



Bath Central School District Reserves

Report of Examination

Period Covered:

July 1, 2012 – September 30, 2016

2016M-401



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State of New York Office of the State Comptroller

Division of Local Government and School Accountability

January 2017

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 Bath Central School District, entitled Reserves. 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 Bath Central School District (District) is located in the Towns of Avoca, Bath, Cameron, Thurston, Urbana and Wheeler in Steuben County. The District is governed by a seven-member Board of Education (Board), which 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 Business Administrator (Administrator) is responsible for the District's finances, including maintaining accounting records and preparing financial reports. The Administrator is assisted by the Board-appointed District Treasurer who performs the day-to-day accounting functions.

The District operates three schools with approximately 1,500 students and 350 employees. The District's budgeted appropriations for the 2016-17 fiscal year total \$35.9 million, which are funded primarily with State aid and real property taxes.

Objective

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

- Does the District properly manage reserves in accordance with statutes?

Scope and Methodology

We examined the District's reserves for the period July 1, 2012 through September 30, 2016. We extended our scope period back to June 30, 2008 to review certain reserve activity.

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 generally agreed with our recommendations and indicated they planned to take corrective action. Appendix B includes our comment on an issue raised in the District's response.

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.

Reserves

The Board and District officials have a responsibility to ensure that all District resources, including fund balance, are properly accounted for. Fund balance plays a key role in managing a school district's operations but must be maintained within the legally established limit.¹ The Board may establish reserve funds and retain portions of fund balance² to finance future costs for a variety of specified objects or purposes but must do so in compliance with statutory requirements and properly account for them in the District's financial records.

While school districts are generally not limited as to how much money can be held in reserves, balances should be reasonable. Therefore, it is important that the Board adopt a written policy that communicates its rationale for establishing reserve funds, objectives for each reserve, targeted funding levels and conditions under which reserves will be used or replenished. The Board should periodically assess the reasonableness of the amounts accumulated in each reserve. When warranted, and in accordance with statute, the Board should reduce reserve balances to a reasonable level or liquidate and discontinue a reserve that is no longer needed or whose purpose has been achieved.

As of June 30, 2016, the District³ reported five general fund reserves totaling approximately \$1.3 million and a debt reserve in the debt service fund totaling approximately \$3.3 million.

The Board has not properly managed reserve funds. District officials could not provide evidence that approximately \$3.3 million was required to be restricted in the debt reserve. The District also maintains an unauthorized E-Rate reserve totaling approximately \$342,000. Furthermore, the District inaccurately reported one reserve totaling \$330,000 and overfunded two reserves totaling approximately \$297,000. Additionally, Business Office officials improperly restricted cash totaling approximately \$1.2 million in reserve funds that was not approved by the Board.

The Board did not properly manage reserve funds primarily because it did not adopt a written policy or exercise proper financial oversight and because the Business Office did not properly account for certain financial activity.⁴ As such, District officials were unable to

¹ New York State Real Property Tax Law (RPTL) establishes a limit on unrestricted fund balance of 4 percent of the subsequent year's budgeted appropriations.

² Fund balance represents the cumulative residual resources from prior fiscal years.

³ As per the District's audited financial statements

⁴ During the course of our fieldwork, District officials began the process with the Board to establish a reserve fund policy.

provide us with evidence that they have determined the financial need or purpose to be served for each reserve, the conditions under which reserves will be used or replenished and the rationale used to determine the appropriate funding level for each reserve. In addition, there was no evidence that District officials periodically assessed the reasonableness of the reserve balances. Further, the Board did not require periodic reports on the activity related to reserves and restricted cash. As such, the Board was not aware of the improper manner in which the Business Office accounted for both reserves and related restricted cash.

Debt Reserve — A debt reserve must be established if unexpended bond proceeds remain on a capital improvement financed with debt. The balance as well as any interest income earned on this money must be used to help finance related debt service costs.⁵ This money must be set aside and accounted for in the debt service fund.

While the District reported a balance in this reserve fund of \$3.3 million, the actual cash restricted for this reserve totaled approximately \$1.3 million as of June 30, 2016. District officials could not provide documentation to show the funds in this reserve were required to be restricted. Consequently, the difference in reported cash and actual cash in the reserve should be resolved.

Unauthorized Reserve — The District reported funding an E-Rate reserve at approximately \$342,000 as of June 30, 2016. This is not a permissible reserve as there is no statutory authority for a school district to establish this type of reserve. The Administrator stated that the prior District administration maintained this reserve to fund future technology-related purchases and repairs. Although the District was made aware, repeatedly, by its external auditors that this reserve was not permitted, the Board and District officials took no action to address it. Because there is no statutory authority for this type of reserve, the funds should not be restricted and must be included in unrestricted fund balance.

Capital Reserve — Education Law authorizes the establishment of this reserve to pay the cost of any object or purpose for which bonds may be issued. Establishment of the reserve requires voter approval. The proposition that is voted upon must specify the purpose of the reserve, the maximum amount to be funded, the probable term and the source from which the funds are to be obtained. Voter approval is also required for using the funds in the reserve.

⁵ See New York State Local Finance Law

As of June 30, 2016, the District reported a balance of approximately \$330,000 in a capital reserve. The District obtained voter approval to establish and use the reserve, and District officials properly liquidated the majority of the reserve during 2014-15, leaving a remaining balance of approximately \$2,800. As a result, we question the accuracy of the amount the District reported in this reserve. The reserve balance should be adjusted to \$2,800 since that is the amount left in the reserve.

Employee Benefit Accrued Liability Reserve (EBALR) — General Municipal Law (GML) authorizes this reserve for the cash payment of accrued and unused sick, vacation and certain other leave time due employees when they leave school district employment. GML does not set a limit on the amount of funds a school district can maintain in an EBALR. However, the balance in this reserve should be reasonable.

As of June 30, 2016, the District reported a balance of approximately \$320,000 in this reserve. We found this reserve balance to be reasonable in comparison to the documentation supporting the long-term liability. However, District officials have not used the funds in this reserve but instead annually budgeted for these costs, which totaled approximately \$140,000 over the last four years.⁶

Tax Certiorari Reserve — Education Law authorizes school districts to establish a reserve for the payment of judgments and claims resulting from tax certiorari proceedings.⁷ Any money not expended after four years must be returned to the general fund.

As of June 30, 2016, the District reported this reserve's balance was approximately \$162,000. This amount has been in this reserve for more than four continuous fiscal years, and according to District officials, the balance of these funds are not related to any specific tax certiorari proceedings that would result in future payments, as required by law. Therefore, this reserve is overfunded and should be returned to unrestricted fund balance in the general fund.

Unemployment Insurance Reserve — This type of reserve is used to fund payments made when a school district elects to reimburse the New York State Unemployment Insurance Fund for actual claims filed. As of June 30, 2016, the District reported this reserve's balance was approximately \$135,000. While the District has these funds set

⁶ Fiscal years 2012-13 through 2015-16

⁷ A tax certiorari is a legal proceeding whereby a resident who has been denied a reduction in property tax assessment by a local assessment review board or small claims procedure challenges the assessment on the grounds of excessiveness, inequality, illegality or misclassification.

aside for the payment of unemployment costs, the District has not used these funds. Rather, the Board and District officials budget for unemployment expenditures by levying taxes.

We analyzed the reasonableness of the balance in this reserve and found that it appears to be excessive. The average annual amount for unemployment costs over the last four completed fiscal years has been approximately \$18,000. Based on this level of expenditure, the District could pay related expenditures from this reserve for more than seven years. Therefore, given the lack of a written reserve policy that communicates the Board's intention for this reserve, we question the need for this reserve at its current funding level.

Restricted Cash — While the District reported general fund reserve funds totaling approximately \$1.3 million as of June 30, 2016, Business Office officials also asserted they restricted cash totaling approximately \$2.5 million⁸ to fund reserves. However, the Board did not approve any actions to reserve the additional \$1.2 million. As such, Business Office officials are improperly recording and reporting this cash as being restricted.

While it is a prudent practice for a school district to save for future expenses, improperly restricting funds in a reserve, retaining more funds than necessary in permissible reserves, improperly using reserve funds for purposes other than statutorily authorized and improperly accounting for reserve funds and related restricted cash all result in missed opportunities to use these funds in a manner that best benefits District residents.

Recommendations

The Board and District officials should:

1. Develop a written policy that indicates the amount of funds to be reserved, how each reserve will be funded and when the balances will be used to finance related costs.
2. Return money improperly maintained in the debt reserve to the general fund as unrestricted fund balance.
3. Discontinue the use of the E-Rate reserve and return the money to the general fund as unrestricted fund balance.
4. Review all reserves at least annually to determine if the amounts reserved and the cash restricted for reserves is properly accounted for, necessary and reasonably funded.
5. Review all cash reported as being restricted and determine

⁸ This amount corresponded to reconciled bank statements.

if these funds should be included in any reserves and take appropriate action to bring reserves and cash set aside into balance and into agreement with Board policy.

The Business Office officials should:

6. Ensure that all financial activity related to reserves is recorded timely and accurately in the accounting records.

APPENDIX A

RESPONSE FROM DISTRICT OFFICIALS

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

Joseph L. Rumsey
Superintendent of Schools

25 Ellas Avenue
Bath, New York 14810
www.bathcsd.org



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December 28, 2016

Mr. Jeffrey D. Mazula
Chief Examiner of Local Government and School Accountability
Office of the New York State Comptroller
Buffalo Regional Office
295 Main Street, Suite 1032
Buffalo, NY 14203-2510

RE: Bath CSD Response to Comptroller's Report

Dear Mr. Mazula,

The Bath Central School District is in receipt of the December 2016 Report of Examination from your office. We would like to thank the field team from your office for their professionalism while conducting their duties during this audit. Please accept this letter as the District's official response and corrective action plan.

The Board of Education and Business Administration at the Bath Central School District have had concerns about the methodology of some of its accounting procedures in recent years and has put in place a process to improve its accounting practices. The first phase of that process was to learn the exact nature of any accounting issues by contacting outside financial experts. In 2012, the District changed its independent auditor in order to hire an accounting firm with fresh eyes and certified public accountants to perform its external audits. Additionally, ongoing advice has been routinely solicited from the District's fiscal and legal advisors during the years covered under this OSC Audit Report.

As a result of the items of concern expressed during the most recent OSC audit process, the District has made it an immediate priority to improve accounting procedures and efficiencies. Most notably, the review completed by your independent experts has validated internal concerns under current review, and more importantly, revealed that the District was not missing any public funds. However, it did show that the District had mislabeled how it reserved funds with the use of specific reserves versus encumbered line items within the general budget (E-Rate), as well as the need for keeping adequate long-term records reserved for certain capital expenses (Mandatory Reserve for Debt Service).

Once the District learned the specifics of this report during the audit process, the District started phase two of its program by improving its procedures and remedying the problems the initial phase had revealed. In response to your recommendations, the

following steps have already been completed and/or are in process and will be completed in the near future:

A. *Policy*-- While not legally required per the Comptroller's recommendation, the Board of Education has modified policies to make sure the creation and use of reserve funds is more closely monitored in the future by the Board, the internal auditor, and the business office. Although the Board has had verbal discussions during their annual budget process, the following language is being added to policy #5500 (Fiscal Accountability) and to policy #5510 (Accounting of Funds) and will be finalized in January 2017: "*A written plan for all reserve funds must be publicly reviewed during each annual budget process and formally adopted by the Board of Education. The written plan will include a rationale of how each amount threshold is determined for each reserve fund. As an additional step of transparency, the Board will review the written plan for each adopted reserve level as part of the reorganizational meeting agenda and subsequently publish as a component of the official reorganizational meeting minutes.*"

B. *Reconcile and Review of Reserve Funds*-- In accordance with advice from our fiscal and legal advisors, and as advised in this audit, the District has moved the funds that were incorrectly allocated to reserves to either the correct reserve or to the general fund in accordance with law. Additionally, all reserves will continue to be publicly reviewed during each budget process and formally adopted by the Board of Education. As an additional step of transparency, it has been placed in our policy and procedures that the Board will openly review each adopted reserve level as part of the reorganizational meeting agenda and subsequently publish as a component of the official reorganizational meeting minutes.

C. *Business Office*-- The Business Office has put procedures in place to make sure that records regarding the sources of funded reserves are maintained for the life of that reserve and comply with all Board policies. The Business Administrator will also initiate and oversee ongoing professional development for the District Treasurer and other key business office personnel.

In response to the report's claims that the District has missed opportunities for savings, the Board, the Business Office, and the District's fiscal and legal advisors strongly disagree and maintain that the District has sustained excellent financial reserves while holding the District's tax levy steady for the last several years, all the while preserving an excellent educational program in an extremely tough economic climate. In fact, even though the District has lost over \$6.4 million due to the Gap Elimination Adjustment and has faced annual uncertainty in state aid due to difficult economic times and inequities in the funding formula, the District was still able to decrease the tax rate for the last four consecutive years.

See Note 1 Page 12

Once again, we thank you for your professional work with our office. We look forward to answering any questions and/or providing any further documentation of our efforts in the future.

Respectfully,

Joseph Rumsey
Superintendent of Schools

Michael Mishook
President-Bath CSD Board of Education

APPENDIX B

OSC COMMENT ON THE DISTRICT'S RESPONSE

Note 1

RPTL limits the amount of unrestricted fund balance school districts can maintain at fiscal year end to 4 percent of the subsequent year's appropriations. Had the Board better managed reserves, the District's unrestricted fund balance would have exceeded this limit. As RPTL requires that amounts above the limit are to be used to reduce the real property tax levy or fund reserves, the Board should balance the intent for accumulating money for future identified needs with the obligation to ensure that District residents are not overburdened. Consequently, District officials missed out on opportunities for savings for District residents.

APPENDIX C

AUDIT METHODOLOGY AND STANDARDS

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

- We interviewed District officials to gain an understanding of the operations related to reserves.
- We reviewed the Board's meeting minutes and the District's policies and procedures to identify and examine any information that related to the Board's oversight and responsibilities when establishing, funding and maintaining reserves.
- We reviewed Board resolutions to determine if the Board had properly established the reserve funds reported as of June 30, 2016.
- We reviewed financial records, bank statements, balance sheets and general ledgers to document the reserve fund balances reported as of June 30, 2016.
- We requested substantiation from District officials as to how they calculated and determined the appropriate balances for each of the reserves. We evaluated the balances in each of the reserves as of June 30, 2016 for reasonableness.
- We evaluated select expenditures that would be eligible to be paid from a reserve for the last four years. We calculated the average amount and determined how many years' worth of payments could be made from the related reserve.

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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