



# Port Chester-Rye Union Free School District Financial Condition

## Report of Examination

Period Covered:

July 1, 2009–June 30, 2014

2015M-147



Thomas P. DiNapoli

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# State of New York Office of the State Comptroller

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## **Division of Local Government and School Accountability**

September 2015

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 district's 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 costs and to strengthen controls intended to safeguard district assets.

Following is a report of our audit of the Port Chester-Rye Union Free 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 Port Chester-Rye School District (District) is located in Westchester County and includes the Village of Port Chester and part of the Village of Rye Brook. 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 District's day-to-day management under the Board's direction.

The District operates six schools with approximately 4,500 students and 680 employees. The District's total expenditures for the 2013-14 fiscal year were \$81,123,507 and budgeted appropriations for 2014-15 were \$88,420,148, funded primarily with State aid and real property taxes.

## Objective

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

- Did District officials ensure budget estimates and reserves are maintained at a reasonable level and fund balance is in accordance with statutory requirements?

## Scope and Methodology

We examined the District's financial condition for the period July 1, 2009 through June 30, 2014.

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. Unless otherwise indicated in this report, samples for testing were selected based on professional judgment, as it was not the intent to project the results onto the entire population. Where applicable, information is presented concerning the value and/or size of the relevant population and the sample selected for examination.

## 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 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.

## Financial Condition

The Board is responsible for making sound financial decisions that are in the best interests of the District, the students it serves and the taxpayers who fund the District's programs and operations. Sound budgeting practices based on accurate estimates along with prudent fund balance management ensure that sufficient funding will be available to sustain operations, address unexpected expenses and satisfy long-term obligations or future expenditures. Accurate budget estimates also help ensure that the real property tax levy is not greater than necessary. Fund balance represents resources remaining from prior fiscal years. A district may retain a portion of fund balance but must do so within the limits established by New York State Real Property Tax Law (RPTL). Currently, the amount of fund balance that a school district can retain may not be more than 4 percent of the ensuing fiscal year's budget.

The Board is responsible for developing a formal plan for funding and using reserves. Funding reserves should be done through appropriations in budgets that are voted on by taxpayers. Funding reserves at greater than reasonable levels contribute to real property tax levies that are higher than necessary because the excessive reserve balances are not being used to fund operations. Therefore, the appropriate use of reserve funds is also an important part of the budget process.

The Board adopted budgets from 2009-10 through 2013-14 that appropriated fund balance to finance operations. However, because the Board overestimated expenditures in those budgets, none of the fund balance that was appropriated was used in four of these fiscal years. As a result, the District's fund balance increased 13 percent from \$10.7 million in 2010-11 to \$12.1 million in 2013-14. Further, the District had three reserves totaling approximately \$5 million at the end of 2013-14 which were funded by transfers of surplus funds at year-end rather than through appropriations in budgets that were voted on by taxpayers. Of these, \$2.9 million from the retirement contribution reserve accounts were excessive. With the inclusion of fund balance and excessive reserves, the District's fund balance has been in excess of the 4 percent allowed by law, ranging from 6.65 percent to 10.59 percent. As a result, District officials may have missed the opportunity to accumulate less fund balance, reduce the tax levy and increase the transparency of the budgeting process.

### Budgeting

The Board is responsible for preparing and adopting reasonable budgets based on historical or known trends for appropriations

and revenues. In preparing the budget, District officials should use the most current and accurate information available to ensure that budgeted appropriations are reasonable and not overestimated.

We reviewed the District's budgets for 2009-10 through 2013-14 and found that actual general fund expenditures were less than the budgeted appropriations for each year. District officials overestimated expenditures by about \$13.6 million from 2009-10 through 2013-14 as shown in Figure 1. Certain expenditures were overestimated each year. For example, the District overestimated salaries by \$1 million in 2009-10, \$2 million in 2010-11, \$1.3 million in 2011-12, \$1.1 million in 2012-13 and \$1.7 million in 2013-14. Because these costs are established by contract, they should be predictable and budget estimates should be close to actual expenses.<sup>1</sup>

<b>Figure 1: Overestimated Expenditures</b>						
	<b>2009-10</b>	<b>2010-11</b>	<b>2011-12</b>	<b>2012-13</b>	<b>2013-14</b>	<b>Five Year Total</b>
Estimated Expenditures	\$75,772,014	\$77,285,465	\$79,555,725	\$81,320,560	\$85,186,834	\$399,120,598
Actual Expenditures	\$73,268,117	\$75,664,048	\$76,556,443	\$78,919,996	\$81,123,507	\$385,532,111
Overestimated Expenditures	\$2,503,897	\$1,621,417	\$2,999,282	\$2,400,564	\$4,063,327	\$13,588,487

District officials told us they budget for four to six extra positions each year because new positions may be required, an example being for an unforeseen special education placement. District officials also stated that maternity leave and sick leave contribute to the variance every year because the full salaries of the teachers or staff members going on leave are budgeted but their replacements are paid at much lower salaries. In addition, in 2012-13, the District experienced a \$1 million cost savings as a result of contractual changes to healthcare plans which also contributed to the operating surplus.

Budgeting practices that continually overestimate expenditures result in the accumulation and retention of excessive funds, placing an unnecessary tax burden on District taxpayers.

## **Fund Balance**

Fund balance represents resources remaining from prior fiscal years. The District may retain a portion of fund balance but must do so within the limits established by RPTL. Currently, the District cannot retain more than 4 percent unrestricted fund balance of the ensuing fiscal year's budget. The remaining fund balance can be used to lower real property taxes or establish reserves for specific purposes.

At the end of 2013-14, the District's unrestricted fund balance was \$3.5 million, an increase of \$518,000 since 2009-10. The increase occurred because the Board overestimated expenditures and

<sup>1</sup> The District was in contract negotiations with unions for teachers and non-teaching staff during budget preparation in 2011-12. In 2012-13, the District was still in contract negotiations with the union for the teachers.

appropriated unrestricted fund balance that was not used to fund operations.

Figure 2: Fund Balance					
	2009-10	2010-11	2011-12	2012-13	2013-14
Beginning Fund Balance	\$8,942,180	\$10,681,621	\$9,394,195	\$9,510,177	\$10,651,787
Operating Surplus/(Deficit)	\$1,739,441	(\$1,287,426)	\$115,982	\$1,141,610	\$1,433,988
Year-End Fund Balance	\$10,681,621	\$9,394,195	\$9,510,177	\$10,651,787	\$12,085,775
Percentage of Ensuing Year's Budget	13.82%	11.81%	11.69%	12.50%	13.67%
Less: Restricted Fund Balance	\$4,688,126	\$3,056,793	\$3,574,694	\$3,906,868	\$4,954,563
Less: Committed/Not Spendable Fund Balance	\$0	\$247,606	\$0	\$401,645	\$618,985
Less: Unrestricted Fund Balance Appropriated for the next Fiscal Year	\$3,000,000	\$3,517,971	\$2,700,000	\$3,000,000	\$3,000,000
Unrestricted Fund Balance at Year-End	\$2,993,495	\$2,571,825	\$3,235,483	\$3,343,274	\$3,512,227
Percentage of Ensuing Year's Budget	3.87%	3.23%	3.98%	3.92%	3.97%

The Board appropriated fund balance to finance operations each year, from 2009-10 through 2013-14. However, the amounts appropriated were not used in four of the five fiscal years because expenditures were overestimated. The District experienced one operating deficit in 2010-11 and used appropriated fund balance; however, of the \$3 million appropriated for use, the District used only \$1,287,424 to finance operations.

The Board did not adopt realistic budgets, because it consistently overestimated appropriations and appropriated fund balance that was not needed to fund operations. As a result, the District's fund balance has exceeded the legal limit for the five fiscal years that we reviewed. With the inclusion of the unused appropriated fund balance and excessive reserves, the total fund balance maintained was actually in excess of the 4 percent allowed, ranging from 6.65 percent to 10.59 percent.

Figure 3: Unused Fund Balance					
	2009-10	2010-11	2011-12	2012-13	2013-14
Unrestricted Fund Balance at Year End	\$2,993,495	\$2,571,825	\$3,235,483	\$3,343,274	\$3,512,227
Add: Unused Appropriated Fund Balance	\$1,500,000	\$1,712,576	\$3,517,971	\$2,700,000	\$3,000,000
Add: Unnecessary Moneys in the Retirement Contribution Reserve	\$1,000,000	\$1,005,000	\$1,010,025	\$1,815,188	\$2,855,551
<b>Total</b>	<b>\$5,493,495</b>	<b>\$5,289,401</b>	<b>\$7,763,479</b>	<b>\$7,858,462</b>	<b>\$9,367,778</b>
As a Percent of Ensuing Year's Budgeted Appropriations	7.11%	6.65%	9.55%	9.22%	10.59%



Had District officials adopted realistic estimates for expenditures and used appropriated fund balance to finance operations, they could have accumulated less fund balance and possibly reduced the tax levy. Furthermore, the budgetary practice of adopting unrealistic estimates for expenditures and appropriating fund balance that will not be used to finance operations diminishes the transparency of the budgeting process.

## **Reserves**

Fund balance may be restricted for particular purposes or appropriated to reduce the real property tax levy. When District officials establish reserve funds for specific purposes, it is important they develop a plan for funding the reserves, determining how much should be accumulated and how and when the funds will be used to finance related costs. Such a plan should guide the Board in accumulating and using reserve funds and would help inform District residents about how their tax dollars will be used. In addition, the Board should review the District's reserves at least annually and fund them through budget appropriations that are voted on by taxpayers to help ensure the amounts reserved are necessary and provide transparency to the taxpayers.

The District had three reserve funds totaling \$4,954,456 at the end of 2013-14: the retirement contribution reserve, the tax certiorari reserve and the employee benefit accrued liability reserve (EBALR). We reviewed Board resolutions that established these reserves and their financial histories. Each reserve was properly established. In 2010-11, the District expended \$1.1 million from the EBALR but no other expenditures have been made from these three reserves during the audit period. Overall, the District had accumulated excess funds totaling \$2,855,551 in the retirement contribution reserve at the end of 2013-14. Further, the Board budgeted for retirement costs in the general fund and levied taxes to fund them. It is unclear why the Board funded the retirement contribution reserve but did not use that reserve to pay for the retirement costs. While the tax certiorari and EBALR reserves do not appear to be overfunded based on potential District liabilities, the lack of use of any of these reserves indicates that the District has no current need to restrict these moneys. District officials transferred surplus funds at year-end to fund each of these reserves, rather than funding them through appropriations in the District's budgets.

As a result, the Board and District officials have may have missed the opportunity to accumulate less fund balance, reduce the tax levy and increase the transparency of the budgeting process. District officials provided a multiyear plan which outlines the use of the reserve moneys. The plan includes the liquidation of the retirement contribution reserve over the next five years and the use of EBALR

funds for related expenditures. District officials should ensure the amounts reserved are reasonable and necessary.

## **Recommendations**

The Board should:

1. Adopt budgets with realistic estimates of anticipated expenditures that do not appropriate fund balance that is not needed to fund operations.
2. Discontinue the practice of adopting budgets that levy taxes to pay for costs that could reasonably be paid for using existing reserve funds.
3. Include planned transfers to reserves as appropriations in the budget for transparency.
4. Ensure the amounts reserved are necessary and reasonable.

## **APPENDIX A**

### **RESPONSE FROM DISTRICT OFFICIALS**

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



[www.portchesterschools.org](http://www.portchesterschools.org)

## Port Chester-Rye Union Free School District Board of Education

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*District Clerk*  
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*School Attorney*  
Coleen Kotzur  
*District Treasurer*

September 12, 2015

Ms. Tenneh Blamah  
Chief Examiner of Local Government and School Accountability  
Office of the State Comptroller  
Newburgh Regional Office  
33 Airport Center Drive  
Suite 103  
New Windsor, NY 12553

Dear Ms. Blamah:

The Board of Education of the Port Chester-Rye Union Free School District, the Administration and the Port Chester community are appreciative of the efforts of the auditing team from the Office of the State Comptroller. We believed from the onset that the Comptroller's Audit can only help to reassure the Port Chester community that improprieties do not exist in Port Chester. No wrongdoing, fraud, waste and/or abuse was found or even suggested by the audit team thus confirming the honesty, integrity and professionalism of our dedicated and diligent employees. We are pleased that the audit report provides this reassurance.

We are in full agreement that sound budgeting practices along with prudent fund balance and reserve management builds capacity toward ensuring sufficient funding will be available to sustain operations, manage emergencies, address unexpected expenses, and satisfy long-term obligations or future expenditures. In addition, having cash on hand is essential for our District's cash flow given the significant state and federal grant programs (Title I, II, III, IDEA, Extended Day and Violence Prevention) and other programs like EXCEL Capital Projects, eRate and the Smart Schools Bond Act for which the District receives funding on a reimbursement basis.

Below please find the District's response to the Office of the State Comptroller's report:

### Budgeting:

The table below lists the adopted (budgeted) and actual expenditures for each of the years in the audit period. Of particular note is that, on average, 97% of the adopted expenditures were utilized at the close of the school year. In other words, the variance between adopted and actual expenditures for the 5 year period was 3%.

	2009-2010	2010-2011	2011-2012	2012-2013	2013-2014	5-Year Total
Adopted Expenditures	\$75,772,014	\$77,285,465	\$79,555,725	\$81,320,560	\$85,186,834	\$399,120,598
Actual Expenditures	\$73,268,117	\$75,664,048	\$76,556,443	\$78,919,996	\$81,123,507	\$385,532,111
% of Adopted	97%	98%	96%	97%	95%	97%
Variance	\$2,503,897	\$1,621,417	\$2,999,282	\$2,400,564	\$4,063,327	\$13,588,487
% of Variance	3%	2%	4%	3%	5%	3%



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The District works diligently to establish budgets with realistic estimates of anticipated expenditures available at the time of adoption. Budget development begins in October of the preceding year and progresses until the community vote on the third Tuesday of May. Expenditure projections are estimated and those estimates are refined throughout the collaborative process until the budget is adopted by the Board of Education in April of each year. Public presentations are made at Board of Education meetings throughout the year culminating with the annual hearing. Input from the community is welcomed and encouraged.

The District is pleased that the Comptroller included in the audit report the explanations of operating surplus and variances between estimated expenditures and actual expenditures which included funding for instructional and non-instructional positions that may be required as a result of increased enrollment, special needs programming, new mandates, as well as replacements for existing staff on maternity and sick leaves. The Comptroller also acknowledged the \$1 million cost savings in 2012-13 as a result of contractual changes to healthcare plans. The District wishes to add to this list, additional savings realized during the audit period including:

- 1- In certain years, contract negotiations remain unresolved during the budgeting process. Such was the case for the Port Chester Teachers Association and the Civil Service Employees Association bargaining unit agreements which expired on June 30, 2011 requiring conservative estimates for increases in contractual salaries and benefit related costs for the 2011-2012 and 2012-2013 to ensure funding for future agreements. While the CSEA contract agreement was reached on May 19, 2011, after the budget vote, two year estimates for teacher salaries and benefits were necessary as the teachers' agreement was not settled until June 14, 2012, after the budget vote. In both instances, final salaries and benefit costs were less than estimated and a primary reason for the overestimated expenditures in 2011-2012 and 2012-2013.
- 2- Cost savings and efficiencies are goals each and every year. To that end, the Board offered retirement incentives affecting three of five years in the audit period. In 2012-2013, 26 instructional staff members opted to retire under the incentive program. The District was able to fill the vacancies at salaries less than the projected salaries estimated for the replacements which also contributed to the overestimation of expenditures.
- 3- Successful negotiation of transportation contract extensions below the allowable consumer price increase which becomes available in June of each year after the May budget vote also saved the District money.

### **Fund Balance:**

The District has been successful in ensuring fiscal health and ending each fiscal year within the 4% limit of the Real Property Tax Law for unrestricted fund balance.

Our status of "No designation" as determined by the 2014 State Comptroller's Fiscal Health Monitoring System distinguishes the District from others whose status was determined to be "Susceptible Fiscal Stress," "Moderate Fiscal Stress," and "Significant Fiscal Stress." This designation is of particular importance to the community as it was a factor in the Moody's affirmation of the Aa3 bond rating in a recent refinancing of outstanding bonds. This bond rating gave rise to a competitive sale resulting in a significant savings over the term of the refinanced bonds. The Moody's report issued to potential bidders in the bond market stated:

### **FINANCIAL OPERATIONS AND RESERVES: STRENGTHENING FINANCES WITH SATISFACTORY RESERVES April 1, 2015**

*The district's financial position will continue to improve in the medium term as management continues to budget for surpluses. Since 2009, total fund balance has increased 35% to \$12.1 million or 14.6% of General Fund revenues.*

*The improvement has been gradual with the district running modest surpluses in 4 of the past 5 years.*

*Management plans to continue budgeting conservatively and has contingency plans in case state aid increases less than forecast.*



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As the District contemplates a \$63 million bond issue in the immediate future, the District's Aa credit rating (Moody's Credit Worthiness defined as "An obligor has VERY STRONG capacity to meet its financial commitments. It differs from the highest-rated obligors only to a small degree.") would likely save taxpayers approximately \$2,000,000 of interest costs as compared to an A credit rating (Moody's Credit Worthiness defined as "An obligor has STRONG capacity to meet its financial commitments but is somewhat more susceptible to the adverse effects of changes in circumstances and economic conditions than obligors in higher-rated categories.") and more if the rating were to drop to a B credit rating.

### Reserves:

Saving for future projects, acquisitions, and other allowable purposes is an important planning consideration for school districts. According to the Office of the State Comptroller's Office Local Government Management Guide for Reserves:

*Reserve funds provide a mechanism for legally saving money to finance all or part of future infrastructure, equipment, and other requirement.*

*In uncertain economic times, reserve funds can also provide officials with a welcomed budgetary option that can help mitigate the need to cut services or to raise taxes. In good times, money not needed for current purposes can often be set aside in reserves for future use.*

The Board reviews the District's reserves multiple times each year to ensure the amounts reserved are reasonable and necessary. The financial strategy is to accumulate when feasible, to the "reasonable limit," a reserve so as to ensure necessary programming is maintained and contractual commitments are met in economically challenging times. With a near 0% CPI predicted for the 2016-2017 tax cap formula, local governments need to prepare for little or no levy growth.

Void of written guidance from any State agency regarding the "reasonable limit" for the Retirement Reserve, the District has relied on the opinion of the external auditor. The operational definition employed has been, from the establishment of the reserve, to set the reasonable limit at approximately 1.5 to 2 times the annual bill from the Employee's Retirement System (ERS).

Year		2009-2010	2010-2011	2011-2012	2012-2013	2013-2014
Month Paid		Dec-09	Dec-10	Dec-11	Dec-12	Dec-13
Amount <sup>1</sup>		\$449,154	\$692,381	\$1,021,858	\$1,213,194	\$1,382,882
Annual Increase			\$243,227	%329,477	\$191,336	\$169,688
% of Increase			35.10%	32.20%	15.80%	12.30%
Approximate Reasonable Limit	1.5 x Bill	\$673,731	\$1,038,572	\$1,532,787	\$1,819,791	\$2,074,323
	2.0 x Bill	\$898,308	\$1,384,762	\$2,043,716	\$2,426,388	\$2,765,764
Reserve Amount		\$1,000,000	\$1,005,000	\$1,010,025	\$1,815,188	\$2,855,551

<sup>(1)</sup> Discounted amount based on date bill is paid.

As the ERS bill increased (67.5% over the five year audit period), the District opted to increase the reserve within the reasonable limit. When funding retirement contributions would create an unacceptable tax burden or would force less spending on other priorities or the reserve exceeds the reasonable limit, the District appropriates funds from the Retirement Reserve. Such was the case in the 2014-2015 school year when the District used \$500,000 from the Retirement Reserve to partially fund the ERS bill. So as to avoid a funding cliff, the amount of reserve money used in 2014-2015 can be sustained as needed in subsequent years.





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In the recent Moody's Report previously referenced, the importance of General Fund Reserves was cited as one of only two factors that could make our bond rating go up or down:

***WHAT COULD MAKE THE RATING GO UP***

- Continued structurally balanced financial operations leading to healthier General Fund reserves
- Substantial growth in the district's tax base and socioeconomic indicators

***WHAT COULD MAKE THE RATING GO DOWN***

- Material deterioration of the tax base and socioeconomic indices
- Structural imbalance leading to significant decrease in reserves

Given the susceptibility of our community to environmental stress as defined by the Fiscal Health Monitoring System, it behooves us to seize control of the fiscal factors to a greater extent than those districts with less volatile environmental factors.

The Port Chester-Rye Union Free School District appreciates the hard work and thorough efforts, and continued communication with the auditors throughout the process. As we are dedicated to the use of taxpayer resources in an efficient, effective, and thoughtful manner, your recommendations are respectfully received and will be implemented in accordance with legal requirements and guidance for reasonability from the Office of the State Comptroller as well as our external and internal auditors to enhance our overall management of the District and in the best interest of the Port Chester community.

Sincerely,

Robert H. Johnson  
President of the Board of Education

## **APPENDIX B**

### **AUDIT METHODOLOGY AND STANDARDS**

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

- We interviewed officials to gain an understanding of the District's budgeting process.
- We reviewed the results of operations and analyzed changes in fund balance for the general fund for the period July 1, 2009 through June 30, 2014.
- We compared the adopted budgets to the modified budgets and actual operating results to determine if the budget assumptions were reasonable.
- We reviewed the appropriation of the District's reserves and fund balance from July 1, 2009 through June 30, 2014.
- We reviewed expenditures based on the District's budget categories to identify significant expenditures and analyze trends.
- We tested the reliability of the accounting records by reviewing bank reconciliations and compared them to the annual financial report filed with the Office of the State Comptroller and to the District's independently audited financial statements.
- We reviewed budget and revenue status reports.
- We reviewed meeting minutes and interviewed officials to determine whether the District's management is involved in financial matters by receiving and reviewing financial reports, analyzing the need for and establishing reserves and otherwise monitoring the District's financial condition.
- We reviewed Board minutes and resolutions to verify the establishment of reserve funds.
- We reviewed the balances of the reserves for reasonableness.

We conducted this 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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