



Alexander Central School District Financial Condition

Report of Examination

Period Covered:

July 1, 2010 — August 4, 2015

2015M-227



Thomas P. DiNapoli

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State of New York Office of the State Comptroller

Division of Local Government and School Accountability

February 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 compliance with relevant statutes and observance of good business practices. This fiscal oversight is accomplished, in part, through our audits, which identify opportunities for improving operations and Board of Education governance. Audits also can identify strategies to reduce district costs and to strengthen controls intended to safeguard district assets.

Following is a report of our audit of the Alexander 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 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 Alexander Central School District (District) is located in the Towns of Alexander, Batavia, Bethany and Darien in Genesee County and the Town of Bennington in Wyoming County. 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 affairs. The Superintendent of Schools (Superintendent) is the District's chief executive officer and is responsible, along with the Business Administrator, for the District's day-to-day management and for the development and administration of the budget.

The District operates two schools with 858 students and 172 employees. The District's 2014-15 general fund appropriations totaled approximately \$17 million and were funded primarily with real property taxes and State aid.

Objective

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

- Does the Board adopt realistic budgets that are structurally balanced and take appropriate actions to maintain the District's fiscal stability?

Scope and Methodology

We examined the District's financial condition for the period July 1, 2010 through August 4, 2015.

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 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 that they planned to initiate corrective action.

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 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

A school district's financial condition is a factor in determining its ability to fund public educational services for students within the district. The responsibility for accurate and effective financial planning for the use of District resources rests with the Board, the Superintendent and the Business Administrator. Fund balance represents the cumulative residual resources from prior fiscal years that can, and in some cases must, be used to lower property taxes for the ensuing fiscal year. A district also can legally set aside and reserve portions of fund balance to finance future costs for a variety of specified objects or purposes.

The Board did not adopt realistic budgets or ensure that reserves were reasonably funded. District officials consistently overestimated expenditures during the last five fiscal years (2010-11 through 2014-15). These budgeting practices generated approximately \$2.4 million in operating surpluses. The District also appropriated an average of approximately \$670,000 in fund balance annually, which was not needed to fund operations due to operating surpluses. This practice allowed the District to appear that it was within the 4 percent statutory limit imposed on the level of unrestricted fund balance. However, when adding back unused appropriated fund balance, the District's recalculated unrestricted fund balance ranged between 5.0 and 7.4 percent of the ensuing year's appropriations, exceeding the limit. From 2010-11 to 2015-16, District officials increased the tax levy by 10 percent. District officials also used approximately \$2.5 million of fund balance to fund seven reserves that, as of June 30, 2015, totaled approximately \$5 million. Three of these reserve funds are overfunded. As a result of these practices, District officials have levied real property taxes that were higher than necessary to fund District operations.

Budgeting and Fund Balance

The Board and District management are responsible for accurately estimating revenues and appropriations in the District's annual budget. Accurate budget estimates help ensure that the levy of real property taxes is not greater than necessary. Estimating fund balance is also an integral part of the budget process. New York State Real Property Tax Law currently limits unrestricted fund balance to no more than 4 percent of the ensuing fiscal year's budget. Any surplus fund balance over this percentage should be used to reduce the upcoming fiscal year's tax levy.

When fund balance is appropriated as a funding source, the expectation is that there will be a planned operating deficit in the

ensuing fiscal year, financed by the amount of the appropriated fund balance. Conversely, an operating surplus (when revenues exceed expenditures) results in an increase in year-end fund balance. Sound budgeting practices provide that adopted annual budgets do not routinely appropriate fund balance that will not actually be used to fund operations. Instead of decreasing fund balance, as reflected in the budget presented to taxpayers, this practice increases the amount of fund balance.

We compared the District’s annual appropriations with actual results of operations for 2010-11 through 2014-15 and found that the District consistently overestimated expenditures ranging from 3 to 12 percent of appropriations, as shown in Figure 1. The majority of these variances were for certain line items. For example, in 2013-14 District officials expended less than budgeted for instructional salaries (\$414,984, or 10 percent¹) and employee benefits (\$269,141, or 15 percent²). Because these expenditures are governed by contractual agreements, they could have been reasonably predicted and should not have been overestimated. Such large and repeated variances in accounts that can be accurately projected indicates that the overbudgeting was intentional.

Figure 1: Overestimated Expenditures

Fiscal Year	Appropriations ^a	Expenditures	Difference	Percentage of Appropriations
2010-11	\$16,938,838	\$14,919,106	\$2,019,732	12%
2011-12	\$16,589,267	\$14,722,318	\$1,866,949	11%
2012-13	\$16,756,659	\$15,303,172	\$1,453,487	9%
2013-14	\$17,133,894	\$15,749,927	\$1,383,967	8%
2014-15 ^b	\$16,739,944	\$16,266,034	\$473,910	3%
Totals	\$84,158,602	\$76,960,557	\$7,198,045	9%

^a Includes budget modifications
^b Expenditures exclude \$1,155,000 transferred from general fund reserves to the capital projects fund. For purposes of our analysis, these are not considered operating expenditures.

Due to the District’s practice of overestimating appropriations, fund balance has increased by more than \$2.4 million over this five-year period, an annual average of 3 percent of the appropriations, as shown in Figure 2. The District realized a small operating deficit in 2014-15 because the Board approved an \$850,000 transfer of general fund surplus to the capital projects fund in July 2015, after the fiscal year had ended. The transfer was intended to reduce the amount the District needed to borrow to fund an approved capital project. If

¹ The percentage of the adjusted budget for instructional salaries

² The percentage of the adjusted budget for employee benefits

this transfer had not been made, the District would have realized an operating surplus.

Figure 2: Results of Operations				
Fiscal Year	Revenues	Expenditures	Operating Surplus/(Deficit)	Percentage of Appropriations
2010-11	\$15,927,502	\$14,919,106	\$1,008,396	6%
2011-12	\$15,250,926	\$14,722,318	\$528,608	3%
2012-13	\$15,785,896	\$15,303,172	\$482,724	3%
2013-14	\$16,280,732	\$15,749,927	\$530,805	3%
2014-15	\$16,155,237	\$16,266,034	(\$110,797)	(1%)
Totals	\$79,400,293	\$76,960,557	\$2,439,736	3%

In each budget for the last five years, the District appropriated an average of approximately \$670,000 of fund balance to fund the ensuing year's appropriations. However, except for 2014-15, the District did not use any fund balance to finance operations. As a result, the District's fund balance has remained excessive. Furthermore, the District's practice of consistently appropriating fund balance that is not needed to finance operations is, in effect, a reservation of fund balance that is not provided for by statute and a circumvention of the statutory limit imposed on the level of unrestricted fund balance.

Figure 3: Unrestricted Fund Balance at Year-End					
	2010-11	2011-12	2012-13	2013-14	2014-15
Beginning Fund Balance	\$4,927,785	\$5,936,181	\$6,464,789	\$6,944,586	\$7,475,409
Add: Operating Surplus/(Deficit)	\$1,008,396	\$528,608	\$482,724	\$530,805	(\$110,797)
Adjustments and Use of Reserves			(\$2,927)	\$18	(\$1,155,000)
Ending Fund Balance	\$5,936,181	\$6,464,789	\$6,944,586	\$7,475,409	\$6,209,612
Less: Non-Spendable Fund Balance	\$231,300	\$235,006	\$255,060	\$263,045	\$253,445
Less: Restricted Fund Balance	\$4,550,733	\$4,994,495	\$5,533,015	\$6,256,714	\$5,047,539
Less: Encumbrances	\$0	\$0	\$18,993	\$5,821	\$18,198
Less: Appropriated Fund Balance for the Ensuing Year	\$703,554	\$707,641	\$595,452	\$652,128	\$650,000
Unrestricted Fund Balance at Year End	\$450,594	\$527,647	\$542,066	\$297,701	\$240,430
Ensuing Year's Budgeted Appropriations	\$16,483,028	\$16,706,092	\$17,088,600	\$16,734,123	\$17,226,269
Unrestricted Fund Balance as a Percentage of Ensuing Year's Budget	2.7%	3.2%	3.2%	1.8%	1.4%

These budgeting practices allowed the District to circumvent the 4 percent statutory limit imposed on the level of unrestricted fund balance. When unused appropriated fund balance was added back, the District's recalculated unrestricted fund balance ranged between 5 and 7.4 percent of the ensuing year's appropriations as shown in Figure 4.

Figure 4: Unused Fund Balance					
	2010-11	2011-12	2012-13	2013-14	2014-15
Unrestricted Fund Balance at Year End	\$450,594	\$527,647	\$542,066	\$297,701	\$240,430
Add: Appropriated Fund Balance Not Used to Fund Ensuing Year's Budget	\$703,554	\$707,641	\$595,452	\$541,331	\$650,000
Recalculated Unrestricted Fund Balance	\$1,154,148	\$1,235,288	\$1,137,518	\$839,032	\$890,430
Recalculated Unrestricted Fund Balance as a Percentage of Ensuing Year's Budget	7.0%	7.4%	6.7%	5.0%	5.2%

These budgeting practices made it appear that the District needed to raise real property taxes and use fund balance to close projected budget gaps. As a result, real property taxes levied were greater than necessary to fund operations. The District increased the tax levy by about 10 percent over the past five years from \$5.4 million in 2010-11 to \$5.9 million in 2015-16. We reviewed the 2015-16 budget, in which the District budgeted similarly to previous years and most likely will not use the \$650,000 it appropriated in fund balance. Therefore, the District's recalculated fund balance will likely continue to exceed the statutory limit.

Reserves

Reserves may be established by the Board in accordance with applicable laws. Money set aside in reserves must be used in compliance with statutory provisions which determine how reserves are established, funded, expended and discontinued. Generally, while school districts are not limited as to how much money can be held in reserve funds, reserve fund balances must be reasonable. Funding reserves at greater than reasonable levels contributes to real property tax levies that are higher than necessary because the excessive reserve balances are not being used as intended (i.e., to fund operations). Reserve funds should not merely be used as a means to accumulate excess fund balance. The Board should balance the intent for accumulating money for future identified needs with the obligation to ensure that taxpayers are not overburdened.

As of June 30, 2015, the District had seven reserve funds with balances totaling approximately \$5 million. District officials used a total of \$2.5 million in fund balance to increase these reserves

from 2010-11 through 2013-14. We analyzed these reserves for reasonableness and adherence to statutory requirements and found the balances of the three capital reserves and the employee benefit accrued liability reserve to be reasonable. However, the balances in the workers' compensation, unemployment insurance and retirement contribution reserves, totaling approximately \$3.7 million, were higher than necessary to fund the expenditures that may be legally paid from these reserves.

Workers' Compensation Reserve – General Municipal Law (GML) authorizes the Board to establish this type of reserve to pay for workers' compensation benefits and related medical expenditures based on workers' compensation claims, rather than paying annual premiums. The balance of this reserve as of June 30, 2015 was more than \$1.3 million. The balance is more than 17 times the District's four-year average annual workers' compensation expenditures of approximately \$75,000, which were budgeted for and paid out of the general fund. In addition, no money has been spent from this reserve since 2010-11. Therefore, we question the reasonableness of the amount in this reserve.

Unemployment Insurance Reserve – GML authorizes the Board to establish this type of reserve to reimburse the New York State Unemployment Insurance Fund for payments made to claimants on the District's behalf. The balance of this reserve as of June 30, 2015 was \$920,000. While the District incurred unemployment costs totaling approximately \$65,000 from 2010-11 through 2013-14, these expenditures were budgeted for and paid from the general fund as routine operating costs. If unemployment costs continue to average approximately \$16,000 per year, the reserve would last for more than 50 years. Therefore, we question the reasonableness of the amount in this reserve. District officials stated that they were aware this reserve balance was too high, and the Board approved a transfer of \$540,000 from this reserve to a capital reserve to help fund a school building and facilities capital project in May 2015.

Retirement Contribution Reserve – GML authorizes the Board to establish this type of reserve to pay contributions for employees covered by the New York State and Local Retirement System. The balance of this reserve as of June 30, 2015 was more than \$1.4 million, which was more than four times the District's average contribution of approximately \$300,000 over four years.³ District officials told us that this amount was based on five-year retirement contribution costs. However, no money has been expended from this reserve since 2010-

³ These expenditures were budgeted for and paid out of the general fund as routine operating costs.

11. Consequently, we question the reasonableness of the amount in this reserve.

By maintaining excessive reserves, combined with ongoing budgeting practices that generate repeated operating surpluses, the Board and District officials have consistently levied unnecessary taxes, putting an unfair burden on taxpayers in the District.

Recommendations

The Board and District officials should:

1. Develop realistic estimates of expenditures and the use of fund balance in the annual budget.
2. Use the excess amounts in reserve funds, in accordance with applicable statutory provisions, in a manner that benefits District taxpayers.

APPENDIX A

RESPONSE FROM DISTRICT OFFICIALS

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



February 9, 2016

Office of the State Comptroller
Buffalo Regional Office
295 Main Street, Room 1032
Buffalo, New York 14203-2510

To Whom It May Concern:

Please accept this letter as notification that the Alexander Central School District has received and reviewed the preliminary draft findings that resulted from the audit recently conducted by the Comptroller's Office. It is our impression that the report accurately reflects the financial status of the District.

Based on the preliminary report we are in the process of developing a corrective action plan to respond to the findings in the report.

If additional information is required from the District at this time please inform me accordingly.

Thank you.

Respectfully,

Kathleen Maerten
Superintendent of Schools

xc: T. Batzel

ALEXANDER CENTRAL SCHOOL DISTRICT
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APPENDIX B

AUDIT METHODOLOGY AND STANDARDS

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

- We interviewed District officials to obtain an understanding of the District's oversight of budgeting and the reserves.
- We compared the District's budgeted appropriations and estimated revenues with the actual results of operations to determine if there were significant budget variances from 2010-11 through 2014-15.
- We analyzed the District's property tax levy for 2010-11 through 2015-16 to determine percentage increases and whether the tax levy agreed with the Board-approved amount.
- We reviewed the District's trial balance reports to identify the District's current reserves and document the corresponding balances. We compared the amounts in the reserves with the average expenditures to determine if the reserve fund balances were reasonable.
- We reviewed unrestricted fund balances reported at fiscal year-end to determine whether fund balances were within the limit established by statute.

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.

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