensation, but not fully-funded. Accordingly, the reserve fund is used to pay claims on a year-to-year basis as the District moves towards fully-funding its workers compensation liabilities.

- A Tax Certiorari Reserve Fund, which is primarily allocated to the outstanding New York City tax certiorari proceedings relating to the reservoir properties. This fund is discussed in more detail below.

The District also believes that it is properly carrying Unexpended Surplus Funds, subject to the 4% cap, and that it has generally done so during the audit period. Indeed, in every year covered by the examination, the District has used money in excess of the 4% Unexpended Surplus Funds cap to reduce the succeeding year's tax levy.

The third component of fund balance as described in the Report is the "Appropriated Fund Balance" portion, which has generally held steady at approximately $1.5 million from 2009-2014. As indicated during the examination and referenced in the Report, this component of fund balance is comprised of monies budgeted to deal with uncertainty regarding teachers' salaries, teacher retirement costs, and health insurance.

As noted in the Report, during the examination District staff explained their rational for budgeting teachers' salaries. Based on the fact that the District had two sets of labor negotiations relating to the teachers' collective bargaining agreement during the time-frame covered by the examination, the District budget for the "worst case scenario[1]" based on proposals the teachers union had presented. To the extent that the District was ultimately successful in negotiating contract extensions without substantial retroactive payments, it could not have anticipated doing so at the outset of those negotiations.

Similarly, the retirement estimates contributing to the Appropriated Fund Balance were based on anticipated salary increases due to those same collective bargaining negotiations. These estimates also were made at or about the same time that estimates from TRS and ERS on the employer contribution levels were increasing year-over-year.

Finally, a portion of the Appropriated Fund Balance was being driven by health insurance estimates. As indicated during the examination, the District participates in NYSHIP which is based on a calendar year cycle, rather than the District's July to June fiscal cycle. This creates a constant scenario where the District's budget is based on six months of known costs, and six months of estimated costs (based on estimates provided by NYSHIP for the upcoming year's rates). The trend in increases in the NYSHIP rates have averaged 7.5%/year and the District conservatively budgeted a 10-13% annual increase to ensure that it did not under collect on this substantial expense. Moreover, Appropriated Fund Balance contains some allocation for a Medicare reimbursement based on the rates charged to retirees for Medicare. Again, this rate has increased over time, but the rate increases are not known during the budget cycle. The uncertainty is further enhanced by the fact that the District doesn't always know the number of retirees and spouses who will be eligible in any given year.

While it is undisputed that these budgeting estimates generated Appropriated Fund Balance in excess of the District's ultimate needs, the District believes that it was responsibly budgeting for each of these expenses. It does, however, recognize its obligation to account for

[1] It is noteworthy that over 25% of the teachers in the District were, at the relevant times, at the highest step on the salary schedule and, would therefore, receive only a negotiated increase. Thus, the District expected that a substantial retro-active salary payment would be needed to settle the contract for those persons, who had not received any step-increases during the negotiations.

the excess revenues, and to attempt to reduce the Appropriated Fund Balance to an amount consistent with the true estimated expenses in these various categories.

With respect to the substantial Tax Certiorari Reserve Fund, the District is cognizant of the potential impact that a multi-year settlement with the City of New York could have on the stability of the school tax rate. In an effort to smooth the burden on the taxpayers and reduce the likelihood of a need for bonding of a settlement of the tax proceedings (or a large spike in tax levy), the District has routinely contributed to the Tax Certiorari Reserve Funds, saving money each year with the realization that the impact of a judgment or settlement could be substantial.

We further recognize that, to the extent that the amount of reimbursement owed to the City of New York is less than the amount held on tax certiorari reserve fund (less any other accrued liabilities for tax certiorari proceedings pending at the time of settlement), the District will need to spend down those funds. The District is currently working with counsel, in connection with the potential settlement of the City's proceedings, to design a way to gradually, yet lawfully, spend down those amounts in a manner that would maintain the stability of the District's tax rate, while respecting the rule that that unneeded reserves must be used to offset levy.

In closing, the District makes an annual effort to present a budget that is both justified and reasonable during its annual budget cycle. The District is constantly looking for avenues to save money, and has pursued approaches such as cooperative purchasing, cooperative bidding, energy efficiencies, and inter-municipal agreements to do so. Similarly, while the District recognizes the uncertainty generated by collective bargaining, it believes its methodology – for budgeting for salaries during an expired contract and estimating health insurance contributions – is vital to adopting a viable budget because those two components make up the largest percentage of the District's budget. Quite frankly, the District believes that under budgeting presents a more dangerous scenario for the District's financial position than the conservative budgeting approach the District has taken. Nevertheless, the District will continue to analyze its largest potential costs (for example, salaries, benefits, special education, and transportation) and focus on ways to stabilize their magnitude.

RECOMMENDATIONS

1. District Officials should develop:

- ***Realistic budgets that are consistent with the District's actual revenues and expenditures, including funding reserves.***

The District agrees with and will implement this recommendation as it begins the 2014-2015 process for developing the 2015-2016 budget. The Administration acknowledges its obligation to do a better job at developing expenditure estimates that are both accurate and precise.

- ***Formal contingency plans for the use of surplus funds that may be available if potential liabilities are not realized.***

The Board agrees with and will implement this recommendation. The most likely source of excess available funds remains the Tax Certiorari Reserve Fund if the District is successful in limiting its exposure to refund liability to the City of New York. The District is actively working with counsel to structure any settlement with the City of New York in a manner that minimizes instability in tax rates. As a first step towards doing that, the Board of Education passed a resolution in June to reallocate the funds held in the Tax Certiorari Reserve Fund to those tax years in which the greatest potential liability exists. As noted by the Report, however, the District's total potential liability for the tax certiorari proceedings brought by the City of New York exceeds the amount currently available in the Tax Certiorari Reserve Fund.

Once again, thank you for your assistance through this process. If we can answer any further questions or provide additional information, please do not hesitate to contact us. In the meantime, the District intends to continue to focus its efforts to implement your recommendations.

FOR THE BOARD OF EDUCATION:

Michael Brooks, President

cc: Members of the Board of Education
Thomas Palmer, Superintendent
Lisa Raymond, Asst. Superintendent for Business
Robert Schofield, Esq., School Attorney

APPENDIX B

AUDIT METHODOLOGY AND STANDARDS

Our overall goal was to evaluate the District's financial condition. To accomplish our objective and to obtain appropriate audit evidence, we performed the following steps:

- We interviewed District officials and reviewed Board minutes to gain an understanding of the budget process and rationale behind the District's financial decisions.
- We compared budgeted revenues and appropriations to the actual revenues and expenditures in the general fund for fiscal years 2008-09 through 2012-13. In addition, for line items with significant variances, we analyzed District officials' budget estimates for reasonableness.
- We reviewed the results of operations and effect on fund balance from fiscal years 2008-09 through 2012-13.
- We compiled the District's tax levies, taxable assessments and tax rates for fiscal years 2008-09 through 2012-13 and analyzed for trends in tax levies and rates.
- We reviewed reserve and fund balances to determine if they were reasonable.
- We reviewed collective bargaining agreements and tax certiorari court documents.

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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Nathaalie N. Carey, Assistant Comptroller

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