



Palmyra-Macedon Central School District Reserves and Fund Balance

Report of Examination

Period Covered:

July 1, 2014 – October 23, 2015

2015M-336



Thomas P. DiNapoli

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State of New York Office of the State Comptroller

Division of Local Government and School Accountability

June 2016

Dear School District Officials:

A top priority of the Office of the State Comptroller is to help school district officials manage their districts efficiently and effectively and, by so doing, provide accountability for tax dollars spent to support district operations. The Comptroller oversees the fiscal affairs of districts statewide, as well as districts' compliance with relevant statutes and observance of good business practices. This fiscal oversight is accomplished, in part, through our audits, which identify opportunities for improving district operations and Board of Education governance. Audits also can identify strategies to reduce district costs and to strengthen controls intended to safeguard district assets.

Following is a report of our audit of the Palmyra-Macedon Central School District, entitled Reserves and Fund Balance. This audit was conducted pursuant to Article V, Section 1 of the State Constitution and the State Comptroller's authority as set forth in Article 3 of the New York State General Municipal Law.

This audit's results and recommendations are resources for district officials to use in effectively managing operations and in meeting the expectations of their constituents. If you have questions about this report, please feel free to contact the local regional office for your county, as listed at the end of this report.

Respectfully submitted,

*Office of the State Comptroller
Division of Local Government
and School Accountability*

Introduction

Background

The Palmyra-Macedon Central School District (District) is located in the Towns of Palmyra, Macedon and Walworth in Wayne County and the Towns of Farmington and Manchester in Ontario 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 is responsible, along with other administrative staff, for the District's day-to-day management under the Board's direction.

The District covers 48.5 square miles. It has two elementary schools,¹ a middle school and a high school with a total of approximately 1,900 students and 380 employees. The District's budgeted appropriations for the 2015-16 fiscal year are \$36.9 million, which are funded primarily with State aid and real property taxes.

Objective

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

- Did the Board ensure that fund balance was within legal limits and reserve funds were properly established and funded?

Scope and Methodology

We examined the District's reserves for the period July 1, 2014 through October 23, 2015. We expanded our scope back to July 1, 2012 to review fund balance trends.

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

Comments of District Officials and Corrective Action

The results of our audit and recommendations have been discussed with District officials, and their comments, which appear in Appendix A, have been considered in preparing this report. Except as specified in Appendix A, District officials 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.

¹ One elementary school is in the Village of Macedon and the other is in the Village of Palmyra.

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

Reserves and Fund Balance

The board and district officials have a responsibility to ensure that all district resources, including fund balance, are classified and reported correctly and maintained within legally established limits. Fund balance plays a key role in managing a district's operations. Fund balance represents the cumulative residual resources from prior fiscal years. A district may retain a portion of fund balance to help finance the next fiscal year's budget. This is referred to as appropriated fund balance. When fund balance is appropriated as a funding source, the expectation is that there will be a planned operating deficit in the ensuing fiscal year that will be financed by the amount of the appropriated fund balance. It is not a sound practice to routinely adopt budgets that appropriate fund balance that will not actually be used. Fund balance can also be maintained within legally established limits² to address unforeseen expenditures and set aside in approved reserve funds to finance certain specified future expenditures.

Reserve funds may be established by Board action, pursuant to various laws, and are used to finance the cost of a variety of objects or purposes. Reserve funds are generally created under GML and Education Law. These statutes determine how the reserves may be funded, expended and discontinued. Generally, the amount of money school districts can maintain in reserves is not limited. However, it is important that districts maintain reserve balances that are reasonable.

The Board did not effectively manage reserves and fund balance. We found that, as of June 30, 2015, the District had an account for post-employment benefit liabilities totaling over \$7.1 million when there is currently no authority to reserve funds for this purpose. District officials also could not provide documentation for the establishment of its unemployment reserve fund. Additionally, three reserve funds with balances totaling over \$1.5 million may be excessively funded. Had the unauthorized post-employment benefit liability funds been properly reported, total unrestricted fund balance would have been 23 percent of the ensuing year's budgeted appropriations, far exceeding the statutory limit of 4 percent. The District also did not use appropriated fund balance of \$1.62 million, which would further increase the unrestricted fund balance beyond the 23 percent.

As of June 30, 2015, the District reported 10 reserves in the general fund and one liability reserve in its trust and agency fund totaling \$16,790,573. We found that the District properly established, in

² New York State Real Property Tax Law establishes a limit on unrestricted fund balance of 4 percent of the ensuing year's budgeted appropriations.

accordance with statute and through Board resolution, the following nine reserves: workers' compensation (\$113,064), retirement contribution (\$547,917), insurance (\$494,974), tax certiorari (\$776,996), capital reserves³ (\$5,256,217), repairs (\$100,408), employee benefit accrued liability (\$405,921), property loss and liability (\$520,728) and debt service (\$936,283). However, the District could not provide documentation of the Board's creation of the unemployment insurance reserve⁴ (\$527,917) to verify that the reserve was properly established.

In 1996, the Board began to accumulate money in an account within its trust and agency fund for future District costs for retiree health insurance. The accumulated amount now totals \$7,110,148 (42 percent of the District's total reserves). However, there is no statutory authority under current law for a school district to accumulate and legally reserve or restrict money for the District's liability for post-employment health care benefits.⁵ During our audit period, no additional contributions were made into the fund. However, interest earnings of \$29,944 were added to the fund. Additionally, District officials transferred \$485,700 out of the reserve for general fund use. The Board chose to retain the remaining reserve balance in anticipation of legislative action authorizing the funding of long-term liabilities for post-employment benefits. However, absent enactment of such authorizing legislation, the District is without statutory authority to accumulate and legally reserve and restrict moneys for this purpose.

Because there currently is no statutory authority for this type of reserve, the improperly restricted amounts must be included in the District's unrestricted fund balance. We recalculated the District's unrestricted fund balance by adding back the amounts improperly allocated to the unauthorized retiree health insurance reserve as illustrated in Figure 1.

³ This includes the 2009 and 2015 capital reserves totaling \$4,441,310 and the 2002 and 2009 bus reserves totaling \$814,907.

⁴ This reserve may be established by Board resolution for the purpose of reimbursing the New York State Unemployment Insurance Fund for payments made to claimants. District officials were unable to provide evidence that such a resolution was passed. However, they did provide documentation of transfers being made to this reserve dating back to 1978.

⁵ See <http://osc.state.ny.us/localgov/pubs/opeb45faqs.htm#opebreserve>. We note that the District has established an employee benefit accrued liability reserve (EBALR). This type of reserve fund is authorized by GML Section 6-p to accumulate and reserve money for the cash payment of the monetary value of accrued and accumulated but unused and unpaid sick leave, vacation time and other forms of accrued but unliquidated time earned and payable to employees upon termination of service. As noted in the cited publication, payments of the District's costs for retiree health insurance is not one of the permissible uses of this reserve fund (see also Office of the State Comptroller Opinion No. 2004-8).

Figure 1: Recalculated General Fund's Year-End Unrestricted Fund Balance

	FY 2012-13	FY 2013-14	FY 2014-15
Reported Unrestricted Fund Balance	\$1,402,231	\$1,446,399	\$1,475,913
Plus: Net Amount Improperly Allocated to the Retiree Health Insurance Reserve	\$7,581,262	\$7,591,092	\$7,110,148
Recalculated Unrestricted Fund Balance	\$8,983,493	\$9,037,491	\$8,586,061
Ensuing Year's Appropriations	\$35,079,630	\$36,169,750	\$36,923,135
Unrestricted Fund Balance as a Percent of the Ensuing Year's Appropriations	26%	25%	23%

Had the funds been properly reported, the statutory fund balance limit of 4 percent would have been exceeded for all three years reviewed. As of June 30, 2015, the District reported unrestricted fund balance totaling \$1,475,913, and the reserve fund reported a balance of \$7,110,148. If the funds were properly reported, unrestricted fund balance would have totaled \$8,586,061, which is 23 percent of the ensuing year's budgeted appropriations, exceeding the statutory limit by more than \$7,109,136, about 481 percent more than allowed.

The Board adopted budgets that included plans to use appropriated fund balance totaling \$2.43 million from 2012-13 through 2014-15. Instead, 67 percent of the appropriated fund balance totaling \$1.62 million went unused, which was due primarily to the District overestimating expenditures by \$1.88 million for this period.⁶ When appropriated fund balance goes unused, it is in effect a reservation of fund balance that is not provided for by statute and a circumvention of the statutory limit imposed on the level of unrestricted, unappropriated fund balance.

In addition, three of the District's reserves may be excessively funded:

- Unemployment Insurance Reserve – This reserve had a balance of \$527,917 as of June 30, 2015 with an average annual expenditure of \$8,789. Therefore, the current balance in this reserve would cover approximately 60 years of average expenditures. While the District's reserve plan states the long-range funding goal for this reserve is an amount sufficient to pay claims for a 15 percent reduction in workforce, there are currently no plans to reduce the workforce.
- Insurance Reserve and Property Loss and Liability Reserve⁷ – As of June 30, 2015 these reserves had a combined balance totaling \$1,015,702. No funds from these reserves were used during

⁶ Revenues were within 1 percent of their budgeted amount each year.

⁷ The insurance reserve is used for uninsured losses, claims, actions or judgments. The property loss and liability reserve is used to pay for property loss and liability claims.

our audit period. However, District officials stated that they are involved in current litigation to recoup certain uninsured losses and depending upon the results of that litigation, the District may use these reserve funds to cover those losses.

The unused appropriated fund balance and any excessive reserve funds would further increase the level of unrestricted fund balance beyond the 4 percent limit.

Recommendations

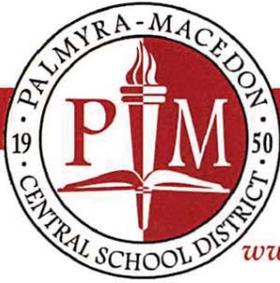
The Board should:

1. Ensure that funds in unauthorized reserves are properly classified as unrestricted fund balance.
2. Adopt budgets with realistic estimates of appropriations and appropriated fund balance.
3. Review the unemployment insurance reserve to determine the amount necessary. The Board should establish the reserve in conformance with GML.
4. Review all reserves currently established and determine if the balances are necessary, reasonable and in compliance with statutory requirements. To the extent that they are not necessary, transfers should be made to other reserves established and maintained in compliance with statutory directives or used to benefit taxpayers.
5. Develop a plan for the use of the excess fund balance in a manner that benefits District taxpayers. Such uses could include, but are not limited to, paying off debt, financing one-time expenditures and reducing District property taxes.
6. Develop a system to assure corrective action in response to the findings in this audit.

APPENDIX A

RESPONSE FROM DISTRICT OFFICIALS

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



Palmyra-Macedon Central School District

Board of Education



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April 15, 2016

Edward V. Grant Jr., Chief Examiner
Office of the State Comptroller
Division of Local Government and School Accountability
The Powers Building
16 W. Main Street – Suite 522
Rochester, New York 14614-1608

Dear Mr. Grant:

Thank you for the opportunity to work closely with staff from your office. The draft report reinforces our confidence in the financial practices of the School District. As expected, we are pleased to note that you found no evidence of fraud, theft, or professional misconduct and the positive results of your assessment are a credit to the work of District staff and serve as a reminder of Palmyra-Macedon Central School District's high standards for fiduciary responsibility.

The District accepted the 2009 audit by the Office of the State Comptroller and in consultation with legal counsel and independent auditors, took appropriate action. This 2015 audit report is also accepted with the understanding that it is one resource we may use to help manage operations effectively and meet the expectations of our constituents. The Palmyra-Macedon Central School District has always welcomed the opportunity to review and strengthen our financial practices and oversight. We have worked diligently to update policies, strengthen internal controls, and develop budgets that balance short term financial priorities with the long term financial well-being of the District. The administration and Board take pride in operating the school district with fiscal integrity on behalf of the community.

See
Note 1
Page 11

New York State's statutes regarding Other Post-Employment Benefits (OPEB) have not kept pace with government accounting standards and best practices, and so we appreciate the continued advocacy by the Office of the New York State Comptroller in this regard. We support Comptroller DiNapoli's recently-proposed legislation (A.5525 / S.5111-A) that would provide express authority and an OPEB trust mechanism to encourage other districts to follow in Palmyra-Macedon's footsteps in beginning to fund our long-term liabilities for post-employment benefits. We agree that "a State statute providing express authority is highly advisable as it would eliminate questions as to the underlying authority for the creation of the trust" (Office of the New York State Comptroller: Local Government and School Accountability: GASB 45 & OPEB Frequently Asked Questions).

See
Note 2
Page 11



The District will develop an action plan to address your specific recommendations, and we look forward to providing further information to our community upon release of your final report.

Thank you.

Sincerely,

Robert R. Ike, Ed.D.
Superintendent

Sharon M. Lang
Board of Education, President

Laura Arrington
Board of Education, Vice President

Christine A. Cole
Board of Education

Beth Grier-Leva
Board of Education

Sherry Lambert
Board of Education

David Landon
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Donald E. Miller Jr.
Board of Education

Susan M. Moak
Board of Education

BjM Toomey
Board of Education

APPENDIX B

OSC COMMENTS ON THE DISTRICT'S RESPONSE

Note 1

Although the District did not make any additional contributions to the fund during our audit period, it did not take appropriate action to discontinue the use of this reserve for which no statutory authority exists, as recommended in the 2009 audit.

Note 2

As noted in the report, there is currently no authority to reserve funds for this purpose. Absent enactment of such authorizing legislation, the District is without statutory authority to accumulate and legally reserve and restrict funds for this purpose.

APPENDIX C

AUDIT METHODOLOGY AND STANDARDS

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

- We reviewed applicable laws, the Board’s policies and minutes and reserve fund plans.
- We interviewed District officials to gain an understanding of District operations related to reserve funds.
- We analyzed reserves to determine if they were properly established, supported and reasonably funded.
- We selected the last three completed fiscal years (2012-13 through 2014-15) to perform our financial analysis of the general fund. As part of our analysis we reviewed both restricted and unrestricted fund balance levels.
- We reviewed total actual revenues and expenditures to calculate the operating deficits or surpluses and compared the operating results to appropriated fund balance to determine the amount of fund balance used and if any operating deficits were planned.
- We compared budgeted revenues and appropriations to actual operating results.
- We reviewed the reserve fund activity to determine any funding or use.
- We calculated the adjusted unrestricted fund balance based on the improperly restricted funds and compared it to the ensuing years’ budget appropriations.

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

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