



Belleville-Henderson Central School District Financial Condition

Report of Examination

Period Covered:

July 1, 2014 – September 30, 2015

2016M-46



Thomas P. DiNapoli

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State of New York Office of the State Comptroller

Division of Local Government and School Accountability

May 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 Belleville-Henderson 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 Belleville-Henderson Central School District (District) is located in the Towns of Adams, Ellisburg and Henderson in Jefferson County. The District is governed by the Board of Education (Board) which is composed of seven 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 one school, with approximately 475 students and 85 employees. The District's budgeted general fund appropriations for the 2015-16 fiscal year are approximately \$9.4 million, which are 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 the Board adopt reasonable budgets and adequately manage the District's financial condition?

Scope and Methodology

We evaluated the District's financial condition for the period July 1, 2014 through September 30, 2015. We extended our audit scope back to July 1, 2012 to analyze financial trends in prior years.

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 they planned to take 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 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

A school district's financial condition is a factor in determining its ability to continue funding public educational services. The responsibility for accurate and effective financial management rests with the Board and Superintendent. The Board is responsible for adopting realistic budgets and for ensuring that fund balance does not exceed the amount allowed by law. Fund balance represents the cumulative residual resources from prior years that can, and in some cases must, be used to fund operations in the ensuing fiscal year. 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 RPTL limits the amount of fund balance a school district can retain to no more than 4 percent of the ensuing year's budget.

Districts may also establish reserves to restrict a reasonable portion of fund balance for a specific purpose in compliance with statutory directives. Prudent fiscal management includes establishing reserves needed to address long-term obligations or planned future expenditures. When the Board establishes reserve funds, it is important that it develop a plan for funding the reserves, determining how much should be accumulated and how and when the funds will be used to finance the related costs. Such a plan should guide the Board in accumulating and using reserve funds and would help inform District residents about how District resources will be used.

The Board did not adopt reasonable budgets or effectively manage the District's financial condition to ensure that the general fund's unassigned fund balance was within the statutory limit. The Board adopted budgets which included appropriated fund balance that was not needed as a funding source because the Board and District officials overestimated appropriations when they prepared and adopted budgets for the last three fiscal years. These budgeting practices produced operating surpluses in two of the three fiscal years and the unassigned fund balance has exceeded legal limits all three years. As of June 30, 2015, the District's unassigned fund balance was 13.1 percent of the next year's appropriations, or \$855,000 over the legal limit. The District also maintained approximately \$28,600 in its tax certiorari reserve fund with no plan for its use. In addition, for three of the four District reserves, the Board has not developed a written plan that communicates to taxpayers the optimal funding levels or conditions under which the reserves will be used.

Budgeting and Fund Balance

The Board should adopt structurally balanced budgets in which recurring revenues finance recurring expenditures and reasonable levels of fund balance are maintained. In preparing a realistic budget, the Board is responsible for estimating what the District will spend and what it will receive in revenue, estimating how much fund balance will be available at fiscal year-end and determining what the expected tax levy will be. Accurate budget estimates help ensure that the tax levy is not greater than necessary. Budgets should be based on prior years' operating results, past expenditure trends and anticipated future needs.

When fund balance is appropriated as a funding source, the expectation is that there will be a planned operating deficit (planned expenditures exceed planned revenues) in the ensuing fiscal year, financed by the amount of the appropriated 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.

District officials overestimated appropriations when they prepared and adopted general fund budgets for fiscal years 2012-13 through 2014-15. We compared the District's general fund budgeted revenues and appropriations with actual results of operations for this period. The District's revenue estimates were reasonable and generally close to the actual revenues received. However, the Board approved budgets which overestimated expenditures for this period. As a result, the District spent an average of approximately \$557,000 less than planned each year and unassigned fund balance was higher than necessary.

The District's budget percentage variances for expenditures were 7.6 percent and 9.9 percent for fiscal years 2012-13 and 2013-14. However, the District experienced a much lower budget variance of 1 percent in the 2014-15 year due to an unbudgeted interfund transfer of \$705,469 to the capital projects fund.¹ Without the unbudgeted transfer to the capital projects fund, the expenditure budget variance for the general fund would have been about 8 percent for 2014-15, consistent with the overestimated amounts in the previous two years.

¹ The transfer from the general fund's capital reserve was for the voter-approved propositions for the purchase of a truck and minivan, totaling \$55,469, and also \$650,000 towards renovations and improvements to buildings, playgrounds and athletic fields.

Figure 1: Expenditure Variances

Fiscal Year	Budgeted	Actual	Difference	Percentage Difference
2012-13	\$8,872,858	\$8,196,527	\$676,331	7.6%
2013-14	\$9,090,184	\$8,191,492	\$898,692	9.9%
2014-15	\$9,267,465	\$9,171,856	\$95,609	1.0%
Total	\$27,230,507	\$25,559,875	\$1,670,632	6.1%

The majority of overestimated expenditures during the three-year period were for instructional salaries (\$729,810 or 10.4 percent), health and dental insurance (\$346,298 or 9.5 percent) and special education contractual costs (\$248,001 or 8.7 percent). The Director of Business and Finance (Director) told us that the variances for instructional salaries and health/dental insurance was attributable to the reduction of several teaching positions and also because teacher contract negotiations were not yet finalized during the 2014-15 budget development process. He further explained that the District budgets conservatively for special education costs because it could be required to provide education to more students with disabilities than originally anticipated.

The District exceeded the statutory fund balance limit of 4 percent in each year and the District's unassigned ending fund balance has increased over the past three years, reaching over \$1.2 million as of June 30, 2015, or 13.1 percent of the 2015-16 budgeted appropriations.

Figure 2: Unassigned Fund Balance at Year-End

	2012-13	2013-14	2014-15
Beginning Fund Balance	\$3,528,014	\$3,537,644	\$3,747,927
Plus: Operating Surplus ^a	\$9,630	\$210,283	(\$546,058)
Ending Fund Balance	\$3,537,644	\$3,747,927	\$3,201,869
Less: Restricted Fund Balance	\$1,751,387	\$1,894,925	\$1,289,655
Less: Appropriated Fund Balance	\$790,000	\$775,288	\$645,378
Less: Encumbrances	\$121,975	\$98,397	\$35,076
Unassigned Ending Fund Balance	\$874,282	\$979,317	\$1,231,760
Ensuing Year's Budgets	\$9,090,184	\$9,267,465	\$9,420,517
Reported Unassigned Fund Balance as a Percentage of Ensuing Year's Budgets	9.6%	10.6%	13.1%

^a Includes interfund transfers

Because the Board did not adopt budgets with more accurate estimates of appropriations, the District used only \$546,058 of the \$2.4 million² appropriated fund balance that was planned for use. When unused appropriated fund balance is added back, the District's recalculated unassigned fund balance further exceeded the statutory limit, ranging between 13 and almost 20 percent of the ensuing year's appropriations.

Figure 3: Unused Fund Balance			
	2012-13	2013-14	2014-15
Total Unassigned Funds at Year End	\$874,282	\$979,317	\$1,231,760
Add: Appropriated Fund Balance Not Used to Fund Ensuig Year's Budget	\$790,000	\$229,230	\$645,378
Total Recalculated Unassigned Funds	\$1,664,282	\$1,208,547	\$1,460,990
Recalculated Unassigned Funds as Percentage of Ensuig Year's Budget	18.3%	13.0%	19.9% ^a

^a We estimated this percentage because the year-end operating results for the current fiscal year (2015-16) are unknown at this time. If the District experiences similar operating results during 2015-16 as it did in each of the prior two years, without the unbudgeted transfer to capital projects, the fund balance appropriated at the end of 2014-15 will not be used to finance operations.

The result of these budgeting practices made it appear that the District needed to both raise taxes and use fund balance to close projected budget gaps. However, the District's budgets resulted in operating surpluses in two of the three years reviewed. The District increased the tax levy from \$3.9 million in 2012-13 to \$4.1 million in 2015-16, an increase of about 5.1 percent. Had District officials used more reasonable budget estimates, they could have avoided the accumulation of excess fund balance and reduced the tax levy.

Reserves

Reserve funds may be established by the Board in accordance with applicable laws to provide financing for specific purposes. When District officials establish a reserve, it is important that they develop a formal plan for the use of the reserve, including how and when disbursements should be made, optimal or targeted funding levels and why these levels are justified. When conditions warrant (subject to legal requirements), the Board should reduce reserve funds to reasonable levels or liquidate and discontinue a reserve fund that is no longer needed or whose purpose has been achieved.

As of June 30, 2015, the District had three reserves in the general fund consisting of a retirement contribution reserve with a balance of \$503,600, an unemployment insurance reserve with a balance of

² The District appropriated \$818,000 in fund balance for use in the 2012-13 fiscal year, \$790,000 for the 2013-14 fiscal year, and \$775,288 for the 2014-15 fiscal year.

\$30,317 and a reserve for tax certiorari with a balance of \$28,627. The balances in these reserves have remained relatively consistent for the last three completed fiscal years. We analyzed reserve cash balances and reviewed the activity in each reserve for adherence to statutory requirements over the last three fiscal years. Although the balances in the retirement contribution and unemployment insurance reserves are reasonable, the Board has not developed a written policy that communicates to District residents the optimal funding levels for these reserves or conditions under which they will be used.

In addition, the District's tax certiorari reserve may be overfunded, as officials could not provide us with any documentation of anticipated tax certiorari claims. Education Law authorizes districts to establish a tax certiorari reserve fund to pay judgments and claims resulting from tax certiorari proceedings. However, funds held in such a reserve may not exceed the amount that might reasonably be deemed necessary to meet anticipated judgments and claims arising out of such proceedings. In addition, any amounts not used to pay judgments and claims must be returned to the general fund within four years of deposit.³

The District maintains a capital reserve which had a balance of \$727,111 as of June 30, 2015. The cash balance and activity for this reserve appear to be reasonable and proper.

Although the District is generally not limited as to how much it can maintain in its reserve funds, it is important for District officials to periodically evaluate the reserve fund balances and to develop multiyear financial and capital plans to help determine how the reserve funds fit into the District's overall financial management strategy. The District has developed a long-term financial plan which shows that it intends to use approximately \$1.1 million from all of its reserves over the next five to six years.

By maintaining an excessive unassigned fund balance and excess funds in the tax certiorari reserve and not using fund balance appropriated in adopted budgets, District officials are withholding significant funds from productive use and may be levying more taxes than necessary to sustain District operations. The Director and a Board member told us they prefer to maintain enough fund balance to provide the District with an adequate financial cushion in case of unforeseen circumstances. However, the District's reported unassigned fund balance as of June 30, 2015 was more than three

³ Subsequent to our fieldwork, in March 2016, the District paid \$15,066 for tax refunds to two District property owners, leaving a balance of \$13,561 in its reserve for tax certiorari.

times the statutory limit and if current budgeting practices continue, the District's excessive fund balance will continue to grow.

Recommendations

The Board should:

1. Adopt budgets that include the District's actual needs, based on available current information and historical data.
2. Discontinue the practice of adopting budgets with the appropriation of fund balance that will not be used.
3. Ensure that the amount of the District's unassigned fund balance is in compliance with statutory limits.

The Board and District officials should:

4. Develop a formal reserve fund plan that outlines targeted funding levels and the conditions under which the funds will be used.
5. Return any excess funds in the tax certiorari reserve to the unrestricted fund balance in the general fund.

APPENDIX A

RESPONSE FROM DISTRICT OFFICIALS

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

BELLEVILLE HENDERSON CENTRAL SCHOOL

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Adams, New York 13605
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Fax: 315-846-5617



April 24, 2016

Rebecca Wilcox, Chief Examiner
State Office Building, Room 409
333 E. Washington Street
Syracuse, N.Y. 13202-1428

RE: Belleville Henderson Central School Response to Draft Financial Report of Examination

Belleville Henderson Central School District is in receipt of the Draft Financial Condition Report of Examination for the period July 1, 2014 to September 30, 2015.

On behalf of the Board of Education and district's administration, we would like to thank the local field staff of the Comptroller's Office. They were professional and courteous in conducting their duties associated with this audit.

The District is pleased that this extensive examination has resulted in no findings of material weakness, operational improprieties, fraud, waste, or abuse. As such, the focus of the referenced examination was our financial condition, with recommendations regarding our budget preparation, fund balance, and reserves.

While the district does not dispute the findings of the report, *we feel that including the rationale for having an unassigned fund balance that exceeds the amount stated in the New York State Real property tax law is worth mentioning.*

Belleville Henderson CSD is a small, rural school district that can justify having additional reserves as a necessary and reasonable management decision. The audit focuses on short-term goals while the Board must address long term objectives. Funds in the reserves have been and will continue to be used to fund anticipated expenses in order to protect the fiscal and academic integrity of the district.

The district which has one of the lowest tax rates in this area while increasing taxes only an average of 1.7 % per year has maintained a quality education while staying under the tax cap.

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Using additional reserves in the budget to comply with the New York State Real Property Tax law would have meant that, in the ensuing year, to maintain a quality education, the district would have needed to raise taxes above the tax cap limit. By using reserves and remaining under the tax cap the local tax payers are not penalized and qualify to receive the Property Tax Freeze Credit Checks. These checks paid for the increases in property taxes.

The district has established a gradual budgeting process to reach realistic budget appropriation while operating with conservative assumptions. The District plans in the 2016-17 budget to continue this gradual process to use reserves and become compliant. It is projected that due to the constraints in growth in revenue from the tax cap, no additional revenue from the restoration of the gap elimination adjustment, and the uncertainty of future growth in state aid, that maintaining these reserves will be essential to fiscal stability. History has proven that projected increases in revenue will not match the projected growth in expenditures for employee contracts, medical insurance, state unfunded mandates, and other expenses. This will require the use of fund balance which will gradually bring the district into compliance without penalizing the taxpayers.

Sincerely,

Rick T. Moore, Superintendent

Kurt E. Gehrke, BOE President

APPENDIX B

AUDIT METHODOLOGY AND STANDARDS

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

- We interviewed District officials to gain an understanding of their budget development process and budget monitoring procedures and to determine whether the District adopted long-term financial and capital plans and a reserve fund policy.
- We reviewed the results of operations and analyzed changes in fund balance for the general fund including the use of reserves for the period July 1, 2012 through June 30, 2015.
- We compared the adopted budgets to the actual operating results for the period July 1, 2012 through September 30, 2015 to determine if the budget assumptions for revenues and expenditures were reasonable. We interviewed District officials to identify reasons for significant budget variances.
- We reviewed the appropriation of the District's fund balance for the period July 1, 2012 through June 30, 2015.
- We reviewed adopted budgets to identify the trend in real property tax levies for the 2012-13 to 2015-16 fiscal years.

We conducted this performance audit in accordance with GAGAS. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

APPENDIX C

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