



Cattaraugus-Allegany- Erie-Wyoming Board of Cooperative Educational Services

Financial Management

Report of Examination

Period Covered:

July 1, 2012 – December 30, 2015

2016M-77



Thomas P. DiNapoli

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State of New York Office of the State Comptroller

Division of Local Government and School Accountability

August 2016

Dear Board of Cooperative Educational Services (BOCES) Officials:

A top priority of the Office of the State Comptroller is to help BOCES officials manage BOCES resources efficiently and effectively and, by so doing, provide accountability for tax dollars spent to support BOCES operations. The Comptroller oversees the fiscal affairs of BOCES statewide, as well as BOCES' 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 BOCES operations and Board of Education governance. Audits also can identify strategies to reduce BOCES costs and to strengthen controls intended to safeguard BOCES assets.

Following is a report of our audit of the Cattaraugus-Allegany-Erie-Wyoming BOCES, entitled Financial Management. 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 BOCES 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 Cattaraugus-Allegany-Erie-Wyoming Board of Cooperative Educational Services (BOCES) is a public entity serving 22 component school districts in a four-county area. BOCES is governed by a nine-member Board of Education (Board) elected by the boards of the component districts. The Board is responsible for the general management and control of BOCES' financial and educational affairs. The District Superintendent is BOCES' chief executive officer and serves dual roles. The District Superintendent is responsible, along with other administrative staff, for the day-to-day management and for regional educational planning and coordination. The District Superintendent also serves the state as a representative for the New York State Commissioner of Education.

BOCES also employs a Controller responsible for managing daily financial operations and overseeing business office staff. The District Superintendent and the Controller are responsible for developing and administering the budget. The Controller prepares the annual operating budget for review and approval by the District Superintendent and the Board. Annually, BOCES must prepare and adopt an operating budget based upon the requests for services received from its component school districts. The general fund budget is comprised of separate budgets for administrative, capital and program costs. BOCES will amend or revise the program budget as needed based on participation in program services throughout the fiscal year.

Combined, the component districts educate approximately 18,000 students in Allegany, Cattaraugus, Erie and Wyoming Counties. BOCES enrolls approximately 1,700 students directly in its special education and career/technical education programs. BOCES delivers more than 115 educational and administrative services and employs approximately 640 staff members. BOCES has no taxing authority and derives all of its financial support from its component and participating districts, as well as State and federal aid. The general fund 2015-16 budget totaled approximately \$65 million.

Objective

The objective of our audit was to review BOCES' financial management practices. Our audit addressed the following related question:

- Has BOCES properly accounted for surpluses and managed reserves appropriately?

**Scope and
Methodology**

We examined BOCES' financial records and reports for the period July 1, 2012 through December 30, 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 C of this report.

**Comments of BOCES
Officials and Corrective
Action**

The results of our audit and recommendations have been discussed with BOCES officials, and their comments, which appear in Appendix A, have been considered in preparing this report. BOCES officials generally disagreed with our recommendations. Appendix B includes our comments on issues raised in the BOCES' response letter.

The Board has the responsibility to initiate corrective action. Pursuant to Section 35 of General Municipal Law and Section 170.12 of the Regulations of the Commissioner of Education, a written corrective action plan (CAP) that addresses the 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 should 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 Management

The Board is responsible for appropriately managing BOCES' financial affairs. To accomplish this, the Board must ensure that management adheres to requirements regarding the apportionment of surpluses or deficits back to its component and participating districts. Although BOCES are not permitted to maintain any unrestricted fund balance, BOCES can legally set aside and reserve portions of fund balance to finance future costs for a variety of specified objects or purposes. BOCES officials are responsible for developing policies and procedures to ensure that reserves comply with applicable laws, regulations and good management practices concerning reserve establishment, allocation of funds, and reporting to the component and participating districts. BOCES should transparently fund reserves by including a specific appropriation for the intended purpose in the annual budget. Year-end reporting to its districts should clearly identify such allocations.

BOCES has not properly accounted for surplus funds and has not properly managed reserves in a transparent manner. From fiscal years 2012-13 through 2014-15, the Board and BOCES officials have consistently overestimated appropriations¹ by an average of \$4.4 million or 6.6 percent each year. As a result of these practices, BOCES has generated annual operating surpluses averaging \$4.7 million and totaling approximately \$14 million during this time. Although BOCES has refunded more than \$10 million of its surpluses to the districts, BOCES has also used approximately \$4 million (29 percent) to increase its reserves without adequate disclosure to the public and the districts. BOCES officials also overfunded three reserves and maintained a trust that was not allowable. As a result, BOCES has restricted more than \$15 million in funds that should have been returned to the component and participating districts.

Allocation of Surpluses

New York State Education Law requires BOCES to apportion surpluses (credit excess money) to each of its component and participating districts every fiscal year. BOCES must also report to each district the cost allocated to that district in the past year's budget, the actual expenditures associated with providing shared services and any operating surplus that resulted. While BOCES may retain surplus funds for reserves, good management practices require BOCES to obtain Board approval of allocations made to various reserve funds; such allocations may be appropriated annually in the budget or

¹ Comparison of the revised budget against actual results for the 2012-13, 2013-14 and 2014-15 fiscal years

made from operating surpluses available at the end of the fiscal year. However, any operating surpluses used to fund the reserves should be clearly identified, apart from other expenditures, in BOCES' reporting to its districts.

Any BOCES Board that is planning to establish and finance reserve funds on a regular basis should develop a written policy or plan that communicates to the districts why the money is being set aside, the Board's financial objectives for the reserves, optimal funding levels and conditions under which the assets will be utilized.²

During our audit period, BOCES used 29 percent of its operating surpluses to increase reserves by more than \$4 million, as shown in Figure 1. These allocations were recorded as expenditures and were deducted from amounts refunded to the component and participating districts.

Figure 1 – Allocation of Surpluses to Reserves				
	2012-13	2013-14	2014-15	Total
Property Loss Reserve and Liability Reserve ^a	\$1,216,955	\$742,630	\$712,600	\$2,672,185
Career and Technical Equipment Reserve	\$619,153	\$574,295	\$322,811	\$1,516,259
Retirement Contribution Reserve	\$0	\$149,545	\$0	\$149,545
Employee Benefit Accrued Liability Reserve	\$0	\$43,673	\$0	\$43,673
Totals	\$1,836,108	\$1,510,143	\$1,035,411	\$4,381,662
^a Transfers made out of the liability reserve were recorded on the same day as the deposits or allocations into the reserve. These transfers were made to the special aid fund to cover pre-kindergarten program deficits and totaled \$1.7 million or approximately 63 percent of the funds transferred into this reserve.				

The Board has not adopted a comprehensive written policy or plan for its reserves and allocations to reserves from surplus funds were not clearly reported to the component and participating school districts. BOCES reported to each district the cost allocated to that district in the past year's budget, the actual expenditures associated with providing the shared services and any surplus or refund due and payable to that district. However, BOCES did not clearly identify the amounts it retained from end-of-year surpluses for funding reserves, but instead factored them into the expenditure amounts presented to the districts. Without adequately informing the districts for all reserve fund allocations made from operating surpluses, management is not truly reporting BOCES' results of operations to the districts involved.

Reserves

Reserve fund balances should represent reasonably accurate estimates of anticipated costs that are based on an actual calculated liability, historical spending and/or information from external sources. Reserve balances also must comply with statutory limitations regarding

² For more information, please refer to our *Local Government Management Guide*: <http://www.osc.state.ny.us/localgov/pubs/lgmg/reservefunds.pdf>

their purpose. In addition, the Board should periodically assess the reasonableness of the amounts accumulated in reserves.

BOCES maintained an Other Post-Employment Benefits (OPEB) Trust in the trust and agency fund totaling \$12.7 million and six reserves in the general fund totaling \$9.9 million as of June 30, 2015. BOCES does not have the legal authority to restrict money in the OPEB Trust. In addition, BOCES overfunded three reserves.³ More than \$15 million in the OPEB Trust and the career and technical equipment (CTE) reserve should have been returned to the component and participating districts.

OPEB Trust – Other post-employment benefits are employee benefits other than pensions – primarily health care benefits – that employees receive after their employment ends. This trust, accounted for in the trust and agency fund, was financed with annual operating surpluses transferred from the general fund and had a balance of \$12.7 million as of June 30, 2015. BOCES established the trust to finance retiree health insurance costs. Until recently,⁴ this trust had not been used to finance those costs and all such payments were made from budgeted appropriations.

Although a liability for post-employment health insurance costs must be disclosed in the financial statements, there is no statutory authority to reserve or otherwise set aside money for this purpose. Therefore, the entire \$12.7 million being improperly restricted for this purpose would have been subject to refunds to the component and participant districts. As such, and as recommended in our previous audit,⁵ these funds should be returned to the general fund and disbursed to the component and participating districts.

CTE Reserve – Education Law permits the establishment of this reserve⁶ to finance all or part of the cost to replace or purchase advanced technology equipment used in instructional programs. Education Law allows two methods of funding such a reserve: 1) proceeds from the sale of career education instructional equipment no longer needed by BOCES and 2) a depreciation allowance for equipment used in career and technology instruction. Both methods may be used simultaneously.

³ The employee benefit accrued liability, retirement contribution and the property loss reserves were reasonably funded.

⁴ BOCES officials recorded the transfer of \$200,000 in May 2014 and \$200,000 in June 2015 to the general fund for retiree health insurance payments.

⁵ 2009M-151: *Cattaraugus-Allegany-Erie-Wyoming BOCES, Internal Controls Over Selected Financial Activities, November 2009*

⁶ Referred to in Education Law as the career education instructional equipment reserve

BOCES reported a balance of \$4.7 million in the CTE reserve as of June 30, 2015. BOCES did not properly fund the reserve or maintain a balance in compliance with the rules and regulations of the Commissioner of Education. From 2012-13 through 2014-15, BOCES transferred approximately \$1.5 million of its annual operating surpluses into this reserve. However, depreciation on the related equipment for the same time period was approximately \$220,000 and no such equipment had been sold. As such, BOCES improperly transferred approximately \$1.3 million into the reserve.

Furthermore, the total balance of this reserve cannot exceed 20 percent of the current year career education services budget or \$500,000, whichever is greater. The 2015-16 adopted budget for these services totaled approximately \$9.2 million; therefore, BOCES is only permitted to maintain a CTE reserve with a maximum balance of approximately \$1.8 million as of June 30, 2015. Consequently, BOCES overfunded the reserve by approximately \$2.9 million, and these funds should have been disbursed to the component and participating districts.

Unemployment Insurance Reserve – GML authorizes this type of reserve for reimbursing New York State for unemployment benefits paid to claimants. The balance in this reserve as of June 30, 2015 was approximately \$1.1 million. BOCES' unemployment costs average approximately \$100,000 per year. While withdrawals from this reserve were made from 2012-13 through 2014-15 totaling approximately \$280,000, during the same time frame transfers were made into the reserve totaling approximately \$461,000, more than enough to replenish costs recorded. Therefore, unemployment insurance claims were budgeted for and paid from revenues derived from the districts without using any money from the reserve.

We question the reasonableness of this reserve's funding level given that it represents approximately 11 times the average annual expenditures and the Board's consistent funding for these costs through operating revenues.

Property Loss Reserve and Liability Reserve – Education Law authorizes establishing and funding such a reserve for property loss and for liability claims. The reserve's balance may not exceed 3 percent of the annual budget. As of June 30, 2015, the reserve had a balance of approximately \$1.1 million.⁷ While BOCES had property loss or liability claims totaling approximately \$16,000 over the past

⁷ Separate funds must be established for property loss and for liability claims and the separate identity of each fund must be maintained. The portion of the reserve reportedly restricted for liability claims totaled almost \$1 million while the portion restricted for property loss claims totaled approximately \$75,000.

three years, it did not use this reserve to pay those claims. Currently, there are no claims for which the reserve could be used. Therefore, we question why BOCES has chosen to fund this reserve to such a significant level by transferring more than \$2.6 million of its annual surpluses into the reserve.

During the past three fiscal years, BOCES officials have also improperly transferred approximately \$1.7 million from the reserve to the special aid fund to offset operating deficits generated by the pre-kindergarten program. As such, the reserve funds were used for something other than their intended purpose. Moreover, had these funds not been improperly used, the reserve's balance would have exceeded the maximum funding level by approximately \$800,000.⁸ Once established, this reserve may not be reduced below the total amounts estimated to be necessary to cover incurred but unsettled claims or lawsuits, including related expenses. Payments may not be made for purposes other than those for which the reserve was established. A board may authorize the use of the reserve funds (other than amounts allocated for unsettled claims or suits including related expenses) to pay premiums for insurance policies purchased to insure subsequent losses in areas previously self-insured, in the event of dissolution of the self-insurance plan.

BOCES officials do not have a written policy or plan for the use of reserves, including how and when disbursements should be made or optimal or targeted funding levels and why these levels are justified. In addition, by overfunding reserves and improperly maintaining an OPEB Trust, BOCES officials have restricted money that should have been allocated as surplus funds to component and participating districts, which could have reduced their tax levies.

Recommendations

The Board and BOCES officials should:

1. Develop reasonable budget appropriation estimates.
2. Ensure that the funding of reserves is transparent to the districts and the public by including appropriations for the amounts the Board intends to transfer in the proposed budget.

The Board should:

3. Develop a comprehensive written policy or plan for establishing, funding and using reserve funds.

⁸ The June 30, 2015 reserve balance would have totaled \$2.8 million had the BOCES not transferred \$1.7 million to the special aid fund. The 2015-16 budget totaled \$65 million; therefore, the reserve balance cannot exceed approximately \$2 million.

4. Ensure that all surplus funds, except those properly restricted in reserves in accordance with applicable statutes, are distributed back to the districts.
5. Review all reserves and determine if the amounts reserved are necessary and reasonable. To the extent that they are not, transfers should be made, where allowed by law, to other reserves established and maintained in compliance with statutory directives.

APPENDIX A

RESPONSE FROM BOCES OFFICIALS

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



Lynda M. Quick,
District Superintendent
and Chief Executive Officer

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May 23, 2016

Mr. Jeffrey D. Mazula
Chief Examiner
Office of the State Comptroller
Buffalo Regional Office
295 Main Street, Suite 1032
Buffalo, NY 14203-2510

Dear Mr. Mazula:

We are writing on behalf of the Cattaraugus-Allegany-Erie-Wyoming BOCES in response to the NYS Office of the State Comptroller's draft of the Financial Management Report of Examination (2016M-077), for the period of July 1, 2012 to December 30, 2015.

It is BOCES understanding that the objective of the audit was to review BOCES' financial management practices, and that it included interviewing appropriate BOCES' officials, and a review of policies and procedures. As a result, the audit specifically focused on the BOCES' financial records and reports to determine the appropriateness of the accounting for surpluses and the management of its reserves.

The BOCES is committed to ensuring the BOCES' financial operations are managed legally, prudently, and with the highest level of integrity. BOCES administration and the Board of Education believe we have a fiduciary responsibility to maintain the financial stability of our service organization and to properly protect and report the use of the monies our school districts have entrusted to us in operating quality, efficient, and effective programs. The BOCES will examine and assess the areas identified in the Report of Examination and undertake appropriate corrective action as necessary.

We appreciate the opportunity to respond to the draft findings of the "Report of Examination", and to address each of the five recommendations. We are concerned however about the tone of the report with some of the statements and accusations. We are not in agreement with such comments made like: "BOCES has not properly accounted for surplus funds and has not properly managed reserves in a transparent manner," or that BOCES increased "its

reserves without adequate disclosure to the public and the districts,” and “management is not truly reporting BOCES’ results of operations to the districts involved.” Terms used such as “not properly accounted for,” “not properly managed,” “consistently overstated appropriations,” “without adequate disclosure,” “without adequately informing” and “not clearly identify,” give the inference of malfeasance and fraudulent activities by BOCES administration and the Board of Education. We do not believe that the BOCES financial operations, and the recording and reporting of its financial transactions are inaccurate, improper, illegal, non-transparent, or inadequate.

RECOMMENDATION #1: *“The Board and BOCES officials should develop reasonable budget appropriation estimates.”*

The Cattaraugus/Allegany BOCES General Fund budget is comprised of more than 125 individual budgets and services. Each of these 125 budgets are accounted for with separate and distinct appropriations and revenues. Each budget must support its specific service that it is providing. In other words, one budget’s expenses and/or revenues cannot be transferred, comingled, borrowed, or loaned to or from another service budget.

BOCES is not permitted to, nor does it, maintain a fund balance. At the end of each fiscal year, all unexpended or unencumbered monies have been, and are, refunded to the component school districts. Any and all surpluses for each of the 125 budgets are allocated to each of the districts that participated in each of the services. The refunds are allocated based on the level of participation in each service budget.

See
Note 1
Page 19

Each year, BOCES service budgets are individually developed on a zero-based budget environment based on the level of services requested by the component districts for each service. On a regular basis throughout the fiscal year, service requests change based upon individual school needs. These needs are often caused by changes in the school’s student enrollment, classifications, staffing, and unanticipated service needs. These increases in service requests, and sometimes decreases, impact both the expenditures and revenues for individual service budgets. Summarized below are the changes in the most recent 5 fiscal year budgets.

<u>Fiscal Year</u>	<u>Beginning Budget</u>	<u>Final Budget</u>	<u>Budget Increases</u>
2010-11	\$56,683,000	\$63,485,109	\$6,802,109
2011-12	\$56,419,000	\$62,870,606	\$6,451,606
2012-13	\$57,816,000	\$64,434,580	\$6,618,580
2013-14	\$59,302,000	\$64,652,236	\$5,350,236
2014-15	\$62,834,000	\$69,150,986	\$6,316,986

The average increase from the beginning budget to the final budget is 10.8%. These increases are not caused by an increase in rates or the basis of charges. These increases are almost solely caused by additional services being provided based on the increase in requested services from school districts.

When budgets are developed initially they are based on anticipated or actual initial service requests, and the basis of service charges are reflective of the estimated services to be provided and the expenditures to be incurred. If additional services are provided throughout the fiscal year, and additional revenues are generated based on the basis of service charges (per student, per session, per staff, per hour, etc.) the question is, at what point should BOCES reduce the service charge rates.

Because it is required that the Annual Budget appropriations and revenues equal in each of the individual service budgets, BOCES is not allowed to plan on or anticipate these increases in service requests.

Since BOCES has no fund balance to use in case of budgetary shortfalls, and due to the fact that each budget must support itself with its own appropriations and revenues, it is necessary to appropriate in each service budget, enough monies to cover for unexpected expenses. Such things as staff changes affecting salaries, family health insurance premiums for eligible employees, increases in either teacher or employees retirement systems, and operation and maintenance related expenses, must be budgeted for, where appropriate, in each individual budget. This accounting requirement, by necessity, generates an overall surplus at the end of each fiscal year.

Without budgeting for these possible expenses, there would be many times throughout the year where the charges for an individual service would have to be increased during the fiscal year to those schools that are receiving the service, in order to cover the costs associated with operating that particular service. Our BOCES takes great efforts in striving to not increase the cost basis of services to its customers, our component school districts, during the fiscal year. We believe our schools appreciate not having “surprise billings” for increased costs because of unanticipated expenses that BOCES may incur after their own individual school budgets have been established. Schools can budget for known refunds, but cannot afford to budget for surprise rate increases.

In addition, our BOCES budget philosophy is to avoid a “roller coaster” up and down effect in establishing service costs rates. We have consistently been able to maintain increases of less than 2% in almost all of our individual budgets for the last several years. When establishing our budget parameters each year, we anticipate what our rate increases will be in the forthcoming couple of years, in order to “smooth out” necessary increases to cover on-going cost increases.

Because of these things, BOCES will continue to develop budgets that are accurate and reasonable, and that reflect anticipated or estimated costs and revenues. BOCES will also continue to refund, on an annual basis, all revenue surpluses to the participating school districts, as required by regulations.

RECOMMENDATION #2: *“The Board and BOCES officials should ensure that the funding of reserves is transparent to the districts and the public by including appropriations for the amounts the Board intends to transfer in the proposed budget.”*

The BOCES’ funding of reserves is transparent to both the school districts and the public. Total expenditures are reported to the districts as required. In order to properly account for the funding of reserves, transfers to the reserves are expensed in the individual budgets in separate line item budget codes. We are unaware of any legal regulation that requires the BOCES to report to its components on the specific issue regarding the allocation of funds to reserve funds. There are at least three ways in which the reserves are communicated to the schools and others.

See
Note 2
Page 19

Each year on an annual basis the BOCES Board of Education at a regular scheduled meeting, approves the funding and the use of each reserve fund along with the ending balance of each reserve fund. The BOCES’ minutes are public documents and are accessible to the public via the BOCES’ website.

BOCES is required to present at its Annual Meeting, a proposed budget for the ensuing year, and a line-by-line comparison of both the current budget and the prior year actual expenses. When there are transfers to any reserve fund there is always an appropriation line item for the expenses, shown in the prior year in each budget affected. This budget document is distributed to and reviewed by both component school district administration and boards of education.

Also, included in the BOCES Annual Budget Book, the balances of each of the BOCES’ Reserve Funds and long-term liabilities at the end of the prior year, are listed on a separate page. The annual Budget Book is distributed prior to the Annual Meeting to all component district board members, Superintendents and Business Officials and copies are made available to attendees at the Annual Meeting. In addition, all of our reserve funds and long term liabilities have been specifically identified in our annual external CPA audit reports, as well as the Annual Financial Report that is submitted each year to both the NYS Education Department and the NYS Comptroller’s office.

Recommendation #2 also states that the BOCES should include appropriations for the amounts the Board intends to transfer in the proposed budget. As stated throughout your “Report of Examination”, BOCES has generated surplus revenues in each of the three years examined. If BOCES were to budget for reserve fund transfers, there would be at least two results, neither of which would accomplish its intended purpose.

If BOCES were to budget for transfers to reserve funds, and BOCES maintained its current budget philosophy stated earlier in this response, the calculations for charges for each impacted service budget would increase, causing the basis of charges for each student, each staff, each session, and/or each school to be adjusted at a greater percentage than what has recently been experienced.

Secondly, if BOCES were to budget for reserve fund transfers, revenue surpluses would increase more than they currently have been. Your report claims that the surpluses are excessive and if BOCES budgeted to fund reserves, the surpluses would be even greater. It should be noted the NYS Comptroller’s Local Government Management Guide on Reserve Funds, states that “reserve funds are typically funded from amounts raised through the annual budget process, transfers from unexpended balances of existing appropriations, and surplus moneys”. BOCES’ practice of funding its reserve funds is supported by the Comptroller’s guidelines, and funding reserves only “by including a specific appropriation for the intended purpose on the annual budget,” as stated in the Report of Examination on page 6 is not supported by the Guide on Reserve Funds.

See
Note 3
Page 19

BOCES has by design been able to budget appropriately and responsibly, and at the same time been able to fund reserves and liabilities where appropriate.

RECOMMENDATION #3: *“The Board should develop a comprehensive written policy or plan for establishing, funding and using reserve funds.”*

As stated in the “Report of Examination,” “although BOCES are not permitted to maintain any unrestricted fund balance, a BOCES [may] legally set aside and reserve portions of funds balance (surplus) to finance future costs for a variety of specified objects or purposes.” The funding of and use of reserve funds is part of the BOCES long-range financial planning. In the aforementioned guide on Reserve Funds it says that “reserve funds can be excellent financial planning tools when combined with a realistic analysis of future financial needs and obligations”. The BOCES Reserve Funds and accounting for liabilities have been established and maintained based on financial planning and because of realistic analysis of future financial needs and obligations.

BOCES are not required by statute or other regulation to have written plans for reserve funds, and, it is acknowledged that there has not been a formal written plan for funding and using the individual reserve funds and liabilities. However, it is the intent of the BOCES Board to develop a written policy and procedure that will identify the need for, the purpose of, the funding of, and the use of, each reserve fund and liability account. We believe that this will validate and support the funding and use of these in the future.

The comprehensive plan will establish and communicate to its customers why the money is being set aside, the board's financial objectives for the reserves, optimal funding levels, and conditions under which the assets will be utilized. The Board will also periodically assess the reasonableness of the amounts accumulated in each reserve. We agree that a more written plan would be beneficial.

RECOMMENDATION #4: *"The Board should ensure that all surplus funds, except those properly restricted in reserves in accordance with applicable statutes, are distributed to the districts."*

The BOCES has not maintained an Other Post-Employment Benefits (OPEB) Trust or Reserve Fund. BOCES recognizes that it does not have the legal authority to restrict money in an OPEB Trust. However, according to the Governmental Account Standards Board (GASB), governmental entities such as BOCES are required to actuarially identify, but not fund, the liability for post employment benefits and to recognize the liability on its financial statements.

See
Note 4
Page 19

BOCES has a financial responsibility to account for and to fund all current and future liabilities. Because BOCES follows a cost accounting model to charge users for services requested and provided, it makes fiduciary sense to charge current users of services to fund liabilities for future anticipated costs associated with the current BOCES operations, instead of assessing school districts with a pay-as-you-go methodology.

BOCES believes that financing and accounting for its liability for retiree health insurance is financially prudent and responsible, and shields its component districts from the disruptive consequences in the future of not funding this liability on a current basis.

According to the Uniform System of Accounts for BOCES, "Trust and Agency Funds are used to account for assets held by a BOCES in a trustee capacity and/or as agent for other funds". An explanation of General ledger account TA20, Group Insurance, states that "the balance will represent amounts accumulated for payment of group insurance contracts" and that the account is to be credited with the BOCES share. Accordingly, BOCES believes that it has the fiscal responsibility and authority to fund its financial liabilities.

See
Note 5
Page 19

Beginning in fiscal year 2013-14, and continuing in 2014-15 and 2015-16, \$200,000 has been used each year in this liability account to pay for retiree health insurance premiums. Starting in 2016-17 all retiree health insurance premiums are budgeted for to be paid from this liability account.

BOCES acknowledges that it overfunded its Career and Technical Equipment Reserve above the maximum allowed by regulation. This was done inadvertently and unknowingly. An equipment acquisition plan is being developed to reduce the reserve so that it is within the maximum allowed and will not be funded in the future beyond the maximum allowed.

The Liability Reserve Fund was properly established by BOCES Board action on March 5, 2014. As such, the reserve funds were used for their intended, and authorized purpose as approved annually by the BOCES Board.

See
Note 6
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RECOMMENDATION #5: *“The Board should review all reserves and determine if the amounts reserved are necessary and reasonable. To the extent that they are not, transfers should be made, where allowed by law, to other reserves established and maintained in compliance with statutory directions.”*

This recommendation will be accomplished in conjunction with the comprehensive written plan is established as recommended in Recommendation #3 and agreed to by the BOCES.

In analyzing the comments made in the Report of Examination concerning the Unemployment Insurance Reserve, it would appear that some of these funds should be transferred to other reserves or returned to the component school districts.

With the anticipated increases in the employer contribution rates of the Employee Retirement System in the forthcoming years, it may be deemed prudent to transfer excess funds from the Unemployment Insurance Reserve, to the Retirement Contribution Reserve.

See
Note 7
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Once a plan is developed and approved by the BOCES Board as to the optimal or targeted funding levels for each reserve fund, a final determination will be made regarding this matter.

It is the responsibility of Cattaraugus/Allegany BOCES to manage its financial and capital resources efficiently and effectively and to provide accountability for its resources that are spent to support the BOCES operations and services. The Board and BOCES officials take this responsibility seriously and attempts to do its best in overseeing its fiscal affairs and to be in compliance with relevant laws, regulations, internal controls and good business practices.

As stated in the Comptroller's Reserve Fund guide, "planning today and saving [and budgeting] incrementally for expected future events can help mitigate the financial impact of major, nonrecurring or unforeseen expenditures on your annual operating budget." With this in mind Cattaraugus/Allegany BOCES will continue to be fiduciarily responsible in its budgeting practices, and accounting for its reserve funds and liabilities.

Thank you for providing us with the opportunity to respond to your Report of Examination of Financial Management findings and recommendations of our BOCES.

Sincerely,

Sincerely,

Lynda Quick
District Superintendent &
Chief Executive Officer

~~Lou Nicol~~
Board of Education President

Cc: Board of Education
Thomas Potter, Controller

APPENDIX B

OSC COMMENTS ON BOCES' RESPONSE

Note 1

BOCES did not return all of its surpluses to the component and participating districts; over \$4 million was used to fund reserve accounts.

Note 2

In the interest of transparency, BOCES should report to its component districts the amounts allocated to reserve funds regardless of whether there is a legal requirement to do so.

Transfers to reserves should not be recorded as current year expenditures because funds are not being used to satisfy a current obligation, but rather set aside for future obligations. Additionally, the expenditure account codes being used would not signify to component districts or the public that the funds are being used to fund a reserve. A more transparent approach would be to clearly identify transfers to reserves as such in year-end financial reports.

Note 3

Recommendations in the audit report are consistent with the guidance contained in our Local Government Management Guide on Reserve Funds. By making provisions to raise resources for reserve funds explicit in the proposed budget, the Board gives the component districts an opportunity to know the Board's plan for funding reserves.

Note 4

Regardless of whether BOCES officials consider the surplus funds in the trust and agency fund a "trust" or a reserve, they have improperly set aside \$12.7 million for other post-employment benefits despite having no statutory authority to retain surplus funds for this purpose.

Note 5

GASB Statement 75 states that, in order to be considered funded in accordance with GASB, the employer must transfer assets to a "qualifying trust or equivalent arrangement" in which OPEB assets are held in trust for the exclusive benefit of plan members and their beneficiaries in accordance with the terms of the OPEB plan. Local governments, school districts and BOCES in New York State currently do not have the legal authority to establish a trust or equivalent arrangement to accumulate such funds.

Furthermore, GASB Statement 34 states that fiduciary funds (agency funds are a subset) should be used to report assets held in a trustee or agency capacity for others and, therefore, cannot be used to support the entity's own programs. Based on this definition, the use of an agency fund by BOCES to fund a long-term OPEB liability for BOCES employees is inappropriate. Therefore, setting aside

money in the TA 20 account for retiree health insurance does not meet the requirements of GASB Statement 75 for an OPEB trust, does not meet the requirements of GASB Statement 34 for the use of an agency fund, and is not currently allowed by New York State Law.⁹ This money should be returned to the school districts.

Note 6

The liability reserve was not used properly. Statute does not permit BOCES to choose to establish and fund a reserve for whatever purpose it chooses. A liability reserve can be established, funded and used for property loss and liability claims, but there is no provision allowing BOCES to use such a reserve to offset operating deficits generated by a BOCES program.

Note 7

Employer contributions to the New York State and Local Retirement System (NYSLRS) Fund are based largely on the Fund's performance and the subsequent performance of its investments, which include those in the stock market. NYSLRS has provided plan participants with contribution rates for 2017 and will provide future years' contribution rates when available.

⁹ The State Comptroller has proposed legislation that would provide statutory authority for BOCES and other "local governments" to establish "OPEB Trusts" (see A5525 of 2015).

APPENDIX C

AUDIT METHODOLOGY AND STANDARDS

The objective of our audit was to review BOCES' financial management practices for the period July 1, 2012 through December 30, 2015. To achieve our audit objective and obtain valid evidence, we performed the following procedures:

- We interviewed BOCES officials and reviewed adopted policies and procedures.
- We reviewed applicable sections of laws and regulations to determine if reserves recorded by BOCES were legally permissible.
- We reviewed BOCES' financial records and reports to determine reserve account balances, transfer activity and its overall cash position.
- We reviewed BOCES' results of operations for 2012-13 through 2014-15 to assess whether there was an annual surplus and if so, if it was properly apportioned back to the component and participating districts.

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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