Office of the New York State Comptroller

Division of Local Government
& School Accountability

Delaware Academy Central School District at Delhi

Fund Balances

Report of Examination

Period Covered:

July 1, 2014 – November 9, 2015

2016M-36

Thomas P. DiNapoli

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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 Delaware Academy Central School District at Delhi, entitled Fund Balances. 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 Delaware Academy Central School District at Delhi (District) is located in the Towns of Andes, Bovina, Delhi, Franklin, Hamden, Kortright and Meredith in Delaware 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 Board's direction. The Business Manager plays a key role in the budget development process and daily administration of the Business Office.

The District operates two schools with approximately 750 students and 152 employees. The District's budgeted appropriations for the 2015-16 fiscal year are approximately $19.7 million, which are funded primarily with State aid and real property taxes (taxes).

Objective

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

- Did the Board and District officials ensure that certain fund balances and certain reserves were reasonable?

Scope and Methodology

We examined the financial management practices of the District for the period July 1, 2014 through November 9, 2015. We extended our scope back to July 1, 2010 to analyze the District's financial condition and fund balances.

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 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. Except as specified in Appendix A, District officials generally agreed with our recommendations and indicated they planned to take corrective action. Appendix B includes our comment on the issue raised in the District's response letter.

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.

Fund Balances

Fund balance represents resources remaining from prior fiscal years that can be used to lower taxes for the ensuing fiscal year. A district may retain a portion of fund balance, referred to as unrestricted fund balance, within the limits established by New York State Real Property Tax Law (RPTL).[1] Districts may also establish reserves to restrict a portion of fund balance for a specific purpose, in compliance with statutory directives. However, reserve balances must be reasonable. Combining a reasonable level of unrestricted fund balance with specific legally established reserves provides resources for both unanticipated events and other identified or planned needs. Funding reserves at greater than reasonable levels contributes to tax levies that are higher than necessary because the excessive reserve balances are not being used to fund operations. The Board is responsible for developing a formal plan for the use of its reserves, including optimal or targeted funding levels and the justification for them. The Board and District officials are also responsible for ensuring that proceeds accumulated in the debt service fund are used for the payment of principal and interest on long-term debt.

Over the five-year period ending June 30, 2015, the Board and District officials have adopted budgets that reduced unrestricted fund balance to within the 4 percent statutory limit of the ensuing year's appropriations.[2] However, each year in the period, District officials appropriated more fund balance than needed, which artificially lowered the percentage. Instead of having operating deficits totaling $2.8 million for the period, as planned, the District's net result of operations was a surplus of $705,000. In addition, District officials overfunded five of the six reserves[3] as of June 30, 2015. Moreover, District officials did not use debt service funds[4] to make payments on long-term debt. This fund's balance ranged from $1.3 to $1.8 million for the five-year period. With the inclusion of the unused appropriated fund balance, the overfunded reserves[5] and the unused debt service

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1 RPTL requires that unrestricted fund balance not exceed 4 percent of the ensuing year's budgeted appropriations.

2 The unrestricted fund balance, as a percent of the ensuing year's appropriations, decreased from 6.3 percent as of June 30, 2011 to 3.9 percent as of June 30, 2015.

3 In 2004 and 2009, the Board passed resolutions to properly establish the District's six reserves.

4 The debt service fund is used to account for and report the accumulation of resources for the payment of principal and interest on long-term debt.

5 For illustrative purposes, we included total balances of the overfunded reserves. We do not recommend that the District remove the total balances of these overfunded reserves. However, because the reserves have not been used recently, we are providing perspective on the total amount of fund balance that has accumulated and is not being used.

funds, the fund balance for the five years ranged from 26.7 percent to 29.4 percent of the ensuing year's appropriations. Appropriating fund balance that is not needed and the lack of a formal plan for the use of reserves, including optimal or targeted funding levels and the justification for them, has resulted in the tax levy appearing to be higher than necessary.

Unrestricted Fund Balance – The District's general fund unrestricted balance was excessive, but District officials decreased the balance to within the statutory limit to 3.9 percent of the ensuing year's budget for the last two years. However, in each of the past five years, District officials have appropriated more fund balance than was needed. After adding back the ensuing year's unused appropriated fund balance to the unrestricted fund balance, the 4 percent limit was exceeded in each of these years (see Figure 1).

Figure 1: Unused Fund Balance

	2010-11	2011-12	2012-13	2013-14	2014-15
Total Unrestricted Fund Balance at Year-End	$1,151,842	$849,145	$829,167	$746,768	$777,677
Add: Appropriated Fund Balance Not Used to Fund Ensuing Year's Budget	$414,431	$646,755	$650,866	$606,988	$659,626[a]
Total Recalculated Unrestricted Funds	$1,566,273	$1,495,900	$1,480,033	$1,353,756	$1,437,303
Recalculated Unrestricted Funds as Percentage of Ensuing Year's Budget	8.5%	8.1%	8.0%	7.2%	7.3%[a]

[a] The 2014-15 unused portion of ensuing year's (2015-16) appropriated fund balance, and the resulting effective unrestricted fund balance, was estimated based on the previous five-year average of unused appropriated fund balance as a percentage of budgeted appropriated fund balance.

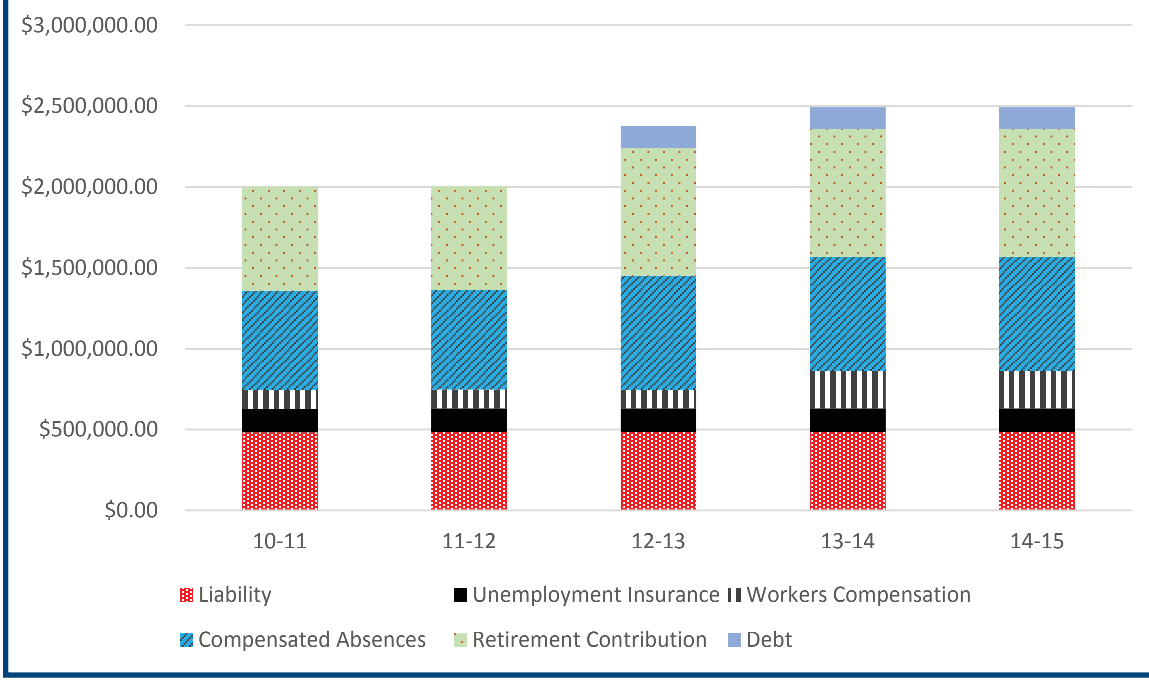
The average variances in expenditures were 3.9 percent from 2010-11 through 2014-15. Although the Board-adopted budgets included a planned use of more than $2.8 million in fund balance over the last five years, the District's operations did not always use the fund balance and instead generated a surplus of $705,000. We note that the variance has decreased over the five-year period (see Figure 2).

Figure 2: Budget Variances

	2010-11	2011-12	2012-13	2013-14	2014-15	Average
Budgeted Appropriations	$18,508,246	$18,401,464	$18,391,233	$18,425,930	$18,705,997	$18,486,574
Actual Expenditures	$17,443,924	$17,346,971	$17,924,255	$17,907,002	$18,182,228	$17,760,876
Dollar Variance	$1,064,322	$1,054,493	$466,978	$518,928	$523,769	$725,698
Percentage Variance	5.8%	5.7%	2.5%	2.8%	2.8%	3.9%

Reserves – As of June 30, 2015, fund balances for the six reserves totaled $2.5 million, an increase of $500,000 over the five-year period (see Figure 3). Offsetting expenditures actually charged to the reserves in the past five years were $145,000. Five of the reserves appear to be overfunded because related expenditures have been funded through the operating budget.[6]

Figure 3: Reserved Fund Balances



- Unemployment Insurance Reserve – This reserve is used to pay unemployment insurance claims under the "benefit reimbursement" method. The average of the qualifying expenditures over the past five years, was approximately $24,000. However, these expenditures were paid from the operating budget. The reserve balance has remained steady over the past five years, with a balance of $145,398 as of June 30, 2015. This amount is more than six times the average annual qualifying expenditures. Based on the lack of use or long-term plans and, most importantly, the balance compared to the annual expenditures, the reserve balance is overfunded.

- Workers' Compensation Reserve – This reserve is used to pay compensation and benefits; to pay medical, hospital or other authorized expenditures; and to pay the expenditures of administering a self-insurance program. The average of the qualifying expenditures over the past five years was approximately $61,000. However, these expenditures were paid from the operating budget. The reserve balance has increased over the past five years from $115,562 as of June 30, 2011 to $231,172 as of June 30, 2015, which is almost four times as large as the average annual qualifying expenditures.

[6] We determined that the debt reserve was reasonable based on the District's long-term debt principal and interest liabilities.

Based on the lack of use and long-term plans, the reserve balance is overfunded.

- Retirement Contribution Reserve – This reserve is used to pay the District's retirement contribution to the New York State and Local Retirement System. The average of the qualifying expenditures over the past five years was approximately $314,481. However, these expenditures were paid from the operating budget. The reserve balance has remained steady over the past three years with a balance of $790,469 as of June 30, 2015, which is two and one-half times as high as the average annual qualifying expenditures. Therefore, based on the lack of use or long-term plans and because of the size of the reserve in relation to the average annual qualifying expenditures, the reserve balance is overfunded.

- Compensated Absences Reserve – This reserve must be used only for cash payments of accrued and unused sick, vacation and certain other leave time owed to employees when they leave District employment. As of June 30, 2015, the total compensated absences liability of the District was $212,025. The Reserve balance has increased from $613,720 as of June 30, 2011 to $705,510 as of June 30, 2015, which is more than three times higher than the District's liability. Based on the excessive balance in the reserve compared to the maximum payout if every employee left at once, this reserve is significantly overfunded.

- Liability Reserve – This reserve is used to establish and maintain a program of reserves to cover property loss and liability claims. There were no qualifying expenditures over the past five years. However, the reserve balance has remained steady with a balance of $486,073 as of June 30, 2015. Based on the lack of use or long-term plans for the uses of this reserve, the reserve balance appears to be overfunded.

Reserve balances accumulated to excessive levels because District officials were historically transferring funds to them without using the funds. Moreover, District officials do not have long-term plans for reserve balance levels or usage. According to District officials, although they have not established formal written plans for reserve balance levels or usage, they established and funded the reserves to be prepared for changes in the fiscal environment due to potential legal liabilities, reduced State aid, the gap elimination adjustment[7] and real property tax cap limitations. However, they chose to fund

[7] Under the gap elimination adjustment, a portion of New York State's funding shortfall is divided among all school districts in the State, and each district's State aid has been reduced accordingly.

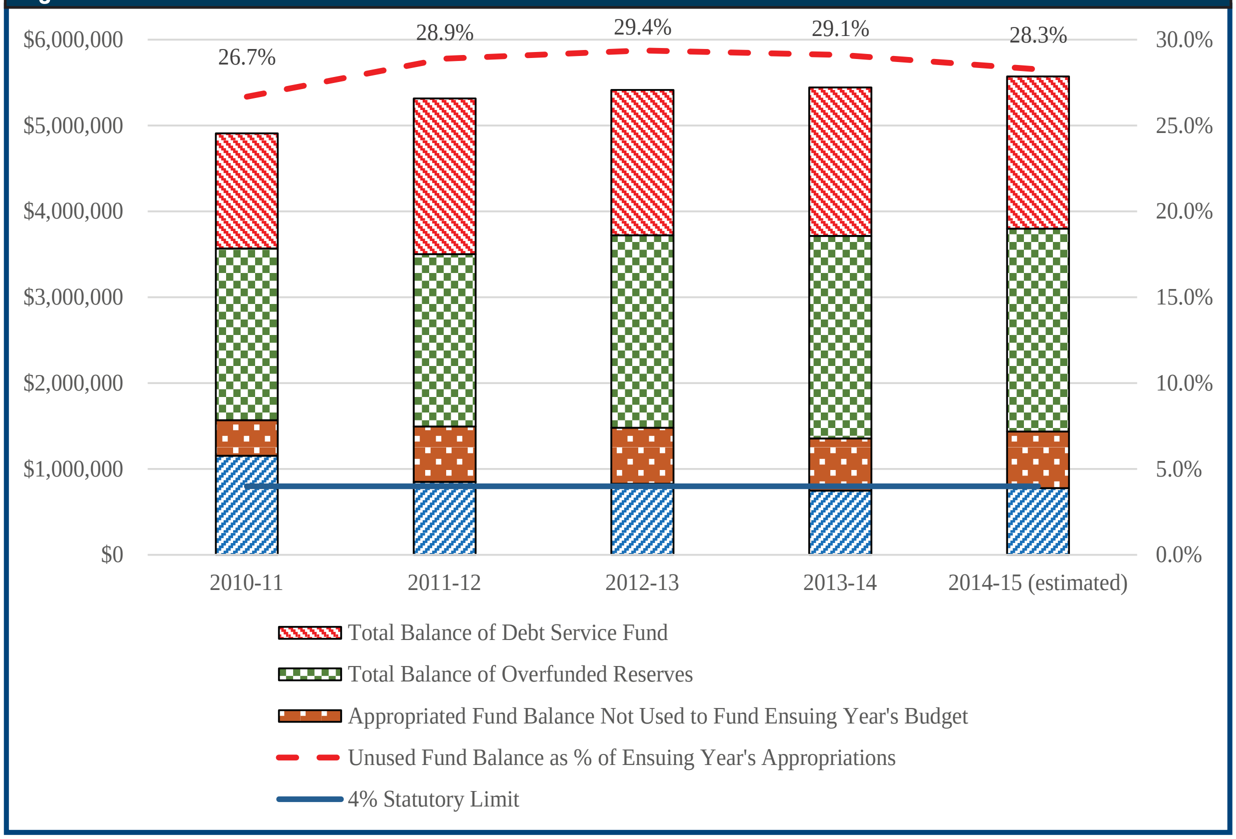
reserves that can only be used to finance small portions of the District's total spending. The five reserves noted as overfunded above can only be used to finance $508,162, or 2.6% of the District's 2015-16 budgeted appropriations. Furthermore, fund balance was increasing, not decreasing, during the time of a poor fiscal environment, reduced State aid, the gap elimination adjustment and the real property tax cap.

Debt Service Fund – The District's principal and interest payments on long-term debt averaged $2.7 million over the last five years. The fund balance for the debt service fund averaged $1.7 million over this same period, with no expenditures made from this fund since 2012-13.

District officials do not have any plans or purposes for maintaining high fund balances and reserves, and there are no specific policies governing their levels. Although there have been qualifying expenditures over the past five years, District officials elected to fund most of these costs through the operating budget.

With the inclusion of the unused appropriated fund balance, the overfunded reserves and the unused debt service funds, the fund balance ranged from 26.7 percent to 29.4 percent of the ensuing year's appropriations (see Figure 4).

Figure 4: Unused Fund Balance



Appropriating fund balance that is not necessary and funding reserves at greater than reasonable levels contributes to tax levies that are higher than necessary because they are not being used to fund operations. Taxes have increased a total of $615,000, or 7.2 percent, from 2011-12 through 2015-16 when these tax increases were not needed.

Recommendations

The Board and District officials should:

1. Discontinue the practice of appropriating unexpended surplus funds that will not be used.

2. Adopt a reserve fund plan that addresses the accumulation and use of reserve funds, review all reserve balances and transfer excess funds to unrestricted fund balance, where allowed by law, or use the reserve funds for their designated purposes.

3. Use available debt service funds to pay debt service principal and interest.

4. Develop a plan to use the surplus fund balance identified in this report in a manner that benefits District taxpayers. Such uses could include, but are not limited to:

    - Using surplus funds as a financing source;

    - Funding one-time expenditures;

    - Funding needed reserves; and

    - Reducing District property taxes.

APPENDIX A

RESPONSE FROM DISTRICT OFFICIALS

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

Delaware Academy Central School District at Delhi

2 Sheldon Drive • Delhi, New York 13753

Mr. Jason D. Thomson
Superintendent

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May 5th, 2016

Office of the State Comptroller
44 Hawley St. 17th Floor
Binghamton, NY 13901

Office of the Comptroller:

Delaware Academy Central School District at Delhi is in receipt of the Fund Balance Report of examination for the period of July 1, 2014 to November 9, 2015. Please accept this letter to serve as the District's' response to the audit findings.

On behalf of the Board of Education and the District's administration, we would like to thank the New York State Comptroller's field staff involved in the audit. They were courteous and professional throughout the process. The District is pleased with the extensive work of the auditors from your office and that the audit resulted in no findings of operational improprieties, fraud, waste or abuse. Rather, the focus of this audit was on the financial condition of the District in which your auditors have made valid recommendations in regards to fund balance and reserves.

While the District does not dispute the findings of the report, we feel that the report fails to cite the volatile economic climate under which the District has been forced to operate. Since New York State established the Gap Elimination Adjustment (GEA), Delaware Academy CSD at Delhi has lost $7,878,573 in state aid. This financial loss, along with the addition of several unfunded mandates, and a 2% tax cap, has caused Delaware Academy to be fiscally conservative in both savings and expenses. The District feels that increasing reserves along with lower than allowable tax levies even during years of reducing state aid is not a detriment to the district but rather an indicator of solid long term financial planning and performance.

The district believes that at no time did it ask taxpayers for more funding than what was applicable and disagrees with the comptroller's comment of tax levy "appearing to be higher than necessary". See Note 1 Page 13 Since the enactment of the 2% tax cap, Delaware Academy CSD at Delhi has consistently requested tax levies lower than the allowable level. For example, in 2012-2013, the district asked for $31,626 below the allowable levy. Likewise in 2013-2014, the district requested $134,829 less than the allowable level. In 2014-2015, the district asked for $9,680 less than the allowable levy set by the state and again in 2015-2016, the district established a tax levy $378,771 less than the allowable amount.

We strongly believe the district has acted and will continue to act appropriately in the future financial climate.

Corrective Action Plan:

As stated above, the District thanks the Office of the Comptroller's auditors for the recommendations they have made to improve the overall operations of Delaware Academy CSD at Delhi. The District's corrective action plan is as follows:

1. The District will examine the unexpended surplus to be used each year and determine a useable amount accordingly.

2. The Board of Education will consider adopting a formal policy that defines the appropriate balances of funding for all reserve funds that are currently established.

3. The Board of Education will consider adopting a formal policy regarding the use of future debt reserve funds.

4. The District will formalize a plan for the use of surplus fund balances year to year for such things as funding appropriate reserves, one time expenditures, reduction of property taxes, and as a financing source when applicable.

In conclusion, the District and the Board of Education welcome the auditors recommendations and are committed to ensuring continued compliance and transparency to the residents of Delaware Academy CSD at Delhi.

Sincerely,

Jason Thomson
Superintendent of Schools
Delaware Academy CSD at Delhi

APPENDIX B

OSC COMMENT ON THE DISTRICT'S RESPONSE

Note 1

Although District officials indicate they levied taxes totaling approximately $555,000 lower than the allowable level from 2011-12 through 2015-16, our report does not indicate they exceeded the tax cap limits established by RPTL. We indicate that District officials adopted budgets that appropriated more fund balance than needed, overfunded five reserves and did not use debt service funds to make payments on long-term debt. These practices contribute to tax levies that are higher than necessary. From 2011-12 through 2015-16, District officials averaged approximately $596,000 in unused appropriated fund balance and increased taxes by a total of $615,000, or 7.2 percent. District officials should develop a plan to use surplus funds in a manner that benefits District taxpayers. Such uses could include reducing District property taxes.

APPENDIX C

AUDIT METHODOLOGY AND STANDARDS

Our overall goal was to assess the District's financial management practices. To achieve our audit objective and obtain valid evidence, we interviewed appropriate District officials and employees, tested selected records and examined pertinent documents.

Our examination included the following:

- We interviewed District officials and reviewed documents, financial reports and adopted budgets to gain background information about the District.
- We interviewed District officials to gain an understanding of the process and procedures over the District's financial management, including the rationale for determining the levels to maintain unrestricted fund balance, reserves and debt service funds.
- We calculated the unrestricted fund balance as a percentage of the ensuing year's appropriations to determine if the District was within the statutory limitation from 2010-11 through 2014-15.
- We analyzed the District's budget over the last five years by comparing budgeted revenues and appropriations to actual revenues and expenditures and comparing these results to appropriated fund balance.
- We analyzed the trend in fund balance over the last five years by comparing the appropriated fund balance to the same year's operating results to determine if appropriated amounts were actually used.
- We added the unused appropriated fund balance from the ensuing year, the overfunded reserves and the unused debt service funds to the general fund's unrestricted fund balance to determine if the District was over the statutory limitation during the last five years. We estimated the amount of unused appropriated fund balance for the 2015-16 year by using the average unused portion of appropriated fund balance over the previous five years.
- We analyzed the District's use of, and balances maintained in, reserves during the last five years to determine if balances were excessive by reviewing related reserve expenditures and liabilities and actual charges to reserves.
- We calculated the District's liability for compensated absences as of June 30, 2015 by reviewing employee contracts and payroll records.
- We analyzed the debt service fund to identify the trend in fund balance and to determine if fund balance had been used during the last five years.
- We reviewed the tax levy increases to determine if they had increased over the past five years, and we calculated the tax levy overage for years that the District exceeded the 4 percent statutory limit.

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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