



Cattaraugus-Little Valley Central School District

Financial Management

Report of Examination

Period Covered:

July 1, 2012 – January 4, 2016

2016M-61



Thomas P. DiNapoli

Table of Contents

	Page
AUTHORITY LETTER	1
INTRODUCTION	2
Background	2
Objective	2
Scope and Methodology	2
Comments of District Officials and Corrective Action	2
FINANCIAL MANAGEMENT	4
Budgeting and Fund Balance	5
Reserve Funds	7
Debt Service Fund	9
Recommendations	9
APPENDIX A Response From District Officials	11
APPENDIX B Audit Methodology and Standards	13
APPENDIX C How to Obtain Additional Copies of the Report	14
APPENDIX D Local Regional Office Listing	15

State of New York Office of the State Comptroller

Division of Local Government and School Accountability

June 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 Cattaraugus-Little Valley Central School District, 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 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 Cattaraugus-Little Valley Central School District (District) is located in the Towns of Dayton, East Otto, Leon, Little Valley, Mansfield, Napoli, New Albion, Otto and Persia in Cattaraugus 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 is the District's chief executive officer and is responsible, along with other administrative staff, for the day-to-day management of the District under the direction of the Board.

The District employs a Business Executive (Executive) who, along with the Superintendent and Board, is responsible for preparing the annual operating budget. The Executive is also responsible for overseeing the District's day-to-day financial operations.

There is one school in operation within the District with approximately 1,000 students and 190 full- and part-time employees. The District's budgeted appropriations for the 2015-16 fiscal year were approximately \$24.6 million, which were funded primarily with State aid and real property taxes.

Objective

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

- Did the Board properly manage District finances by ensuring that budgets were realistic and fund balance levels were maintained in accordance with statutory requirements?

Scope and Methodology

We examined the District's financial condition for the period July 1, 2012 through January 4, 2016.¹

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 indicated they agreed with our findings.

¹ We extended our review of certain documentation relating to the District's reserve funds back to May 2000.

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 Management

A school district's financial condition is a factor in determining its ability to fund public educational services for students within the district. The Board and District officials are responsible for adopting annual budgets that contain realistic estimates of expenditures and the resources available to fund them and for ensuring that fund balance does not exceed the amount allowed by law. Fund balance represents the cumulative residual resources from prior fiscal years that can, and in some cases must, be used to lower property taxes for the subsequent fiscal year. A district may retain a portion of fund balance, referred to as unrestricted fund balance, but must do so within the legal limits established by New York State Real Property Tax Law (RPTL).² The portion of fund balance used to reduce the property tax levy is referred to as appropriated fund balance. A district also can legally set aside and reserve portions of fund balance to finance future costs for a variety of specified objects or purposes.

The Board and District officials have not realistically budgeted or properly managed fund balance. As a result, unrestricted fund balance has consistently exceeded RPTL limits. As of June 30, 2015, the District's unrestricted fund balance was approximately \$3.6 million (14 percent of the ensuing year's budget), or approximately \$2.6 million over the legally allowable limit, and is projected to remain at nearly the same level at the end of 2015-16.³ Although the Board and District officials annually appropriated a portion of fund balance toward the subsequent year's budget, the total amounts appropriated were mostly not used because District officials overestimated appropriations.⁴ Moreover, once the appropriated fund balance not needed to finance operations is included in unrestricted fund balance, recalculated unrestricted fund balance ranged from \$2.9 million (13 percent) to \$4.1 million (17 percent) during 2012-13 through 2014-15.

In addition, District officials consistently budgeted for expenditures that could have been paid for with reserve funds. Although unrestricted fund balance continued to increase through June 30, 2015, District officials continued to raise the tax levy each year of the period by an average of 3 percent. Had District officials retained the same tax

² RPTL limits the amount of unrestricted fund balance to no more than 4 percent of the subsequent year's budget.

³ The legal amount of unrestricted fund balance allowable for the District as of June 30, 2015 was approximately \$980,000.

⁴ The District experienced an operating deficit of \$60,000 in 2012-13 and operating surpluses of approximately \$1.2 million in 2013-14 and approximately \$190,000 in 2014-15.

levy each subsequent year as in 2012-13, taxpayers could have realized approximately \$410,000 in cumulative tax savings.

Budgeting and Fund Balance

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

We compared the District’s appropriations with actual results of operations for 2012-13 through 2014-15 and found that the District overestimated appropriations by an average of \$1.6 million as shown in Figure 1. The most significant variances were found in employee benefits⁵ and instructional salaries each year; \$1,150,000 and \$144,000 in 2012-13, \$810,000 and \$358,000 in 2013-14 and \$820,000 and \$218,000 in 2014-15, respectively. Because some of these costs are determined by contractual agreements, anticipated expenditures should be reasonably estimated and not consistently overestimated.

Figure 1: Overestimated Appropriations			
	2012-13	2013-14	2014-15
Appropriations	\$23,450,000	\$23,040,000	\$24,080,000
Actual Expenditures	\$21,820,000	\$21,450,000	\$22,480,000
Overestimated Appropriations	\$1,630,000	\$1,590,000	\$1,600,000
Percentage Overestimated	7%	7%	7%

We also analyzed the 2015-16 appropriations in comparison with the last three completed fiscal years of actual results and project a similar trend to continue. As a result, we project that appropriations are overestimated by more than \$1.6 million (7 percent) and the District will realize an operating surplus in 2015-16 similar to the past three years.

The budgets⁶ included appropriated fund balance that averaged approximately \$840,000 per year. However, annual operating results generally resulted in either an operating surplus⁷ or a small operating deficit.⁸ As a result, the District did not need to use the appropriated

⁵ Includes retirement contributions, health insurance and Social Security

⁶ 2012-13 through 2014-15 budgets

⁷ The District experienced operating surpluses of approximately \$1.2 million in 2013-14 and approximately \$190,000 in 2014-15.

⁸ The District experienced an operating deficit of \$60,000 in 2012-13. The District had appropriated more than \$1.2 million.

fund balance as budgeted.⁹ Additionally, District officials annually appropriated approximately \$468,000 from reserves that were never used because the District instead paid for the corresponding expenditures through the general operating budget.¹⁰ Routinely adopting budgets that appropriate fund balance and reserves that will not be used is misleading to District residents as they are under the impression that surplus and reserve funds will be used to reduce their taxes. In reality, the District's fund balance continued to increase and was not used to benefit the residents. As of June 30, 2015, unrestricted fund balance was 14 percent of the next year's budget and exceeded the statutory limit by approximately \$2.6 million.

The District's last three independent audit reports contained findings related to unrestricted fund balance being in excess of the statutory limit. However, officials did not take corrective action in response to these findings and unrestricted fund balance continued to increase. As shown in Figure 2, unrestricted fund balance exceeded the limit in all three years, ranging from 10 to 14 percent of the ensuing year's budget.

Figure 2: Unrestricted Fund Balance at Year-End

	2012-13	2013-14	2014-15
Beginning Fund Balance	\$4,520,000	\$4,460,000	\$5,640,000
Add: Operating Surplus/(Deficit)	(\$60,000) ^a	\$1,180,000	\$190,000
Ending Fund Balance	\$4,460,000	\$5,640,000	\$5,830,000
Less: Restricted Funds	\$1,520,000	\$1,530,000	\$1,710,000
Less: Encumbrances	\$40,000	\$130,000	\$50,000
Less: Appropriated Fund Balance for the Ensuing Year	\$630,000	\$700,000	\$510,000
Unrestricted Fund Balance at Year-End	\$2,270,000	\$3,280,000	\$3,560,000
Ensuing Year's Budgeted Appropriations	\$23,040,000	\$24,080,000	\$24,590,000
Unrestricted Fund Balance as a Percentage of Ensuing Year's Budget	10%	14%	14%

^a The District appropriated fund balance totaling \$1.2 million at the end of 2011-12 for 2012-13 but only needed to use approximately \$60,000.

However, as illustrated in Figure 3 below, once the appropriated fund balance not needed to finance operations is included in unrestricted fund balance, recalculated unrestricted fund balance ranges from approximately \$2.9 million (13 percent) to \$4.1 million (17 percent), all exceeding the limit.

⁹ When fund balance is appropriated toward the next year's budget, the expectation is that results of operations will end the year with a planned operating deficit equal to approximately the amount of fund balance that was appropriated. This allows a district to return excess fund balance that has accumulated in prior years back to the taxpayers.

¹⁰ The Board and District officials presented budgets to the taxpayers which included planned appropriations totaling approximately \$698,000 from the employee benefit accrued liability reserve and \$704,500 from the debt service fund during our audit period.

Figure 3: Unused Fund Balance

	2012-13	2013-14	2014-15
Unrestricted Fund Balance at Year-End	\$2,270,000	\$3,280,000	\$3,560,000
Add: Appropriated Fund Balance Not Used to Fund Ensuing Year's Budget	\$630,000	\$700,000	\$510,000
Recalculated Unrestricted Fund Balance	\$2,900,000	\$3,980,000	\$4,070,000
Recalculated Unrestricted Fund Balance as a Percentage of Ensuing Year's Budget	13%	17%	17%

The result of these budgeting practices made it appear that the District needed to both raise taxes and use fund and reserve balance to close projected budget gaps. However, the District's budgets resulted in operating surpluses in two of the three years reviewed and unrestricted fund balance increased by approximately \$1.3 million during the same period. The Board and District officials continued to raise the tax levy every year by an average of 3 percent during our audit period. Had District officials retained the same tax levy as in 2012-13, District residents could have realized approximately \$410,000 in cumulative savings. Furthermore, the District's practice of appropriating fund balance that is not needed to finance operations is, in effect, a reservation of fund balance that is not provided for by statute and a circumvention of the statutory limit imposed on the level of unrestricted fund balance.

Reserve Funds

School districts may establish reserve funds to retain a portion of fund balance to finance a variety of objects or purposes but must do so in compliance with statutory requirements. When districts establish reserves for specific purposes, it is important that a formal written plan is developed for how to fund the reserves, how much should be accumulated in the reserves and when the money will be used to finance related costs. While school districts are generally not limited as to how much money can be held in reserves, balances should be reasonable. Funding reserves at greater than reasonable levels contributes to real property tax levies that are higher than necessary because the excessive reserve balances are not being used to fund operations.

As of June 30, 2015, the District reported four reserves in the general fund totaling approximately \$1.7 million, one reserve in the capital projects fund totaling approximately \$268,000 and cash in the debt service fund totaling approximately \$2 million. We analyzed the reserves and the cash balance in the debt service fund for reasonableness and adherence to statutory requirements. We found the District properly established and funded the retirement contribution reserve (\$477,000) and reasonably funded the employee benefit accrued liability reserve (\$650,000). The remaining two general fund reserves, totaling \$585,500, were not properly established or were overfunded or had insufficient documentation to support the balances.

The capital reserve¹¹ was overfunded by \$165,000. The \$2 million in the debt service fund has not properly been restricted in a debt reserve or used towards related debt principal and interest payments.

Repair Reserve – General Municipal Law (GML) authorizes this type of reserve for certain repairs, capital improvements or equipment purchases. This reserve had a balance of approximately \$362,500 as of June 30, 2015 and has not been used since July 1, 2008 or perhaps earlier. As such, District officials should evaluate the reserve balance for reasonableness.

Unemployment Insurance Reserve – GML authorizes school districts to create a reserve to reimburse the New York State Unemployment Insurance Fund for payments made to claimants. If there are excess amounts after claims are paid and pending claims are considered, the Board can transfer all or part of the excess amounts to certain other reserve funds or apply all or part of the excess to the budgeted appropriations of the next fiscal year.

The District's average annual unemployment insurance expenditure for the past three fiscal years averaged \$17,500. However, the \$223,000 reserve balance as of June 30, 2015 was 12 times the average annual expenditure. The District did not use the reserve in the three fiscal years reviewed and continually budgeted for the expenditure out of the general fund budget. In addition, the District does not have documentation of the establishment of the reserve.

Capital Reserve – This type of reserve is to pay the cost of any object or purpose for which bonds may be issued. The creation of a capital reserve requires authorization by a majority of the voters establishing the purpose of the reserve, the maximum amounts of funding and the source of funding and its probable term.

As of June 30, 2015, the District has one capital reserve with a balance of approximately \$267,000. The reserve was approved by voters to be funded to a maximum not to exceed \$4 million. However, the reserve also previously held funds totaling approximately \$3.9 million.¹² As a result, the reserve has exceeded the \$4 million limit by \$165,000. If voters determine that the original purpose for which the capital reserve was established is no longer needed, the reserve may be liquidated by first applying its proceeds to any related outstanding indebtedness and then applying the balance, if any, to the annual tax levy.¹³

¹¹ This reserve is reported in the capital projects fund.

¹² These funds were approved by voters in May 2007 to be applied towards the local share costs of the \$59 million renovation capital project.

¹³ The District should consult with legal counsel prior to liquidating or removing funds from the reserve.

Debt Service Fund

The District accounts for and reports a debt service fund, which is separate from the general fund. Debt service funds are not required unless segregation of resources is legally mandated. For example, school districts are required to establish a debt reserve, which would be accounted for in the debt service fund, to account for and restrict unexpended bond proceeds and related interest earnings in accordance with statutory provisions.

As of June 30, 2015, the District has approximately \$2 million in the debt service fund, which has not been properly restricted in a debt reserve and is not being used to pay related debt.¹⁴ The majority of this fund balance is leftover bond proceeds from a \$59 million capital project, approved by the voters in 2007.¹⁵ These funds should be used to pay the debt associated with this capital project. However, the District has not used any of these funds and instead raised additional funds by levying taxes for the related debt payments.

We also noted that the Board has adopted a comprehensive reserve policy that requires officials to prepare and submit an annual report to the Board to include the type and description, the date of establishment, financial activity increasing or decreasing the reserve, an analysis of the projected needs for the reserve in the upcoming fiscal year as well as a recommendation regarding the funding of those projected needs.

However, the District was unable to provide this report. Additionally, there is no evidence that officials have used reserves for their intended purposes because District officials routinely levied taxes for expenditures that could be funded with money from the reserves. Funding reserves at greater than reasonable levels causes real property tax levies to be higher than necessary.

Recommendations

The Board and District officials should:

1. Develop realistic estimates of appropriations and the use of fund balance and reserves in the annual budget.
2. Ensure that the amount of unrestricted fund balance is in compliance with statutory limits and develop a plan to use excess funds in a manner that benefits taxpayers. Such uses could include, but are not limited to:
 - Paying off debt.
 - Financing one-time expenditures.
 - Reducing District property taxes.

¹⁴ This fund balance is composed of approximately \$1.2 million in cash and \$800,000 due from the capital projects fund.

¹⁵ The remaining balance of approximately \$100,000 is from leftover bond proceeds relating to three additional small capital projects.

3. Review all reserves at least annually to determine if the amounts reserved are necessary and reasonable. Any excess funds should be transferred to unrestricted fund balance, where allowed by law, or to other reserves established and maintained in compliance with statutory directives.
4. Consult with legal counsel and ensure that the capital reserve is properly used in accordance with statute.
5. Ensure that money residing in the debt service fund is restricted in a debt reserve and used to pay related debt.
6. Annually report on each of the District's reserves and future reserve projections in accordance with the District's reserve policy.

APPENDIX A

RESPONSE FROM DISTRICT OFFICIALS

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



Cattaraugus-Little Valley Central School

"Home of the Timberwolves"

PRIDE • EXCELLENCE • WELLNESS

Sent 5/11/14

May 5, 2016

New York State
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Division of Local Government & School Accountability
110 State Street
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To Whom it May Concern

The Cattaraugus-Little Valley Central School District is in receipt of the draft audit entitled Financial Management and is in agreement with the audit findings. Please contact me at (716) 257-5292 if you have any additional questions. Thank you.

Sincerely,

Sharon Huff
Superintendent

SH:pj

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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 the District's financial management practices.
- We analyzed 2012-13, 2013-14 and 2014-15 budgeted appropriations and revenues and compared them to actual results. We calculated if there was an operating surplus or deficit for each of these years.
- We reviewed the 2015-16 budget and compared it to the 2014-15 budget. We documented any increases or decreases to selected appropriation and revenue codes. Based upon these comparisons, we identified potential and projected trends.
- We analyzed fund balance for 2012-13, 2013-14 and 2014-15 and determined if appropriated fund balance was used as intended.
- We evaluated selected appropriation and revenue codes for 2012-13, 2013-14 and 2014-15 and compared to actual results. We identified those that had significant over or under budget variances.
- We calculated unrestricted fund balance as a percentage of the ensuing year's budget. We included both appropriated fund balance and unrestricted fund balance in our calculation as the District has shown a pattern of not using appropriated fund balance.
- We identified all reserves in the general and capital projects funds, as well as the debt service fund cash during the last three fiscal years and determined if they were properly established or restricted. We analyzed whether these reserves and debt service fund cash were properly used.
- We requested the substantiation that District officials used to calculate the appropriate balances for the reserves and evaluated each for reasonableness.

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

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