Office of the New York State Comptroller
Division of Local Government & School Accountability

Perry Central School District

Financial Management

Report of Examination

Period Covered:

July 1, 2013 – February 24, 2017

2017M-118

Thomas P. DiNapoli

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State of New York
Office of the State Comptroller

Division of Local Government
and School Accountability

October 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 Perry Central School District, entitled Financial Management. This audit was conducted pursuant to Article V, Section 1 of the State Constitution and the State Comptroller's authority as set forth in Article 3 of the New York State General Municipal Law.

This audit's results and recommendations are resources for district officials to use in effectively managing operations and in meeting the expectations of their constituents. If you have questions about this report, please feel free to contact the local regional office for your county, as listed at the end of this report.

Respectfully submitted,

Office of the State Comptroller
Division of Local Government
and School Accountability

Introduction

Background

The Perry Central School District (District) is located in the Towns of Perry, Castile, Warsaw and Covington in Wyoming County and a portion of the Town of Leicester in Livingston County. The District is governed by the Board of Education (Board) which is composed of seven elected members. The Board is responsible for the general management and control of the District's financial and educational affairs. The Superintendent of Schools (Superintendent) is the District's chief executive officer and is responsible, along with the Board and Business Administrator, for the District's financial management.

The District operates two schools with approximately 850 students and 150 employees. The District's budgeted appropriations for the 2016-17 fiscal year are approximately $18 million, which are funded primarily with real property taxes and State aid.

Objective

The objective of our audit was to examine the District's financial condition. Our audit addressed the following related question:

- Did the Board and District officials adequately manage fund balance, including reserves?

Scope and Methodology

We examined the District's financial management practices for the period July 1, 2013 through February 24, 2017.

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.

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 plan to initiate corrective action.

The Board has the responsibility to initiate corrective action. Pursuant to Section 35 of New York State 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.

Financial Management

The Board, Superintendent and Business Administrator are responsible for accurate and effective budgeting and financial planning. In preparing the budget, the Board and District officials should accurately estimate how much the District will likely spend, what it will receive in revenue (e.g., State aid) and how much fund balance will be available at the fiscal year-end to help fund the budget. New York State Real Property Tax Law currently limits the amount of unrestricted fund balance to no more than 4 percent of the subsequent year's budget. Any unrestricted fund balance over this percentage must be used to reduce the upcoming fiscal year's tax levy or fund necessary reserves. A school district can establish reserves and accumulate funds for certain purposes (e.g., capital project or retirement expenditures). District officials should plan for the funding and use of these reserves.

The Board needs to better manage fund balance, improve its budgeting practices and address the reasonableness of reserves. For the 2013-14, 2014-15 and 2015-16 fiscal years the Board overestimated appropriations by $4.4 million (9.2 percent). District officials also appropriated $1.5 million of fund balance that was not needed to finance operations because the District's budgeting practices produced operating surpluses totaling $2.2 million. When unused appropriated fund balance is added back, the District's recalculated unrestricted fund balance exceeds the statutory limit. As a result the District's tax levy was higher than necessary.

Further, while the Board has adopted a reserve fund plan that discusses reserve funding levels, the plan does not include any specifics regarding the use of the reserves. In addition, the District is improperly retaining $1 million in the trust and agency fund for Other Post-Employment Benefits (OPEB). School districts do not have authority to reserve or set aside money for this purpose. The District is also inappropriately holding cash in the debt service fund, rather than using it to help pay the related outstanding debt or reduce the tax levy. Finally, three reserves may be overfunded.

Budget Estimates

The annual operating budget represents the District's financial plan for a fiscal year and is an important tool for managing finances. A good budget begins with sound estimates and well-supported budgetary assumptions to ensure that planned services are properly funded. The Board, Superintendent and Business Administrator are responsible for accurate and effective budgeting. Appropriations should be developed based on prior years' operating results, anticipated future needs and emerging financial trends. Unrealistic budget estimates can significantly affect year-end unrestricted fund balance and result in a tax levy that is higher than necessary.

We compared the District's estimated revenues and appropriations with actual results of operations for 2013-14 through 2015-16. While revenue estimates were generally reasonable (underestimated by an average of 5.8 percent each year), we found that the Board and District officials overestimated appropriations by $4.4 million, averaging $1.5 million annually or 9.2 percent (Figure 1).

Figure 1: Overestimated Appropriations

	2013-14	2014-15	2015-16	Totals
Appropriations[a]	$17,431,929	$17,267,351	$17,562,086	$52,261,366
Expenditures	$16,040,194	$15,891,975[b]	$15,944,410	$47,876,579
Overestimated Appropriations	$1,391,735	$1,375,376	$1,617,676	$4,384,787
Percentage Overestimated	8.7%	8.7%	10.1%	9.2%

[a] Includes year-end encumbrances and amounts appropriated from capital reserves in 2014-15 ($15,400) and 2015-16 ($37,000)

[b] Excludes unbudgeted transfer to the capital projects fund approved by the Board on September 14, 2015

Overestimated appropriations include employee benefits[1] (by $1.3 million, or 15 percent) and utilities (by $397,000, or 57 percent). Because District officials typically receive preliminary information regarding some of these costs, they should be able to closely estimate these amounts in the annual budget. We estimate similar variances in these accounts for 2016-17. The Business Administrator stated that employee benefits were overestimated, in part, to fund the potential additional costs of spouses or family members joining health insurance during the fiscal year, and also said they budget conservatively for unexpected costs for utilities.

Fund Balance

A school district may retain a portion of fund balance at the end of the fiscal year, not to exceed 4 percent of the subsequent year's budget, for cash flow needs or unexpected expenditures. When fund balance is appropriated as a funding source, the expectation is that there will be a planned operating deficit in the subsequent fiscal year, financed by the amount of the appropriated fund balance.

The Board and District officials appropriated an average of $506,000 in fund balance as a financing source in the annual budgets from

[1] Includes retirement, Social Security, workers' compensation, unemployment, and employee and retiree health insurance.

2013-14 through 2015-16.[2] This reduced the level of unrestricted fund balance at fiscal year-end to within the 4 percent limit for the last three completed fiscal years (Figure 2). However, because the Board and District officials overestimated appropriations each year and therefore realized operating surpluses, the appropriated fund balance was not used.

Figure 2: Unrestricted Fund Balance at Year End

	2013-14	2014-15	2015-16
Beginning Fund Balance	$3,840,961	$4,188,718	$4,540,952
Add: Operating Surplus	$347,757	$746,517	$1,083,595
Less: Use of Reserves	$0	$14,652	$36,250
Less: Unbudgeted Transfer to Capital Projects Fund	$0	$379,631	$0
Ending Fund Balance	**$4,188,718**	**$4,540,952**	**$5,588,297**
Less: Reserves	$2,837,301	$3,178,818	$4,258,566
Less: Encumbrances	$33,056	$161,598	$37,754
Less: Appropriated Fund Balance	$506,000	$506,000	$451,532
Less: Nonspendable	$123,606	$0	$122,626
Unrestricted Fund Balance at Year-End	**$688,755**	**$694,536**	**$717,819**
Subsequent Year's Budgeted Appropriations	$17,218,895	$17,363,410	$17,945,474
Unrestricted Fund Balance as a Percentage of Subsequent Year's Budget	4%	4%	4%

When fund balance is appropriated to finance operations the District should incur an operating deficit. However, because the appropriated fund balance was not needed and not used, the unrestricted fund balance at year end was artificially low. When the unused appropriated fund balance is added back, the recalculated unrestricted fund balance exceeds the statutory limit by approximately 3 percentage points (Figure 3).

[2] The Board and District officials appropriated $506,000 in fund balance for the 2013-14 budget.

Figure 3: Unused Fund Balance

	2013-14	2014-15	2015-16
Unrestricted Fund Balance at Year-End	$688,755	$694,536	$717,819
Add: Appropriated Fund Balance Not Used to Fund Subsequent Year's Budget	$506,000	$506,000	$451,532
Recalculated Unrestricted Fund Balance	**$1,194,755**	**$1,200,536**	**$1,169,351**
Recalculated Unrestricted Fund Balance as a Percentage of Subsequent Year's Budget	6.9%	6.9%	6.5%

The Board and District officials appropriated approximately $451,000 as a financing source in the 2016-17 budget. District officials also provided operating projections for 2016-17 that show an anticipated operating surplus. Based on prior years' operating results, we estimate that the appropriated fund balance will likely not be needed to finance operations, and, therefore, unrestricted fund balance may continue to exceed the statutory limit. The District's practice of annually appropriating fund balance that is not needed to finance operations is, in effect, a reservation of fund balance that is not provided for by statute.

While the District has realized operating surpluses and retained excess fund balance, it also levied real property taxes averaging $6.1 million from 2013-14 through 2016-17. The levy could have been lower had the Board adopted more accurate budgets.

Reserve Funds

The Board may establish reserve funds and retain portions of fund balance to finance future costs for a variety of 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 in how much money can be held in reserves, balances should be reasonable. Therefore, the Board should adopt a written policy/plan 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.[3] 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 reasonable levels or liquidate and discontinue a reserve that is no longer needed or whose purpose has been achieved.

[3] For more information, please refer to our *Local Government Management Guide*: http://www.osc.state.ny.us/localgov/pubs/lgmg/reservefunds.pdf

As of June 30, 2016, the District reported 11 general fund reserves,[4] totaling $4.3 million; $1.3 million in the debt service fund; and $1 million in the trust and agency fund set aside for other post-employment benefit (OPEB) costs.

The Board has not properly managed these funds. While the District does have a reserve plan that outlines the purpose and planned funding level of the reserve funds, the plan does not include any specifics for how much of the reserves will be used. The District is inappropriately holding cash in the debt service fund, rather than using it to help pay the related outstanding debt. District officials have also improperly retained $1 million in the trust and agency fund for OPEB costs. School districts do not have authority to reserve or set aside money for this purpose. Finally, the retirement contribution reserve, workers' compensation reserve and unemployment reserve may be overfunded. We found that generally the remaining reserves[5] were reasonably funded and used properly or we did not review certain reserves because the balances were immaterial.

Debt Reserve – New York State Local Finance Law requires unexpended bond proceeds from completed capital projects to be used to help repay the related outstanding debt. This money must be set aside and accounted for in the debt service fund.

The District reported cash of $1.3 million in the debt service fund as of June 30, 2016. While it used $511,000 from this fund in 2013-14 ($336,000) and 2014-15 ($175,000) to help finance debt service costs, the District did not use any money from this fund in 2015-16 or 2016-17. The Business Administrator stated that these funds appear to be from a completed capital project but did not provide us with any documentation to indicate that the funds represented unexpended bond proceeds. District officials stated that they have no plans to use the cash in the immediate future, but intend to use the money in the event of a future economic downturn to help pay down debt service costs. However, if the cash represents unexpended bond proceeds, it must be used to help repay the related outstanding debt and reduce the tax levy for debt service. If the cash represents surplus funds, it should be returned to the general fund and used to reduce the tax levy.

Unauthorized Reserve (Trust and Agency Fund) – As of June 30, 2016, District officials have improperly retained $1 million of cash in the trust and agency fund for OPEB costs. District officials believe it

[4] Three capital reserves totaling approximately $1.2 million; retirement contribution reserve: $875,000; workers' compensation reserve: $631,000; liability reserve: $539,000; unemployment insurance reserve: $499,000; employee benefit accrued liability reserve (EBALR): $396,000; repair reserve: $68,000; tax certiorari reserve: $30,000; and insurance reserve: $25,000

[5] Capital, liability, EBALR, repair, tax certiorari and insurance reserves

is fiscally prudent to set aside funds for this liability. However, school districts do not have the statutory authority to reserve or set aside money for this purpose. The District's external auditors brought this to the attention of the Board in 2014, 2015 and 2016 but the Board and District officials did not take corrective action. District officials told us they plan to keep these funds set aside in anticipation of State legislation that would grant the school districts the statutory authority to establish such a reserve. However, because no statutory authority for this type of reserve currently exists, the funds should be included in unrestricted fund balance in the general fund.

<u>Retirement Contribution Reserve</u> – General Municipal Law (GML) authorizes the Board to establish this type of reserve to pay contributions for employees covered by the New York State and Local Retirement System (NYSLRS). The District's average annual NYSLRS retirement costs for the last three years was approximately $169,000. However, these costs were funded with appropriations in the operating budget, not with reserve funds. As of June 30, 2016, the retirement reserve had a balance of approximately $875,000, which appears excessive.

The District's reserve plan indicates that the reserve will be funded to $1.7 million, which District officials believe would be enough to fund all NYSLRS retirement costs for 10 years. The District will need an additional $850,000 of taxpayer money from budgeted appropriations and surplus funds to meet this goal. The plan further states that 10 years of funding would be sufficient to assist the District with budgeting in times of fiscal stress. However, there is nothing in the plan describing the manner in which the reserve will be used when this event occurs.

<u>Workers' Compensation Reserve</u> – GML authorizes establishing this type of reserve to pay for workers' compensation costs and to pay the expenses of administering a self-insurance program. As of June 30, 2016, this reserve had a balance of approximately $631,000, sufficient to fund workers' compensation costs for five years. The District's average annual workers' compensation costs for the last three fiscal years was approximately $125,000. However, these costs were financed with current appropriations in the annual operating budget, not from the reserve.

The District's reserve plan states that the maximum funding level for this reserve is $1 million, which District officials estimate would be enough to cover 10 years of workers' compensation expenditures. Therefore, if they follow the reserve plan, District officials will add an additional $450,000 of taxpayers' money to the reserve from budgeted appropriations and surplus funds. The plan further states that this funding level is necessary in the event of a prolonged economic downturn but does not state how much District officials plan to annually appropriate from this reserve during an economic downturn. School districts should balance the desirability of accumulating reserves for future needs with the obligation to make sure taxpayers are not overburdened by these practices.

Unemployment Insurance Reserve – GML authorizes establishing this type of reserve to reimburse the New York State Unemployment Insurance Fund for payments made to claimants on the District's behalf. As of June 30, 2016, this reserve had a balance of approximately $499,000.

The District's average annual unemployment expenditures over the last three years were approximately $7,400. The balance of this reserve could pay the District's average unemployment costs for more than 60 years. According to the District's reserve plan, this reserve should be sufficient to pay for full unemployment costs for 10 years for the average number of staff leaving the District and not replaced. The Business Administrator believes that in the event of economic downturn, up to 24 staff members could be laid off and not replaced. However, the plan does not indicate how much these costs would total. Unneeded funds in the unemployment reserve could be available for transfer to other reserves, or applied to the budget, as permitted by statute.

By maintaining excessive reserves, combined with the ongoing budgeting practices that generated operating surpluses and excess unrestricted fund balance, the Board and District officials have levied higher taxes than necessary.

Recommendations

The Board and District officials should:

1. Develop realistic estimates of appropriations and the use of fund balance in the annual budget.

2. Use excess funds in a manner that benefits District taxpayers. Such uses could include, but not be limited to:

   - Funding one-time expenditures;
   - Funding needed reserves;
   - Reducing District property taxes.

3. Identify the source of the cash in the debt service fund and, as the circumstances warrant, either use it to pay related debt or return the money to the general fund.

4. Develop a plan to return the cash set aside for OPEB in the trust and agency fund to the general fund as part of unrestricted fund balance.

5. Update the reserve plan to clearly describe the conditions under which reserve funds will be used.

6. Review all reserves to determine if the amounts reserved are necessary and reasonable. Excess funds should be transferred to unrestricted fund balance (where allowed by law) or to other, necessary reserves established and maintained in compliance with applicable statutes.

APPENDIX A

RESPONSE FROM DISTRICT OFFICIALS

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

Perry Central School District

PERRY, NEW YORK 14530

September 15, 2017

Office of the State Comptroller
Buffalo Regional Office
295 Main Street, Room 1032
Buffalo, New York 14203

Chief Examiner:

Please accept this letter as notification the Perry Central School District has received and reviewed the preliminary draft findings from the recently completed audit conducted by the Comptroller's Office. It is the District's impression the report accurately reflects the financial status of the District.

While the report contains information regarding the District's budgeting, fund balance and reserves, it does not reference two (2) important pieces of information.

- The District has set aside $1 million for other post-employment benefits costs in the trust and agency fund; however, the District has obtained an actuarial valuation report as of June 30, 2016 which indicates that the total liability for other post-employment benefits is **$6,269,856**.
- The following demonstrates expenditures from the District's reserve funds during the most recent economic downturn:
  - 2008 – 09: $176,766 (OPEB)
  - 2009 – 10: $194,082 (OPEB)
  - 2010 – 11: $184,474 (OPEB)
  - 2011 – 12: $275,104 (Debt Service), $216,204 (OPEB), $36,277 (Equipment) = **$527,585**
  - 2012 – 13: $335,710 (Debt Service), $184,409 (OPEB), $128,283 (Tax Certiorari), $5,235 (Unemployment), $50,000 (Workers' Compensation), $31,236 (Equipment), $54,864 (Retirement), $26,000 (Appropriated) = **$815,737**

The District is in the process of developing a corrective action plan to respond to the findings in the report. Please contact the District if additional information is required.

Respectfully,

Jane Pascoe	Daryl McLaughlin	Reed Pettys
Board of Education	Superintendent	School Business
President	of Schools	Administrator

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APPENDIX B

AUDIT METHODOLOGY AND STANDARDS

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

- We gained an understanding of budgeting practices and financial condition oversight by interviewing District officials and management, reviewing Board minutes and District policies regarding budgeting and fund balance practices.

- We calculated unrestricted fund balance as a percentage of the next year's budget. We included both appropriated fund balance and unrestricted fund balance in our calculation as the District has shown a pattern of not using appropriated fund balance.

- We analyzed the District's fund balance for the three most recently completed fiscal years (2013-14, 2014-15 and 2015-16) and determined whether appropriated fund balance was used as intended.

- We reviewed real property tax levy trends for 2013-14 through 2015-16.

- We compared 2013-14, 2014-15 and 2015-16 budgeted appropriations and estimated revenues with actual operating results and reviewed any significant variances.

- We reviewed the results of operations for 2013-14, 2014-15 and 2015-16. We requested 2016-17 year-end projections as of February 2017 and reviewed them for reasonableness.

- We identified all reserves and documented the flow of funds in and out of the reserves over the last three years, assessed if reserve balances were reasonable, reviewed the written reserve fund plan and discussed reserve funding levels with District officials.

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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