

Lancaster Central School District

Financial Management

AUGUST 2022



OFFICE OF THE NEW YORK STATE COMPTROLLER
Thomas P. DiNapoli, State Comptroller

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Report Highlights

Lancaster Central School District

Audit Objective

Determine whether the Lancaster Central School District (District) Board of Education (Board) and District officials properly managed fund balance and reserve funds.

Key Findings

The Board and District officials did not properly manage fund balance and reserve funds. The Board and District officials:

- Did not implement our prior audit's recommendations¹ to improve their budgeting practices and be more transparent with District residents and taxpayers.
- Overestimated budgetary appropriations by an annual average of \$13 million (13 percent).
- Appropriated, on average, \$2.8 million of fund balance that was not used.
- Did not use reserves in accordance with adopted budgets, overfunded two reserves by approximately \$3.3 million, and did not use a debt reserve, with a balance of \$8.3 million, to pay debt as required.

These practices resulted in real property tax levies that were higher than necessary.

Key Recommendations

- Adopt budgets that include reasonable estimates for appropriations, appropriated fund balance and reserves that will be used to fund operations.
- Properly use reserves and reduce overfunded reserves.

District officials did not agree with all of our findings. Appendix B includes our comment on issues raised in the District's response.

Background

The District serves the Towns of Lancaster, Cheektowaga and Elma in Erie County.

The seven-member Board is responsible for managing and controlling 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 Assistant Superintendent of Business and Support Services (Assistant Superintendent) oversees the District's Business Office and maintains its financial records. The Board, Superintendent and Business Administrator are responsible for developing the budget.

Quick Facts

2021-22 Appropriations	\$117.9 million
Enrollment	5,400
Employees	950

Audit Period

July 1, 2018 – January 18, 2022

¹ Lancaster Central School District – Financial Condition (2016M-101)

Financial Management

How Should Fund Balance Be Properly Managed?

To properly manage fund balance, a school board should adopt realistic and structurally balanced budgets based on historical or known trends in which recurring revenues finance recurring expenditures. In preparing the budget, a school board and school district officials must estimate the amounts a school district will spend and receive, the amount of fund balance that will be available at fiscal year-end to use toward the next year's budget and the expected real property tax levy needed to balance the budget. Accurate estimates help ensure that the tax levy is not greater than necessary.

A school board is permitted to retain both a specified amount of fund balance for cash flow needs or unexpected expenditures, and reserves for other identified or planned needs. New York State Real Property Tax Law Section 1318 currently limits the amount of surplus fund balance that a school district can retain to no more than 4 percent of the next year's budget. The school board must use any surplus fund balance over this percentage to reduce the upcoming fiscal year's real property levy or to fund needed reserves.

The Board and District Officials Appropriated Fund Balance and Reserves That Were Not Needed

While the Board and District officials have generally maintained surplus fund balance levels in accordance with the statutory limit, District officials consistently appropriated fund balance and reserve funds that were not needed or actually used to fund operations.

The Board appropriated an average of \$2.8 million of fund balance and \$5.2 million of reserves to finance operations in each of the last three adopted budgets.² However, the District did not use these funds as budgeted, because the Board adopted budgets that consistently overestimated appropriations by an average of approximately \$13 million (13 percent) per year or a cumulative total of approximately \$38.5 million (Figure 1).

Figure 1: Overestimated Appropriations (In Millions)

	2018-19	2019-20	2020-21	Totals
Appropriations^a	\$107.8	\$110.1	\$114.9	\$332.8
Less: Adjusted Expenditures^b	97.5	95.3	101.5	294.3
Overestimated Appropriations	\$10.3	\$14.8	\$13.4	\$38.5
Percentage Overestimated^c	11%	16%	13%	13%

a) Includes encumbrances (prior year funds scheduled to be paid or disbursed in the current fiscal year and recorded with the current year's expenditures)
b) Includes budgeted portion of transfers to other funds
c) Overestimated appropriations divided by adjusted total expenditures

² Budgets for fiscal years 2018-19 through 2020-21

The most significant budget variances were found in the line items for:

- Employee benefits,
- Debt service,
- Teaching-regular,
- Pupil transportation,
- Pupil services and
- Central services.

Each budget variance averaged between \$1.4 million and \$3.6 million annually. Because large portions of these costs are determined by contractual agreements or readily estimated such as debt service payments, officials had sufficient information to estimate anticipated expenditures more reasonably. The Assistant Superintendent declined to provide an explanation of the consistent overestimation of certain expenditures and said that she would include her explanation in the District's response letter to the audit.

When school district officials appropriate fund balance and reserves in a budget developed with realistic revenue and expenditure estimates, the school district should incur a planned operating deficit in the coming fiscal year equal to the amount of fund balance and reserves appropriated. This allows a school district to use reserves and reduce excess fund balance accumulated in prior years.

Because the Board overestimated appropriations, it appeared the District needed to use appropriated fund balance and reserves to close projected budget gaps. In reality, the District's actual annual revenues were more than sufficient to cover annual expenditures. As a result, the District experienced operating surpluses each year and realized a cumulative operating surplus totaling approximately \$17 million and fund balance continued to increase. Over the three-year period,³ general fund balance increased by more than \$7.2 million or nearly 20 percent.

The Board's and District officials' practice of appropriating fund balance that is not needed is, in effect, a reservation of fund balance that is not provided for by statute and circumvents the statutory limit on surplus fund balance. Including appropriated reserve funds in the annual budget that have a history of not being needed or used does not afford a transparent budget process to taxpayers.

The practice of appropriating fund balance that is not needed artificially reduces the amount of surplus fund balance subject to the statutory limit. For perspective, when unused appropriated fund balance is included in surplus fund balance, the District's surplus fund balance would have exceeded the statutory limit by 2 to 8 percentage points over the last three fiscal years (Figure 2). Recalculated fund balance totals range from \$6.4 million (6 percent) to \$13.3 million (12 percent).

³ Fiscal years 2018-19 through 2020-21

Figure 2: Recalculated Surplus Fund Balance Reported Fiscal Year-End (In Millions)

	2018-19	2019-20	2020-21
Surplus Fund Balance	\$4.3	\$10.2	\$4.7
Plus: Unused Appropriated Fund Balance	2.1	3.1	3.5
Recalculated Surplus Fund Balance	\$6.4	\$13.3	\$8.2
Next Year's Budget	\$109.5	\$114.5	\$117.9
Recalculated Surplus Fund Balance as a Percentage of Next Year's Budget	6%	12%	7%

Based on our review of the 2021-22 budget, and year-to-date operating results as of December 2021, we project that the District will generate another operating surplus in 2021-22, and it will not need to use the \$3.5 million in fund balance appropriated in the budget.

The Assistant Superintendent said that fund balance and reserves were not used as budgeted because the COVID-19 pandemic resulted in some expenditures being less than anticipated. We question this explanation considering we had previously reported⁴ on the District's similar financial management practices well before the pandemic. Our previous and current audits have demonstrated that actual expenditures have been consistently less than budgeted appropriations.

Had the Board and District officials adopted more reasonable budgets, they could have considered using excess funds towards paying one-time expenditures and/or funding needed reserves, paying off debt or reducing the tax levy. Further, despite its annual operating surpluses, the Board continued to increase the tax levy on average by approximately 3 percent each year. The Board on average increased the tax levy by \$5.4 million (10 percent) from 2018-19 to 2021-22.

How Should the Board Properly Manage Reserve Funds?

School districts are allowed by law to establish reserves and accumulate funds for certain future purposes (e.g., unemployment or retirement expenditures). While school districts are generally not limited as to the amount of funds that can be held in reserves, the balances should be reasonable. A school board should balance the intent for accumulating funds for identified future needs with the obligation to ensure real property taxes are not higher than necessary.

To help ensure that reserve balances do not exceed the amount necessary to address long-term obligations or planned expenditures, a school board should adopt a comprehensive written policy that states its rationale for establishing reserve funds and the objectives for each reserve, maximum targeted funding

⁴ Lancaster Central School District – Financial Condition (2016M-101)

levels, conditions under which reserves will be used or replenished, and a periodic review of reserve balances to assess reasonableness.

Reserves Were Overfunded and Not Being Used

Although the Board adopted a written reserve fund policy that included optimal funding levels, conditions necessary for when the funds would be used, how and when reserve funds would be replenished, and the periodic review of reserves for reasonableness, we question if this review was adequate. Our prior audit recommended that the District take appropriate action to address overfunded reserves. In the District's response to our previous audit, officials stated they would review reserve funds annually and make a determination of the necessity and reasonableness and transfer reserve funds if needed. Instead, the District increased its reserves by \$8.7 million since our last audit.

As of June 30, 2021, the District reported 10 reserves in the general fund totaling approximately \$35 million, and one reserve in the debt service fund totaling approximately \$8.3 million. While the Board had adopted a written reserve fund policy and written reserve plan and properly established the reserves, the employee benefit accrued liability reserve (EBALR) and the tax certiorari reserve, with balances totaling approximately \$14.7 million, were overfunded by approximately \$3.3 million. In addition, the retirement contribution reserve was funded at a higher level than the ideal balance noted in the District's reserve plan and the debt reserve was not used as required. The reserves for teachers' retirement contribution, insurance, property loss, unemployment insurance, workers' compensation, capital projects and buses, totaling \$13 million were properly used and reasonably funded.

EBALR – The Board established this reserve to pay accrued leave time benefits due to employees upon termination of employment. As of June 30, 2021, this reserve had a balance of approximately \$11.8 million. The corresponding liability was approximately \$10.5 million, which means this reserve is overfunded by approximately \$1.3 million (13 percent).

Debt Reserve – Certain funds are required to be set aside and used to pay related debt. For example, a debt reserve must be established if unexpended bond proceeds remain on a capital improvement or when a capital improvement has outstanding debt remaining at the time of sale. As of June 30, 2021, the reserve had a balance of nearly \$8.3 million and, aside from interest earnings, had not changed.

While District officials were able to demonstrate that the balance consisted of unexpended bond proceeds and interest, these funds were not used to pay corresponding outstanding debt as required. During the last three years, the District paid \$17.5 million in related debt service payments from the general fund.

...[T]he employee benefit accrued liability reserve (EBALR) and the tax certiorari reserve, with balances totaling approximately \$14.7 million, were overfunded by approximately \$3.3 million.

...[T]hese funds were not used to pay corresponding outstanding debt as required.

The Board presented budgets to the public showing that the District would use over \$5.2 million from this reserve to help pay debt; however, this did not happen. Instead, the payments were made from general fund appropriations.

Retirement Contribution Reserve – The Board established a retirement contribution reserve to fund payments to the New York State and Local Retirement System. As of June 30, 2021, this reserve had a balance of approximately \$7.4 million.

This reserve was not used as intended and presented to the public. The Board presented budgets to the public showing that the District would use nearly \$8.6 million from this reserve to fund these costs. However, for fiscal years 2018-19 through 2020-21, even though the District paid over \$6 million in retirement costs, no reserve funds were used because the District instead used general fund appropriations to pay for these costs.

Furthermore, the District's written reserve fund plan indicates that the ideal balance is nearly \$3.6 million based on 20 percent of non-instructional payroll, but the balance as of June 30, 2021 was more than double this amount. The plan does acknowledge that due to fluctuations with the contribution rate, the balance should be sufficient to cover three years of retirement costs for non-instructional employees, but then the District did not use the funds over that amount.

Tax Certiorari Reserve – A tax certiorari reserve can be established to pay for judgments and claims resulting from tax certiorari proceedings. Funds in the reserve that will not be reasonably required to pay a judgment or claim must be returned to the general fund on or before the first day of the fourth fiscal year following the deposit of funds to the reserve.

As of June 30, 2021, the reserve had a balance of approximately \$2.9 million. We found that approximately \$900,000 of the reserve's balance was supported by tax certiorari claims. As a result, this reserve was overfunded by over \$2 million and should have been returned to the general fund as unrestricted fund balance (i.e., surplus fund balance). Had that occurred, the District would have likely exceeded the statutory limit.

The Assistant Superintendent told us that the EBALR overfunding was partially due to the District's erroneous calculation which included employees that did not meet eligibility requirements, and that she used her judgment to fund the tax certiorari conservatively in anticipation of claims. She also told us that they did not use the debt reserve because it would have added more to the surplus general fund balance. However, had they done this, the District could have reduced the tax levy. Furthermore, even though the retirement contribution reserve was not used to fund expenditures, she believes that the balance is reasonable and complies with the District's reserve plan.

By maintaining excessive reserves and not using reserves as budgeted or as required, the Board and District officials have missed opportunities to lower the property tax burden for District residents and withheld funds from being used to meet District needs.

What Do We Recommend?

The Board and District officials should:

1. Develop and adopt budgets that include reasonable estimates for appropriations and the amount of fund balance and reserves that will be used to fund operations.
2. Discontinue the practice of appropriating fund balance and reserves that are not needed or used to fund operations.
3. Ensure that the debt reserve is used to pay related debt as required.
4. Review the EBALR balance and develop a plan to reduce the balance to a reasonable level by using it for allowable expenditures in accordance with statute.
5. Return excess funds in the tax certiorari reserve to unrestricted fund balance in the general fund.
6. Conduct a more comprehensive review of all reserves at least annually to determine whether the amounts reserved are necessary, reasonable, and comply with the reserve plan. Any excess funds should be identified and transferred to unrestricted fund balance (where allowed by law) or to other needed reserves established and maintained in compliance with statutory directives.

...[T]he Board and District officials have missed opportunities to lower the property tax burden for District residents. ...

Appendix A: Response From District Officials

Lancaster Central School District

177 Central Avenue
Lancaster, NY 14086
(716) 686-3201

Michael J. Vallely, Ph.D.
Superintendent of Schools

June 21, 2022

Office of the State Comptroller (OSC)
Buffalo Regional Office
Melissa A. Myers, Chief Examiner
295 Main Street, Suite 1032
Buffalo, NY 14203-2510

Dear Ms. Myers:

The Lancaster Central School District acknowledges the draft report of examination entitled Financial Management covering the time period July 1, 2018 through January 18, 2022. The Board of Education appreciates the opportunities for improving operations and governance provided by OSC and will consider OSC's opinions on the District's financial management as decisions are made in the best interest of our students in the future.

Key Recommendations

The audit report includes two key recommendations. The first recommendation is that the District adopt budgets that include reasonable estimates for appropriations, appropriated fund balance, and reserves that will be used to fund operations. The District has always budgeted conservatively and stands behind its budgeting practices. The Board of Education has always been fiscally prudent in protecting against the financial difficulties of past years and looking into the future.

Many areas of the expenditure budget can be extremely variable in a given year. In fact, during the audit period for this report, special education costs were seriously impacted with the creation of a group home within the District and the education and transportation costs of numerous high cost students becoming our financial responsibility. Additionally, the COVID-19 pandemic was certainly not anticipated, however the district was able to fund the PPE, cleaning supplies, technology, furniture, equipment, staffing, resources, and services necessary to continue the education of our students and return them to regular, full time instruction within the NYS and local guidelines as soon as possible. Heading into the 2022-23 school year, we are already anticipating budget variances due to current utility and fuel pricing, contract transportation costs increased at the 6.3% inflation rate, and drastic supply and service cost price increases beyond what we budgeted for. The Board of Education feels strongly that we are able to navigate these fluctuations without negatively impacting our student programs and opportunities.

See
Note 1
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The District's revenue budgeting follows the same conservative practices. As the Comptroller is well aware, the local ability to raise funds through the property tax levy is limited by the state's tax cap and any one time reductions would have a compounding effect for years to come. Further, if our revenues in a given school year exceed our actual expenditures and reserve funds and appropriated fund balance do not need to contribute towards the revenue receipts, those funds are available for a future year. These funds are one time revenues and to deplete them makes the district extremely susceptible to fiscal stress.

The second recommendation is that the District properly use reserves and reduce overfunded reserves. The District's reserve funds have been properly established, funded and utilized in accordance with statutory requirements and Board of Education policy. As noted earlier, if reserve funds and appropriated fund balance do not need to contribute to a budget in a given year, those funds are available for a future year. These funds are one time revenues and to deplete them makes the district extremely susceptible to fiscal stress.

As stated in the report, the District utilizes a written plan for funding and use of each of the reserve funds. The plan is posted and viewable to the public on the District's website. Annually, the Board of Education is provided with each reserve fund's transactions, including transfers in and transfers out, for approval in public session at a regular board of education meeting. Use of the reserve funds are also discussed numerous times throughout the budget process in public session and included in budget publications provided to the community. The budgeted use of reserves and all reserve transactions align with statutory requirements, Board of Education Policy, and the District's written reserve plan.

The District acknowledges two overfunded reserves. The EBAL reserve is considered overfunded due to a clerical error with the 6/30/21 calculation. The liability associated with this reserve is recalculated each year and the balance is adjusted accordingly, so the balance will be correct again as of 6/30/22. The balance of this reserve was correct in the other two fiscal years in the audit period.

The tax certiorari reserve is overfunded respective to the liability as of 6/30/21. As of the 8/1/21 deadline for tax assessment challenges passed, the liability was \$2 million more than the 6/30/21 balance. Liquidating the reserve on 6/30/21 only to need the liquidated funds for the same liability in one month was not fiscally responsible and therefore, the balance was maintained. The balance of this reserve matched the 6/30 liability in the other two fiscal years in the audit period.

Transparency

There are statements throughout the report regarding transparency, implying a lack of transparency by the school district. The District would like to set forth that all NYS laws and regulations with respect to transparency reporting, budgeting, and financial reporting are met and/or exceeded by the District.

Conclusion

The Lancaster Central School District has been consistently recognized by Buffalo Business First for its cost effectiveness, and spending per pupil. Compared to the 673 New York State school districts, Lancaster CSD has the sixth lowest spending per pupil rate across all school districts. The Board of Education believes our financial management practices provide long-term fiscal stability for our district and help provide the educational program our community and, more importantly, our parents and students expect.

The District acknowledges the opinions set forth in your agency's audit. We will certainly use the examination as a learning experience and a tool for improving operations and governance moving forward. As required, a corrective action plan will be prepared and provided within the ninety day statutory requirement.

Sincerely,

Michael Sage
Board President

Michael J. Vallely, Ph.D.
Superintendent of Schools

Appendix B: OSC Comment on the District's Response

Note 1

While certain expenditures may on occasion fluctuate or be susceptible to varying degrees of uncertainty, the District has consistently spent less than budgeted year after year. This practice contributed to a significant accumulation of fund balance which could and should be used in a manner more beneficial to the taxpayers. The District would have needed to incur unanticipated expenditures of more than \$13 million before even needing to use surplus fund balance or reserves. Further, special education expenditures for high-cost students are typically eligible for additional State aid and reimbursed in the following fiscal year.

Appendix C: Audit Methodology and Standards

We conducted this audit 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. To achieve the audit objective and obtain valid audit evidence, our audit procedures included the following:

- We interviewed District officials and Board members and reviewed Board meeting minutes, resolutions and reserve plans and policies to gain an understanding of the District's financial management policies and procedures and budgeting practices.
- For fiscal years 2018-19 through 2020-21, we:
 - Reviewed the adopted general fund budgets to assess whether they were reasonable and structurally balanced by comparing adopted budgets with actual results of operations and analyzing significant budget-to-actual variances.
 - Analyzed general fund financial records and evaluated any factors contributing to fluctuations in fund balance including real property tax levy fluctuations and trends.
 - Reviewed the District's results of operations and calculated surplus fund balance as a percentage of the next year's appropriations. We also calculated the percentage after adding back unused appropriated fund balance.
 - Reviewed reserve fund activity to determine whether reserve funds were used for related expenditures.
- We compared the adopted 2021-22 general fund budget with actual results of operations through December 31, 2021 and projected results through June 30, 2022 to assess whether similar budgeting and expenditure patterns existed and will continue.
- We reviewed the adopted 2021-22 budget to assess whether any significant changes had been made to the District's budgeting practices and tax levy.
- We reviewed reserve fund balances as of June 30, 2021 to assess whether they were reasonable and being properly used and funded. We reviewed Board minutes to assess whether reserves were properly established.
- We requested substantiation from District officials as to how they calculated balances for each of the reserves. We evaluated the balances in each reserve as of June 30, 2021 for reasonableness and to determine whether their calculations were correct.

We conducted this performance audit in accordance with GAGAS (generally accepted government auditing standards). 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.

The Board has the responsibility to initiate corrective action. 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, 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. 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 CAP should be filed with the District Clerk's Office and posted to the District's website for public review.

Appendix D: Resources and Services

Regional Office Directory

www.osc.state.ny.us/files/local-government/pdf/regional-directory.pdf

Cost-Saving Ideas – Resources, advice and assistance on cost-saving ideas

www.osc.state.ny.us/local-government/publications

Fiscal Stress Monitoring – Resources for local government officials experiencing fiscal problems

www.osc.state.ny.us/local-government/fiscal-monitoring

Local Government Management Guides – Series of publications that include technical information and suggested practices for local government management

www.osc.state.ny.us/local-government/publications

Planning and Budgeting Guides – Resources for developing multiyear financial, capital, strategic and other plans

www.osc.state.ny.us/local-government/resources/planning-resources

Protecting Sensitive Data and Other Local Government Assets – A non-technical cybersecurity guide for local government leaders

www.osc.state.ny.us/files/local-government/publications/pdf/cyber-security-guide.pdf

Required Reporting – Information and resources for reports and forms that are filed with the Office of the State Comptroller

www.osc.state.ny.us/local-government/required-reporting

Research Reports/Publications – Reports on major policy issues facing local governments and State policy-makers

www.osc.state.ny.us/local-government/publications

Training – Resources for local government officials on in-person and online training opportunities on a wide range of topics

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Contact

Office of the New York State Comptroller
Division of Local Government and School Accountability
110 State Street, 12th Floor, Albany, New York 12236

Tel: (518) 474-4037 • Fax: (518) 486-6479 • Email: localgov@osc.ny.gov

www.osc.state.ny.us/local-government

Local Government and School Accountability Help Line: (866) 321-8503

BUFFALO REGIONAL OFFICE – Melissa A. Myers, Chief Examiner

295 Main Street, Suite 1032 • Buffalo, New York 14203-2510

Tel (716) 847-3647 • Fax (716) 847-3643 • Email: Muni-Buffalo@osc.ny.gov

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