

McGraw Central School District

Fund Balances

FEBRUARY 2018



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

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Report Highlights

McGraw Central School District

Audit Objective

Determine whether the Board and District officials ensured that the general fund balance and reserve fund levels were reasonable.

Key Findings

- District officials appropriated, on average, \$638,300 of unrestricted fund balance as a financing source each year for the 2014-15 through 2016-17 budgets. However, because the District generated surpluses each year, the amounts appropriated were not needed to finance operations.
- Recalculated unrestricted fund balance exceeded the 4 percent statutory limit for 2014-15 through 2016-17 ranging from 5 to 10 percentage points.
- Reserves were not used as intended and could be overfunded by \$1.8 million as of June 30, 2017.

Key Recommendations

- Adopt budgets with realistic estimates and discontinue the practice of appropriating fund balance that will not be used.
- Develop a plan for the use of excess unrestricted fund balance in a manner that benefits District residents.
- Review all reserves to determine whether balances are necessary and reasonable, and use excess amounts in accordance with applicable statutes in a manner that benefits District residents.

District officials agreed with our recommendations and indicated they planned to initiate corrective action.

Background

The McGraw Central School District (District) is located in the Village of McGraw in Cortland County.

A seven-member Board of Education (Board) is responsible for the general management and control of District financial and educational affairs. The Superintendent of Schools (Superintendent) is the 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 oversees the District's business operations.

Quick Facts

2017-18 Enrollment	575
2017-18 Appropriations	\$12.1 million
Total General Fund Balance	\$4.5 million

Audit Period

July 1, 2015 – June 30, 2017

Fund Balances

How Should the Board Ensure that Fund Balance is Reasonable?

District officials should ensure that unrestricted fund balance does not exceed the amount allowed by New York State Real Property Tax Law, which currently limits unrestricted fund balance to no more than 4 percent of the following year's appropriations. Any unrestricted funds that exceed the statutory limit may be appropriated to partially fund the next year's appropriations, pay for one-time purchases, fund needed reserves or reduce debt.

Districts may establish reserves to restrict a portion of fund balance that can be used for specific purposes (e.g., capital projects or retirement expenditures), in compliance with statutory requirements. However, reserve balances must be reasonable. Combining a reasonable level of unrestricted fund balance with specific legally established reserve funds provides resources for both unanticipated events and other identified or planned needs.

The Board-adopted fund balance policy specifies that District officials should strive to achieve unrestricted fund balance that does not exceed the statutory limit. The Board also adopted a reserve fund policy that requires the Board to annually perform an analysis of the projected needs for all reserve funds for the upcoming fiscal year and make recommendations regarding funding these projected needs. This policy further requires the Board to periodically review all reserve funds and the Business Official to prepare and submit an annual report of all reserve funds to the Board.

Unrestricted Fund Balance Exceeded the Statutory Limit

The Board and District officials need to improve their budgeting practices to ensure fund balances are reasonable. For 2014-15 and 2015-16, the District's unrestricted fund balance exceeded the limit, ranging from 6.3 to 9.4 percent of the ensuing year's budgeted appropriations. For 2016-17, the District was at the 4 percent limit mainly due to a \$790,000 transfer at year-end to the capital reserve fund for an upcoming capital project approved by District voters in May 2017.

Figure 1: Unrestricted Fund Balance at Year End

	2014-15	2015-16	2016-17
Unrestricted Fund Balance	\$734,931	\$1,137,708	\$485,609
Ensuing Year's Budgeted Appropriations	\$11,699,763	\$12,085,403	\$12,140,290
Unrestricted Fund Balance as Percentage of Next Year's Appropriations	6.3%	9.4%	4.0%

District officials appropriated approximately \$1.9 million of unrestricted fund balance (an average of \$638,300 each year) as a financing source for the 2014-15 through 2016-17 annual budgets. However, because the District generated operating surpluses totaling approximately \$1 million over these years, none of the appropriated fund balance was used to finance operations. When the unused appropriated fund balance was added back, the District's recalculated unrestricted fund balance further exceeded the statutory limit in all three years ranging from 5 to 10.6 percentage points (Figure 2).

Figure 2: Recalculated Fund Balance

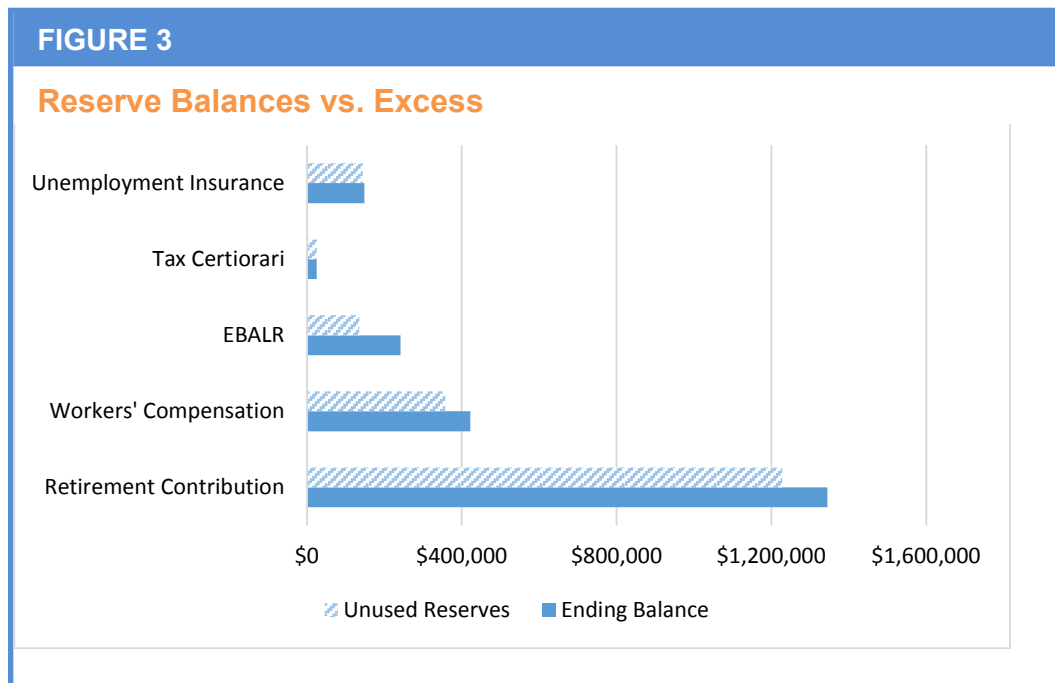
	2014-15	2015-16	2016-17
Total Unrestricted Funds at Year End	\$734,931	\$1,137,708	\$485,609
Add: Appropriated Fund Balance Not Used to Fund Ensuing Year's Budget	\$631,677	\$631,677	\$601,677
Total Recalculated Unrestricted Funds	\$1,366,608	\$1,769,385	\$1,087,286
Ensuing Year's Budgeted Appropriations	\$11,699,763	\$12,085,403	\$12,140,290
Recalculated Unrestricted Funds as a Percentage of Ensuing Year's Budget	11.7%	14.6%	9.0%

Based on our analysis of the 2017-18 adopted budget compared to the prior three years average annual expenditures of \$10.8 million, District officials will not use the \$601,677 appropriated to help finance the 2017-18 year's appropriations, because they appear to have continued the pattern of significantly overestimating expenditures.

Appropriating fund balance each year 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. Adopting budgets that result in the appropriation of fund balance that will not be used causes District officials to retain more fund balance and potentially levy more real property taxes than needed. As a result, the District accumulated unrestricted fund balance in excess of the statutory limit and continued to accumulate additional amounts during our audit period in both reserved and unreserved fund balances.

Five Reserves Were Overfunded

As of June 30, 2017, the District reported seven general fund reserves with cumulative balances totaling approximately \$3.4 million. These included retirement contribution (\$1.3 million), workers' compensation (\$422,466), employee benefit accrued liability (EBALR) (\$242,027), tax certiorari (\$25,003), unemployment insurance, (\$148,408), repairs (\$184,735) and capital (\$985,007) reserves. We examined the District's plans for funding and using these reserves. The balances retained in the repairs and capital reserves appeared reasonable. However, the unemployment insurance, tax certiorari, EBALR, workers' compensation and retirement contribution reserves were overfunded and not used as intended.



Retirement Contribution – The \$1.3 million retained in this reserve is sufficient to cover more than 11 years of retirement cost, which averaged \$117,000 annually over the last five years. However, these expenditures were paid from the general fund operating budget.

Workers' Compensation – Average annual qualifying workers compensation expenditures over the past five years was approximately \$65,000. The \$422,466 balance retained in the reserve is five times the average annual costs. However, these expenditures were paid from the general fund operating budget and the reserve was not used.

EBALR – We recalculated the reserve based on contracts and leave balances and found that the reserve balance should be approximately \$107,000, while the balance retained in this reserve was \$242,027. Therefore, the reserve is overfunded by approximately \$135,000.

Tax Certiorari – Because the District had no pending tax certiorari claims, the Board returned the \$150,000 balance in this reserve to the general fund at the end of 2016-17. However, the Board then created a new tax certiorari reserve and funded it with \$25,000 for any unforeseen circumstances that may arise. The balance in this reserve was not supported by any current pending tax case. Therefore, this amount should be returned to the general fund as unrestricted fund balance.

Unemployment Insurance – The average of annual qualifying unemployment expenditures over the past five years were approximately \$4,200. However, these expenditures were paid from the general fund operating budget. The \$148,408 balance in the reserve could fund benefits to approximately 13 District employees or 9 percent of the District's workforce. However, the amounts retained in this reserve seems to be unnecessary because District officials added additional programs and teaching staff in 2017-18.

While the Business Official presents his reserve fund analysis to the Board and makes recommendations on funding levels as required by the reserve fund policy, we question the reasonableness of the amounts retained in these reserves.

District officials increased the real property tax levy by an average of 1 percent over the last three years (2014-15 through 2016-17), appropriated fund balance that was not necessary and funded reserves at greater than reasonable levels contributing to real property tax levies that are higher than necessary because they are not being used as intended. Officials told us that fund balance levels are an issue and are working on developing long-term plans to fund new programs, staff and infrastructure needs.

What Do We Recommend?

The Board and District officials should:

1. Develop a plan to use excess unrestricted fund balance in a manner that benefits District residents. Such uses include, but are not limited to, reducing real property taxes, establishing necessary reserves or financing one-time expenditures.

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2. Adopt budgets with realistic estimates and discontinue the practice of appropriating fund balance that will not be used to fund operations.
 3. Review all reserves to determine whether balances are necessary and reasonable, and use excess amounts in accordance with applicable statutes in a manner that benefits District residents.

Appendix A: Response From District Officials



McGRAW CENTRAL SCHOOL DISTRICT

10 West Academy Street

McGraw, New York 13101-9479

"To pursue the maximum fulfillment of each student's potential"

February 15, 2018

H. Todd Eames, Chief Examiner
Office of the State Comptroller
State Office Building, Room 1702
44 Hawley Street
Binghamton, NY 13901-4417

Melinda McCool
Superintendent
607-836-3636
(Fax) 607-836-3635
email: mmccool@mcgrawschools.org

Subject: Combined Audit Response Letter and Corrective Action Plan

Unit Name: McGraw Central School
Audit Report Title: Fund Balances Report of Examination
Audit Report Number: 2017M-248
Received: January 19, 2018
Revised Draft Audit Report Received: January 31, 2018

The McGraw Central School district submits the following response and corrective action plan to the Fund Balance Report Examination completed by the Office of the State Comptroller covering the time period of July 1, 2014 through June 30, 2017. The district would like to thank the field examiners for their professionalism throughout the audit.

1. **Audit Finding:** Develop a plan to use excess unrestricted fund balance in a manner that benefits District residents. Such uses include, but are not limited to, reducing real property taxes, establishing necessary reserves or financing one-time expenditures.

District Response: We accept this recommendation. The district recognized this and the finance audit committee responded to the fund balance in the manner suggested in the year prior to the Comptroller's audit. This has been addressed in committee and brought to the Board of Education to complete. However, it would be wildly irresponsible to reduce the levy dramatically in any single year, because as the Comptroller's Office knows full well, the tax levy cap legislation would then freeze the District's levy at that artificially, and destructively low level going forward, when there were no more reserve funds to cover the gap. This would guarantee mass lay-offs of teaching staff at that point. Because of the short sited nature of the tax levy cap law, the District is unable to reduce real property taxes, rather than simply hold them steady.

Corrective Action Plan: Beginning with the 2016-17 Budget, the Board of Education and District Officials began using surplus funds to fund a Capital Project Reserve, finance the purchase of a passenger bus, create necessary primary school programming, and increase technology supports to meet the current needs of our student population. The creation of the Capital Project Reserve will be

Web Site: www.mcgrawschools.org

utilized in the currently planned facility project to offset the local costs of approximately \$10 million worth of improvements identified in the 2016 Building Condition Survey.

2. **Audit Finding:** Adopt budgets with realistic estimates and discontinue the practice of appropriating fund balance that will not be used to fund operations.

District Response: We accept this recommendation. The District has always prepared realistic budgets, which have not raised property taxes more than necessary and have stayed within the required property tax cap.

Corrective Action Plan: The District has prepared a five-year financial plan beginning with 2017-18. This plan was approved by the Board at the February 1, 2018 meeting. The finance audit committee will continue to review appropriation of fund balances and fund them according to district projected need and the advice of our external auditors.

3. **Audit Finding:** Review all reserves to determine whether balances are necessary and reasonable, and use excess amounts in accordance with applicable statutes in a manner that benefits District residents.

District Response: We accept this recommendation. The District firmly believes in the process of establishing appropriately-funded reserves with the intention of using reserves to stabilize the local tax levy, update student programming, and apply towards variable expenses.

The comment that the District does not need reserves for unemployment insurance because it has added teaching staff in 2017-18 fails to consider adding staff in one area does not preclude reducing staff in another area, or that the New York State Government recently froze and withheld State school aid money for several years, leading to massive lay-offs of educational staff throughout New York. The point of such reserves is to protect against reasonable unexpected costs, not just known, expected costs.

Corrective Action Plan: The District will begin using the reserve funds to pay for these budgetary expenses and replenish yearly as needs arise to amounts found acceptable by the finance audit committee. The audit committee met on February 6, 2018 to review policy changes.

The district thanks the Office of the State Comptroller for the opportunity to respond to the audit report. We believe that the audit process assists in our efforts to remain fiscally responsible.

Signed:

Melinda McCool
Superintendent of Schools

Date

2-15-18

Anthony Opera
Board of Education President

Date

2-15-18

Appendix B: 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, we performed the following audit procedures:

- We interviewed District officials and reviewed budgeting policies and procedures to gain an understanding of the budgeting process and financial management processes and procedures, including the rationale for determining the levels to maintain for unrestricted fund balance and reserves.
- We calculated the unrestricted fund balance as a percentage of the ensuing year's appropriations to determine whether the District was within the statutory limitation during 2014-15 through 2016-17.
- We added the unused appropriated fund balance to the general fund's unrestricted fund balance to determine whether unrestricted fund balance was over the statutory limitation during the last three years.
- We analyzed the District's budget over the last three years by comparing budgeted revenues and appropriations to actual revenues and expenditures.
- We analyzed the trend in fund balance over the last three years by comparing the appropriated fund balance to the same year's operating results to determine whether appropriated amounts were actually used.
- We analyzed the District's use of, and balances maintained in, reserves during the last five years to determine whether balances were excessive by reviewing related reserve expenditures, liabilities and charges to reserve funds.
- We reviewed the District's liability relating to the EBALR as of June 30, 2017 by examining employee contracts and leave records.
- We reviewed the real property tax levy increases to determine whether the tax levies increased over the past four years.

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.

Unless otherwise indicated in this report, samples for testing were selected based on professional judgment, as it was not the intent to project the results onto the entire population. Where applicable, information is presented concerning the value and/or relevant population size and the sample selected for examination.

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 2116-1(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 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. We encourage the Board to make the CAP available for public review in the Clerk's office.

Appendix C: Resources and Services

Regional Office Directory

www.osc.state.ny.us/localgov/regional_directory.pdf

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

www.osc.state.ny.us/localgov/costsavings/index.htm

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

www.osc.state.ny.us/localgov/fiscalmonitoring/index.htm

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

www.osc.state.ny.us/localgov/pubs/listacctg.htm#lmgm

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

www.osc.state.ny.us/localgov/planbudget/index.htm

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

www.osc.state.ny.us/localgov/lgli/pdf/cybersecurityguide.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/localgov/finreporting/index.htm

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

www.osc.state.ny.us/localgov/researchpubs/index.htm

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

www.osc.state.ny.us/localgov/academy/index.htm

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.state.ny.us

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BINGHAMTON REGIONAL OFFICE – H. Todd Eames, Chief Examiner

State Office Building, Suite 1702 • 44 Hawley Street • Binghamton, New York 13901-4417

Tel: (607) 721-8306 • Fax: (607) 721-8313 • Email: : Muni-Binghamton@osc.state.ny.us

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