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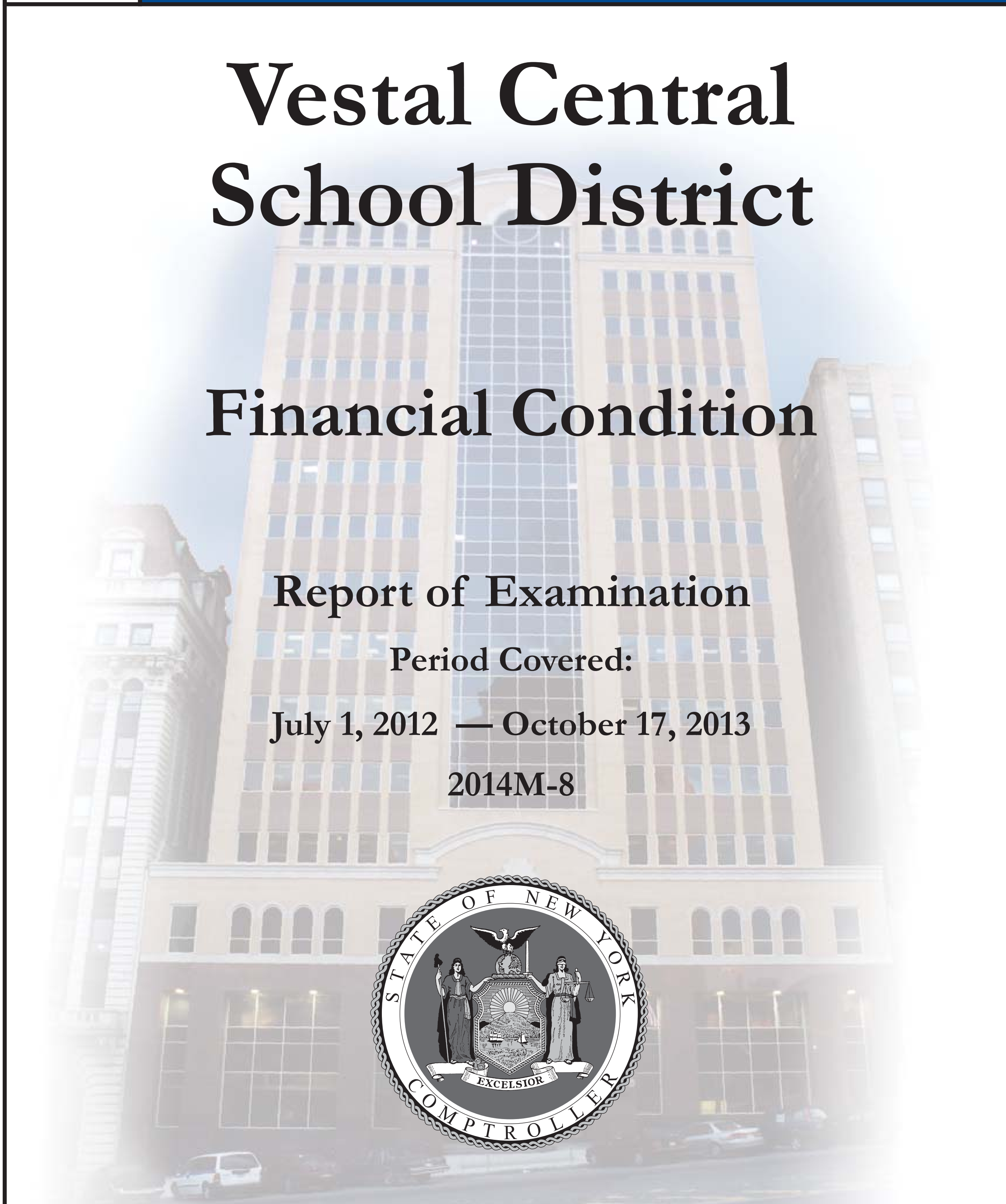
Division of Local Government & School Accountability

Vestal Central School District

Financial Condition



Report of Examination

Period Covered:

July 1, 2012 — October 17, 2013

2014M-8

Thomas P. DiNapoli

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State of New York
Office of the State Comptroller

Division of Local Government
and School Accountability

April 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 Vestal Central School District, entitled Financial Condition. This audit was conducted pursuant to Article V, Section 1 of the State Constitution and the State Comptroller's authority as set forth in Article 3 of the 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 Vestal Central School District (District) is located in the Towns of Vestal and Binghamton in Broome County and in the Town of Owego in Tioga 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 District's chief executive officer and is responsible, along with other administrative staff, for the District's day-to-day management under the Board's direction. The Superintendent and School Business Administrator are responsible for the District's finances, accounting records and financial reports.

There are seven schools in operation within the District, with approximately 3,400 students and 700 employees. The District's general fund budgeted appropriations for the 2013-14 fiscal year are $73.4 million, which are funded primarily with State aid and real property taxes.

Objective

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

- Did the Board and District officials develop reasonable budgets and, when appropriate, use fund balance to lessen the burden of District taxpayers?

Scope and Methodology

We examined the District's financial activities for the period July 1, 2012 through October 17, 2013. We extended our scope back to the 2008-09 fiscal year to analyze budgeting practices, fund balance trends, and reserve account balances.

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 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 generally agreed with our recommendations and indicated they planned to take corrective action. Appendix B includes our comments on issues raised in the District's response letter.

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 Board and District officials are responsible for making sound financial decisions that are in the best interests of the District, the students they serve and the taxpayers who fund the District's programs and operations. Sound budgeting practices based on accurate estimates coupled with prudent fund balance management helps ensure that sufficient funding will be available to sustain operations, address unexpected occurrences and satisfy long-term obligations or future expenditures.

Fund balance represents the cumulative residual resources 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,[1] as well as set aside and reserve reasonable portions of fund balance to finance future costs for a variety of specified objects or purposes. However, Real Property Tax Law requires that unexpended surplus funds not exceed 4 percent of the ensuing year's budget appropriations. Unreasonable budgetary practices or lack of information about actual budget performance can mislead District taxpayers and can significantly impact the District's year-end unexpended surplus funds and financial condition.

The Board and District officials did not develop reasonable budgets. Revenue estimates were generally close to the actual revenues received. However, over the last five fiscal years, the District's general fund spent $21.7 million less than planned. As a result of these budgetary surpluses, the District did not use any of the appropriated fund balance planned to finance operations (an average of $3.5 million for each of the last five years). Instead, between 2008 and 2013, the District's total fund balance for the general fund increased $4.8 million while the real property tax levy also increased by about $4.8 million.

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[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).

Unexpended Surplus Funds – While District officials have maintained unexpended surplus funds in compliance with the statutory limit each year, the process of consistently overestimating expenditures and appropriating fund balance that will not be used serves as a means to circumvent the law and is not transparent to taxpayers. Consequently, the District's effective unexpended surplus funds have exceeded 4 percent of the ensuing year's budget each year during our audit.

Table 1: Unexpended Surplus Funds at Fiscal Year End

	2008-09	2009-10	2010-11	2011-12	2012-13
Beginning Fund Balance	$4,546,998	$4,528,805	$6,438,418	$6,186,704	$7,199,789
Plus: Operating Surplus	$942,618	$493,663	$1,083,500	$993,960	$1,038,981
Unexpended Surplus Funds - Subtotal	$5,489,616	$5,022,468	$7,521,918	$7,180,664	$8,238,770
Less: Appropriated Fund Balance	$1,800,000	$3,450,000	$3,646,835	$4,464,130	$4,464,130
Less: Transfers to Reserves[a]	$967,092	($1,205,751)	$1,335,214	($19,124)	$1,455,917
Total Unexpended Surplus Funds at Year End	**$2,722,524**	**$2,778,219**	**$2,539,869**	**$2,735,658**	**$2,318,723**
Ensuring Year's Budget	$70,159,425	$70,331,110	$72,300,565	$72,264,855	$73,444,173
Reported Unrestricted Funds as a Percentage of Ensuing Year's Budget	3.88%	3.95%	3.51%	3.79%	3.16%
Effective Unexpended Surplus Funds Resulting From Unused Appropriated Fund Balance	$4,522,524	$6,228,219	$6,186,704	$7,199,788	$6,782,853
Effective Unexpended Surplus Funds as a Percentage of Ensuing Year's Budget	6.45%	8.86%	8.56%	9.96%	9.24%

[a] Negative amounts represent the use of reserve funds.

Appropriations – The Board-adopted budgets included an average of more than $70.7 million in appropriations for the last five completed fiscal years. The average actual expenditures totaled $66.3 million during this period.

Table 2: Overestimated Appropriations

Fiscal Year	Budgeted Appropriations	Actual Expenditures	Difference
2008-09	$68,287,605	$67,074,509	$1,213,096
2009-10	$70,159,425	$67,012,998	$3,146,427
2010-11	$70,331,110	$65,796,948	$4,534,162
2011-12	$72,300,565	$65,628,364	$6,672,201
2012-13	$72,264,855	$66,158,268	$6,106,587
Totals	**$353,343,560**	**$331,671,087**	**$21,672,473**
Five-year average	**$70,669,000**	**$66,334,000**	**$4,335,000**

The majority of the overestimated appropriations for the five-year period were for payroll-related expenditures, special education programs and operations and maintenance of the schools. It is also significant to note that the excess budgeted appropriations have increased significantly from $1.2 million to over $6 million.

District officials stated that they budget conservatively and include allowances for settlement payments of salary and fringe benefit costs that could result from renegotiated union contracts.[2] In addition, District officials regularly include provisions for increases in special education costs due to changes in enrollment. However, special education costs have only increased $1.4 million between fiscal years 2008-09 and 2012-13 or an average of $340,000 per year. Even after considering the potential increases due to union contract negotiations and trends in special education costs, the District would still have a significant amount of surplus funds remaining.

District officials also stated that they budget to recover the amount of surplus funds used to finance the ensuing year's operations. Increasing budget estimates in order to recover surpluses the Board planned to use as a financing source only serves to circumvent the legal restriction to retain up to 4 percent of the ensuing year's appropriations. Because the Board consistently adopted budgets with higher than necessary expenditure estimates, there was no need for its planned use of surplus funds. Instead, for the five-year fiscal period, the District's general fund generated approximately $4.5 million in operating surpluses[3] while the real property tax levy increased by nearly $4.8 million during the same period. If District officials budgeted for the actual revenues and expenditures that were anticipated, fund balance or reserves could be used to finance any unforeseen events. More accurate budget estimates may have also reduced, or eliminated, the need to increase the real property tax levy.

<u>Budget Information</u> – The District's budget was approved each year by a majority of the District's taxpayers, and the Board and administration did present to the public the financial information required by law.[4] However District officials did not include actual historical expenditures as compared to the proposed budget for the District taxpayers' consideration. For example, District officials'

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[2] As of the end of our fieldwork, three of the District's six bargaining units' contracts had expired and were being negotiated.

[3] Typically operating surpluses would equal the change in fund balance during the same period of time. Accounting adjustments made at the conclusion of a fiscal year can cause the calculated surpluses to differ from the changes in fund balance. The District had three such entries during our audit period.

[4] School districts, at a minimum, are required to present comparisons of the proposed budget estimates to the previous year's adopted budget.

budget presentations for fiscal year 2013-14 included a report that the District may be facing a $1.9 million budget gap. This gap was calculated in part by applying known contractual increases to fiscal year 2012-13 budgeted appropriations, such as health insurance and pension costs. However, for the fiscal year ended 2012-13, the District realized an operating surplus of over $1 million, with actual expenditures of $66.2 million, or $6.1 million less than budgeted. District officials stated that they attempt to provide as much budget information as possible to taxpayers. However, by not presenting actual expenditure trends, taxpayers may be mislead as to the District's current financial position because the prior year budget information includes overly conservative estimates and a "recapture" of the appropriated fund balance.

Finally, it appears District officials have continued their practice of overestimating expenditures because the District's fiscal year 2013-14 adopted budget totals $73.4 million in appropriations (an increase of $1.2 million from the previous fiscal year's budget). Given the five-year historical average, it is likely the District will again generate an operating surplus for fiscal year 2013-14 similar to those of the previous five fiscal years because at no time during this period have actual expenditures exceeded $67.1 million.

Recommendations

1. The Board should develop and adopt budgets that include reasonable estimates for expenditures and the use of unexpended surplus funds.

2. The Board should discontinue the practice of adopting budgets that result in appropriating unexpended surplus funds that will not be used to sustain District operations.

3. District officials should develop a plan for the use of the surplus funds identified in this report in a manner that benefits District taxpayers. Such uses could include, but are not limited to:

    - Increasing necessary reserves,
    - Paying off debt,
    - Financing one-time expenses and
    - Reducing District property taxes.

4. The Board should consider providing District taxpayers with budgetary information that includes prior fiscal years' actual expenditures as compared to the budgets of those same years.

APPENDIX A

RESPONSE FROM DISTRICT OFFICIALS

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

ADMINISTRATIVE OFFICES
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VESTAL, NEW YORK 13850

March 26, 2014

Office of the State Comptroller
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H. Todd Eames, Chief Examiner
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This correspondence is the official response from the Vestal Central School District Board of Education to the draft "Financial Condition Report of Examination, Period Covered: July 1, 2012 to October 17, 2013". The Board of Education takes seriously the responsibility of making sound financial decisions governing the best interest of students, programs, operations, and taxpayers. The Board looked forward to the audit that might identify opportunities and strategies to further improve current operations.

There are a number of positive and independent accolades District taxpayers can feel reassured about.

- In recent years, the District has experienced exemplary results in the annual financial audits, performed by an independent audit firm, with no significant or reported findings.
- Moody's upgraded the District's financial rating due to the strength of the financial position.
- Most recently, the District was notified by the New York State Comptroller's Office itself that the district was designated to be in good financial standing based on a recent financial stress audit.

The Board is pleased that this audit acknowledges that the district has been in compliance with statutory limits pertaining to unexpended surplus funds over the years. It is also recognized that the audit recommendations arise from a difference in budget philosophy between the Board and auditors.

The appropriated fund balance and surplus funds are two focal points in the audit. The use and recovery of both are true and are by design. Over recent years, new regulatory challenges, along with unfunded mandates, have caused the District to re-evaluate fiscal strategies in order to continually provide quality educational programs and safeguard district assets. Sustaining fiscal balance entails planning on a multiple year basis. This balance must be met by managing the current budget, but also planning and positioning for future years. Anticipating changes in

Challenge Support Foster Invest

regulations, unfunded mandates and unexpected expenditures are part of the decision-making process. This is vital in order to preserve programs and personnel, and smooth potential impact on taxpayers. This being said, the district has been forced to adapt to recent changes in the way revenues are received, namely state aid.

Since the 2008-09 fiscal year, state aid to the District has been severely impacted due to the Gap Elimination Adjustment (GEA). GEA is that amount of District's state aid retained by New York State to balance the state's budget. Since the inception of GEA, the Vestal Central School District has lost in excess of $17 million (including 2014-15 estimates), that will never be recovered. Institution of the maximum allowable levy regulation limits the District's ability to raise a tax levy. These new parameters have forced the District to change the philosophy and adjust operations to use and protect fund balance levels. It would be fiscally irresponsible to utilize one-time monies, such as fund balance resources, to balance year-to-year operations, without trying to recover these same funds. The District was able to apply, but not use all, appropriated fund balance in recent budgets. These funds help to balance the budget and serve to minimize the chance of overspending the budget. Historically, these funds have been used per the intent. District spending is monitored closely throughout the year to safeguard against overspending, with a desirable outcome of having some surplus. This approach, and the surplus, has helped to improve the financial strength and stability of the District and serves to address other necessary needs of the District, without going back to the taxpayers.

See Note 1 Page 12

Finally, the tone and implication of the audit report is very disappointing, offensive and untypical of an audit centered on fact, in light of the positive fiscal positioning that the Vestal Central School District has strived for.

See Note 2 Page 12

The Board appreciates and embraces constructive audit findings. The recommendations from this audit will be evaluated and utilized where deemed appropriate.

Kim A. Myers, President, Board of Education

APPENDIX B

OSC COMMENTS ON THE DISTRICT'S RESPONSE

Note 1

The appropriation of fund balance in a budget should be based on the Board's intent to fund a portion of District operations with available surplus funds. If the Board does not intend to use the appropriation, it should not include it in the budget. Including an appropriation of fund balance in the budget that is offset with overestimated expenditures or underestimated revenues is not a "recapture of fund balance." This type of budgeting costs the taxpayers money.

Note 2

Our findings and recommendations are based on the facts as presented to us by District officials.

APPENDIX C

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 October 17, 2013. To analyze the District's historical financial condition, budgeting practices and reserve balances, we extended our audit scope period back to July 1, 2008. Our examination included the following:

- We interviewed District officials and reviewed Board meeting minutes to gain an understanding of their budgeting process including their procedures for monitoring and controlling the budget and plans for funding and using reserves.

- We calculated the results of operations over the last five years by comparing actual revenues to actual expenditures including appropriated fund balance where applicable.

- We compared adopted budgeted revenues to actual revenues for the general fund for the fiscal years 2008-09 through 2012-13 to determine if the District's revenue budget estimates were reasonable. We examined the revenue budget line items to determine which line items accounted for 75 percent of both overbudgeted and/or underbudgeted variances.

- We compared adopted budgeted appropriations by functional area to actual expenditures for the general fund for the fiscal years 2008-09 through 2012-13 to determine if the District's budget estimates were reasonable. For those functional areas that accounted for 75 percent of the overbudgeted variances, we examined the budget line items to determine which line items accounted for at least 75 percent of those variances.

- We evaluated whether the planned uses of fund balances were reasonable and if the use actually occurred. We calculated the true unexpended surpluses each year in which a deficit did not occur as planned. We determined if this amount was greater than the statutory limits as defined by law.

- We evaluated the reasonableness of budgeted appropriations for fiscal year 2013-14 by comparing budgeted amounts for selected accounts to the amounts budgeted for fiscal year 2012-13. The accounts selected for review were those accounts identified in the fiscal year 2012-13 budget to actual variance testing that comprised at least 75 percent of overestimated expenditures by functional area.

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 D

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