



Phelps-Clifton Springs Central School District

Financial Condition

Report of Examination

Period Covered:

July 1, 2014 – May 24, 2016

2016M-269



Thomas P. DiNapoli

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State of New York Office of the State Comptroller

Division of Local Government and School Accountability

December 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 Phelps-Clifton Springs 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 Phelps-Clifton Springs Central School District (District) is located in the Towns of Arcadia, Hopewell, Junius, Lyons, Manchester, Phelps and Seneca in Ontario County. The District is governed by the Board of Education (Board), which is composed of seven elected members. The Board is responsible for the general management and control of the District's financial and educational affairs. The Superintendent of Schools (Superintendent) 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 operates two schools with approximately 1,580 students and 280 employees. The District's budgeted appropriations for the 2015-16 fiscal year \$34.4 million, which are funded primarily with State aid, real property taxes and grants.

Objective

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

- Does the District develop realistic budgets that are transparent to residents and maintain reasonable reserve balances?

Scope and Methodology

We examined the District's budgetary results and reserve balances for the period July 1, 2014 through May 24, 2016. We expanded our review back to July 1, 2010 for additional financial trend analysis.

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

Comments of District Officials and Corrective Action

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

The Board has the responsibility to initiate corrective action. Pursuant to Section 35 of General Municipal Law, Section 2116-a (3)(c) of New York State Education Law and Section 170.12 of the Regulations of the Commissioner of Education, a written corrective action plan (CAP) that addresses the findings and recommendations in this report must be prepared and provided to our office within 90 days, with a copy forwarded to the Commissioner of Education. To

the extent practicable, implementation of the CAP must begin by the end of the next fiscal year. For more information on preparing and filing your CAP, please refer to our brochure, *Responding to an OSC Audit Report*, which you received with the draft audit report. The Board should make the CAP available for public review in the District Clerk's office.

Financial Condition

A school district's financial condition is a factor in determining its ability to fund public educational services for students within the district. The responsibility for accurate and effective financial planning for the use of District resources rests with the Board, the Superintendent and the Business Administrator. Fund balance represents the cumulative residual resources from prior fiscal years that can, and in some cases must, be used to lower property taxes for the ensuing fiscal year. A district also can legally set aside and reserve portions of fund balance to finance future costs for a variety of specified objects or purposes.

The Board did not adopt realistic budgets or ensure that reserves were reasonably funded. District officials consistently overestimated expenditures during the last five fiscal years (2010-11 through 2014-15). These budgeting practices generated more than \$3.5 million in operating surpluses. The District also appropriated an average of approximately \$995,000 in fund balance annually, which was not needed to fund operations due to the operating surpluses. This practice allowed the District to appear that it was within the 4 percent statutory limit imposed on the level of unrestricted fund balance. However, when adding back unused appropriated fund balance, the District's recalculated, unrestricted fund balance ranged between 6 and 9 percent of the ensuing year's appropriations, exceeding the limit for all five years.

In addition, from 2010-11 to 2015-16, District officials increased the tax levy by 12 percent. District officials also used approximately \$8.5 million¹ of fund balance to fund six reserves that, as of June 30, 2015, totaled approximately \$8.3 million. The retirement contribution reserve is overfunded, and the employee benefit accrued liability reserve (EBALR) is fully funded but not used. As a result of these practices, the District's tax levy may have been higher than necessary.

Budgeting and Fund Balance

The Board and District management are responsible for accurately estimating revenues and appropriations in the District's annual budget. Accurate budget estimates help ensure that the real property tax levy is not greater than necessary. The estimation of fund balance is also an integral part of the budget process. New York State Real Property Tax Law currently limits unrestricted fund balance to no more than

¹ The District transferred approximately \$8,489,000 into reserve funds during the audit period while transferring \$7,784,000 out of the reserves, for a net increase of \$705,000.

4 percent of the subsequent year's budget. Any surplus fund balance over this percentage should be used to reduce the upcoming fiscal year's tax levy.

We compared the District's appropriations with actual results of operations for fiscal years 2010-11 through 2014-15 and found that the District overestimated appropriations by \$8.3 million (5 percent) (Figure 1). During the same time period, the District's actual revenues varied from the budgeted revenues by less than 1 percent. The District increased the tax levy from \$12 million in 2010-11 to \$13.4 million in 2015-16, an increase of about 12 percent.

Figure 1: Overestimated Appropriations				
Fiscal Year	Appropriations	Expenditures	Difference	Percentage
2010-11	\$33,571,510	\$32,489,300	\$1,082,210	3.3%
2011-12	\$32,786,814	\$30,726,897	\$2,059,917	6.7%
2012-13	\$33,219,758	\$31,534,366	\$1,685,392	5.3%
2013-14	\$32,468,863	\$31,133,462	\$1,335,401	4.3%
2014-15	\$33,796,909	\$31,628,636	\$2,168,273	6.9%
Total	\$165,843,854	\$157,512,661	\$8,331,193	5.3%

Due to the District's practice of overestimating appropriations, it has experienced a cumulative operating surplus of more than \$3.5 million for the five-year period (Figure 2). District officials used the surpluses to fund various reserves.²

Figure 2: Results of Operations				
Fiscal Year	Revenue	Expenditures	Operating Surplus	Percentage of Appropriations
2010-11	\$32,641,128	\$32,489,299	\$151,829	0.45%
2011-12	\$31,502,282	\$30,726,897	\$775,385	2.36%
2012-13	\$32,268,581	\$31,534,366	\$734,215	2.21%
2013-14	\$31,730,760	\$31,133,462	\$597,298	1.84%
2014-15	\$32,935,473	\$31,628,636	\$1,306,837	3.87%
Total	\$161,078,224	\$157,512,660	\$3,565,564	2.15%

Because District officials significantly overestimated appropriations, it appeared that the District needed to raise taxes and use fund balance to close projected budget gaps. In each budget for the last five years, the District appropriated an average of approximately \$995,000 of

² The District transferred funds to the retirement reserve and capital reserve during the audit period.

fund balance to fund the ensuing year's budgeted appropriations. However, the District did not use any fund balance to finance operations. As a result, the District's fund balance has remained higher than necessary. This budgeting practice allowed the District to stay within the 4 percent statutory limit imposed on the level of unrestricted fund balance for all five years. Figure 3 demonstrates the District's allocation of fund balance to reduce reportable unreserved fund balance.

Figure 3: Unrestricted Fund Balance at Year-End

	2010-11	2011-12	2012-13	2013-14	2014-15
Total Beginning Fund Balance	\$11,721,294	\$11,673,759	\$12,218,807	\$12,746,653	\$9,666,800
Add: Operating Surplus	\$151,828	\$775,385	\$734,215	\$597,297	\$1,306,837
Less: Unbudgeted Transfers Out	\$199,363	\$230,337	\$206,369	\$3,677,150	\$201,470
Total Ending Fund Balance	\$11,673,759	\$12,218,807	\$12,746,653	\$9,666,800	\$10,772,167
Less: Restricted Funds	\$9,068,932	\$9,779,711	\$10,474,958	\$7,456,615	\$8,812,249
Less: Encumbrances	\$7,205	\$8,119	\$22,942	\$8,310	\$80,742
Less: Appropriated Fund Balance for the Ensuing Year	\$1,575,000	\$1,102,188	\$950,000	\$850,000	\$500,000
Total Unrestricted Funds at Year-End	\$1,022,622	\$1,328,789	\$1,298,753	\$1,351,875	\$1,379,176
Ensuing Year's Budgeted Appropriations	\$32,786,814	\$33,219,758	\$32,468,863	\$33,796,909	\$34,479,417
Unrestricted Funds as Percentage of Ensuing Year's Budget	3%	4%	4%	4%	4%

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 statutory limit imposed on the level of unrestricted fund balance. When unused appropriated fund balance was added back, the District's recalculated unrestricted fund balance ranged between 6 and 9 percentage points of the ensuing year's appropriations (Figure 4).

Figure 4: Unused Fund Balance

	2010-11	2011-12	2012-13	2013-14	2014-15
Total Reported Unrestricted Funds at Year-End	\$1,022,622	\$1,328,789	\$1,298,753	\$1,351,875	\$1,379,176
Appropriated Fund Balance Not Used to Fund Current Year's Budget	\$1,259,945	\$1,575,000	\$1,102,188	\$950,000	\$850,000
Total Actual Unrestricted Funds	\$2,282,567	\$2,903,789	\$2,400,941	\$2,301,875	\$2,229,176
Actual Unrestricted Funds as Percentage of Ensuing Year's Budget	7%	9%	7%	7%	6%

The result of this budgeting practice made it appear that the District needed to both raise taxes and use fund balance to close projected budget gaps. These tax levy amounts may have been lower had the excess fund balance been used to finance District operations.

Reserves

Reserves may be established by the Board in accordance with applicable laws. Money set aside in reserves must be used in compliance with statutory provisions which determine how reserves are established, funded, expended and discontinued. Generally, while school districts are not limited as to how much money can be held in reserve funds, reserve fund balances must be reasonable. Funding reserves at greater than reasonable levels essentially results in real property tax levies that are higher than necessary. Reserve funds should not be used as a means to accumulate excess fund balance. The Board should balance the intent for accumulating money for future identified needs with the obligation to ensure that residents are not unnecessarily burdened.

As of June 30, 2015, the District had six reserve funds with balances totaling approximately \$8.3 million. From the period 2010-11 through 2014-15, the District transferred \$8,489,000 into reserves, while expending \$7,784,000 from the reserves, resulting in a net difference of \$705,000. We analyzed these reserves for reasonableness and adherence to statutory requirements. We found the balances of the capital reserve,³ workers' compensation reserve, unemployment reserve and tax certiorari reserve to be reasonable. Although the EBALR was fully funded, the District did not always use the funds for related expenditures and instead made payments out of the operating funds. Finally, the retirement contribution reserve was overfunded and funds were not used for related expenditures.

³ The capital reserve includes four various projects, resulting in four subsets under the term "capital reserve."

Employee Benefits Accrued Liability Reserve – General Municipal Law (GML) authorizes school districts to create this reserve to fund the cash payment of accrued and unused sick, vacation and certain other leave time owed to employees when they separate from school district employment. The District’s EBALR is fully funded. However, the District has failed to use it to pay for accrued employee benefits upon separation from the District. The District used only \$5,000 from the reserve during the 2013-14 year. The District made employee benefit related payments of \$112,000 during the 2014-15 year, which were paid out of operating funds rather than using the reserve. This defeats the purpose of having a fully funded reserve for separation costs.

Retirement Contribution Reserve – GML authorizes the Board to establish this type of reserve to pay contributions for employees covered by the New York State and Local Retirement System. The balance of this reserve as of June 30, 2015 was more than \$3.7 million, which was more than eight times the District’s average contribution of approximately \$450,000 over four years. The District’s previous response to an audit released by the Comptroller’s office in 2009 stated that the reserve was for the severe increases in retirement contributions which it faced. However, during our current audit period, no funds were disbursed from the reserve. Instead, the reserve increased 633 percent during the five-year period.

By maintaining excessive reserves, combined with ongoing budgeting practices that generate repeated operating surpluses, the Board and District officials may have levied unnecessary taxes.

Recommendations

The Board and District officials should:

1. Develop realistic estimates of expenditures and the use of fund balance in the annual budget.
2. Use surplus funds as a financing source for:
 - a. Funding one-time expenditures;
 - b. Funding needed reserves; and
 - c. Reducing District property taxes.
3. Review all reserve balances and determine if the amounts reserved are necessary, reasonable and in compliance with statutory requirements. To the extent they are not, transfers should be made in compliance with statutory requirements.

APPENDIX A

RESPONSE FROM DISTRICT OFFICIALS

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



DISTRICT OFFICE

JAMIE M. FARR
Superintendent
(315) 548-6421

MATTHEW T. FITCH
Business Administrator
(315) 548-6434

November 22, 2016

Ann Singer, Chief Examiner
State Office Building, Room 1702
44 Hawley Street
Binghamton, NY 13901-9313

Dear Ms. Ann Singer:

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. We are pleased to note that you found no evidence of fraud, theft or professional misconduct. The positive results of your assessment are a credit to the work of District staff and serve as a reminder of Phelps-Clifton Springs Central School District's high standards for fiduciary responsibility.

This 2016 audit by the Office of the State Comptroller is accepted with the understanding that it is one resource we may use to help manage operations effectively and meet the expectations of our constituents. Operating with fiscal integrity is an expectation of the Board of Education and our community.

With uncertain revenues due to the inception of the tax cap combined with continued underfunded and unpredictable state aid, it has been important for the District to budget conservatively. Listed below are actions taken by the District to manage finances effectively.

- Reduced more than 40 staff positions
- Closed nearly all District use of the Middle School and rented vacant rooms to BOCES
- Negotiated lower cost health insurance with retirees saving \$1 million in the first year alone
- Moved business office functions to the BOCES Central Business Office (CBO)
- Refunded bonds resulting in cost savings while qualifying for waiver to avoid Building Aid Reduction
- Never exceeded the Tax Cap, averaging 0.79% below the allowable levy limit since its inception
- Allocated and spent \$1.75 million to pre-pay debt on a Bond Anticipation Note (BAN)
- Reduced appropriate fund balance each year
- Used \$52,295 of EBLAR Reserve in 2015-16
- Used \$3.5 million in Capital Reserves to pay the local share of a \$14.8 million capital project

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The Phelps-Clifton Springs Central School District will consider all factors relevant to our district and constituents and proceed with caution and conservatism in order to ensure quality programming and sustainability is achieved.

Sincerely,

Jamie Farr
Superintendent of Schools

APPENDIX B

AUDIT METHODOLOGY AND STANDARDS

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

- We interviewed District officials to obtain an understanding of the District's oversight of budgeting and the reserves.
- We compared the District's budgeted appropriations and estimated revenues with the actual results of operations to determine if there were significant budget variances for the period 2010-11 through 2014-15.
- We compared approved budgeted appropriations to those entered into the financial software.
- We reviewed bank statements and accounting records to determine if records were suitably reliable.
- We reviewed unrestricted fund balances reported at fiscal year-end to determine whether fund balances were within the statutory limit.

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

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