OFFICE OF THE NEW YORK STATE COMPTROLLER

DIVISION OF LOCAL GOVERNMENT
& SCHOOL ACCOUNTABILITY

Sweet Home Central School District

Financial Management

Report of Examination

Period Covered:

July 1, 2012 – March 18, 2016

2016M-207

Thomas P. DiNapoli

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State of New York
Office of the State Comptroller

Division of Local Government
and School Accountability

September 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 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 Sweet Home Central School District, entitled Financial Management. 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 Sweet Home Central School District (District) is located in the Towns of Amherst and Tonawanda in Erie 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 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 six schools with approximately 3,200 students and 730 employees. The District's general fund budgeted appropriations for the 2015-16 fiscal year were $72 million, which were funded primarily with State aid, sales tax and real property taxes.

Objective

The objective of our audit was to review the District's financial management practices. Our audit addressed the following related question:

- Did the Board properly manage District finances by ensuring budgets were realistic and by properly planning for and using fund balance?

Scope and Methodology

We examined the District's financial records for the period July 1, 2012 through March 18, 2016.

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 did not agree with all of our recommendations but indicated they would be taking 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 the 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 and District management are responsible for properly managing the District's finances, which includes adopting realistic budgets and ensuring that fund balance does not exceed the amount allowed by law. Fund balance represents the cumulative residual resources from prior years that can, and in some instances must, be used to lower property taxes for the ensuing year. A school district may retain a portion of fund balance, referred to as unrestricted fund balance, but must do so within the statutory limit established by New York State Real Property Tax Law (RPTL). RPTL limits the amount of unrestricted fund balance for school districts to 4 percent of the ensuing year's budget. A school district may also legally set aside and reserve portions of fund balance to finance future costs for a variety of specified objects or purposes. In addition, District officials should periodically analyze cash flow to ensure sufficient cash is available to pay obligations and short-term debt is issued only when necessary.

The Board did not adequately manage the District's finances by ensuring budgets were realistic and by properly planning for and using fund balance. The District generated a cumulative operating surplus of $720,000 from fiscal years 2012-13 through 2014-15. Although District officials appropriated $2.6 million of fund balance to help finance the budget each year, none of it was needed because District officials overestimated appropriations each year by an average of $2.7 million, or 4 percent. When unused appropriated fund balance is added back, unrestricted fund balance exceeded the statutory limit by amounts ranging from $2 million to $2.4 million, or 2.9 to 3.6 percentage points.

District officials also improperly set aside more than $6.5 million in a debt reserve. During the last three fiscal years, District officials have transferred more than $1.3 million from unrestricted fund balance to the reserve. Had District officials accounted for these funds properly, unrestricted fund balance would have further exceeded the statutory limit. Despite the significant amount of accumulated fund balance, District officials have increased the tax levy by more than $5 million (13.7 percent) from 2012-13 through 2015-16. Furthermore, because District officials did not properly analyze cash flow, they unnecessarily issued $6 million of short-term debt each year, incurring $81,000 in debt issuance and interest costs over the past four years.

Budgeting and Fund Balance

The Board and District management are responsible for ensuring that the annual budget includes realistic estimates of expected revenues, appropriations and the use of fund balance. Accurate budget estimates help ensure that the levy of real property taxes is not greater than necessary.

During 2012-13 through 2014-15, the District appropriated $2.6 million of fund balance each year and an average of $1.1 million from reserve funds annually to help finance budgeted appropriations.[1] However, because District officials overestimated appropriations and underestimated revenues, appropriated fund balance was not used to finance operations.

When fund balance is appropriated as a funding source, it reduces the fund balance subject to the statutory limit, and the expectation is that there will be a planned operating deficit in the ensuing fiscal year equal to the amount of fund balance appropriated. Although the District appropriated fund balance each year, none of it was used because the District overestimated appropriations each year by an average of $2.7 million, or 4 percent, and underestimated revenues by approximately $1 million, or 2 percent each year.

The most significant variances were in employee benefits (average variance of $843,000 or 32 percent), utilities ($839,000 or 32 percent) and instructional and administrative salaries ($395,000 or 15 percent). Because appropriations were overestimated and revenues were underestimated, the District realized operating surpluses of approximately $310,000 in 2012-13, $100,000 in 2013-14 and $310,000 in 2014-15, as indicated in Figure 1. As a result, appropriated fund balance was not used to finance operations.

Figure 1: Unrestricted Fund Balance at Year-End

	2012-13	2013-14	2014-15
Beginning Fund Balance	$13,410,000	$13,620,000	$13,600,000
Add: Operating Surplus	$310,000	$100,000	$310,000
Less: Unbudgeted Transfers Out	$100,000	$120,000	$160,000
Ending Fund Balance	$13,620,000	$13,600,000	$13,750,000
Less: Restricted Funds	$7,820,000	$7,990,000	$8,320,000
Less: Encumbrances	$580,000	$450,000	$480,000
Less: Appropriated Fund Balance	$2,620,000	$2,620,000	$2,420,000
Unrestricted Fund Balance at Year-End	$2,600,000	$2,540,000	$2,530,000
Ensuing Year's Budgeted Appropriations	$68,610,000	$70,270,000	$71,920,000
Unrestricted Fund Balance as a Percentage of Ensuing Year's Budget	3.8%	3.6%	3.5%

[1] The District appropriated $2.6 million of fund balance and $1.3 million from reserves to help finance 2012-13 appropriations, $2.6 million of fund balance and $1.1 million from reserves for 2013-14 and $2.6 million of fund balance and $1 million from reserves for 2014-15.

In addition, the District's practice of annually appropriating fund balance that is not needed to finance operations is, in effect, a reservation of fund balance that is not provided for by statute and is a circumvention of the statutory limit imposed on the level of unrestricted fund balance. As shown in Figure 2, when unused appropriated fund balance is added back, unrestricted fund balance actually exceeded the 4 percent limit by 2.9 to 3.6 percentage points.

Figure 2: Unused Fund Balance

	2012-13	2013-14	2014-15
Unrestricted Fund Balance at Year-End	$2,600,000	$2,540,000	$2,530,000
Add: Appropriated Fund Balance Not Used to Fund Ensuing Year's Budget	$2,620,000	$2,620,000	$2,420,000
Recalculated Unrestricted Fund Balance	$5,220,000	$5,160,000	$4,950,000
Recalculated Unrestricted Fund Balance as Percentage of Ensuing Year's Budget	7.6%	7.3%	6.9%

Based on the 2015-16 adopted budget, the District budgeted similarly to previous years and will not use the $2.4 million it appropriated in fund balance. Therefore, recalculated fund balance will likely continue to exceed the limit. We also reviewed the District's 2016-17 adopted budget and found that appropriations increased by about $3.9 million, or 5.5 percent, but estimated State aid revenues also increased by approximately $3.2 million, or 15.5 percent. However, the Board again appropriated $2.4 million in fund balance to help finance operations in the 2016-17 budget even though it will likely not be needed to finance operations.

The District continued to increase the tax levy by an average of 4 percent each year. The District increased the real property tax levy by approximately $5.2 million (13.7 percent) from 2012-13 through 2015-16. Budgeting practices that produce operating surpluses and maintain fund balance in excess of the amount allowed by law result in real property tax levies that are greater than necessary to fund operations.

Debt Reserve

Certain funds are required by law to be set aside and used to pay related debt. A debt reserve must be established if a capital improvement that was financed with debt that remains outstanding is sold. Additionally, bond proceeds not expended for the purpose for which they were issued and related interest earnings are required to be set aside in a debt reserve and used for related debt service payments. The reserve should be reported in the debt service fund, which is separate from the general fund.

The District accounts for and reports a debt reserve in the general fund. As of June 30, 2015, the debt reserve had a reported balance of $6.5 million. District officials could not demonstrate that there was a statutory requirement to legally restrict the funds for debt service payments.[2] District officials told us that they had set the money aside because the District was paying off its capital improvement bonds over a 20-year period but would receive its State building aid over a 15-year period. Therefore, they intended to use the reserve funds in place of building aid during the last five years of the debt repayment schedule. District officials intended to use annual operating surpluses and unrestricted fund balance in excess of the statutory limit to fund the reserve. However, there is no statutory authority for a school district to choose to reserve or otherwise set aside unrestricted fund balance in a debt reserve.

District officials continued to transfer surplus fund balance to the reserve even after we advised them that the District had no authority to set up such a reserve in our 2009 audit.[3] At the end of the past three fiscal years, the District used $1.3 million of unrestricted fund balance to fund the debt reserve. Had District officials accounted for these funds properly, unrestricted fund balance would have further exceeded the statutory limit.

Cash Flow and Short-Term Borrowing

Cash flow analysis is a tool to evaluate an entity's cash position and help ensure that sufficient cash is available to pay obligations as they come due. District officials should periodically analyze cash flow and issue appropriate amounts of short-term financing only if necessary. If a cash shortfall is expected, the District can issue short-term debt, such as a tax anticipation note (TAN), in anticipation of receiving real property tax revenues.

District officials did not properly analyze cash flows and had not attended training to learn how to properly complete and maintain the cash flow forecast. District officials prepared a cash flow analysis once each year, using budget estimates of revenues and expenditures for the upcoming year. District officials incorrectly used the same estimated amount as the beginning cash balance for the last four completed years. For example, instead of using actual cash on hand of $7.3 million (excluding TAN proceeds) as of June 30, 2015, District officials used an estimated cash balance of approximately $2 million. District officials used the same amount when they prepared the cash flow analysis for the previous three years. Based on this incorrect information, it appeared that the District needed to issue short-term financing.

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[2] We reviewed transfers made to the debt reserve during fiscal years 2012-13 through 2014-15 and found $42,226 had been properly restricted in the reserve. These transfers included a premium on a bond anticipation note totaling $37,141 and interest earnings totaling $5,085 on debt proceeds issued for a capital project.

[3] *Financial Condition and Internal Controls Over Procurement, 2009M-40*, July 2009

Annually, in June, the District issued a $6 million TAN that matured in November. We analyzed the District's cash flow, exclusive of TAN proceeds, and found that sufficient cash balances were available throughout the fiscal year. The District's monthly bank balances ranged from $1.4 million to $32 million.

District officials indicated that they issued the TAN because, although there was sufficient cash available at month-end, there would be days during the months of August and September when the District had insufficient cash if it did not issue short-term financing. We analyzed the District's daily cash balances during August and September and found that there were periodic cash shortages during these months. During the audit period, the District's cash shortage would have ranged from approximately $500,000[4] to $2.7 million[5] had the District not issued TANs. For example, the District would have had a cash shortage of $2.1 million over a four-day period in September 2015. However, the District has more than $6.5 million inappropriately sitting idle in the debt reserve which could be used for general operations because these funds are not legally restricted.

Because District officials did not properly analyze cash flow during the last three completed fiscal years, as well as for the current year, they unnecessarily issued a $6 million TAN each year and incurred more than $81,000 in associated debt issuance and interest costs.

While it is prudent to provide for unforeseen circumstances, maintaining excessive levels of fund balance, using overly conservative budget estimates and issuing unnecessary short-term financing results in the tax levy being higher than necessary and unnecessary debt issuance and interest cost.

Recommendations

The Board and District officials should:

1. Ensure budgets include realistic estimates of appropriations, revenues and appropriated fund balance and reserves.

2. Identify the composition of the funds in the debt reserve, properly report and use statutorily restricted money to pay debt in the debt service fund and return all other money to unrestricted general fund balance.

3. Properly analyze cash flow periodically throughout the year by using actual cash on-hand, revenues and expenditures to ensure short-term financing is issued only if needed.

District officials should:

4. Attend training on cash flow analysis and forecasting.

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[4] August 2015

[5] September 2012

APPENDIX A

RESPONSE FROM DISTRICT OFFICIALS

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

Sweet Home Central School District
of Amherst and Tonawanda

Office of the Superintendent
1901 Sweet Home Road • Amherst, New York 14228
(716) 250-1402

Anthony J. Day
Superintendent of Schools

August 5, 2016

Mr. Jeffrey D. Mazula, Chief Examiner
Office of the State Comptroller
295 Main Street, Room 1032
Buffalo, New York 14203

Dear Mr. Mazula:

We are in receipt of the draft report from the State Comptroller's Office audit of the Sweet Home Central School District for the period July 1, 2012 – March 18, 2016. On behalf of the District, I would like to thank the staff of the Comptroller's Office, who we found to be courteous and professional throughout the audit process. The District welcomes the feedback provided by the Comptroller's Office and appreciates the opportunity to strengthen our practices as a result of reflection on that feedback. We are pleased that the draft report does not suggest any malfeasance or legal impropriety with respect to the District's general business operations. Our response to the particular areas of examination follows.

Recommendation #1: Budgeting and Fund Balance: The Sweet Home Central School District has been committed to balancing fiscal responsibility while delivering excellent education to our students by taking a conservative approach to the budgeting process. Traditionally, this approach results in an Appropriated Fund Balance which provides a proper level of budgetary flexibility in the face of shifting revenue sources and unexpected expense. We believe that the maintenance of the Appropriated Fund Balance has provided fiscal stability through the years and limited the amount of taxes we have levied. These measures have been instrumental in helping the District maintain a sound financial footing that has enhanced the quality of programs we deliver to our students. Standard and Poor's, in their rating of our capital project borrowing this past June, confirms our fiscal status by writing, "Overall, management's budgeting practices have historically been conservative, supported by ongoing budgetary controls, resulting in a stable financial position."

This approach has served the District well during a time when New York State school districts have faced numerous financial challenges. Since Foundation Aid was implemented in 2007 as a result of a successful lawsuit that found that State Aid was distributed inequitably, Sweet Home has received $24.5 million less in Foundation Aid than what was calculated in the Foundation Aid formula. The Gap Elimination Adjustment was imposed as a means to close State budgetary gaps on the backs of local school districts. This move reduced the District's State Aid revenue by over $18 million since 2010. In addition, the Tax Cap legislation enacted in 2011 further decreases financial options for school districts by essentially capping the amount of revenue a district can raise locally. It has been the conservative approach to budgeting coupled with strategic use of fund balance and reserves that have helped the District get

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through these challenging financial times while maintaining a robust program for the students.

The report suggests that the unused Appropriated Fund Balance becomes part of the Unassigned Fund Balance; thus, the District exceeds the statutory 4% limit on Unassigned Fund Balance. It is important to note that the District's Unassigned Fund Balance has been under the legal limit of 4% each year as shown in Figure 1 of the Comptroller's report (it is called "Unrestricted Fund Balance" there). The Appropriated Fund Balance is a part of the Assigned Fund Balance category and is not subject to the 4% limit.

See Note 1 Page 13

The report says that budgeting Appropriated Fund Balance produces an "expectation of a planned operating deficit." Actually the expectation is that the District will not fully expend the budget since we are not allowed to spend more than we appropriate. It is easy to look back on completed fiscal years and determine exactly how much was needed and how much variance was produced by budgeted appropriations. However, it is a different story when budgets are constructed up to 18 months prior to expenditures taking place. Ultimately a budget is an estimated spending plan. The report points out a few areas of positive variance to the budget but there were several areas of negative variance as well including special education tuition, charter school tuition, and transportation to name a few. The positive variances helped to offset the negative ones. The District will continue to use Appropriated Fund Balance as a budgeting tool but will strive to efficiently manage the budget and access as many revenue sources as possible so as to limit its use in any given year.

Conservative budgeting, the use of Appropriated Fund Balance, and the use of reserve funds are all part of constructing a budget that helps to produce stability over the long term. Each year all factors are considered and adjustments are made where necessary and prudent. The Appropriated Fund Balance was reduced by $200,000 in 2015-16 and $725,000 was used from three reserve funds over the last three years. Moreover, the budget for the use of reserve funds has been reduced significantly over the last three years as well with the hope of eliminating their use in the revenue budget in the next year or two.

The process of constructing a budget in the District is an open one where all details are thoroughly reviewed and made available to the public. The use of Fund Balance and reserves are in the budget material and discussed at budget workshops. We appreciate the tremendous support of the community in passing budgets for the last 39 years in a row with an average passing rate of 75% over the last five years. We have been at or under the Tax Levy Limit every year since its inception. These are all indicators that the District treats our taxpayers with respect.

Recommendation #2: Debt Reserve: The Comptroller's report suggests that the District improperly reports a Reserve for Debt in the general fund and points out that there is no authority for a school district to reserve general fund moneys for future debt payments. While respectfully acknowledging the Comptroller's opinion on the Reserve for Debt, the District believes that its current use of the Reserve is legal, prudent, and in the best interest of the District's taxpayers and students.

See Note 2 Page 13

The district maintains the position that it is necessary to fund the Reserve for Debt for future debt resulting from a mismatch between the amortized length of payments on capital improvement bonds (20 years) and the revenue generated from state building aid (15 years). The Reserve for Debt is prudently being used to accumulate district funds equivalent to yearly state aid applicable to debt service that the district is receiving over the initial 15-year period for payment. These Reserve funds will then be used to supplant the missing state aid in the remaining five years of debt payment due in years 2020 and beyond. This strategy was recommended by our financial and legal advisors and is supported by the Office of the State Comptroller in Opinion 95-24.

See Note 3 Page 13

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The State Education Department changed the prior practice of amortizing state aid payments after the capital improvement bonds for the District's $29 million project were sold. The project was approved during a period of amortization transition in the State. The State changed their practice in the middle of the project period, changing to a set period of aid amortization based on the scope of the project, rather than providing aid on the same schedule as the debt service payments. The result for the District is a five-year State building aid gap at the end of the project. It is the District's opinion, which is also shared by our financial and legal advisors as well as our external auditor, that the best way to meet our future debt obligation and prohibit a negative impact on taxpayers over the final five years of bond repayments is to hold the surplus money in the Reserve for Debt until such time as those payments come due. The District believes the Debt Reserve is set up properly and funded as specified by General Municipal Law Sec 6L and Sec 27:46 of School Law. The District's Debt Reserve account is listed in the general fund group of accounts A884 per the Uniform System of Accounts.

See Note 4 Page 13

Recommendation #4: Cash Flow and Short-Term Borrowing: The District acknowledges the comments from the Comptroller's report regarding cash flow and has taken steps to ensure that the cash flow analysis upon which the short-term borrowing is based is completed accurately. While the District needs to make sure there is enough cash on hand to pay its bills, it will endeavor to borrow only what it needs for the minimum duration that it is needed. The District does maintain that funds held in reserve accounts, including the Reserve for Debt, are segregated and restricted from general fund usage and are not generally available for cash flow purposes. Thus, there is still a necessity for short-term borrowing under current conditions but not for the amount or length of time that has been done in the past.

Conclusion:

In conclusion, the Sweet Home Central School District appreciates the feedback provided by the Comptroller's Office and views it as an opportunity to improve upon our financial practices. The District is committed to taking appropriate corrective action to correct, clarify, and/or strengthen our operating procedures in those areas of concern that were noted, and to fully comply with State guidelines.

While respectfully acknowledging that the Comptroller has, from a policy perspective, taken issue with certain aspects of the District's fiscal approach, the District maintains that its primary financial objective is to minimize the cost of delivering a high quality education to our students. The District's current budgeting practice and management of its fund balance and reserves is conducted in furtherance of this objective and has resulted in, by any measure, one of the highest achieving districts in Western New York, along with one of the lowest residential tax rates in Erie County.

The District has already begun to implement the recommendations specified in the audit document. Our Board of Education is working to complete the Corrective Action Plan, which will be approved in September and forwarded to all appropriate parties. Thank you for the opportunity to review and respond to these recommendations.

Sincerely,

Anthony J. Day
Superintendent of Schools

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APPENDIX B

OSC COMMENTS ON THE DISTRICT'S RESPONSE

Note 1

Appropriating fund balance in the annual budget will reduce the amount of fund balance subject to the statutory limit at year-end. However, in this instance, District officials consistently used appropriated fund balance to give the impression that fund balance would be used when, in reality, it was not needed because budget estimates were not realistic. We recalculated unrestricted fund balance to demonstrate how District budgeting practices essentially circumvented the statutory limit.

Note 2

Our assessment of the use of the debt reserve is based on the express provisions of General Municipal Law and New York State Local Finance Law, which specify the circumstances when a reserve must be established and what funds must be placed into the reserve. The statutes do not permit the District to establish and fund a debt reserve with whatever money it chooses.

Note 3

As we advised the District in our 2009 audit, OSC Opinion No. 95-24 addresses the General Municipal Law Section 6-l reference to State and federal aid received for a capital improvement financed by debt. Here, it is not apparent that the District placed excess State aid in the reserve, because the District did not meet the requirements of General Municipal Law. Most of the increases to this reserve were made at fiscal year-end and appear to have been made to reduce unrestricted fund balance below the statutory limit rather than using the funds to reduce the tax levy.

Note 4

The Office of the State Comptroller, which is responsible for prescribing an accounting system for school districts and municipalities, has determined that the debt reserve should be in the debt service fund.

APPENDIX C

AUDIT METHODOLOGY AND STANDARDS

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

- We interviewed District officials and reviewed Board minutes and policies to gain an understanding of the procedures for maintaining financial records, monitoring fund balance and developing the annual budget.

- We reviewed the last three years of financial data and budgets to document fund balance levels, determine the general fund's operating results and determine if budget estimates were reasonable.

- We analyzed changes in fund balance, including the use of appropriated fund balance, in the general fund for the fiscal years 2012-13 through 2014-15. We also compared unrestricted fund balance to the ensuing year's budgeted expenditures to determine if the District was within the statutory limit during the same fiscal years.

- We reviewed the District's tax levy from 2012-13 through 2015-16 and budget documents provided by District officials to support tax levy calculations.

- We reviewed all significant additions, withdrawals and transfers made to or from the debt reserve to determine whether the transactions were Board-approved and made in accordance with applicable statutes.

- We analyzed cash flow and bank account balances for the last three completed fiscal years and the current year.

- We reviewed TAN borrowings for the last three completed years and the current fiscal year to determine if they were necessary in comparison to cash flow analyses.

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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