



Olean City School District

Reserve Funds

2022M-187 | June 2023

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Report Highlights

Olean City School District

Audit Objective

Determine whether the Olean City School District (District) Board of Education (Board) and District officials properly established and used reserve funds and maintained them at reasonable levels.

Key Findings

The Board and District officials properly established the District's nine general fund reserve funds totaling \$10.9 million but did not use the reserve funds and could not demonstrate that approximately \$8 million held in seven of these reserves was reasonable or needed.

In addition, the Board and District officials did not:

- Adopt a comprehensive written reserve fund policy or transparently fund reserves.
- Take appropriate action to address overfunded reserves.

Funding reserves at levels higher than necessary for operations and/or need creates an undue burden on taxpayers and withholds funds that may have been used in a more beneficial way.

Key Recommendations

- Adopt a comprehensive written reserve fund policy.
- Transparently fund reserves and maintain needed reserves at reasonable levels.

District officials generally agreed with our recommendations and indicated they planned to initiate corrective action. Appendix B includes our comments on issues raised in the District's response.

Background

Our previous District audit, released in 2016, included findings on excessive reserve fund balances. As of June 30, 2015, the audit reported the District had eight general fund reserves totaling about \$5.4 million. The audit recommended officials adopt a comprehensive reserve policy and address overfunded reserves.

The District serves the City of Olean and the Towns of Olean and Portville in Cattaraugus County. The nine-member Board manages and controls the District's financial and educational affairs. The Superintendent of Schools and other administrative staff are responsible for managing the District.

The Business Administrator (Administrator) oversees the District's Business Office and maintains its financial records. The Board, Superintendent of Schools and Administrator are responsible for properly establishing, funding and using reserves.

Quick Facts

2022-23 Appropriations	\$47.3 million
2021-22 Year-End Reserve Balances	\$10.9 million
Number of Reserve Funds	9

Audit Period

July 1, 2018 – September 2, 2022

Reserve Funds

School districts are allowed to establish reserves and accumulate funds for certain future purposes (e.g., unemployment or retirement expenditures).

How Should a School Board Properly Manage Reserve Funds?

To properly manage reserve funds, a school board should adopt a comprehensive written reserve fund policy that states its rationale for establishing reserve funds and the objectives for each reserve, maximum targeted funding levels, conditions under which reserves will be used or replenished, and a periodic review of reserve balances to assess reasonableness. A reserve fund policy helps ensure that reserve balances are reasonably funded and do not exceed the amount necessary to address long-term obligations or planned expenditures.

While school districts are generally not limited to the amount of funds that can be held in reserves, a school board should maintain reserve balances which are reasonable. A school board should balance the intent for accumulating funds for identified future needs with the obligation to help ensure real property taxes are not higher than necessary.

School districts are required to set certain funds aside and use them to pay related debt. A board should ensure compliance with New York State Local Finance Law (LFL) Section 165 that requires a debt reserve to be established if unexpended bond proceeds remain after a capital improvement project is completed. The debt reserve should be recorded in the debt service fund and used for related debt principal and interest payments. A board should also ensure compliance with New York State General Municipal Law (GML) Section 6-l that requires school districts to establish a debt reserve when a capital improvement has outstanding debt remaining at the time of sale.

In addition, school boards should include amounts to be placed in reserve funds in the annual budget. By making provisions to raise resources for reserve funds explicit in the proposed budget, a school board gives voters, residents and taxpayers an opportunity to know its plan for funding reserves.

Reserves Were Not Properly Managed

Even though our prior audit recommended that officials take appropriate action to address overfunded reserves and adopt a comprehensive written reserve fund policy, officials did not take action. District officials acknowledged our perspective on reserve fund management, but they felt their management of reserves was within their legal authority and was adequate.

The prior audit reported as of June 30, 2015, the District reported eight reserves in the general fund totaling about \$5.4 million. As of June 30, 2022, the District reported nine reserves in the general fund totaling \$10.9 million.

... [A] school board should adopt a comprehensive written reserve fund policy. ...

The Board has not updated its written reserve fund policy that it adopted in February 2011. The policy is still inadequate because it does not address:

- The rationale for establishing each reserve,
- Specific objectives for the reserves,
- Funding methods,
- Optimal funding levels or
- Conditions under which the reserves would be used or replenished.

Although the Administrator continued to create a yearly reserve fund plan that the Board reviewed and approved, these plans were also inadequate because they did not address maximum funding levels for each reserve or when reserve funds should be used and replenished. It is essential that the Board first establish its expectations through a Board-adopted policy that District officials can further implement through the development of comprehensive written plans and procedures.

While the reserves were properly established, they were generally not used even though the District appropriated \$1 million in reserves during the audit period. Except for the capital reserve, which had a \$2.9 million voter-approved balance as of June 30, 2022, District officials could not demonstrate that the approximately \$8 million held in the following reserves was reasonable and necessary:

- Retirement contribution,
- Insurance,
- Employee benefit accrued liability reserve (EBALR),
- Tax certiorari,
- Unemployment insurance,
- Teachers' retirement contribution and
- Workers' compensation.

These reserves were overfunded based on a review of eligible liabilities and a historical cost comparison. Furthermore, the Board and District officials did not transparently fund reserves by including a provision to fund reserves in the annual budget. From July 1, 2018 through June 30, 2022, the reserves increased by more than \$3.3 million because of unbudgeted transfers at fiscal year-end. Additionally, the District improperly restricted nearly \$58,000 of unexpended bond proceeds in a debt reserve in the general fund instead of in the debt service fund and was not using the funds to pay related debt service payments as required.

[T]he Board and District officials did not transparently fund reserves. ...

Retirement Contribution Reserve (New York State and Local Retirement System)– Although the Board established this reserve to fund contributions to the New

York State and Local Retirement System and the reserve, with a balance of approximately \$4 million, is sufficient to pay approximately seven years of the District's retirement contribution expenditures, District officials did not use the reserve fund to pay for these expenditures.

From 2018-19 through 2021-22, the District incurred associated retirement contribution costs totaling approximately \$2.2 million. During this same time period, the District appropriated a total of \$753,000 from this reserve to help fund these expenditures. However, the District did not use reserve funds to pay for these expenditures and the reserve balance, other than interest earnings, remained unchanged.

The Administrator told us that she did not recommend reducing the reserve because surplus fund balance would exceed the statutory limit¹ if the reserve was reduced. However, the reserve could be used to pay for retirement contributions instead of levying taxes to do so without increasing surplus fund balance. In addition, because the District has not used the reserve fund or formalized a reserve policy stating when the reserve fund will be used, we question why the District is maintaining a high reserve balance.

Insurance Reserve – The Board established this reserve to pay certain uninsured losses, claims, actions or judgments. As of June 30, 2022, this reserve had a balance of \$1.5 million. According to the Administrator's plan, these funds have been accumulated to pay for potential replacement of technology assets, such as laptops and tablets, given to students and staff to use. Currently, the District has approximately 3,000 laptops and tablets in use by students and staff.

Although the Administrator's 2022 plan did not recommend any additional funding for this reserve, we question why the District is maintaining this reserve at this level. According to the District's Erie 1 Board of Cooperative Educational Services agreement, the average replacement cost for laptops and tablets is approximately \$500 per device. We calculated that it would take replacing all 3,000 devices at the same time to exhaust this reserve. This is highly unlikely. District officials could reduce this reserve to a more reasonable level and use the excess funds for a purpose more beneficial to current taxpayers.

EBALR – The Board established this reserve to pay accrued leave time benefits due to employees when separating from District employment. As of June 30, 2022, this reserve had a \$713,000 balance. The corresponding potential liability, that we calculated using only eligible employees, was \$130,000. Consequently this reserve was overfunded by \$583,000.

¹ New York State Real Property Tax Law Section 1318 currently limits the amount of surplus fund balance that a school district can retain at fiscal year end to 4 percent of the next year's budget. Any surplus fund balance over this percentage must be used to reduce the upcoming fiscal year's real property tax levy or to fund needed reserves.

From July 1, 2018 through June 30, 2022, the District paid approximately \$254,000 in separation payments to employees for accrued leave that could have been paid from this reserve. The Administrator and the former² Board President told us the District has not used funds from the EBALR because they were not needed due to general fund operating surpluses. The Administrator told us that the EBALR overfunding was a result of calculations based on the recommendations of the District's external auditors that included costs for employees that did not meet eligibility requirements. The Administrator's 2022 plan includes increasing the funding for this already overfunded reserve.

Tax Certiorari Reserve – A tax certiorari reserve can be established to pay for judgments and claims resulting from tax certiorari proceedings (legal proceedings resulting from real property tax assessment challenges). 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, 2022, the reserve had a \$469,000 balance and was not needed or used for tax certiorari claims. The Business Administrator was not aware that the money had to be returned to the general fund after four years. Because the District had no tax certiorari claims associated with the balance of the reserve, the funds should be returned to the general fund as surplus fund balance.

Unemployment Insurance Reserve – The Board established this reserve for the payment of contributions to the New York State Unemployment Insurance Fund. As of June 30, 2022, the reserve had a \$381,000 balance. If unemployment costs continue to average \$20,000 per year, as they have over the last four years, the reserve at its current funding level would be sufficient to pay average annual unemployment expenditures for more than 18 years.

We question the need to maintain the reserve at its current level when District officials could reduce it to a reasonable level and use the excess funds for a purpose more beneficial to current taxpayers.

Retirement Contribution Reserve (New York State Teachers' Retirement System)– The Board established this reserve to fund contributions to the New York State Teachers' Retirement System. Districts are allowed to reserve up to 10 percent of teachers' salaries paid in the preceding fiscal year. As of June 30, 2022, this reserve had a balance of approximately \$310,000, which was within the allowable limit.

From 2018-19 through 2021-22, the District incurred associated retirement contribution costs totaling approximately \$5.2 million, which were budgeted for

² Resigned effective October 1, 2022.

and paid from general fund appropriations, not the reserve. The Administrator and the former Board President told us they did not use this reserve because the funds were not needed as a result of general fund operating surpluses. However, we question why the District is maintaining this reserve because the District has no formalized policy stating when it will use the reserve and did not use the reserve funds during the audit period. Because officials did not include the reserve's funding in the annual operating budget, officials missed an opportunity to be transparent with District taxpayers.

Workers' Compensation Reserve – The Board established this reserve to pay for workers' compensation claims. As of June 30, 2022, the reserve had a balance of approximately \$308,000.

From 2018-19 through 2021-22, the District paid approximately \$358,000 in workers' compensation claims. No reserve funds were used to pay for these expenditures and the reserve balance has remained unchanged. The Administrator and the former Board President told us the District did not use the reserve because it did not need to. Instead of using the reserve to pay for these expenditures, the District chose to levy taxes each year for these costs.

The District had no detailed written policy providing the expected use and funding of this reserve, and the reserve's balance is sufficient to pay average annual workers' compensation claims for the next three years. Therefore, we question why the District maintains this reserve.

Debt Reserve – The District reported a debt reserve in the general fund with a \$355,000 balance as of June 30, 2022. The Board properly funded this reserve with the proceeds from the sale of a District building in 2014. In 2017, the District added \$58,000 of unexpended bond proceeds into the reserve. While District officials properly established this reserve and restricted the sale proceeds in the general fund, the District was required to restrict the unexpended bond proceeds in a separate debt reserve in the debt service fund. Furthermore, during our audit period, the District has not used the reserve to pay debt principal or interest payments and has instead levied taxes for this purpose. The Administrator told us the District did not use this reserve because it had sufficient appropriations in the general fund annual budget for debt service. By not using the debt reserve as intended, the Board and District officials have missed opportunities to lower the real property tax levy.

These reserves were overfunded, in large part, because the Board had not taken an active role in managing and overseeing reserve fund activity by establishing a comprehensive written reserve fund policy. Additionally, while the District appropriated \$1 million in reserve funds during the audit period, it did not use these funds because it experienced general fund operating surpluses. The Administrator – who was relatively new to serving the District and was not present during our previous audit – and the former Board President – told us that they and

... [T]he Board had not taken an active role in managing and overseeing reserve fund activity. ...

the Board did not realize that the existing reserve fund policy was inadequate or that guidance from our Office was available for developing a more comprehensive reserve fund policy.³

The Administrator told us that she did not include provisions to increase reserves in the annual budget because, historically, the decision to increase reserves had not been based on anticipated need. Instead, it was based on the availability of funds or operating results. However, if reserve funds were necessary and part of an overall financial plan, their funding should be planned and included in the operating budget to help ensure proper funding is available for anticipated costs.

Because the Board did not adopt a comprehensive written reserve fund policy, District officials could not demonstrate that the balances held in certain reserves were needed or reasonable. Funding reserves at levels higher than necessary for operations and/or need creates an undue burden on taxpayers and withholds funds that may have been used in a more beneficial way.

What Do We Recommend?

The Board and District officials should:

1. Develop and adopt a comprehensive written reserve fund policy that includes the rationale for establishing each reserve, the specific objectives for the reserves, funding methods, optimal funding levels, and conditions under which the reserves would be used or replenished.
2. Transparently fund reserves by including anticipated funding of reserves in the annual operating budget.
3. Review all reserve balances to determine whether the amounts reserved are necessary and reasonable. Reduce overfunded reserves, in accordance with applicable statutes, to reasonable levels; and liquidate and discontinue reserve funds that are no longer needed or whose purpose has been achieved.
4. Use the debt reserve to pay debt instead of levying real property taxes for this purpose.

District officials should:

5. Transfer funds in the tax certiorari reserve to the general fund as unrestricted fund balance (i.e., surplus fund balance).
6. Transfer unexpended bond proceeds improperly restricted in the general fund to a debt reserve in the debt service fund and use the proceeds to pay the related debt principal and interest payments as required.

³ *Local Government Management Guide Reserve Funds* <https://www.osc.state.ny.us/files/local-government/publications/pdf/reserve-funds.pdf>

Appendix A: Response From District Officials



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VIA EMAIL

April 26, 2023

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To Whom It May Concern:

We want to thank the New York State Comptroller and Auditors of the Comptroller's Office for the recent audit of the Olean City School District. We appreciate the recommendations you have provided our District on how to better manage our reserve funds and be more transparent with our community and taxpayers.

The Board of Education and the District Administration will develop a comprehensive Corrective Action Plan in the coming months. We understand the need to develop a more comprehensive written reserve plan, and we understand the importance of transparency around these reserve funds with our community and taxpayers. The difficulty we face with the funds is that the future of education funding is unpredictable. There is no definite Foundation Aid formula or understanding of whether or not the Foundation Aid will be fully funded for Districts to base our future revenues. This forces Districts to budget conservatively and maintain reserve funds that can be used for specific purposes if our revenues fall short due to unknown future funding from the State.

The District regularly reports the balances and funding activity in our reserves throughout the year. We have available on our website a summary of all the reserves and the current amount in those reserves. We also report on the reserves and any activity within the reserves at the Audit & Finance Subcommittees of the Board of Education throughout the year.

While one of the callouts indicates that the Board had not taken an active role in managing and overseeing reserve fund activity, we respectfully disagree with this statement. The Board was involved in the decision-making process to fund these reserves and withdraw funds from any reserves. The Business Administrator and Superintendent would discuss this with the Audit & Finance Subcommittee of the Board. Once the Audit & Finance Subcommittee decided to fund the reserves, the decision would be presented to the entire Board of Education, and the

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Board of Education would formally act on this recommendation.

The calculation of the EBALR Reserve is based on discussions District officials have had over the last several years with our External Auditors. This calculation is based on employees who would be eligible to retire over a five-year period. This is in contrast to the calculation completed by the NYS Comptroller's calculation which only provides for the benefits of those individuals retiring in one year. To plan and be fiscally responsible, we must plan for the retirements of our employees further than one year out.

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In general, our reserves have assisted us in not increasing taxes over the past decade within the Olean City School District. We appreciate the time the Auditors from the NYS Comptroller's Office have spent developing this Audit Report for the Olean City School District.

Sincerely,

Dr. Genelle Morris
Superintendent

Appendix B: OSC Comments on the District's Response

Note 1

Foundation Aid estimates are made available to school districts in January or February each year prior to the adoption of a school district's budget in mid-May and before the school board approves the tax levy in August each year. This timeframe provides school district officials with time to adjust their budget estimates if needed based on anticipated aid.

Note 2

A comprehensive written reserve fund policy is an essential tool for actively managing and overseeing reserve fund activity. The Board has not documented or communicated its intentions or goals for funding and using reserves in a clear or transparent manner. District officials have primarily relied on annual operating surpluses to fund reserves instead of developing a financial plan which considers funding goals and needs or including provisions to fund reserves in the annual budget.

Note 3

Our calculation is based on the long-term liability of eligible employees and is not based on the potential liability for a year. We updated the final report to clarify our calculation.

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 to gain an understanding of reserve fund management practices.
- We reviewed the Board meeting minutes and District policies and procedures to identify and examine any information that related to the Board's oversight and responsibilities for establishing, funding, using and maintaining reserves.
- We reviewed financial records and reports to determine the reserve fund balances and reviewed each reserve's activities.
- We analyzed the balances maintained in reserves during the audit period to determine whether balances were reasonable. We reviewed the related reserve's potential liabilities and expenditures, Board resolutions and the reserve fund policy.

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

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 posted on 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

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

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