



Afton Central School District

Management of Fund Balance and Reserves

Report of Examination

Period Covered:

July 1, 2014 – February 3, 2016

2016M-134



Thomas P. DiNapoli

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State of New York Office of the State Comptroller

Division of Local Government and School Accountability

July 2016

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 Afton Central School District, entitled Management of 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 Afton Central School District (District) is located in five Towns and one Village¹ in Chenango and Broome Counties. The District is governed by the Board of Education (Board), which is composed of five 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 day-to-day management of the District under the Board's direction.

The District operates one school with 575 students and 161 teachers and staff. The District's general fund budgeted appropriations for the 2015-16 fiscal year are \$15.2 million, which are funded primarily with State aid, real property taxes and grants.

Objective

The objective of our audit was to assess District officials' management of fund balance and reserves. Our audit addressed the following related question:

- Did District officials ensure that fund and reserve balances were reasonable?

Scope and Methodology

We examined the financial information of the District for the period of July 1, 2014 through February 3, 2016. We extended our audit period back to July 1, 2012 to examine fund and reserve balances and obtain a comprehensive understanding of officials' management of those balances. We also extended the audit period forward to May 31, 2016 to determine current unrestricted fund balance levels.

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. Except as indicated in Appendix A, District officials generally agreed with our recommendations and indicated they will take corrective action. Appendix B includes our comments on issues raised in the District's response.

¹ The Towns of Coleville, Sanford, Afton, Bainbridge and Coventry and the Village of Afton

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

Management of Fund Balance and Reserves

The Board and Superintendent are responsible for making sound financial decisions that are in the best interests of the District, the students it serves, and the residents who fund its programs and operations. Sound budgeting practices based on accurate estimates, together with prudent fund balance management, ensure that sufficient funding will be available to sustain operations, address unexpected occurrences and satisfy long-term obligations or future expenditures. A key component of budgeting is managing fund balance, which represents moneys accumulated from prior years and reserve balances. The Superintendent and Board must use the most current and accurate information available to ensure that budgeted appropriations are estimated reasonably, and that fund balance appropriated as a funding source is actually used in the next fiscal year to cover expenditures. While the District may retain a portion of fund balance (unrestricted fund balance), New York State Real Property Tax Law limits the amount allowable to 4 percent of the ensuing year's budgeted appropriations. The Board may also establish and fund reserves for various purposes; however, these reserve amounts should be supported by clear intent or plans for using and replenishing reserves.

District officials did not ensure that unrestricted fund balance and reserves were reasonable. The unrestricted fund balance has been well over the statutory limit for the past several years, while at the same time real property taxes were raised to the maximum allowable by the Real Property Tax Cap² regulations. Conservative budgeting practices have contributed to appropriated fund balance and reserves not being used as budgeted. Furthermore, certain reserves had excessive balances when compared to their respective liabilities.

Unrestricted Fund Balance – The District's unrestricted fund balance was significantly over the statutory limit³ in each of the last three fiscal years (Figure 1).

² The tax cap precludes a school district from adopting a budget that requires a tax levy that exceeds the prior year's tax levy by more than 2 percent or the rate of inflation, whichever is less, and certain exclusions permitted by law, unless 60 percent of District voters approve a budget that requires a tax levy that exceeds the statutory limit.

³ New York State Real Property Tax Law limits the amount of unrestricted surplus funds that can be legally retained by school districts to no more than 4 percent of the next fiscal year's budgeted appropriations.

Figure 1: Unrestricted Fund Balance at Year-End

	2012-13	2013-14	2014-15
Total Beginning Fund Balance	\$5,581,262	\$5,706,494	\$6,135,025
Add: Operating Surplus/(Deficit)	\$124,232	\$428,531	(\$170,545)
Total Ending Fund Balance	\$5,705,494	\$6,135,025	\$5,964,480
Less: Restricted Funds (Reserves)	\$3,385,737	\$3,385,738	\$3,385,746
Less: Encumbrances	\$52,597	\$219,908	\$31,266
Less: Appropriated Fund Balance for the Ensuing Year	\$625,000	\$600,000	\$727,668
Total Unrestricted Funds at Year-End	\$1,642,160	\$1,929,379	\$1,819,800
Ensuing Year's Budgeted Appropriations	\$15,722,941	\$16,262,243	\$15,209,263
Unrestricted Funds as Percentage of Ensuing Year's Budget	10%	12%	12%

Unrestricted fund balance remained high even though District officials appropriated over \$1.9 million in unrestricted fund balance as a financing source from 2011-12 through 2013-14 to help finance operations. However, little of that fund balance was actually used, while the District accumulated surpluses of over \$382,000.

In addition, although the District's budgeted revenues were generally reasonable, its expenditures averaged 5 percent under budgeted appropriations from 2012-13 through 2014-15. These budgetary variances⁴ contributed to the excessive unrestricted fund balance. During 2014-15, District officials appropriated \$727,668 to help finance the 2015-16 budget. As of May 31, 2016,⁵ the District had used this entire amount plus an additional \$787,000 due to a revenue shortfall of just over \$210,000, increased special-education costs and equipment purchases. Therefore, we project that the unrestricted fund balance will decline to below the statutory limit at the end of the 2015-16 fiscal year.

Reserves – As of June 30, 2015, the District had seven reserves in the general fund totaling approximately \$3.4 million. We determined that the retirement contribution and capital reserve balances were reasonable. However, the reserves for workers' compensation, unemployment insurance, compensated absences and tax certiorari, with balances totaling approximately \$1.4 million, were excessive compared to the amounts necessary for their stated purposes.

⁴ The variances were distributed throughout multiple line items.

⁵ Based on unaudited financial statements provided by District officials

- **Workers' Compensation Reserve** – This reserve is used to pay workers' compensation benefits and medical, hospital or other expenses authorized for employees who are removed from active service due to a work-related injury. The balance in this reserve remained at \$160,000 over the last three fiscal years. During the same time period, approximately \$91,000 in qualifying expenditures were paid from the operating budget. If expenditures continue at about \$30,000 per year, the balance in this reserve is enough to fund over five years of payments. Furthermore the District has been funding this cost in the annual budget and has included \$139,394 in the 2015-16 budget for workers' compensation. Therefore, this reserve appears to be unnecessary and is overfunded by \$160,000.
- **Unemployment Insurance Reserve** – This reserve is used to reimburse the State Unemployment Insurance Fund for payments made to claimants where the District has elected to use the "benefit reimbursement" method based on actual unemployment claims. The balance in this reserve remained at \$93,500, or nine times the annual average qualifying expenditures of just over \$10,000. Furthermore, the District has been paying unemployment costs from the operating fund and has included \$20,000 in the 2015-16 budget for this expenditure.
- **Reserve for Tax Certiorari** – New York State Education Law (Education Law) authorizes school districts to establish a reserve for the payment of judgments and claims resulting from tax certiorari proceedings.⁶ Any money not expended after four years must be returned to the general fund. The District's balance in this reserve has remained at over \$92,000 for the last three fiscal years although the District has no qualifying expenditures or current tax certiorari proceedings. Therefore, this balance should be returned to the general fund.
- **Compensated Absences Reserve** – This reserve must only be used for cash payments of accrued and unused sick, vacation and certain other leave time owed to employees when they leave the District's employment. This reserve balance remained at \$1,050,000 over the last three fiscal years, and as of June 30, 2015, had a liability of \$698,344. Therefore, this reserve is overfunded by roughly \$350,000 (33 percent).

⁶ 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 various grounds.

District officials have not established a policy for reserves stating the desired balances and planned uses for amounts to be held in reserves and do not have a plan to reduce their balances to appropriate levels.

The District had also set aside \$550,000 in a liability reserve.⁷ In May 2010, when this reserve was established, the District was involved in a lawsuit and planned accordingly based on the information available. This lawsuit was resolved in August 2015. In May 2015, the District was involved in another suit which was resolved in February 2016. Therefore, the anticipated liability expenditures no longer exist and this reserve is not needed. Officials have not developed a plan for the return of those reserved moneys to unrestricted fund balance, as allowed by law.

By not ensuring that unrestricted fund and reserve balances were reasonable, District officials have raised more real property taxes than necessary. Over the past three completed fiscal years (2012-13 through 2014-15), District officials raised real property taxes to the maximum allowable by the Real Property Tax Cap while the unrestricted fund balance exceeded the statutory limit. However, they have made subsequent efforts to bring unrestricted fund balance to within the statutory limit. We encourage District officials to continue their monitoring and management of current fund balance levels.

Recommendations

District officials should:

1. Ensure that unrestricted fund balance remains in compliance with the statutory limit.
2. Discontinue the practice of adopting budgets with the appropriation of unrestricted fund balance that will not be used.
3. Review all reserve balances and transfer overfunded amounts to unrestricted fund balance, where allowed by law, or other reserves established and maintained in compliance with statutory directives.

⁷ New York State Education Law authorizes school districts to establish and maintain reserves, not to exceed 3 percent of the annual budget, to cover property loss and liability claims. The primary purpose of this statute is to provide the ability to “self-insure” for all or portions of claims that would typically be covered by insurance, to reduce a school district’s insurance costs.

APPENDIX A

RESPONSE FROM DISTRICT OFFICIALS

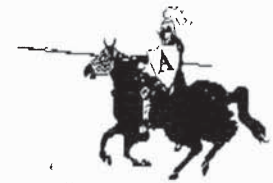
The District officials' response to this audit can be found on the following page.

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Afton Central School

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**Crimson Knights**

Elizabeth Briggs, Superintendent
Kenneth Howard, Business Manager/Treasurer

David Glover, Secondary Principal
Beth Carsello, Elementary Principal

June 17, 2016

Re: Afton Central School

Audit Response and Corrective Action Plan

The Afton Central School District is in receipt of the Draft Audit Report – Management of Fund Balance and Reserves for the period of July 1, 2014 through February 3, 2016, prepared by the Office of the State Comptroller. On behalf of the Board of Education and the District Administration, we would like to thank the Comptroller's staff for their professionalism and courtesy in conducting their duties associated with this audit.

The Afton Central School is committed to providing an excellent educational program that prepares students for college and career readiness in the 21st century. To this end, our budget development is guided by the following principles, reviewed and adopted by the Board during each year's budget calendar.

- 1) Provide a strong program for students that will prepare them to be college and career ready.
- 2) Improved student achievement
- 3) Maximize available resources
- 4) Seek savings through efficiencies
- 5) Staffing based on enrollment and program needs
- 6) Affordability to taxpayers
- 7) Do not use one time funding for ongoing expenses
- 8) Focus on the long-term financial well-being of the district

These principles have allowed us to maintain both educational excellence and financial stability through challenging economic times.



The Afton Central School District has always welcomed the opportunity to review and strengthen our financial practices and oversight. We have worked diligently over the past several years to update policies, strengthen internal controls, and develop budgets that balance short term financial priorities with the long term financial well-being of the District. To that end, we have developed and maintained long term financial projections that guide our decision making. We communicate with the public about our financial strategies and our annual budget materials seek to provide a transparent and engaging environment.

The audit report focused on the District's budgeting and use of appropriated fund balance, a topic on which the District and the Comptroller's Office have a difference of opinion. The Comptroller is of the opinion that the school district should deplete its appropriated fund balance annually. The school district respectfully disagrees. The audit report contains a number of conclusions with respect to the District's financial management, specifically as they relate to financial planning, appropriate fund balance, and appropriate reserves. The Afton Central School District utilizes a long term budgeting strategy in which the appropriated fund balance mentioned in the Comptroller's audit plays an important role. Schools in New York have been underfunded by State Aid and face additional limits to their revenue posed by the New York State property tax cap.

See
Note 1
Page 13

The School District Board of Education and Administration have made it clear to the voters and residents of the District that they do indeed utilize an appropriated fund balance as a budget tool, and that it is available in the event of unanticipated events such as special education increases, increased student enrollments, emergency repair expenses, and unanticipated shortfalls of District revenues. This information is communicated in the popular budget document, the School District website, and Board of Education meetings throughout the budgeting process. As has been seen throughout the state, District's that have not had adequate fund balance and reserves have been made to make drastic cuts to programs and services and or levy tax increases that exceed the tax cap.

See
Note 2
Page 13

The taxpayers from our School District recognize that the School Board and Administration are transparent with the public regarding the budget and finances of the District. The Board and Administration hold numerous public meetings concerning the budget.

Comptroller Recommendation 1:

Ensure that unrestricted fund balance remains in compliance with the statutory limit.

As was projected in the OSC audit, the Afton Central School unrestricted fund balance is projected to be in compliance with the statutory limit at the end of the current school year.

The District will continue to closely monitor compliance.

Comptroller Recommendation 2

Discontinue the practice of adopting budgets with appropriation of unrestricted fund balance that will not be used.

The School District does not unnecessarily appropriate fund balance. The appropriated fund balance is a lawful budget tool along with estimated revenues to support the appropriations in the adopted budget. Throughout the budget process, the Board of Education and the Administration explain that appropriated fund balance is used to support any shortfall in revenues and/or unexpected increases in expenditures. Absent appropriated fund balance, estimated revenues would need to increase or budget reduction which would negatively impact the students, staff and taxpayers of the District.

However, the District is aware of the Comptroller's recommendation and the Business Manager will continue to monitor the amount of appropriated fund balance as an integral part of the budget process.

The District budgets for expenses that may be volatile and subject to external forces beyond the District's control. The budget is expected to fund educational programs to meet the needs of the students and community regardless of any changes in external factors which can lead to unexpected increases to the budget.

The Board systematically reviews every budget line of the appropriations and adopts realistic estimates for expenditures. In addition, the Board of Education has built contingencies into the budget to account for unexpected expenses. The contingencies allow the District to be prepared for unforeseeable increases to the budget due to various items such as increases in the number of special education students/services, fluctuations in utility prices, or health insurance premium increases. The Board's philosophy is to leave enough flexibility in the budget to meet any worst case financial demands which may arise during the school year.

See
Note 2
Page 13

Recommendation 3

Review all reserve balances and transfer overfunded amounts to unrestricted fund balance, where allowed by law, or other reserves established and maintained in compliance with statutory directives.

The Afton Central School Board of Education will follow the Comptroller's recommendation and review its policies and update where the Board deems appropriate.

(4)

Conclusion:

We would like to thank the Comptroller's Office for their thoroughness and professionalism over the course of the time that they spent in Afton.

We would like to assure the Office of the Comptroller that the recommendations included in this report will be followed as Afton Central School continues to provide the best possible education for our students in a fiscally responsible manner.


Elizabeth Briggs
Superintendent of Schools

APPENDIX B

OSC COMMENTS ON THE DISTRICT'S RESPONSE

Note 1

The Office of the State Comptroller does not express the opinion that appropriated fund balance should be depleted annually. Rather, the amount of appropriated fund balance is a budgetary estimate of the amount needed to finance the difference between appropriations and estimated revenues. The District should not appropriate fund balance when there is no planned operating deficit and, therefore, the appropriated fund balance will not be used. The District's approach of showing appropriated fund balance that will not be used is misleading.

Note 2

The District can legally retain year-end unrestricted fund balance (of up to 4 percent of the next year's appropriations) to help with the management of unexpected expenditures and/or cash flow. However, the budgeted appropriation of fund balance is a tool for balancing the budget. There is no authority for school districts to budget (or appropriate) funds for contingency purposes.

APPENDIX C

AUDIT METHODOLOGY AND STANDARDS

To achieve our audit objective and obtain valid evidence, we performed the following procedures:

- We conducted interviews with District officials and Board members to gain an understanding of how officials determine the amount of fund balance to be appropriated each year and threshold amounts for both unrestricted fund balance and reserves.
- We compared actual revenues to actual expenditures for fiscal years 2012-13 through 2014-15 to determine if the District ended with an operating surplus or deficit, and if fund balance and reserve appropriations were used as budgeted.
- We compared the budgeted revenues and appropriations to the actual revenues and expenditures for the general fund for fiscal years 2012-13 through 2014-15 to determine if the District's adopted budgets were reasonable.
- We compared budgeted revenues and appropriations to actual revenues and expenditures to determine which lines drove the variances between budgeted amounts and actual amounts for fiscal years 2012-13 through 2014-15.
- We reviewed Real Property Tax Cap filings for 2013-14 through 2015-16 to determine if real property tax levies had been within the real property tax levy limit.
- We calculated the unrestricted fund balance as a percentage of the ensuing year's appropriations to determine if the District was within the statutory limit from 2012-13 through 2014-15.
- We compared reserve balances to supporting documentation to determine if they were reasonable.

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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