



Worcester Central School District Unassigned Fund Balance

Report of Examination

Period Covered:

July 1, 2014 – November 16, 2015

2016M-1



Thomas P. DiNapoli

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State of New York Office of the State Comptroller

Division of Local Government and School Accountability

May 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 Worcester Central School District, entitled Unassigned 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 Worcester Central School District (District) is located in the Town of Harpersfield in Delaware County and the Towns of Decatur, Maryland, Westford and Worcester in Otsego County. The District is governed by the Board of Education (Board) composed of five elected members. The Board is responsible for the general management and control of the District's financial and educational affairs. The Superintendent of Schools (Superintendent) is the District's chief executive office and is responsible, along with other administrative staff, for the day-to-day management of the District under the Board's direction. The District Treasurer (Treasurer) plays a key role in the budget development process and is responsible for properly accounting for all District funds.

The District operates one school with 350 students and 81 employees. The 2015-16 budget appropriations are \$10.9 million funded primarily with State aid and real property taxes. The District contracts with the Otsego Northern Catskill Board of Cooperative Educational Services for accounting services.

Objective

The objective of our audit was to examine District officials' management of unassigned fund balance. Our audit addressed the following related question:

- Did District officials maintain unassigned fund balance in accordance with statutory requirements?

Scope and Methodology

We examined District financial records for the period July 1, 2014 through November 16, 2015. We extended our scope back to July 1, 2012 to analyze fund balance, budget, revenue and expenditure 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 B of this report. Unless otherwise indicated in this report, samples for testing were selected based on professional judgment, as it was not the intent to project the results onto the entire population. Where applicable, information is presented concerning the value and/or size of the relevant population and the sample selected for examination.

Comments of District Officials and Corrective Action

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

generally agreed with our recommendations and indicated they planned 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.

Unassigned Fund Balance

District officials are responsible for making sound financial decisions that are in the best interest of the District, the students they serve and the taxpayers who fund the District's programs and operations. Fund balance represents resources remaining from prior fiscal years that can be used to finance the next year's budget, set aside in reserve funds for specific purposes, or both. New York State Real Property Tax Law currently limits the amount of fund balance that can be legally retained by District officials to no more than 4 percent of the ensuing year's budget. Accurate budget estimates and projected fund balance levels help the Board ensure that real property levies are not greater than necessary. Expenditure estimates should be developed based on prior years' operating results, past expenditure trends, anticipated future needs and available information related to projected changes in significant expenditures.

District officials did not maintain fund balance in accordance with statutory requirements. The District's unassigned fund balance has exceeded the statutory limit in two of the last three fiscal years. In an attempt to comply with the 4 percent limit, upon advice of their certified public accountant, District officials erroneously classified almost \$1.2 million of surplus funds as other restricted funds and in a reserve for tax reduction. For the 2012-13 fiscal year, \$873,000 was classified as other restricted fund balance and for the 2013-14 fiscal year, \$315,000 was classified as a reserve for tax reduction. As a result of these errors, the District's unassigned fund balance did not include funds that should have been included when calculating the statutory limit. During 2014-15, District officials reported these funds as unassigned fund balance after they realized these funds were truly unassigned. Currently, officials have no plans to expend these excess funds.

Over the past three years (2012-13 through 2014-15) District officials appropriated a combined total of approximately \$3 million of fund balance as a funding source in the annual budgets for these years. However, the District needed only a small amount (\$122,000 or approximately 4 percent) because the District significantly overestimated expenditures and raised more taxes than necessary.

When the improperly classified funds and unused appropriated fund balance are added back, the Districts recalculated unassigned fund balance ranged from 13.8 to 18.6 percent of the ensuing year's appropriations and was far in excess of the statutory limit, as indicated in Figure 1.

Figure 1: Unassigned Fund Balance at Year End and Unused Fund Balance

	2012-13	2013-14	2014-15
Total Unassigned Fund Balance at Year End	\$422,779	\$737,525	\$1,132,787
Unassigned Fund Balance as a Percentage of Ensuing Year's Appropriations	4.0%	6.8%	10.4%
Add: Misclassified Restricted and Reserve Funds	\$873,013	\$315,000	\$0
Add: Appropriated Fund Balance Not Used to Fund Ensuing Year's Budget	\$360,000	\$438,196	\$900,000
Total Recalculated Unassigned Funds	\$1,655,792	\$1,490,721	\$2,032,787
Recalculated Fund Balance as Percentage of Ensuing Year's Budget	15.7%	13.8%	18.6%

We compared the District's budgeted and actual expenditures for 2012-13 through 2014-15 and found that District officials overestimated appropriations by a combined total of \$2.4 million or 7.5 percent. The largest variances between budgeted and actual expenditures for these years were for health insurance by approximately \$754,000 (16.7 to 21.6 percent), handicap services by \$910,000 (16.5 to 29.2 percent), plant and operations by \$197,000 (9.6 to 14.7 percent), unemployment insurance by \$188,000 (89.3 to 92.8 percent) and transportation by \$176,000 (7.2 to 13.7 percent).

Based on the 2015-16 adopted budget, the District budgeted similarly to previous years and most likely will not use the more than \$1 million it appropriated in fund balance. Therefore, the District's recalculated fund balance will likely continue to exceed the statutory limit.

District officials told us these appropriations were overestimated to compensate for the reduction in State aid and the uncertainty of special education students moving in or out of the District. District officials also told us they were building fund balance levels to help alleviate the need to cut programs in the future. While a conservative budget, reserve funds or accumulated fund balance can be a prudent way to provide for unanticipated expenses, doing all three is excessive.

By maintaining excessive unassigned fund balance, adopting overly conservative budgets and placing unassigned fund balance in inappropriate reserves, District officials have unnecessarily levied \$112,000 in real property taxes over the last three years and reduced the transparency of District finances. Furthermore, 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.

Recommendations

District officials should:

1. Develop a plan to reduce the amount of unassigned fund balance in a manner that benefits District taxpayers. Such uses could include, but are not limited to, using surplus funds as a financing source, funding one-time expenditures or funding needed reserves to finance future capital needs.

The Board should:

2. Adopt more realistic appropriation estimates in the District's budgets to avoid raising more real property taxes than necessary.
3. Adopt a reserve policy to govern the types of reserves the District will use and the intended balances, how the reserves will be funded and used.

APPENDIX A

RESPONSE FROM DISTRICT OFFICIALS

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



WORCESTER CENTRAL SCHOOL

198 Main St., Worcester, NY 12197
Phone (607) 397-8785 • Fax (607) 397-9454
www.worcestercs.org

April 20, 2016

Mr. H Todd Eames
Office of the State Comptroller
Division of Local Government and School Accountability
Binghamton Regional Office, Suite 1702
44 Hawley Street
Binghamton, NY 13901-4417

Dear Mr. Eames:

This letter serves as the official response and action plan regarding the audit report covering July 1, 2014 to November 16, 2015. We recognize the time and effort put forward in reviewing the District's financial management procedures and welcome suggestions that would improve our operations without compromising our educational needs.

It is important to note that the fund balance allocated toward recent budgets is a direct result of the Gap Elimination Adjustment, which took more than \$1.8 Million in aid from Worcester Central since its inception. Prior to the 2009-2010 year, our fund balance allocation toward the budget was a nominal amount of \$150,000. With the reduction in State Aid in 2009-2010 and implementation of the GEA in subsequent years, the District felt compelled to allocate increasingly significant amounts of fund balance toward the respective budgets, in addition to the reserves used and staff cuts that were necessary since that time. The amount assigned grew to \$1,075,000 in 2014-2015.

Recognizing the cumbersome appearance of the situation, we are certainly committed to reducing the amount of fund balance we apportion to our annual budget, and you will note that we have already begun to reverse the trend. In 2015-16, we lowered the allocation by \$50,000 and we plan to continue to decrease it on an annual basis going forward.

At the same time, it should be noted that our total fund equity has actually decreased from June of 2013 to June of 2015. It is anticipated that it will also decrease by the end of the current school year. Regardless of the details of our budgeting process, the reduction in fund equity is a factor not to be overlooked as the District looks to maintain its economic and educational viability.

Furthermore, we have not exceeded the tax cap since it was enacted in 2012-2013. In three of the four years, we actually increased taxes by an amount less than we could have under the tax cap. We will not be asking the taxpayers to exceed the limit in 2016-17, either.

Regarding the OSC recommendations, please see below.

1. Develop a plan to reduce the amount of unassigned fund balance in a manner that benefits district taxpayers. Such uses could include, but are not limited to, using surplus funds as a financing source, funding one-time expenditures or funding reserves to finance capital needs.

The district plans to use some of its fund balance for one-time expenditures, assist future capital needs and fund needed reserves.

2. Adopt more realistic appropriation estimates in the District's budgets to avoid raising more real property taxes than necessary.

The district will review all appropriations and adjust accordingly, although it is probable that reductions in appropriations will merely be offset with corresponding reductions in fund balance allocations. Our budget will continue to allow for unanticipated costs of which school districts are often burdened.

3. Adopt a reserve policy to govern the type of reserves the District will use and the intended balances, how the reserves will be funded and used.

The district will review its balances and will develop strategic plans for expending and funding its reserves in the future.

The Worcester Central School District would again like to thank the audit staff for its suggestions.

Sincerely,

William R. Diamond,
Superintendent

APPENDIX B

AUDIT METHODOLOGY AND STANDARDS

To accomplish the objective of our audit, we performed the following steps:

- We interviewed District officials and reviewed the Board minutes to gain an understanding of the District's budget development process, including the use of fund balance.
- We documented the general fund results of operations and analyzed general fund balance trends for the 2012-13 through 2014-15 fiscal years.
- We recalculated the unassigned fund balance as a percentage of the ensuing year's appropriations to determine if the District was within the statutory limit during fiscal years 2012-14 through 2014-15.
- We documented the use of appropriated fund balance and compared it to the results of operations to determine how much appropriated fund balance was actually used to finance operations. If we determined that the appropriated fund balance was not needed, we included that amount in the 4 percent calculation to determine the unassigned fund balance as a percentage of the ensuing year's appropriations.
- We captured the budgeted use of reserve funds and compared this to the results of operations to determine how much of the appropriated reserves were used to finance operations.
- We reviewed the classification of funds reported as other restricted and tax reduction reserves to determine if they were actually unrestricted funds.
- We recalculated the 4 percent fund balance limitation for the 2012-13 through 2014-15 fiscal years to determine the unused unassigned fund balance as a percentage of the ensuing year's appropriations.
- We compared budgeted expenditures to the actual expenditures for the general fund for 2012-13 through 2014-15 to determine if there were any expenditure accounts with a variance of \$50,000 or 10 percent of the total revenue and expenditure variances. We reviewed all such accounts in detail to determine why the variance and if the District is budgeting properly.
- We reviewed the trend of real property tax levies for the 2012-13 through 2014-15 fiscal years.

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 C

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