



Downsville Central School District Fund Balance

Report of Examination

Period Covered:

July 1, 2014 – January 12, 2016

2016M-79



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 Downsville Central School District, entitled Fund Balance. 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 Downsville Central School District (District) is located in the Towns of Andes, Colchester, Hamden, Hancock, Tompkins and Walton in Delaware County. The District is governed by a five-member Board of Education (Board). 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 District Treasurer plays a key role in the budget development process as well as overseeing the finances and daily accounting duties.

The District operates one school with approximately 295 students and 85 employees. The District's 2015-16 budgeted appropriations are \$9.9 million, funded primarily through real property taxes and State aid.

Objective

The objective of our audit was to examine the District's general fund balance. Our audit addressed the following related question:

- Did the Board and District officials maintain a reasonable fund balance?

Scope and Methodology

We examined the District's general fund balance for the period July 1, 2014 through January 12, 2016. We extended our scope back to July 1, 2012 to analyze the District's budgeting practices and forward to June 30, 2016 to project fund balance.

We conducted our audit in accordance with generally accepted government auditing standards (GAGAS). More information on such standards and the methodology used in performing this audit are included in Appendix B of this report.

Comments of District Officials and Corrective Action

The results of our audit and recommendations have been discussed with District officials, and their comments, which appear in Appendix A, have been considered in preparing this report. District officials generally agreed with our recommendations and indicated they planned to initiate corrective action.

The Board has the responsibility to initiate corrective action. Pursuant to Section 35 of General Municipal Law, Section 2116-a (3)(c) of New York State Education Law and Section 170.12 of the Regulations of the Commissioner of Education, a written corrective

action plan (CAP) that addresses the findings and recommendations in this report must be prepared and provided to our office within 90 days, with a copy forwarded to the Commissioner of Education. To the extent practicable, implementation of the CAP must begin by the end of the next fiscal year. For more information on preparing and filing your CAP, please refer to our brochure, *Responding to an OSC Audit Report*, which you received with the draft audit report. The Board should make the CAP available for public review in the District Clerk's office.

Fund Balance

Fund balance represents resources remaining from prior fiscal years. 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.¹ Districts may also legally establish reserves to restrict a reasonable portion of fund balance for a specific purpose. Combining a reasonable level of unrestricted fund balance with specific legally established reserve funds provides resources for unanticipated events and identified or planned needs. Funding a reserve at greater than reasonable levels contributes to real property tax levies that are higher than necessary because the excessive reserve balance is 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.

The Board and District officials did not maintain reasonable fund balance. As of June 30, 2015, the District's unrestricted fund balance totaled \$1,134,700, exceeding the 4 percent statutory limit by 7.3 percentage points as shown in Figure 1. With the inclusion of the unused appropriated fund balance, the fund balance ranged from 12.1 to 14.7 percent of the ensuing year's appropriations. In addition, the District had a reserve fund that was overfunded by \$703,000.

| Figure 1: General Fund Unrestricted Fund Balance at Year-End | | | |
|--|-------------|--------------------------|--------------------------|
| | 2012-13 | 2013-14 | 2014-15 |
| Total Beginning Fund Balance | \$4,940,201 | \$5,480,085 ^a | \$5,453,952 ^a |
| Add: Operating Surplus (Deficit) | \$539,880 | (\$68,658) | \$286,692 |
| Total Ending Fund Balance | \$5,480,081 | \$5,411,427 | \$5,740,644 |
| Less: Restricted Funds | \$4,146,513 | \$4,146,513 | \$4,146,513 |
| Less: Encumbrances | \$106,502 | \$39,360 | \$9,032 |
| Less: Appropriated Fund Balance for the Ensuing Year | \$522,354 | \$522,354 | \$450,359 |
| Total Unrestricted Funds at Year-End | \$704,712 | \$703,200 | \$1,134,740 |
| Ensuing Year's Budgeted Appropriations | \$9,589,123 | \$9,860,957 | \$9,999,506 |
| Unrestricted Funds as Percentage of Ensuing Year's Budget | 7.3% | 7.1% | 11.3% |
| Percentage Points Over 4 Percent Statutory Limitation | 3.3 | 3.1 | 7.3 |
| ^a Includes prior period adjustments. | | | |

¹ Currently, the amount of unrestricted surplus funds that can be legally retained by a school district is no more than 4 percent of the next fiscal year's budgeted appropriations.

Furthermore, the District appropriated an average of \$498,000 in fund balance as a financing source in each of the annual budgets for 2013-14 through 2015-16. Even with this appropriation of fund balance, the District's unrestricted fund balance was over the 4 percent statutory limit, as shown in Figure 1. Moreover, the District used \$68,658 of the appropriated fund balance in 2013-14, used none in 2014-15 and we have projected it will use approximately \$115,000 in 2015-16 to finance operations. When unused appropriated fund balance was added back, the District's recalculated unrestricted fund balance exceeded the 4 percent statutory limit each year by at least 8 percent of the ensuing year's appropriations, as indicated in Figure 2.

| Figure 2: Unused Fund Balance | | | |
|--|-------------|-------------|-------------|
| General Fund | 2012-13 | 2013-14 | 2014-15 |
| Total Unrestricted Funds at Year-End | \$704,712 | \$703,200 | \$1,134,740 |
| Add: Appropriated Fund Balance Not Used to Fund Ensuing Year's Budget | \$453,696 | \$522,354 | \$335,047 |
| Total Recalculated Unrestricted Funds | \$1,158,408 | \$1,225,554 | \$1,469,787 |
| Recalculated Unrestricted Funds as Percentage of Ensuing Year's Budget | 12.1% | 12.4% | 14.7% |

We compared the budgeted revenues and appropriations to the actual revenues and expenditures and found that appropriations have been overestimated by \$2 million in total, or an average of 6.9 percent per year, from 2012-13 through 2014-15. District officials were generally overestimating health insurance, contractual special education and certain teachers' salaries instead of relying on historical information. District officials told us they budgeted conservatively and attempted to limit the impact of unanticipated expenditures that may arise during the year. For example, over the last three years, the appropriation for health insurance was consistently overestimated by an average of approximately \$198,000 because employees might change coverage from an individual plan to a more costly family plan. However, even if all 18 employees with an individual plan for 2014-15 switched to a family plan, this appropriation would still have been overestimated by \$82,000.

These budgeting practices made it appear that the District needed to both raise taxes and use fund balance to close projected budget gaps. However, the District's budgets resulted in operating surpluses in two of the three years reviewed. Furthermore, the District increased the tax levy from \$7.3 million in 2012-13 to \$7.7 million in 2015-16, a total increase of about 4.5 percent or an annual average of 1.5 percent. Additionally, the District's practice of annually 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.

Because the Board did not have a formal plan for the use of its reserves, including optimal or targeted funding levels, we analyzed the District's reserves for reasonableness and found the Employee Benefit Accrued Liability Reserve (EBALR) totaling approximately \$1.1 million to be excessive. This reserve must be used for cash payments of accrued and unused sick, vacation and certain other leave time owed to employees when they leave District employment. We determined the District's liability for these compensated absences was approximately \$432,000.² As a result, the reserve was overfunded by approximately \$703,000.

While it is prudent to have some provision for unanticipated expenditures, it can be done with maintaining ample fund balance, adopting a conservative budget or using reserves. Doing all three of these concurrently results in unnecessary increases in real property taxes.

Recommendations

The Board and District officials should:

1. Ensure that the amount of the District's unrestricted fund balance is in compliance with statutory limits and 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.
2. Adopt budgets with appropriations that are based on historical estimates for expenditures.
3. Review the reserve for compensated absences and transfer excess funds to unrestricted fund balance, where allowed by law, or other reserves established and maintained in compliance with statutory directives.

² See Appendix B for more details.

APPENDIX A

RESPONSE FROM DISTRICT OFFICIALS

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

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Principal

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Superintendent

Robert Rhinchart
Administrator/Guidance

The Downsville Central School District has appreciated the efforts and insights of the Comptroller's Office during their audit of the school district. The discussions with the auditors from the Comptroller's Office were helpful and informative. Below are our responses to the recommendations included in this report:

1. The Downsville Central School Board of Education and District Officials acknowledge their responsibility to manage the fund balance in a way that benefits the taxpayers and the educational needs of its students. They will continue to use the fund balance utilizing many of the strategies suggested by the Office of the State Comptroller.
2. The district does develop its budgets based on historical estimates of expenditures. In addition, changes to the budget line items take into account projected increases and/or decreases related to anticipate changes in programs and/or market conditions for the coming year.
3. The Board of Education plans to review its options regarding transferring funds from the compensated absences reserve to another reserve. Following that review, they will make a decision regarding the most appropriate use/transfer of those funds.

Educationally yours,

John P. Evans, Superintendent

We, the Downsville Central School Community, will be a high achieving, evolving educational environment responsible for building a foundation of trust, fairness, and consistency by working collaboratively to inspire and nurture each individual's passion, voice, and character for life-long success.

APPENDIX B

AUDIT METHODOLOGY AND STANDARDS

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

- We interviewed Board members and District officials and reviewed Board minutes to gain an understanding of the budgeting process for the general fund and the procedures for monitoring and controlling the budget.
- We compared the budgeted revenues and appropriations to the actual revenues and expenditures for the general fund for 2012-13 through 2014-15 to determine if budget estimates were reasonable.
- We projected revenues and expenditures to June 30, 2016 to determine the projected results of operations using actual revenues and expenditures as of December 31, 2015.
- We calculated the general fund's unrestricted fund balance as a percentage of the ensuing year's appropriations to determine if the District was within the statutory limitation during 2012-13 through 2014-15 and the additional percentage points over the statutory limitation when unused appropriated fund balance was added back.
- We calculated how much the cost increase would be if all employees who had individual plans for 2014-15 changed to family plans.
- We calculated the percentage increase in real property taxes for 2012-13 through 2014-15.
- We analyzed the general fund's reserves for 2012-13 through 2014-15 to identify the trends and to determine if the reserves were properly supported, reasonably funded and used. We utilized the EBALR review and certification that our office completed for the compensated absences liability balance as of June 30, 2013 to document the amount of the liability and the excess amount in this reserve.

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

APPENDIX C

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