



Wellsville Central School District Financial Management

Report of Examination

Period Covered:

July 1, 2013 – April 19, 2017

2017M-159



Thomas P. DiNapoli

Table of Contents

	Page
AUTHORITY LETTER	1
INTRODUCTION	2
Background	2
Objective	2
Scope and Methodology	2
Comments of District Officials and Corrective Action	2
FINANCIAL MANAGEMENT	4
Budgeting and Fund Balance	4
Reserves	7
Recommendations	8
APPENDIX A Response From District Officials	9
APPENDIX B Audit Methodology and Standards	11
APPENDIX C How to Obtain Additional Copies of the Report	12
APPENDIX D Local Regional Office Listing	13

State of New York Office of the State Comptroller

Division of Local Government and School Accountability

December 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 Wellsville 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 Wellsville Central School District (District) is located in the Towns of Alma, Andover, Independence, Scio, Wellsville and Willing in Allegany County. The District is governed by an elected 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 (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 Business Administrator is responsible for accounting for the District's finances, maintaining accounting records and preparing financial reports.

The District operates two schools with approximately 1,300 students and 250 employees. The District's general fund appropriations for the 2016-17 fiscal year are approximately \$29 million, which are funded primarily with State aid and real property taxes.

Objective

The objective of our audit was to review the District's financial management practices. Our audit addressed the following related question:

- Did the Board adopt realistic budgets and take appropriate action to address the reasonableness of fund balance and reserves?

Scope and Methodology

We examined the District's financial management practices for the period July 1, 2013 through April 19, 2017. In July 2017, we obtained the 2017-18 adopted budget and District officials provided us with updated financial information for the 2016-17 fiscal year.

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 that they plan to take corrective action.

The Board has the responsibility to initiate corrective action. Pursuant to Section 35 of General Municipal Law, Section 2116-a (3) (c) of New York State Education Law and Section 170.12 of the Regulations of the Commissioner of Education, a written corrective action plan (CAP) that addresses the findings and recommendations in this report must be prepared and provided to our office within 90 days, with a copy forwarded to the Commissioner of Education. To the extent practicable, implementation of the CAP must begin by the end of the next fiscal year. For more information on preparing and filing your CAP, please refer to our brochure, *Responding to an OSC Audit Report*, which you received with the draft audit report. The Board should make the CAP available for public review in the District Clerk's office.

Financial Management

The Board, Superintendent and Business Administrator are responsible for adopting realistic budgets and ensuring fund balance does not exceed the amount allowed by law. Fund balance represents the cumulative residual resources from prior fiscal years. New York State Real Property Tax Law currently limits unrestricted fund balance to no more than 4 percent of the subsequent year's budget. A school district can also legally establish reserves and accumulate funds for certain future purposes (e.g., capital projects, retirement expenditures). The Board should appropriately fund reserves, monitor reserve balances and use them as intended to pay related expenditures.

The District's unrestricted fund balance has exceeded the statutory limit for the past three fiscal years by amounts ranging from \$1.5 million to nearly \$3 million, or by 5.7 to 10.3 percentage points. Although the Board appropriated fund balance each year to help finance the budget, none of it was needed because the Board and District officials overestimated appropriations each year. District officials have also allowed the unemployment reserve balance to accumulate to an excessive level and have not used funds from the retirement contribution reserve as budgeted. As a result, the Board and District officials have missed opportunities to reduce taxes and return excess funds back to the residents.

Budgeting and Fund Balance

Accurate budget estimates and reasonable levels of fund balance help ensure that the levy of real property taxes is not greater than necessary.

During fiscal years 2013-14 through 2015-16, unrestricted fund balance increased by approximately \$1.5 million (59 percent) and exceeded the statutory limit by an annual average of \$2.2 million. The District appropriated \$350,000 from fund balance annually. When fund balance is appropriated as a funding source, it reduces the fund balance subject to the statutory limit and there should be a planned operating deficit in the subsequent fiscal year. However, due to positive variances between amounts budgeted and actual operating results, no fund balance was actually used to finance operations and fund balance increased each year.

Annually, appropriations were overestimated by approximately \$2.6 million or 10 percent and revenues were overestimated by approximately \$1.3 million or 5 percent.

Figure 1: Overestimated Appropriations

	Budgeted Appropriations	Actual Expenditures	Overestimated Appropriations	Percentage Overestimated
2013-14	\$27,357,546	\$24,826,380	\$2,531,166	10.2%
2014-15	\$27,835,815	\$25,528,293	\$2,307,522	9.0%
2015-16	\$28,294,181	\$25,415,741	\$2,878,440	11.3%
Totals	\$83,487,542	\$75,770,414	\$7,717,128	10.2%

The most significant variances were found in appropriations for instructional and employee benefit costs which averaged \$975,000 or 19 percent and \$1.3 million or 24 percent. Because many of these costs are determined by contractual agreements, District officials should be able to estimate these amounts very closely in the annual budget. District officials also consistently overestimated State aid revenues even though better information was available to develop these estimates. State aid was overestimated by \$1.6 million in 2013-14, \$1.3 million in 2014-15 and \$542,000 in 2015-16. Even though revenues were overestimated, the significant overestimation of appropriations resulted in positive budget variances and generated operating surpluses which increased each year and totaled \$2.3 million. Budgeting practices that continually overestimate appropriations result in property tax levies that are higher than necessary and budgets that are not an effective tool for financial control.

Figure 2: Unrestricted Fund Balance at Year-End

	2013-14	2014-15	2015-16
Beginning Fund Balance	\$4,482,074	\$4,830,678	\$5,372,065
Add: Operating Surplus/(Deficit)	\$348,604	\$604,143	\$1,341,200
Less: Transfers	\$0	\$62,756	\$30,000
Ending Fund Balance	\$4,830,678	\$5,372,065	\$6,683,265
Less: Restricted Fund Balance (Reserves)	\$1,775,299	\$1,963,668	\$2,163,827
Less: Encumbrances	\$395	\$0	\$14,634
Less: Appropriated Fund Balance	\$350,000	\$350,000	\$350,000
Unrestricted Fund Balance at Year End	\$2,704,984	\$3,058,397	\$4,154,804
Subsequent Year's Budgeted Appropriations	\$27,835,815	\$28,294,181	\$29,039,629
Unrestricted Fund Balance as a Percentage of Subsequent Year's Budget	9.7%	10.8%	14.3%

Routinely adopting budgets that appropriate fund balance that will not be used can be misleading to residents because they are under the impression that surplus funds will be used to reduce taxes. In addition, 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 and a circumvention of the statutory limit imposed on the level of unrestricted fund balance. Because the District did not actually use the appropriated fund balance to finance operations, when unused appropriated fund balance is added back, it exceeded the statutory limit by amounts ranging from \$1.9 million to \$3.3 million or 7 to 11.5 percentage points.

Figure 3: Unused Fund Balance

	2013-14	2014-15	2015-16
Unrestricted Fund Balance at Year End	\$2,704,984	\$3,058,397	\$4,154,804
Add: Appropriated Fund Balance Not Used to Fund Subsequent Year's Budget	\$350,000	\$350,000	\$350,000
Recalculated Unrestricted Fund Balance	\$3,054,984	\$3,408,397	\$4,504,804
Recalculated Unrestricted Fund Balance as a Percentage of Subsequent Year's Budget	11.0%	12.0%	15.5%

Based on the 2016-17 and 2017-18 adopted budgets, the District budgeted similarly to previous years and fund balance will remain in excess of the statutory limit unless the Board develops a plan to use excess fund balance in a manner more beneficial to residents. We found that 2016-17 appropriations increased by about \$745,000 or 3 percent while 2017-18 appropriations increased by about \$187,000 or less than one percent. However, appropriations in both of these budgets are nearly \$4 million or 15 percent more than the District's three-year average expenditures. Additionally, State aid increased by approximately \$650,000 for 2016-17 and is projected to increase by approximately \$450,000 for 2017-18.¹ District officials budgeted more accurately for State aid when developing the 2016-17 and 2017-18 budgets. However, without the negative variance created by overestimating revenues, annual operating surpluses will be even greater than in prior years and fund balance will continue to increase because appropriation estimates are unrealistic. The Board appropriated more fund balance in these budgets, but it will not be needed because of this budgeting practice.

¹ 2017-18 State aid increase based on projections published by the New York State Education Department.

The Board has not increased the tax levy during the period reviewed, and even decreased the tax levy by half a percent in 2017-18. While it is good that the Board realized the tax levy was too high, it did not take steps to reduce it to appropriate levels.

Reserves

Generally, school districts are not limited in the amounts they can maintain in reserves. However, funding reserves at greater than reasonable levels contributes to higher than necessary tax levies because excessive reserve balances are not used to fund operations. Therefore, it is important that the Board adopt a written policy that states its rationale for establishing reserve funds, objectives for each reserve, targeted funding levels and conditions under which reserves will be used or replenished.

As of June 30, 2016, the District reported approximately \$2.2 million in five general fund reserves. We analyzed the reserves for reasonableness and to determine if the Board had adopted an adequate policy or plan for establishing, funding and using these reserves.

We found that one reserve balance is excessive and funds were not used from another reserve as budgeted. The remaining reserves were properly established and reasonably funded. The Board developed a reserve policy to ensure reserve funds are properly established and reserve information is made available to the Board annually, but the policy did not address the need for maintaining certain reserve balances or under what specific circumstances they will be used or replenished.

Unemployment Reserve – General Municipal Law (GML) authorizes this reserve for reimbursing the New York State Unemployment Insurance Fund for unemployment benefits paid to claimants on the District’s behalf. As of June 30, 2016, the reserve’s balance totaled \$80,000 which represents six times the five-year annual average unemployment costs of approximately \$13,000. Because the balance is significantly higher than the average annual claims, and the Board and District officials consistently levy taxes in order to pay for unemployment related claims instead of using the reserve, the purpose of maintaining this reserve at this amount is unclear.

Retirement Contribution Reserve – GML authorizes this reserve for the payment of retirement contributions to the New York State and Local Employees’ Retirement System. As of June 30, 2016, the reserve’s balance totaled \$892,000 which represents approximately 2.5 times the three-year annual average cost for retirement contributions. Reserve funds were not being used to pay for retirement contributions and taxes were levied for this purpose instead. Further, as part of the 2015-16 adopted budget, the Board appropriated \$426,000 from the

reserve to pay for retirement contributions, but no reserve funds were actually used. District officials charged expenditures to the reserve to pay for retirement contributions during the year but replenished the reserve at the end of the year therefore the reserve's balance remained unchanged.

While it is prudent to provide for unforeseen circumstances, overfunding and/or not using reserves for their intended purpose results in property taxes being higher than necessary because the funds are not being used to fund operations.

Recommendations

The Board and District officials should:

1. Ensure budgets include realistic estimates of revenues and appropriations to avoid levying property taxes at a level greater than needed.
2. Ensure that estimates in the annual budget for the planned use of fund balance are accurate and reasonable.
3. Maintain unrestricted fund balance within the statutory limit.
4. Develop a plan to reduce unrestricted fund balance in a manner that benefits District residents. Such uses could include, but are not limited to:
 - Funding one-time expenditures
 - Funding needed reserves
 - Reducing District property taxes
5. Adopt a more comprehensive reserve policy to include targeted funding levels and conditions under which reserves will be used or replenished.
6. Ensure that reserve fund balances are maintained at reasonable levels, used as budgeted and take appropriate action, in accordance with applicable statutes and Board policy, to reduce any reserves with excess funds.

APPENDIX A

RESPONSE FROM DISTRICT OFFICIALS

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



Our Mission
*To prepare our students to be successful, contributing members of
their communities through excellence in education.*
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December 15, 2017

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

Dear Mr. Mazula:

This letter is the initial response from the Wellsville Central School District (the “District”) to the draft Report of Examination of Financial Management (the “audit report”) for the period of July 1, 2013 through April 19, 2017, which was released to the District with a letter dated November 24, 2017.

We believe the draft audit report recommendations encouraging the District to review and further develop our procedures and plans for developing budgets and using reserves were appropriate and are consistent with the changes which we have either already made or are planning to make in the near future.

Once the final audit report is issued, the District will follow-up with an analysis and specific responses in a Corrective Action Plan (CAP) within 90 days. The CAP will be filed with the Office of the State Comptroller and New York State Education Department. In addition, the CAP will be made available for public inspection.

The Board of Education and Administration are always eager to consider suggestions and ideas to improve the financial operations of our District, especially in light of our strong commitment to protect both the short-term and the long-term fiscal health of the District and, at the same time, ensure that our residents continue to receive the same high level of efficiency and predictability from the District that they have enjoyed and benefited from in the past, and justifiably, expect to receive in the future. It has been and will continue to be a top priority of this District to maintain and improve upon our record of providing a strong education for our students in the most cost effective manner possible. The Board of Education and Administration are committed to ensuring the District’s financial operations are conducted with the highest level of integrity and that the interest of the District’s taxpayers are properly protected.

As an additional comment, the District wishes to acknowledge and express our appreciation for the professional and courteous interaction we experience with your staff throughout the audit process.

Sincerely,

David Foster
Superintendent of Schools

APPENDIX B

AUDIT METHODOLOGY AND STANDARDS

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

- We interviewed District officials to gain an understanding of the District’s financial management practices.
- We analyzed budgeted appropriations and estimated revenues and compared them to actual results for three fiscal years and analyzed significant variances.
- We calculated if there was an operating surplus or deficit for the past three years and assessed if appropriated fund balance was used as budgeted.
- We calculated unrestricted fund balance as a percentage of the subsequent year’s budget to assess whether the District was in compliance with statute.
- We reviewed the 2016-17 and 2017-18 adopted budgets to assess whether the District budgeted similarly to the previous three years.
- We documented the flow of funds in and out of the reserves and determined if reserve funds were used towards related expenditures.
- We reviewed the reserve fund policy and evaluated each reserve for reasonableness.

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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