Office of the New York State Comptroller

Division of Local Government
& School Accountability

East Rochester Union Free School District

Financial Management and Separation Payments

Report of Examination

Period Covered:

July 1, 2012 – November 24, 2015

2016M-97

Thomas P. DiNapoli

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State of New York
Office of the State Comptroller

Division of Local Government
and School Accountability

July 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 East Rochester Union Free School District, entitled Financial Management and Separation Payments. 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

State of New York
Office of the State Comptroller

EXECUTIVE SUMMARY

The East Rochester Union Free School District (District) is located in the Towns of East Rochester, Perinton and Pittsford in Monroe County. The District is governed by the Board of Education (Board), which is composed of five elected members. The Board is responsible for the general management and control of the District's financial and educational affairs.

The Superintendent of Schools (Superintendent)[1] 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 Assistant Superintendent for Finance and Operations (Assistant Superintendent) is responsible for the accounting of District finances, maintaining accounting records, preparing financial reports and supervising all functions within the Business Office.

The District has two schools in operation: an elementary and a junior/senior high school, which are located on the same campus. In total, the District has approximately 1,190 students and 220 employees. The District's appropriations for the 2015-16 fiscal year were $26.5 million, funded primarily with State aid and real property taxes.

Scope and Objectives

The objectives of our audit were to review the District's financial management for the period July 1, 2012 through November 24, 2015 and examine the District's calculation of separation payments for the period July 1, 2013 through November 24, 2015. Our audit addressed the following related questions:

- Did the Board and District officials effectively manage the District's finances by ensuring that budget estimates and fund balances are reasonable?

- Were separation payments calculated correctly?

Audit Results

The Board did not adopt budgets based on historical or known trends. The Board consistently overestimated expenditures between 4 and 11 percent from fiscal years 2012-13 through 2014-15, which generated $4.2 million in operating surpluses. The Board also budgeted for operating deficits during this time by appropriating $400,000 in fund balance each year, but did not need to use these funds

[1] The current Superintendent was appointed to the position in July 2015.

due to the operating surpluses. District officials reduced the year-end fund balance, to stay within the 4 percent limit established by New York State Real Property Tax Law, by making unbudgeted transfers to the capital projects fund and to the District's reserves. When adding back unused appropriated fund balance, the District's recalculated unrestricted fund balance exceeded the statutory limit. It was more than 5.5 percent of the ensuing year's budget in each year.

Further, as of June 30 2015, the District overstated encumbrances by at least $198,771, which understated the amount of available unrestricted fund balance. As a result, unrestricted fund balance was actually 6.3 percent of the 2015-16 budget. These actions diminish the transparency of District finances to District residents. We also found that four of the District's 10 general fund reserves, which had balances totaling $6.3 million as of June 30, 2015, were overfunded or potentially unnecessary.

District officials did not have written policies or procedures governing separation payments and did not maintain adequate supporting documentation for each separation payment. The District's three collective bargaining agreements and three of its individual employment contracts did not clearly indicate at what point in the school year leave is granted or whether the available leave for the current year should be pro-rated if an employee leaves before the end of the school year. We reviewed separation payments totaling $188,276 made to 17 employees. District officials made payments totaling $12,058 to four employees that they could not verify were correct due to ambiguous contract terms.

Comments of District Officials

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 comments on the issues raised in the District's response letter.

Introduction

Background

The East Rochester Union Free School District (District) is located in the Towns of East Rochester, Perinton and Pittsford in Monroe County. The District is governed by the Board of Education (Board), which is composed of five elected members. The Board is responsible for the general management and control of the District's financial and educational affairs. The Superintendent of Schools (Superintendent) is the District's chief executive officer and is responsible, along with other administrative staff, for the day-to-day management of the District under the Board's direction.

The Assistant Superintendent for Finance and Operations (Assistant Superintendent) is responsible for the accounting of the District's finances, maintaining accounting records, preparing financial reports and supervising all functions within the Business Office.

The District has two schools in operation: an elementary and a junior/senior high school, which are located on the same campus. In total, the District has approximately 1,190 students and 220 employees. The District's appropriations for the 2015-16 fiscal year were $26.5 million, funded primarily with State aid and real property taxes.

Objectives

The objectives of our audit were to review the District's financial management and examine the District's calculation of separation payments. Our audit addressed the following related questions:

- Did the Board and District officials effectively manage the District's finances by ensuring that budget estimates and fund balances are reasonable?

- Were separation payments calculated correctly?

Scope and Methodology

We reviewed the District's financial management for the period July 1, 2012 through November 24, 2015 and examined the District's calculation of separation payments for the period July 1, 2013 through November 24, 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. Unless otherwise indicated in this report, samples for testing were selected based on professional judgment, as it was not the intent to project the results onto the entire population. Where applicable, information is presented concerning the value and/or size of the relevant population and the sample selected for examination.

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 comments on the issues 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.

Financial Management

The Board, Superintendent and Assistant Superintendent are accountable to District residents for the use of District resources and are responsible for effectively planning and managing the District's financial operations. One of the most important tools for managing the District's finances is the budget process. District officials must ensure that annual budgets accurately depict the District's financial activity and effectively use available resources. Prudent fiscal management includes maintaining sufficient and appropriate balances in reserves that are needed to address long-term obligations or planned future expenditures. 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.

The Board did not adopt budgets based on historical or known trends. The Board consistently overestimated expenditures between 4 and 11 percent from fiscal years 2012-13 through 2014-15, which generated $4.2 million in operating surpluses. The Board also budgeted for operating deficits during this time by appropriating $400,000 in fund balance each year, which were never used due to the operating surpluses. District officials reduced the year-end fund balance, to stay within the 4 percent limit established by New York State Real Property Tax Law, by making unbudgeted transfers to the capital projects fund and to the District's reserves.

When adding back unused appropriated fund balance, the District's recalculated unrestricted fund balance exceeded the statutory limit each year; it was more than 5.5 percent of the ensuing year's budget. In addition, as of June 30 2015, the District overstated encumbrances and thereby understated the amount of available unrestricted fund balance. Unrestricted fund balance was actually 6.3 percent of the 2015-16 budget. Further, four of the District's 10 general fund reserves, which had balances totaling $6.3 million as of June 30, 2015, were overfunded or potentially unnecessary.

Budgeting and Fund Balance

In preparing the general fund budget, the Board is responsible for estimating what the District will spend and what it will receive in revenue (e.g., State aid), estimating how much fund balance will be available at the fiscal year-end for use to help fund the budget and balancing the budget by determining the expected tax levy. Accurate estimates help ensure that the tax levy is not greater than necessary. Real Property Tax Law allows the District to retain up to 4 percent of the ensuing year's budget for unexpected events and to provide for cash flow. Fund balance in excess of that amount must be used to fund a portion of the next year's appropriations, thereby reducing the tax levy, or used to fund one-time expenditures, pay down existing debt or fund legally-established and necessary reserves.

The Board and District officials adopted budgets that overestimated expenditures by between 4 and 11 percent from fiscal years 2012-13 through 2014-15, totaling over $5 million (see Figure 1). Expenditure variances were generally spread throughout the line items. Employee health insurance had one of the largest variances; it was overestimated by a total of $2.7 million (12 percent) over the three years.[2]

These significant budget variances resulted in operating surpluses that increased available surplus fund balance each year. The District reported operating surpluses in 2012-13 and 2013-14 and an operating deficit in 2014-15. However, the operating deficit resulted from unbudgeted interfund transfers[3] totaling $2.8 million[4] to the capital projects fund, as indicated in Figure 1. Because these were unbudgeted transfers and were not general fund operating expenditures, we analyzed the operating results excluding these transfers to determine the reasonableness of the budget estimates. We found that the District generated operating surpluses totaling more than $4.2 million (an average of $1.4 million a year, 6 percent of the average budget). The Board should include any planned transfers for known capital projects in its adopted budgets to increase transparency.

Figure 1: Budget-to-Actual Results

	2012-13	2013-14	2014-15	Totals
Appropriations	$25,132,776	$25,525,920	$25,286,645	$75,945,341
Actual Expenditures[a]	$22,491,595	$23,690,101	$24,370,649	$70,552,345
Variance	$2,641,181	$1,835,819	$915,996	$5,392,996
% Variance	10.5%	7.2%	3.6%	
Operating Surplus (Revenues[b] - Expenditures[a])	$1,550,825	$1,194,334	$1,484,407	$4,229,566
Unbudgeted Transfers to Capital Projects Fund	$13,676	$150,000	$2,800,000	$2,963,676
District-Reported Operating Surplus/(Deficit)[b]	$1,537,149	$1,044,334	($1,315,593)	$1,265,890

[a] Total expenditures do not include unbudgeted interfund transfers made to the capital projects fund because they were not budgeted and are not actual general fund operating expenditures.

[b] We reduced total revenues for 2012-13 and 2013-14 by amounts (totaling $1,321,771) incorrectly reported as interfund revenues and prior period adjustments, which reflected temporary utilization of reserve funds and should have been recorded as reallocation from restricted to unrestricted fund balance.

2 This positive variance decreased each year.

3 These transfers were not budgeted, but were all Board-approved and for voter-approved projects.

4 This included $1.8 million from the capital reserve approved as part of a capital project proposition in February 2014 (actually transferred May 2015) and a $1 million transfer from surplus unrestricted fund balance approved by Board resolution in June 2015.

The Board also appropriated a total of $1.2 million in fund balance and approximately $1.8 million from reserves (see Reserves section) to finance operations from 2012-13 through 2014-15, which should have resulted in operating deficits and reductions in fund balance and reserves. However, the District did not use any of this budgeted amount for operations due to the operating surpluses, as indicated in Figure 2.

Figure 2: Reported Unrestricted Fund Balance at Year-End

	2012-13	2013-14	2014-15
Total Beginning Fund Balance [a]	$13,657,703	$15,194,852	$16,239,186
Add: Operating Surplus/(Deficit)[b]	$1,537,149	$1,044,334	($1,315,593)
Total Ending Fund Balance	$15,194,852	$16,239,186	$14,923,593
Less: Restricted Funds	$12,956,346	$14,036,896	$12,662,901
Less: Encumbrances	$817,469	$790,824	$799,855
Less: Appropriated Fund Balance for the Ensuing Year	$400,000	$400,000	$400,000
Total Unrestricted Funds at Year-End	$1,021,037	$1,011,466	$1,060,837
Ensuing Year's Budgeted Appropriations	$25,525,920	$25,286,645	$26,520,888
Unrestricted Funds as a Percentage of Ensuing Year's Budget	4.0%	4.0%	4.0%

[a] Beginning fund balance for the 2012-13 and 2013-14 fiscal years excludes reported prior period adjustments that were unnecessary and represent reserve interest and the utilization of reserves. We also decreased reported revenues by the net amount of the prior period adjustments, which were incorrectly reported as interfund revenue in the general fund (instead of a reallocation from restricted to unrestricted fund balance).

[b] Operating surplus/(deficit) calculation (revenues less expenditures) includes interfund transfers.

Because the District made unbudgeted transfers to the capital projects fund, appropriated fund balance to fund operations and funded reserves at year-end, it reported year-end unrestricted fund balance that complied with the 4 percent statutory restriction from fiscal years 2012-13 through 2014-15. However, after adding back unused appropriated fund balance, the District's recalculated unrestricted fund balance was more than 5.5 percent of the ensuing year's budget, and exceeded the statutory limit each year, as indicated in Figure 3.

Figure 3: Unused Fund Balance

	2012-13	2013-14	2014-15
Total Unrestricted Funds at Year-End	$1,021,037	$1,011,466	$1,060,837
Add: Appropriated Fund Balance Not Used to Fund Ensuing Year's Budget	$400,000	$400,000	$400,000
Total Recalculated Unrestricted Funds	$1,421,037	$1,411,466	$1,460,837
Recalculated Unrestricted Funds as Percentage of Ensuing Year's Budget	5.6%	5.6%	5.5%

The Board again appropriated $400,000 in fund balance for the 2015-16 budget; however, we project that it will not be needed. As such, we expect the District's unrestricted fund balance will continue to exceed the statutory limit. The District's practice of consistently 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 4 percent statutory limit imposed on the level of unrestricted, unappropriated fund balance.

In addition, the District has been improperly accounting for encumbrances. Encumbrances are obligations in the form of unfilled purchase orders (POs) or unfulfilled contracts. An appropriation is reserved at the time orders are placed or contracts approved, prior to the actual expenditure of funds. Encumbrances that exist at the end of the fiscal year may be carried over to the next year, but must represent valid commitments for specific expenditures for the current year, and should not be established simply as a means of reducing available year-end fund balance. Encumbrances that are established without a genuine purchase or contractual commitment for the fiscal year they are related to inflate assigned fund balance and circumvent the statutory fund balance limitation.

We judgmentally selected 15 POs totaling $376,560 (47 percent of total encumbrances of $799,855 reported as of June 30, 2015) and identified nine POs (60 percent) totaling $198,771 that did not represent valid encumbrances. All nine POs were issued on June 30, 2015 and were for supplies or services for the 2015-16 fiscal year. Adding back the $198,771 in invalid encumbrances, the recalculated unrestricted fund balance increased to 6.3 percent of the 2015-16 budget. It is likely this amount is greater because, per a cursory review of the list of 614 POs encumbered as of June 30, 2015, we found that a majority of the POs were issued in June 2015 and related to the 2015-16 fiscal year. These encumbrances should not have been reported as encumbrances for the 2014-15 fiscal year-end.

Reserves

Districts may establish reserves, in compliance with applicable laws, to restrict a reasonable portion of fund balance for specific purposes to address long-term obligations or planned future expenditures. District officials should adopt a detailed policy or plan governing the establishment, use and funding levels/goals of reserve funds. While school districts are generally not limited as to how much money can be held in reserves, reserve balances must be reasonable and substantiated. The Board should make clear provisions to raise resources to fund reserves in the proposed budget to give voters and residents the opportunity to know the Board's plan for funding reserves, which increases transparency. When conditions warrant, the Board should reduce reserves to reasonable levels, or liquidate and discontinue a reserve fund that is no longer needed or whose purpose has been achieved in accordance with law. This can be done by transferring unneeded balances to other existing reserves as authorized by applicable laws.

As of June 30, 2015, the District had 10 general fund reserves totaling approximately $12.7 million, which represents 85 percent of its total fund balance. The Board and District officials have not included provisions in the annual budgets for funding the reserves. Instead, District officials used year-end operating surpluses to fund reserves, in amounts totaling $5.3 million over the three years from 2012-13 through 2014-15 (averaging $1.8 million per year). In addition, while District officials budgeted to use reserve funds for operations, which should have decreased reserve balances by approximately $1.8 million over our three-year audit period, most reserves increased significantly instead.

As a result, total restricted fund balance decreased by only $300, which resulted solely from large unbudgeted transfers from capital reserves to the capital projects fund for project expenditures. In certain cases, the Board budgeted to use more money from a reserve than the annual expenditures for the legal purpose of that reserve and, in most cases, the Board both replenished and further funded each reserve every year, in the same month the purported reserve usage was recorded.

During our audit period, the District had an informal reserve expenditure plan that the Board had not adopted, but used in the budgeting process. The reserve expenditures plan included all of the reserve balances and the future anticipated use of each reserve. The plan also included past use of appropriated and undesignated fund balance. However, the plan did not establish planned funding levels for the reserves. After we completed audit fieldwork, the Board formally adopted a more comprehensive fund balance and reserves funding and use plan for 2015-16.[5] The plan generally included the current balance and ideal balance goal, along with brief descriptions of the authorized purpose and past or planned uses of each reserve.

We evaluated the reserve funds for reasonableness and adherence to statutory requirements. We determined that four of these reserves, totaling approximately $6.3 million, were overfunded or potentially unnecessary, as indicated in Figure 4.

Figure 4: General Fund Reserves with Excess Balances

Reserve	2012-13	2013-14	2014-15
Retirement Contribution Reserve	$2,866,109	$2,868,148	$2,781,204
Tax Certiorari Reserve	$1,651,633	$2,162,521	$1,961,005
Unemployment Insurance Reserve	$915,195	$979,640	$1,044,238
Insurance Reserve	$500,891	$501,329	$501,529
Totals	**$5,933,828**	**$6,511,638**	**$6,287,976**

Retirement Contribution Reserve – By law, this reserve can only be used to finance retirement contributions of employees covered

[5] On February 5, 2016, District officials provided us a copy of the plan which was adopted by the Board on January 19, 2016.

by the New York State and Local Retirement System. The District cannot use this reserve to pay contributions for employees covered by the New York State Teachers' Retirement System. The Retirement Contribution Reserve balance has remained consistent and was approximately $2.8 million as of June 30, 2015, which is over eight times the three-year average annual expenditures of approximately $310,000. We question why the Board is continuing to maintain such a substantial balance in this reserve.

The Board's new plan indicated that the District has been utilizing this reserve as a direct offset to the expense for the employees' retirement system. Furthermore, the Board annually authorized transfers to the reserve from annual operating surpluses, to replenish and further fund the reserve, totaling more than $1.3 million over the last three years. These transfers exceeded the $810,000 temporary transfers out by more than $507,000.

Tax Certiorari Reserve – This reserve was established under Education Law to pay judgements or claims arising out of tax certiorari proceedings in accordance with Real Property Tax Law. Pursuant to Education Law, funds reserved for tax certiorari judgements or claims that are not expended for the payment of judgements or claims arising out of tax certiorari proceedings for the tax roll in the year the moneys are deposited to fund, and will not be reasonably required to pay any such judgement or claim, must be returned to the general fund on or before the first day of the fourth fiscal year following their deposit to the reserve fund.

We reviewed the District's list of tax certiorari proceedings provided[6] to support the reserve balance of approximately $2 million as of June 30, 2015. Only four of the cases, with estimated liabilities totaling approximately $83,000, were still in dispute and should have been reserved. The rest of the claims had already been resolved. The District may only maintain money in this reserve to cover the estimated liabilities for currently pending tax certiorari claims. Further, as of August 3, 2015, the four outstanding claims were resolved and the District had no outstanding claims.[7] In addition, the Board made transfers of lump sum amounts into the reserve from operating surpluses at the end of each year, totaling $1 million over the last three years, which did not correlate to estimated liabilities for actual tax certiorari claims filed.

Unemployment Insurance Reserve – This reserve was established under General Municipal Law (GML) to reimburse the State

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6 The District's list included estimated liabilities totaling over $2.3 million for cases dating as far back as 2002.

7 Per representations of the applicable town tax assessors

Unemployment Insurance Fund (SUIF) for payments made to claimants. The District's SUIF three-year average expenditures were approximately $13,000. However, the District has budgeted to use (and recorded a transfer in June from the reserve of) an average of $39,000 annually over the past three fiscal years, which exceeded the actual expenditures made for the legal purpose of this reserve by an average of $26,000, or a total of more than $77,000.

Furthermore, the District continuously funded the reserve in June each year by a total of $400,000 for the last three years, increasing the total balance to approximately $1 million as of June 30, 2015. We question the necessity of this reserve and its substantial balance. Based on the three-year average of expenditures, the District could pay for unemployment insurance costs for over 78 years. The District's goal in its new reserve plan is to maintain a balance of $500,000 in this reserve, which officials represented as 12.5 years of claims at their current rate. However, the District's calculation was based on its average annual budgeted amount of $40,000. Because actual expenditures averaged $13,000, the District's new funding goal[8] would cover more than 38 years of claims at its current rate.

<u>Insurance Reserve</u> – This reserve was established under GML to fund certain uninsured losses, claims, actions or judgements for which the District is authorized or required to purchase or maintain insurance. As of June 30, 2015, the balance in this reserve was $501,529. The District purchases liability insurance to limit the need for substantial reserves to fund insurance claims. Over the last three fiscal years, the District has not used this reserve to pay for uninsured losses. Thus, we question the balance and the necessity of this reserve. The Board's new reserve plan identified a funding goal of 3 percent of the budget (approximately $780,000), yet went on to recognize the limited ability to use the reserve and the potential consideration of future transfers of this balance to a different reserve fund.

Because the District does not include its funding of reserves in the annual budgets, but instead funds reserves with year-end surpluses generated from unrealistic budgets, District officials have not provided District residents with realistic and transparent budget information. In addition, retaining unsubstantiated and potentially excessive reserve balances effectively increases the amount by which the District has exceeded statutory fund balance limits. For example, the addition of the four unsubstantiated reserve balances to the unrestricted fund balance and unused appropriated fund balance as of June 30, 2015 equates to 24 percent of the 2015-16 budget.

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8 Which is half of the reserve's current balance

By maintaining excess fund balance, both restricted and unrestricted, and not using the fund balance appropriated in adopted budgets, District officials are levying more taxes than necessary to sustain District operations. In addition, some current budgeting practices circumvented statutory controls and resulted in fund balance that exceeded the 4 percent statutory limitation.

Recommendations

The Board and District officials should:

1. Adopt budgets that reflect the District's actual needs and include realistic estimates based on historical trends or other identified analysis.

2. Ensure that year-end encumbrances relate to the fiscal year that they are recorded in and avoid recording invalid encumbrances that result in circumventing the fund balance limitation.

3. Review all reserves and determine if the amounts reserved are necessary, reasonable and in compliance with statutory requirements. To the extent that they are not, transfers should be made in compliance with statutory requirements.

4. Fund reserves through budgeted transfers from the general fund, as part of the voter-approved budgets.

Separation Payments

In addition to established wages and salaries, school districts often provide separation payments to employees for a retirement incentive, recognition of years of service or all or a portion of their earned but unused leave time when the employee retires or otherwise leaves district service. These payments are an employment benefit generally granted in negotiated collective bargaining agreements (CBAs) or individual employment contracts and can represent significant expenditures for a district. As such, District officials must be sure that employees are paid only the amounts to which they are entitled, by ensuring each payment is accurate and authorized by a Board-approved employment contract.

District officials should implement written policies and procedures governing the separation payments process that require adequate supporting documentation and evidence of management review for all separation payments. All contracts should have well-defined language that clearly states when leave is granted during the year, whether earned leave is pro-rated if an employee leaves the District before the end of the school year, and if unused leave balances can be paid out upon an employee's separation from District employment.

The District has three CBAs and nine individual employment contracts that stipulate the terms and benefits for its employees. All of these contracts include provisions for eligible employees to receive a payment upon separation from the District. District employees use a resignation/termination checklist to calculate employees' separation payments and have implemented informal review and approval procedures. However, District officials have not developed written policies and procedures to formalize this process.

The District had 47 employees who retired, resigned or otherwise separated from the District during our audit period and were eligible for separation payments based on their position. Of these, 17 employees received separation payments totaling $188,276 for either recognition for years of service, a retirement incentive or all or a portion of their unused leave time. We found that, except for one minor exception that we discussed with District officials, employees received the proper amount upon separation from the District. However, some of the supporting documentation for these separation payments was inadequate or inconsistent. Specifically, we found four instances with no checklist included, six instances with no evidence of review of a checklist, three instances that did not include salary notices that agreed with the separation payment made and two instances that lacked supporting leave and accrual records. Supporting documentation for certain individuals had multiple deficiencies.

Further, the District's three CBAs and three of its individual employment contracts did not clearly indicate at what point in the school year the leave is granted[9] or whether the available leave for the current year should be pro-rated if an employee leaves before the end of the school year. As a result, four employees received payments totaling $12,058 (6 percent) for which District officials could not support that they made correct calculations due to the ambiguous contract terms. Absent clear contract language, the District used the more cost-effective approach of pro-rating leave and only paid for leave earned for the portion of the year worked. However, clearer contract language would prevent potential misinterpretation of or dispute over the contract provisions.

Written policies and procedures and well-defined contract language within all CBAs and individual employment contracts would help prevent any confusion or misunderstandings regarding the separation payment process.

Recommendations

District officials should:

5. Develop written policies and/or procedures to govern the separation payments process.

The Board should:

6. Ensure that all contracts have well-defined language clearly stating when leave is granted during the year (i.e., if leave is accrued throughout the year and is pro-rated when an employee leaves before the end of the year). Contracts also should state if and when unused leave balances can be paid out upon an employee's separation from District employment.

District officials and staff should:

7. Ensure that all separation payments have adequate and consistent supporting documentation with evidence of appropriate review.

[9] For example, if the full amount of leave for the year is credited at the start of the fiscal year or pro-rated at a specific rate throughout the year.

APPENDIX A

RESPONSE FROM DISTRICT OFFICIALS

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

East Rochester Schools, District

222 Woodbine Ave. East Rochester, NY 14445 (585) 248-6302 Fax: (585

Website: http://www.ers

June 1, 2016

Mr. Edward V. Grant, Jr., Chief Examiner
Office of the State Comptroller
The Powers Building
16 West Main Street – Suite 522
Rochester, NY 14614

Dear Mr. Grant:

The East Rochester Union Free School District has received and reviewed the draft Financial Management Report of Examination for the audit period July 1, 2012 – November 24, 2015. On behalf of the Board of Education and administration, we appreciate this opportunity to respond to the findings and to provide our responses to the audit recommendations.

The Comptroller's Office performed a comprehensive examination of the District's financial practices. We appreciate the collaborative and professional manner in which the auditors conducted the audit. We are proud that in nearly four months of the audit fieldwork, no fraud, waste or abuse was detected during this examination.

This audit, the fourth in the last eight years, focused on the District's separation of pay calculations and financial management practices. The Board of Education and District administration strive to achieve and maintain the highest standard of fiscal management by seeking the highest quality of instruction for our students first while remaining focused on the financial strain placed on the community when taxes are increased.

We have a commitment to long-range and responsible planning when developing budgets. This focus has allowed the District to weather economic down-turns, state aid reductions, unfunded mandates, sharp pension cost increases while maintaining an average levy increase of 1.41% over the past eight years. Our commitment and partnership with our taxpayers precedes the legislative tax cap. This is well demonstrated by our budget and capital project vote passage rates.

In this reply letter, we have included both the District's response and the corrective action plan. The corrective action plan was reviewed and approved by our audit committee on May 24, 2016 and is anticipated to be approved by our Board of Education at its June 21, 2016 meeting.

Audit Recommendation #1: *Adopt budgets that reflect the District's actual needs and include realistic estimates based on historical trends or other identified analysis.*

District Response:

Our District uses a comprehensive, conscientious approach to budget development. We identify current expenditure and revenue trends, we engage instructional departments to identify curriculum and instructional needs to improve the quality of education for students, and we examine 5-year expenditure and revenue trend data. This information allows us to establish short and long-term budget priorities, and assess the impact of current budget decisions on future budgets.

Our District is fiscally diligent and committed to not over-spending the budget. We focus on partnerships with the community and neighboring school districts whenever possible to streamline services to ensure that we minimize costs for maximum efficiency. This practice allows us to maintain the quality educational opportunities that our community expects and deserves. Good budget practice indicates that a budget should be conservative enough to meet its obligations. State law allows contingency appropriations of up to 10% for counties, towns, and villages. Education Law does not contain provisions relative to school district contingency accounts and no state agency has established guidance. The District expended, on average, approximately 93% of the budgeted expenditures during the audit period.

The District reviews budget documentation extensively in open session and works to ensure that it's financially prepared to meet students' needs, sustain operations, and manage emergencies. Moody's Investor Services has commended our budget practices in granting East Rochester Union Free School District an Aa3 rating, in the top tiers of the rating system.

See Note 1 Page 24

The tax cap directive placed on school districts only adds to the financial pressure of each budget decision made by our District. Each year forms a new base, and a budget deficit is not easily corrected. Our administrators must operate to be financially solvent while maintaining highly qualified staff, providing educational tools, technology, and curriculum. In addition, the District must provide a safe, comfortable, energy-efficient learning environment. Our community has been tremendously supportive of our school. We value the trust they place in us by communicating openly and making decisions in the best interest of students.

Action Plan:

Our District will continue to prepare conservative, 5-year trend data analysis budgets in an attempt to offset unforeseen increases in costs and/or mid-year State aid revenue reductions. We will remain fiscally responsible to our community. We will continue to be forward-thinking by following our long-range financial plan.

Audit Recommendation #2: *Ensure that year-end encumbrances relate to the fiscal year that they are recorded in and avoid recording invalid encumbrances that result in circumventing the fund balance limitation.*

District Response:

Our District maintains the highest standards when authorizing encumbrances. An encumbrance is a commitment to expend resources for goods and services that have not yet been received or completed at fiscal year-end. The District has strict internal controls in place to ensure a purchasing request complies with District purchasing policy and is reviewed by multiple individuals prior to becoming a financial commitment to the District. As long as the commitment is proven valid with all appropriate documentation and the District has approved the encumbrance by June 30 each year, then the District meets the legal requirement of a valid and proper encumbrance. Once the goods or services have been rendered in the following fiscal year, the encumbrance is liquidated. As part of our District's external audit each year, encumbrances are reviewed for validity and compliance with District purchasing policy. During the last several years of external, independent, annual audits, the District has never received a management comment regarding invalid or excessive encumbrances.

See Note 2 Page 24

Action Plan:

The District will continue to apply purchasing policy and standards to all purchasing requests. Going forward, purchasing requests at fiscal year-end will be reviewed by an additional administrator prior to final approval as an encumbrance.

Audit Recommendation #3: *Review all reserves and determine if the amounts reserved are necessary, reasonable and in compliance with statutory requirements. To the extent that they are not, transfers should be made in compliance with statutory requirements.*

District Response:

Annually, the Board and Administration review reserve balances and discuss planning strategies for anticipated on-going expenditures, replacement projects, District technology initiatives, and current funding strategies. In December 2015, Administration presented the Board with a comprehensive District Reserve Plan encompassing the historical practice already in place. The Board officially adopted this Reserve Plan at the January 19, 2016 board meeting. The Board also reviews and adopts a formal resolution each year establishing restrictions on amounts funded to each reserve.

It is important to recognize that approximately half of the total District reserve balances is designated to Capital Reserves. Voter authorization is required for both the establishment of the Capital Reserves and for payments from this type of reserve, making it very restrictive and a very useful mechanism in keeping taxes from increasing with necessary capital improvement work, Technology initiatives, or large equipment purchases.

This audit review identified four reserves as being potentially overfunded: the Retirement Contribution Reserve, Tax Certiorari Reserve, Unemployment Reserve, and the Insurance Reserve.

Retirement Contribution Reserve: This reserve was authorized by the state legislature in reaction to the significant increases in retirement contribution rates faced by municipalities and school districts. Its purpose is to set aside funds to limit the property tax impact of increases in employer contribution rates for the Employees' Retirement System. In accordance with our District reserve plan, we anticipate funding this reserve when retirement rates are below long-term averages and utilizing it when rates exceed long-term averages.

No state agency has provided guidance on the appropriate level of funding in this reserve.

Action Plan:

As part of the ongoing reserve planning process, the Board will examine the funding level in this reserve. As part of the 2016-17 budget planning process, it is proposed that approximately 80% of the Employees' Retirement system expenditure will be paid by directly appropriating monies in this reserve. The Board adopted the 2016-17 budget at the April 19, 2016 board meeting. This review process will continue annually.

See Note 3 Page 24

Tax Certiorari Reserve: The District reserves approximately 83% of the outstanding tax certiorari cases in our possession. Education Law states that amounts not necessary to refund taxes must be returned to the unreserved fund balance of the general fund by the first day of the fourth fiscal year following the year for which the reserve was created. While we do have funding set aside for tax certiorari cases more than 4 years old, the District has not yet received closing statements on these cases. In 2012, the District paid approximately $100,000 for a six-year old tax certiorari case. In 2015, the District paid approximately $450,000 for another six-year old tax certiorari case. On May 5, 2016, the District received a judgement for a tax certiorari proceeding dating back 6 years and ordering the District to pay approximately $20,000. In each of these cases, the judge ordered assessment corrections dating back six years. The District fully utilizes the Tax Certiorari Reserve each year for payment of any notice of claim associated with an assessment reduction.

Action Plan:

As part of the ongoing reserve planning process, the Board will examine the funding level in this reserve. Input will be solicited from the Town Assessor and District attorneys as to the validity of past notices of claim in order to establish a substantiated amount in the reserve.

Unemployment Reserve: The District utilizes this reserve to directly offset the expenses in unemployment claims each year. During the budget process, the amount used to offset the expense is based on information we have at the time of budget development. If the actual expenditure turns out to be lower than anticipated, the transfer from the reserve to cover this expenditure is also lowered to reflect the correct amount. Looking at past unemployment expenses is not a realistic approach to fiscal management given current economic uncertainties. Our District has funded this reserve in recent years in order to protect against multi-person layoffs. Should the District be forced to have layoffs like many Districts throughout the state, our District would have significant increases to our unemployment expenses. If there is a decrease in state aid, program reductions may result in the elimination of positions in order to present a reasonable budget to our voters.

Action Plan:

Although our District appropriately funded this reserve in accordance with General Municipal Law, the Board will examine the funding level in this reserve as part of the ongoing reserve planning process. Our District board-approved reserve plan states that discussion will begin regarding the possible moving of $500,000 from this reserve to a Workers' Compensation Reserve in order to offset the growing claims for Workers' Compensation.

Insurance Reserve: The District established this reserve in 2011 to cover uninsured losses. This reserve is not intended for use on an ongoing basis; rather, it protects the District in case of a catastrophic event or an event not covered by the District insurance policy.

Action Plan:

As part of the ongoing reserve planning process, the Board will examine the funding level of this reserve and begin considering whether transferring a portion of the reserve balance to another reserve is a more efficient use since the District has not used this reserve in several years.

Audit Recommendation #4: *Fund reserves through budgeted transfers from the general fund, as part of the voter-approved budgets.*

District Response:

The District's commitment to transparency and long-range planning is exemplified by its approach to both reserves and use of surplus as a way to minimize future costs. As stated previously, the District now has a comprehensive, Board approved Reserve Plan. As part of the annual budget development process, reserve balances and their utilization are discussed in open forum at budget workshops and board meetings. This review encompasses the statutory requirements, funding levels, and activity in each reserve. Each board meeting and budget workshop is televised and presentations posted to the District website following the meeting.

The audit review indicates that "fund balance in excess of 4% must be used to fund a portion of the next year's appropriations – thereby reducing the tax levy – or used to fund one-time expenditures, pay down existing debt or fund legally-established and necessary reserves." We realize this audit focused on the review of past data but the District has been very proactive in utilizing surplus to reduce future expenditures. For example, in 2014-15 the voters authorized by means of public vote to allow a $1.8 million draw from the District Capital Reserve for the purpose of funding the local portion of an upcoming capital project. Also in 2014-15, the Board passed a formal resolution and followed the legal process to move $1 million dollars from the general fund to the capital fund in order to reduce borrowing for the aforementioned capital project. The District directly funded this one-time capital project expenditure, reduced the amount of debt to be issued, and reduced interest costs to taxpayers as well as the state.

Action Plan:

As part of the continued focus on long-term financial planning and commitment to our taxpayers, the Board will discuss appropriate funding of reserves and appropriate surplus levels in relation to the overall budget process.

Audit Recommendation #5: *Develop written policies and/or procedures to govern the separation payments process.*

District Response:

The District created and is using a form entitled, "Uniform Separation from District Checklist" to use in combination with accompanying documentation for any employee leaving the District. The calculations are uniform and reviewed by both the Assistant Superintendent for Business & Operations, as well as the Superintendent of Schools.

Action Plan:

The District will continue to develop and enhance our current practices with regards to separation of pay calculations. During 2016-17, the District will review all Policy regulations to determine accuracy and any need for modification or enhancement.

Audit Recommendation #6: *Ensure that all contracts have well-defined language clearly stating when leave is granted during the year (i.e., if leave is accrued throughout the year and is pro-rated when an employee leaves before the end of the year). Contracts also should state if and when unused leave balances can be paid out upon an employee's separation from District employment.*

District Response:

The District has contracted with an individual to review contract language in order to present information at the next phase of union negotiations. The language used for an employee's separation from the District will be a topic for future review.

Action Plan:

Administration will continue to review contract language and strive to eliminate ambiguous contract terms and inconsistencies in the overall language. Upon review, negotiations with respective bargaining units will be necessary to change any language inconsistencies.

Audit Recommendation #7: *Ensure that all separation payments have adequate and consistent supporting documentation with evidence of appropriate review.*

District Response:

The District created and is using a form entitled, "Uniform Separation from District Checklist" to use in combination with accompanying documentation for any employee leaving the District. The calculations are uniform and accurate and reviewed by both the Assistant Superintendent for Business & Operations, as well as the Superintendent of Schools.

Action Plan:

Going forward, the District will ensure that separation payments are based upon data contained within our financial system, either in electronic or document form, and which originate from Board approved reports and approved employment contracts or memoranda of agreement.

The East Rochester School District appreciates the collaboration, thorough effort and communication with the auditors throughout the process. We are committed to the use of taxpayer resources in an efficient, effective and responsible manner. Your audit is an important perspective and will provide guidance as we continue to make the best decisions possible for our community and our students.

Colette Morabito
Board of Education President

Dr. Mark D. Linton
Superintendent of Schools

APPENDIX B

OSC COMMENTS ON THE DISTRICT'S RESPONSE

Note 1

Bond rating services analyze the risk to investors of an entity's indebtedness. They are not concerned if District residents' excess funds are accumulated. Our audit analyzed the District's finances on behalf of the residents.

Note 2

Compliance with the District's procurement policy does not equate to proper encumbrance accounting. The primary purpose of encumbrance accounting is to enhance budgetary control. Encumbrances recorded at year-end must represent valid commitments for goods or services budgeted for and ordered during that year just ended but not yet received. Recording approved purchase orders for the ensuing school year as year-end encumbrances is an improper practice that should not be used to reduce available year-end fund balance to within the statutory limit.

Note 3

This is consistent with the budgeting practices from prior years. To date, this practice has not resulted in the actual use of and reduction in the reserve balance, because the District immediately replenishes and often further increases the reserves using operating surpluses generated by its overly conservative budgets.

APPENDIX C

AUDIT METHODOLOGY AND STANDARDS

The objectives of our audit were to review the District's financial management for the period July 1, 2012 through November 24, 2015 and examine the District's calculation of separation payments for the period July 1, 2013 through November 24, 2015. To achieve our audit objectives and obtain valid evidence, we performed the following procedures:

- We interviewed District officials to gain an understanding of the budget process. We reviewed financial information provided to the Board and reviewed the Board minutes to determine the reports provided to the Board.

- We reviewed the District's reserve policy and multiyear financial and capital plans for adequacy.

- We reviewed the general fund's results of operations for fiscal years 2012-13 through 2014-15.

- We compared the general fund's budgeted revenues and expenditures to the actual revenues and expenditures for fiscal years 2012-13 through 2014-15.

- We analyzed the total fund balance, including the use of reserves, in the general fund for the fiscal years 2012-13 through 2014-15.

- We reviewed the budget for the current fiscal year (2015-16) to determine if the District had made any significant changes to its budgeting practices.

- We reviewed District reserve accounts and related expenditures to determine if reserves were properly and legally established, if they were being funded or used and if their balances were reasonable.

- We interviewed District officials and staff to gain an understanding of the District's processing and approval of separation payments and controls over the computerized financial software.

- We reviewed the negotiated collective bargaining agreements and individual employment contracts to identify terms authorizing separation payments.

- The District provided data directly from the computerized financial software and we analyzed it electronically using computer-assisted techniques.

- We reviewed Board minutes, analyzed District employee listings, inquired with District officials and reviewed results of the analysis of the electronic data to identify all employees who were eligible for separation payments based on position and all separation payments made during our audit period.

- We identified and reviewed all 47 employees who were eligible for separation payments based on position who left District service to determine if they received a separation payment.

- We examined the supporting documentation of the 17 employees who received separation payments during our audit period to determine if the payments were supported and correctly calculated according to the Board-approved agreements.

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 objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

APPENDIX D

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