Office of the New York State Comptroller

Division of Local Government & School Accountability

Indian River Central School District

Financial Condition

Report of Examination

Period Covered:

July 1, 2014 – March 31, 2016

2016M-287

Thomas P. DiNapoli

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State of New York
Office of the State Comptroller

Division of Local Government
and School Accountability

November 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 Indian River Central School District, entitled Financial Condition. 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 Indian River Central School District (District) is located in the Towns of Alexandria, Antwerp, Le Ray, Orleans, Pamelia, Philadelphia and Theresa in Jefferson County and the Town of Rossie in St Lawrence County. The District is governed by the Board of Education (Board), which is composed of nine 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 along with other administrative staff is responsible for the District's day-to-day management under the Board's direction. The District Business Manager (Business Manager) plays a key role in the budget development process and daily administration of the business office.

The District's budgeted appropriations for the 2015-16 fiscal year were approximately $87.3 million, which were funded primarily with State aid, federal Impact Aid[1] (Impact Aid) and real property taxes.

The District operates eight schools with approximately 4,000 students and 690 employees. The District's student population is impacted greatly by its proximity to the military base at Fort Drum and fluctuates depending on the military staffing level at Fort Drum Army Base.[2] The student population attributed to the military base averaged 66 percent from 2010-11 through 2014-15. As a result, the District was eligible to receive significant Impact Aid.

Objective

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

- Did the Board and District officials develop realistic budgets that were transparent to residents and ensure that fund balance was reasonable?

Scope and Methodology

We examined the District's financial activities for the period July 1, 2014 through March 31, 2016. We extended our scope back to the 2010-11 fiscal year for financial trend analysis.

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1 The Impact Aid law (now Title VIII of the Elementary and Secondary Education Act of 1965 (ESEA)) provides assistance to local school districts with concentrations of children residing on Indian lands, military bases, low-rent housing properties or other federal properties and, to a lesser extent, concentrations of children who have parents in the uniformed services or employed on eligible federal properties who do not live on federal property.

2 The student population was 3,976 for 2010-11, 4,178 for 2011-12, 4,089 for 2012-13, 4,230 for 2013-14 and 4,042 for 2014-15.

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. District officials generally agreed with our recommendations and indicated they plan to initiate corrective action. Appendix B includes our comments on 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 Condition

A district's financial condition is a factor in determining its ability to fund public educational services for students. The responsibility for accurate and effective financial planning for the use of District resources rests with the Board, the Superintendent and the Business Manager. The Board is responsible for adopting realistic budgets and for ensuring that fund balance does not exceed the amount allowed by law. Fund balance represents the cumulative residual resources from prior fiscal years. New York State Real Property Tax Law (RPTL) requires that unrestricted fund balance cannot exceed 4 percent of the subsequent year's appropriations. The Board should prepare a multiyear operational plan based on reasonable estimates that project future revenues, expenditures and fund balance amounts.

The Board and District officials did not develop reasonable budgets or effectively manage the District's financial condition to ensure that the general fund's unrestricted fund balance was within the statutory limit. Over the last 5 years, District officials underestimated revenues by $74.2 million and overestimated expenditures by $22.3 million. The District appropriated over $81 million[3] in fund balance, but only needed about $4.7 million to finance operations. Further, officials increased the tax levy by almost $250,000 (or 8.2 percent) over the last four years. Overall, these budgeting practices generated approximately $15.2 million in operating surpluses. District officials also improperly reported about $862,000 of unrestricted fund balance in the debt service fund. As a result, the District's recalculated year-end unrestricted fund balance exceeded the 4 percent statutory limit by up to 27 percentage points. Finally, the District's long-range financial plan does not show detailed projections and its effect on fund balance levels.

Budgeting and Fund Balance

The Board and District officials are responsible for preparing and presenting the District's budget to the public for vote. In preparing the budget, District officials must estimate what the District will receive in revenue (e.g., State aid), how much fund balance will be available at fiscal year-end (some or all of which may be used to fund the subsequent year's appropriations) and, to balance the budget, what the expected tax levy will be. Accurate estimates help ensure that the levy of real property taxes is not greater than necessary. RPTL limits the amount of unrestricted fund balance a school district can retain to no more than 4 percent of the next year's budgetary appropriations.

[3] 2009-10 appropriated fund balance for the ensuing years budget was $13,653,787.

We compared the District's budgeted revenues and appropriations with actual results of operations for fiscal years 2010-11 through 2014-15. District officials underestimated revenues by over $74.2 million and overestimated expenditures by nearly $22.3 million, or a total budget variance of $96.5 million. (Figure 1).

Figure 1: Budget-to-Actual Comparison of Revenues and Expenditures

Fiscal Year	2010-11	2011-12	2012-13	2013-14	2014-15	Totals
Estimated Revenues	$54,900,952	$56,656,294	$60,401,535	$62,062,371	$65,970,569	$299,991,721
Actual Revenues	$64,983,401	$66,999,394	$83,335,185	$79,084,485	$79,807,134	$374,209,599
Amount Over Budget	$10,082,449	$10,343,100	$22,933,650	$17,022,114	$13,836,565	$74,217,878
Budgeted Appropriations	$68,554,739	$71,099,455	$75,524,149	$79,997,182	$86,089,003	$381,264,528
Actual Expenditures	$63,239,271	$66,650,475	$69,843,912	$83,769,901[a]	$75,505,636	$359,009,195
Amount Over/(Under) Budget	($5,315,468)	($4,448,980)	($5,680,237)	$3,772,719	($10,583,367)	($22,255,333)
Total Over/(Under) Budget	$15,397,917	$14,792,080	$28,613,887	$13,249,395	$24,419,932	($96,473,211)

[a] Officials made an unbudgeted transfer of $10,229,416 to the capital fund. Without this transfer, actual expenditures would have been $73,540,485 with a budget variance of ($6,456,697).

The District applies for Impact Aid every year in January for the following fiscal year. The District received Impact Aid for Basic Support Payments for Local Educational Agencies (LEAs) and for Basic Support Payments for Heavily Impacted LEAs. Impact Aid has accounted for over 32 percent of the District's annual revenues over the fiscal years 2010-11 through 2014-15. For fiscal years 2010-11 through 2014-15 District officials estimated federal aid of $52 million and received almost $121 million, a difference of $69 million. District officials told us uncertainties with the federal budget process, possible sequestration, their eligibility for high impact federal aid and the timing of the revenues were the primary reasons for the differences.

Over the five-year period, overbudgeted appropriations included teacher salaries ($8,388,883), Board of Cooperative Educational Services ($7,243,781), fuel ($3,514,687), medical insurance ($2,727,348) and transportation costs ($1,320,941). District officials stated that they begin the budget process in October and base budgeted appropriations on an estimated enrollment projection for the coming school year. District officials stated they take a conservative approach in budgeting for enrollment and related appropriations. However, the projected enrollments did not materialize which resulted in less expenditures.

As indicated in Figure 2, the District reported unrestricted fund balances that generally complied with the 4 percent statutory limitation during the five years reviewed. However, District officials used certain budgeting practices − including appropriating fund balance that was never used and inappropriately reporting general fund moneys in a debt service fund – that make it appear the District had less unrestricted fund balance than it actually had.

Figure 2: Unrestricted Fund Balance at Year-End					
Fiscal Year	2010-11	2011-12	2012-13	2013-14	2014-15
Total Beginning Fund Balance	$15,622,855	$17,366,985	$17,715,904	$31,207,177	$26,521,761
Add: Operating Surplus/(Deficit)	$1,744,130	$348,919	$13,491,273	($4,685,416)	$4,301,498
Total Ending Fund Balance	$17,366,985	$17,715,904	$31,207,177	$26,521,761	$30,823,259
Less: Restricted Funds	$35,000	$89,000	$10,000,000	$4,000,000	$4,000,000
Less: Encumbrances	$97,890	$51,345	$255,482	$50,834	$74,362
Less: Appropriated Fund Balance for the Ensuing Year	$14,443,161	$15,122,613	$17,934,811	$20,067,600	$22,443,274
Total Unrestricted Funds at Year-End	$2,790,934	$2,452,946	$3,016,884	$2,403,327	$4,305,623
Ensuing Year's Budgeted Appropriations	$71,099,454	$75,524,147	$79,997,182	$86,089,003	$87,301,523
Unrestricted Funds Balance as a Percent of Ensuing Year's Budget	3.93%	3.25%	3.77%	2.79%	4.93%

Appropriated Fund Balance – Districts may use or appropriate a portion of the fund balance as a financing source for the budget. The District appropriated over $81 million in fund balance as a financing source for 2010-11 through 2014-15 budgets even though it only needed about $4.7 million (or 5.8 percent) as a financing source. As a result, the appropriation of fund balance reduced the level of unrestricted fund balance at fiscal year-end to almost the 4 percent limit.

Debt Service Fund – Debt service funds are used to account for and report the accumulation of resources that are restricted, committed or assigned to the payment of principal and interest on long-term debt.[4] These funds should be used for debt service payments on that debt.

The District maintained a debt service fund with a balance of approximately $862,000 as of June 30, 2015. District officials told us that these funds related to a capital project were approved in 1999 and the bonds related to this project were defeased and refunded in 2011 and 2012. However, because the money is not restricted, committed or assigned to existing debt service obligations, it is unassigned and should have been reported in the general fund. In effect, District officials circumvented the statutory limit imposed on the level of unrestricted fund balance by reporting this money in the debt service fund.

[4] A debt service fund must be established and maintained to account for the proceeds of a sale of a capital asset with outstanding debt, or if State or federal aid is received for a capital improvement for which there is outstanding debt. If a district has residual bond proceeds and/or interest earned on bond proceeds upon completing a project, those moneys must be maintained in the debt service fund and used to pay debt service on any related obligations.

The unnecessary appropriation of fund balance and the improper moneys in the debt service fund made it appear that the District's unrestricted fund balance was generally within the 4 percent statutory limit. When these amounts were added back, the District's recalculated unrestricted fund balance exceeded the 4 percent statutory limit each year by up to 27 percentage points. (Figure 3)

Figure 3 - Unused Fund Balance

Fiscal Year	2010-11	2011-12	2012-13	2013-14	2014-15
Total Unrestricted Funds at Year-End	$2,790,934	$2,452,946	$3,016,884	$2,403,327	$4,305,623
Add: Debt Service Fund Balance	$857,484	$860,142	$861,576	$862,126	$862,126
Add: Appropriated Fund Balance Not Used to Fund Ensuing Year's Budget	$14,443,161	$15,122,613	$17,934,811	$20,067,600	$22,443,274
Total Recalculated Unrestricted Funds	$18,091,579	$18,435,701	$21,813,271	$23,333,053	$27,611,023
Recalculated Unrestricted Funds as Percentage of Ensuing Year's Budget	25.45%	24.41%	27.27%	27.10%	31.63%

Despite having excessive unrestricted fund balance, the District increased the tax levy by $248,217 from about $3 million in 2010-11 to $3.3 million in 2014-15, an increase of about 8.2 percent.[5] The result of the District's budgeting practices made it appear that the District needed to use fund balance and raise taxes to close projected budget gaps.

These budgeting practices will continue through the 2015-16 fiscal year, as officials anticipate an operating surplus of about $13 million. As a result, the $22 million of appropriated fund balance will not be needed to finance operations. Therefore, the unrestricted fund balance will continue to exceed the statutory limit.

By maintaining excessive or unnecessary fund balance, a result of ongoing budgeting practices that routinely generated operating surpluses, the Board and District officials have withheld significant funds from productive use and levied property taxes that were higher than necessary. These practices decrease the transparency of District finances to its residents.

Multiyear Planning

An effective multiyear plan projects operating needs and financing sources over a three- to five-year period. Such plans allow District officials to identify developing revenue and expenditure trends and set long-term priorities and goals. A multiyear operational plan can also help District officials to assess the effects and merits of alternative approaches to address financial issues, such as using unrestricted fund balance to finance operations. Long-term operational plans work in conjunction with Board-adopted policies and procedures to provide necessary guidance to employees on the financial priorities and goals

[5] Actual number calculation: ($3,278,052-$3,029,836)/$3,029,836 = 8.2 percent

set by District officials. Additionally, District officials should monitor and update long-term operational plans on an ongoing basis to ensure that their decisions are guided by the most accurate information available.

Although the Board has formally adopted a multiyear operational plan, it does not clearly show revenue and expenditure trends, and the effect, on fund balance. A comprehensive long-term plan could help the Board address the excessive unrestricted fund balance. Annually, the Business Manager documents and discusses with the Board anticipated projections of major revenues and expenditures in a narrative report that details the reasons for those projections. In addition, the Business Manager maintains a four-year operational plan which shows prior year revenues and expenditures, current year estimates and the next two years' projections. However, the Business Manager does not provide this information to the Board. After our audit period, the Business Manager began providing these projections to the Board.

It is important for the Board and District officials to develop an effective multiyear operational plan so they can better manage the use of the District's unrestricted fund balance and establish practical goals to ensure that such use is in the best interest of District residents.

Recommendations

The Board and District officials should:

1. Develop realistic estimates of revenues and appropriations and the use of fund balance in the annual budget.

2. Ensure that the amount of the District's unrestricted fund balance is in compliance with the limit established by RPTL.

3. Develop a plan to reduce the amount of unrestricted fund balance in a manner that benefits District residents, including:

   - Funding one-time expenditures;

   - Funding needed reserves; and

   - Reducing District property taxes.

4. Return moneys improperly residing in the debt service fund to the general fund.

5. Ensure the multiyear operational plan clearly shows revenue and expenditure trends, and the effect, on fund balance.

APPENDIX A

RESPONSE FROM DISTRICT OFFICIALS

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

Indian River Central School District
32735B Co. Rt. 29
Philadelphia, New York 13673

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October 20, 2016

Office of the State Comptroller
Binghamton Regional Office
ATTN: Chief Examiner
State Office Building, Suite 1702
44 Hawley Street
Binghamton, NY 13901-4417

Dear Mr. Eames:

This is a written response to the recent audit of the Indian River Central School District, Philadelphia, New York. We generally concur with the auditors findings and would like to thank them for their professionalism and understanding in dealing with a complex budget situation. We note that the auditors listened to the unique issues facing Indian River as a recipient of Federal Impact Aid and spent a considerable amount of time trying to understand the unique underlying issues created through the receipt of this aid stream. Having this aid, which represents a payment in lieu of taxes for all of the children living on non-taxable Federal lands, brings both opportunities and challenges. The auditors spent the time to appreciate both.

The major issue in this report is fund balance. In general, fund balance comes from overbudgeted appropriations, underestimated revenues, and unappropriated fund balance from the prior year. The focus of this five year report weighs heavily on the budgeting and overbudgeted appropriations aspect of the District's financial operations, but an examination of Figure 1 shows that, of the over/under budget figure of $96,473,211, overbudgeted appropriations represents $22,255,333, or 23.1% of that total. This is largely due to attempting to be prepared for an extremely volatile student enrollment during the period and the report accurately shows where these funds were in the budget.

The remainder (76.9%) of the over/under budget figure lies in underestimated revenues, and this directly impacts fund balance. The bulk of the miss on revenue projections is in Federal revenues (Impact Aid), and the District's position and experience is that this is due to three major factors. These are: the impacts of sequestration; the failure of Congress to enact a budget on time which leads to unpredictability of aid flows and late aid payments; and the unanticipated receipt of Heavily Impacted Aid. Thus, with over three quarters of the budgeting variations lying in revenues, the District's response to the report will largely focus on those issues to put

(315) area code
District Office - 642-3441 High School - 642-3427 Middle School - 642-0125 Intermediate School - 642-0405
Antwerp Primary - 659-8386 Calcium Primary - 629-1100 Evans Mills Primary - 629-4331
Philadelphia Primary - 642-3432 Theresa Primary - 628-4432 District Pupil Personnel Services - 642-0100
Transportation - 642-0331 Building & Grounds - 642-0338 Food Services - 642-1250

them into the spotlight, in particular since the majority of that revenue number was in Impact Aid.

The District would point out that, contrary to the assertion made in the audit report that the District had engaged in "appropriating fund balance that was never used," the majority of the fund balance was used, but it was replaced with new revenues, mostly Impact Aid, which were appropriated into the next year. The resulting fund balance numbers are the same; the discussion focuses on how the District ended up with those numbers.

See Note 1 Page 16

The audit had five recommendations. These will be addressed in order:

1. Develop realistic estimates of revenues and appropriations and the use of fund balance in the annual budget.

The District is mindful of the need to be realistic in its budget planning, but is also faced with a high degree of uncertainty when budgeting for a highly mobile, military population on Fort Drum. Children from military families represent 60-65% of the student population in the district, and they are subject to both voluntary and involuntary moves related to deployments and permanent changes of station for the military member. Fort Drum underwent a period of expansion from 2008 through 2012, but began to contract in 2013. The District budgeted conservatively in order to be sure that, in this uncertain enrollment environment, it had the resources to provide a free, appropriate public education for all enrolled students. Once the military deployment schedule began to settle out as combat forces were withdrawn from Iraq and Afghanistan, the size of the contingent on Fort Drum declined. For 2015-16 the District planned for a stable population, and for 2016-17 the District planned for a slight decline in enrollment. The adjusted budget declined from $89,375,885 to $85,236,911 reflecting that decline. We now anticipate stability in the population (barring yet another world event requiring a military response), and the excessive caution previously in budgeting appropriations will become more normalized over the next five years. Nevertheless, the uncertainty around Impact Aid receipts remains a concern, and the District will continue to budget at around 60% of the systems proration formula (the LOT formula) while appropriating excess receipts into the next year via fund balance. Because impact aid is received so late in the school year, this is a common sense approach. The goal, however, is to have a fund balance no greater than 10% of the budget appropriation, and appropriating the unrestricted fund balance into the next year to comply with the limits of RPTL 1318. The Board and Administration will keep these goals at the forefront of the budget development cycle in the upcoming years.

See Note 2 Page 16

2. Ensure that the amount of the District's unrestricted fund balance is in compliance with the limit established by RPTL.

As noted by the auditor, the District generally complied with the 4% limitation over the five years reviewed. District leadership is very much aware of this limit and works diligently to maintain the unrestricted fund balance within the limits. The key to this is not to have unanticipated receipts of aid. Given that the District is no longer eligible for Heavily Impacted Aid under §7003(b)(2) of the Elementary and Secondary Education Act, as amended, predicting aid flows will become easier. As the audit team learned, during the years in question the District received Heavily Impacted Aid, either for the current year or for prior years, sometimes several years at once. This complicated planning. This factor no longer exists. The Board will continue to pay close attention to this during the upcoming budget planning cycle and those in future years, and absent this single source of revenue (Heavily Impacted Aid), that task should be much easier to undertake.

3. Develop a plan to reduce the amount of unrestricted fund balance in a manner that benefits District residents, including:

- Funding one-time expenditures
- Funding needed reserves
- Reducing District property taxes.

The circumstances leading to the extremely high fund balance are simple in their roots. As previously noted, the District's enrollment is comprised of approximately 60-65% children of military personnel stationed on Fort Drum. Many of these service members live directly on the military installation and the homes and the basic infrastructure are not subject to real property taxes. As such, the District can apply annually to the United States Department of Education for Impact Aid under Section 8003 of the Elementary and Secondary Education Act of 1965 (as amended), No Child Left Behind. As this is written the underlying statute has become Section 7003, Every Student Succeeds Act.

Because of the high density of military children in the enrollment, the District annually applies for the Basic Impact Aid under Section 8003(b)(1) and has always applied for Heavily Impacted Aid under Section 8003(b)(2). This latter aid stream provides for a greater payment, but is subject to several qualifications, among them are a minimum 40% military population in enrollment, spending at or below the state or national average per pupil expenditure (whichever is higher), and taxing at least at 95% of the average state tax rate. The formula uses three year old data when making these determinations. Unexpectedly, the District became eligible for Heavily Impacted Aid on 20 October 2011. Eligibility was based on data from Federal Fiscal Years 2008 and 2009. In August 2012 the District received three years of back payments for this aid from Fiscal Years 2009, 2010, and 2011 totaling $17,279,366. Of this amount, only about $3M from Fiscal Year 2011 was anticipated. However, the remainder was neither anticipated nor unwelcome given the precarious nature of funding from the state during those difficult years.

The District was left with the decision on how to utilize this prior year windfall. Research of prior Comptroller audits yielded a volume of guidance on possible uses, including: "Such uses could include, but are not limited to, reducing District property taxes, increasing necessary reserves, paying off debt and financing one-time expenditures." With the exception of reducing debt, we note that these are included in the recommendation in the report here as well.

With this lesson in mind, the District looked at these options. Given that it already had the lowest tax rate in the area and that one of the criteria for receiving the aid was to show a tax effort of at least 95% of the state average rate, lowering taxes further was not considered feasible. To do so would place the aid stream at risk. However, limiting increases in the levy to amounts under the tax cap limits, including one year where the levy dropped by $20, essentially holding the levy at zero, was considered a feasible course of action. The need for tax effort to maintain Heavily Impacted Aid implies the aid received was not to decrease local taxes. To do so would mean it would be withdrawn. In lieu of lowering the levy, the Board decided keeping a reasonable cap on increases was a prudent alternative. The chart below details the tax levy (school taxes only data on tax warrant in September of year listed):

YEAR	TAX LEVY	DOLLAR CHANGE	PERCENT CHANGE	"TAX CAP"
2010	$3,031,662	$116,601	4.00%	
2011	$3,122,327	$90,705	2.99%	
2012	$3,169,554	$47,227	1.51%	4.8%*
2013	$3,248,793	$79,239	2.50%	16.8%
2014	$3,280,695	$31,902	0.98%	2.0%
2015	$3,280,675	($20)	-0.00%	3.6%
2016	$3,329,996	$49,321	1.50%	7.4%

*Tax Cap implemented for Fiscal 2013 (taxes levied in September 2012)

An analysis of this data shows that the aid received in October 2011 impacted the budget development that followed. The taxes levied in 2010 and 2011 were levied without the benefit of Heavily Impacted Aid. The taxes levied after in 2012 through 2015 consider the receipt of Heavily Impacted Aid. The taxes levied in 2016 recognize that the District's last year of Heavily Impacted Aid was Federal Fiscal Year 2014.

A final note on taxes and the tax cap is warranted. The Legislature and the Executive enacted the tax cap to provide relief to the spiraling real property taxes faced by the state's homeowners. The unfortunate part of the formula is that it actually serves as a disincentive to *reducing* taxes. While there is an available carryover as a reward for not levying to the limit, the entry number to the calculation is the prior year's tax levy, and if this is reduced in one year, it carries forward to the following year. Thus, the formula acts as a disincentive to ever reducing taxes. A more realistic approach, and one that would lift this disincentive, would be to permit a governing body to use any of the past three year's tax levies as the entry point into the calculation. In that way, a windfall could be used to make a one year reduction without requiring a supermajority vote the following year to return to prior levels. That vote is always a risk. The irony is that a law intended to reign in tax increases acts as a disincentive to implementing a short term tax decrease!

Increasing necessary reserves was the main course of action taken by the Board upon learning that the District qualified for Heavily Impacted Aid. On May 15, 2012, the District went to the voters and asked to establish a $10 Million Capital Reserve with a ten year life. That referendum was adopted by a vote of 153-43. In January 2014 and again in March 2016 the District asked the voters to authorize the use of this reserve and available fund balance for ongoing capital projects. This resulted in committing nearly $20 Million of the fund balance to the reserve and to the capital project. These were, by far, the largest uses of the windfall in impact aid funds. They were chosen because the legacy costs associated with them were minimal (unlike hiring staff). These significant moves curtailed the growth in fund balance but did not significantly decrease it. Because the amount which could be contributed annually to the Reserve was capped at $2 Million under the terms of the resolution, the reduction of the fund balance was predicted to be gradual.

The District's debt had already been refunded so it was not available to be paid down. The only debt the District carries is on its structures. The District pays cash for all other purchases. Thus, this option for use of fund balance was not a practical alternative.

Finally, the district financed a number of smaller, one-time expenses including expanded bus loops for safety; larger snow removal equipment; rehabilitation of several parking lots and the inter-campus connector road; replacement of the bus fuel management system; and intensive maintenance and upkeep of buildings including refurbishing flooring and adding staff rest room facilities. All of these one-time expenses were undertaken throughout the period in question in an effort to bring the fund balance down.

The other underlying factor was that the wars in Afghanistan and Iraq were changing their nature, and the military was beginning to shrink in response to the changes in the nation's strategic defense policy. Regardless of these external influences, the operational tempo on Fort Drum never abated. Rather, the deployments changed from combat units designed to carry the fight to the enemy to deployments where leaders and support troops trained our allies in their own defense. As discussed in recommendation 1 above, the uncertainty of how this change in direction would impact enrollment loomed over the heads of the Board as they considered programs for the future and developed budgets to support those programs. Therefore in each of the years leading up to 2014-15 the Board prepared for a reasonable measure of growth. In 2015-16 it prepared for stability, and in the year 2016-17 it drew back in its planning and both the budget and the fund balance finally began to shrink. The uncertainty of this era, and the need to support the students of the deployed soldiers, led the Board to adopt budgets which were able to respond quickly to changing circumstances. As such, the budgets were robust and often not executed creating fund balance.

It was never the intention of the District to maintain a fund balance as large as it was, but the drawdown of that fund balance needed to include the factors suggested by the Comptroller as well as making certain that there was flexibility to meet the uncertainties created by the national security situation which is unique to this District.

The Board was fully aware of the size of the fund balance and was committing it in support of its intended target, the education of the student. The Board will continue to monitor this aspect of the budget as part of its fiscal responsibilities to ensure that as it draws down this balance while ensuring additional sources of revenue are identified to maintain program. The long range financial plan submitted and accepted by the Board on October 6, 2016, addresses fund balance and the regulated commitment of fund balance to upcoming budgets. This analysis was provided to the audit team at the exit conference on October 7, 2016.

4. Return moneys improperly residing in the debt service fund to the general fund.

At its regular meeting on May 12, 2016, the Board of Education discussed the disposition of the Debt Service Fund. Because the 2003 debt issue giving rise to the amount in the debt service fund was defeased and advance refunded in December 2011 and January 2012, there was no way it could be applied to original issue as intended. Nevertheless, the Board directed that it be applied to pay the advance refunded issue which was due in June 2016. As such, this fund has been liquidated and no longer exists. No further action is required.

5. Ensure the multiyear operational plan clearly shows revenue and expenditure trends, and the effect, on fund balance.

As noted by the auditors, the Business Manager annually provides a multiyear financial update in a narrative rather than a budgetary fashion. These discussion are documented in the minutes and the plans have been accepted by the Board of Education. This is done immediately following the year-end independent financial audit but before moving into the budget preparation cycle in order to set the stage for the upcoming budget discussions. As part of this process, the Business Manager has utilized internal budget projections to guide the narrative but has not shared these projections with the board in the past. Nevertheless, in a break with past practice, a financial projection was appended to the traditional narrative and shared with the Board of Education on October 6, 2016, at its regular meeting. The amended format was shared with the audit team at its exit briefing on October 7, 2016. This annual process prepared by the business manager, including the budget projection, will continue into the future. The budget projection clearly includes fund balance projections to show the impact going forward.

This was a lengthy review of the reasons giving rise to the fund balance and the background considerations is budgeting which would impact its use. In that each of the recommendations was addressed individually with a planned methodology to address the recommendation, please accept this as the District's Corrective Action Plan.

Respectfully,

James Kettrick
Superintendent of Schools

Frank J. Laverghetta
President, Board of Education

APPENDIX B

OSC COMMENTS ON THE DISTRICT'S RESPONSE

Note 1

When there is a persistent pattern of larger surpluses or deficits, there should be concern about the budgeting practices of the government. Despite officials' intent to budget conservatively and for planned operating deficits of $81 million, the general fund balance continued to increase in fiscal years 2011 through 2015 by $15.2 million. This is an indication of unrealistic budgeting. Our report does not recommend that the District use all of its appropriated fund balance each year. We do recommend that District officials adopt realistic budgets to avoid the further accumulation of fund balance.

Note 2

Officials should include realistic estimates of Impact Aid revenues in their budgets. Including only 60 percent of Impact Aid in the budget is misleading to residents. Without accurate budget estimates, residents cannot make an informed decision whether or not to approve the budget.

APPENDIX C

AUDIT METHODOLOGY AND STANDARDS

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

- We interviewed District officials and reviewed the Board meeting minutes, resolutions and policies to gain an understanding of the process and procedures over the District's financial management.

- We compared the budgeted revenues and appropriations to the actual revenues and expenditures for the general fund for fiscal years 2010-11 through 2014-15 to determine if the District's budgets were reasonable and calculated results of operations.

- We analyzed the trend in total fund balance, including the use of appropriated fund balance, in the general fund for fiscal years 2010-11 through 2014-15. We compared the appropriated fund balance to the ensuing year's operating results to determine if the appropriated fund balance was actually used.

- We calculated the unrestricted fund balance in the general fund as a percentage of the subsequent year's appropriations to determine if the District was within the statutory limit during fiscal years 2010-11 through 2014-15.

- We recalculated unrestricted fund balance as a percentage of the next year's budget. We included both appropriated fund balance and unrestricted fund balance in our calculation because the District has shown a pattern of not using appropriated fund balance. We also included debt service fund moneys, as officials could not identify debt associated with these moneys.

- We reviewed the trend of real property levies for fiscal years 2010-11 through 2014-15.

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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