

Hadley-Luzerne Central School District

Financial Management

OCTOBER 2018



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

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Report Highlights

Hadley-Luzerne Central School District

Audit Objective

Determine whether the Board properly managed District finances by adopting realistic budgets and developing long-term financial plans for reserve funds.

Key Findings

- The Board overestimated appropriations by an average of approximately \$1.9 million annually from 2014-15 to 2016-17, which resulted in accumulation of excess unrestricted fund balance.
- The unrestricted fund balance exceeded statutory limitations.
- District officials did not prepare and submit a plan for reserves annually and reserves were overfunded.

Key Recommendations

- Adopt budgets that include realistic expenditure estimates.
- Develop a plan for the use of excess unrestricted fund balance in the general fund.
- Review reserves to determine if amounts are necessary and reasonable and ensure a plan for reserves is prepared and submitted in accordance with District policy.

Officials generally agreed with our recommendations. Appendix B includes our comments on the District's response.

Background

The Hadley-Luzerne Central School District (District) serves parts of the Towns of Day, Edinburg and Hadley in Saratoga County and Lake Luzerne, Stoney Creek and Warrensburg in Warren County. The five member Board of Education (Board) is responsible for the general management of the District's financial and educational affairs.

The Superintendent of Schools 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.

Quick Facts

Employees	200
Student Enrollment	700
2017-18 Budgeted Appropriations	\$21 million

Audit Period

July 1, 2014 – February 28, 2018

Financial Management

How Do Officials Effectively Manage District Finances?

A board, superintendent and business administrator are responsible for accurate and effective budgeting and financial planning. These officials should prepare and the board should adopt annual budgets that contain realistic estimates of revenues, appropriations and amounts of fund balance to be used as a funding source for operations, if the board chooses to use fund balance in this manner. District officials must ensure that unrestricted fund balance does not exceed the amount allowed by law. New York State Real Property Tax Law (RPTL)¹ limits the amount of unrestricted fund balance a school district can retain 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. However, reserve balances must be reasonable. A board should appropriately fund reserves, monitor reserve balances and use them as intended to pay related expenditures. The Board-adopted reserve policy establishes requirements to ensure adequate oversight and maintenance of reserve funds. Additionally, a board should adopt a fund balance policy to ensure sufficient funding for necessary operations is available and that the real property tax levy is not greater than necessary. Prudent fiscal management also requires the board to establish long-term financial plans which include plans for the maintenance and use of both unexpended surplus funds and reserve funds.

The Board Overestimated Expenditures and Appropriated More Fund Balance Than Needed

We compared budgeted revenues and appropriations with actual operating results for 2014-15 through 2016-17. While revenues estimated were reasonable, the Board overestimated appropriations by an average of approximately \$1.9 million annually (10 percent), or a cumulative total of approximately \$5.7 million.

Figure 1: Overestimated Appropriations

	2014-15	2015-16	2016-17	Totals
Appropriations ^a	\$19,881,742	\$20,288,755	\$20,743,125	\$60,913,622
Expenditures	\$18,142,855	\$18,066,084	\$18,997,693	\$55,206,632
Overestimated Appropriations	\$1,738,887	\$2,222,671	\$1,745,432	\$5,706,990
Percentage Overestimated	9.6%	12.3%	9.2%	10.3%

^a Includes prior-year encumbrances and Board-authorized budget amendments

¹ Real Property Tax Law, Section 1318

We found that over the past three completed years, overestimated expenditures included employee benefits (\$2 million, or 14 percent), certain BOCES contractual services (\$606,532, or 27 percent) and fuel costs (\$263,932, or 53 percent).² The remaining overestimated expenditures were distributed throughout the budget. While a portion of employee benefits were more reasonably budgeted in the 2017-18 and 2018-19³ fiscal years, the trend of overestimating fuel, certain BOCES contractual services and employee benefits for health insurance continued.⁴

The Business Administrator and accounts payable clerk stated that appropriations were over- budgeted to account for unexpected cost fluctuations and that certain appropriation accounts had built in contingent amounts. While it is reasonable to budget for potential changes in costs, budget estimates should be reasonable based on historical costs. In addition to fuel, employee benefits and certain BOCES contractual services appropriation accounts being underspent by \$2.9 million (17 percent) over three years, \$1.4 million was also transferred out of these appropriation accounts,⁵ for a total variance between adopted appropriations and actual expenditures and transfers of \$4.3 million (25 percent).

Because the Board overestimated appropriations, it appeared the District needed to increase its tax levy and use appropriated fund balance to close projected budget gaps. From 2014-15 through 2016-17, the Board increased the real property tax levy by a total of approximately \$323,000, or 3.1 percent⁶ without a fund balance policy.

The Board appropriated \$1.1 million in fund balance annually from 2014-15 through 2016-17 for a cumulative total of \$3.3 million. While the \$1.1 million appropriated to the 2014-15 budget consisted of only unrestricted fund balance, the 2015-16 and 2016-17 appropriated fund balance each included \$1 million of unrestricted fund balance and \$100,000 of appropriated reserves. When fund balance is appropriated for the ensuing year's budget, the expectation is that there will be a planned operating deficit equal to the amount of fund balance that was appropriated. Although the District did use reserve funds of \$183,678 during

2 These figures compare the modified appropriations to actual operating results which include any encumbrances and budget transfers.

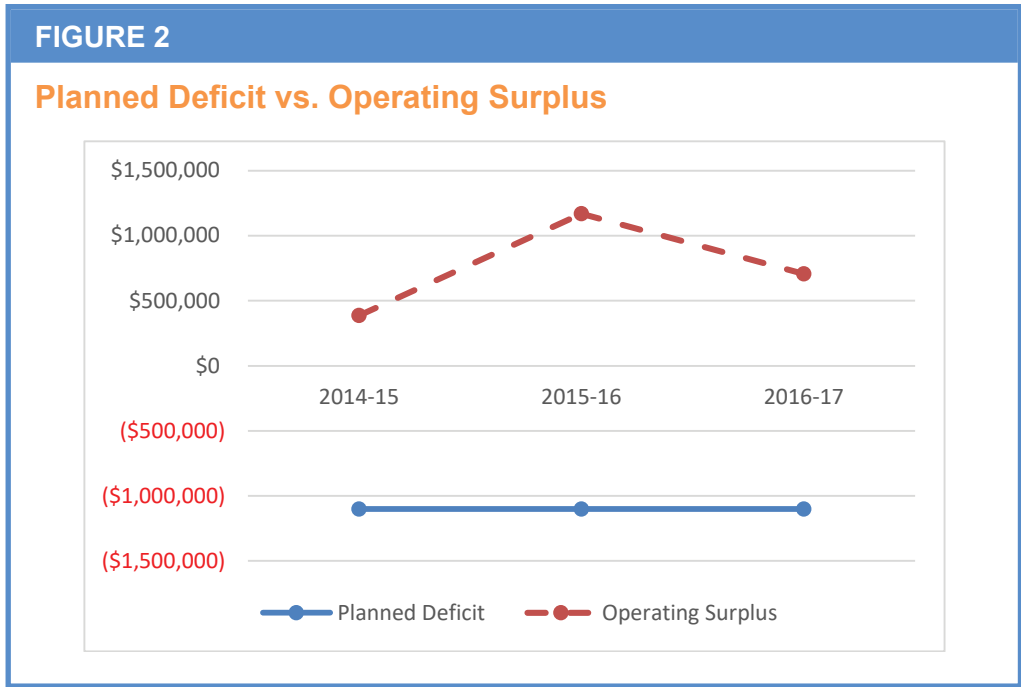
3 Subsequent to fieldwork, the 2018-19 budget was prepared. While not specifically within our audit period, our work was limited to a cursory review of the 2018-19 budget.

4 Budgets included the same or higher estimates, although the prior year's actual expenditures for fuel costs and certain BOCES contractual services were less than 65 and 75 percent of the modified budget amounts.

5 Budgeted appropriations were transferred to other appropriation accounts that were underbudgeted due to unanticipated expenditures.

6 Each of the District's tax levy increases over the three-year period reviewed were within the allowable tax levy limits (tax cap). Additionally, the 2017-18 tax levy was within the allowable tax cap.

2015-16 and \$148,312 during 2016-17, operating surpluses were realized during each of these years for a cumulative surplus of \$2.3 million.



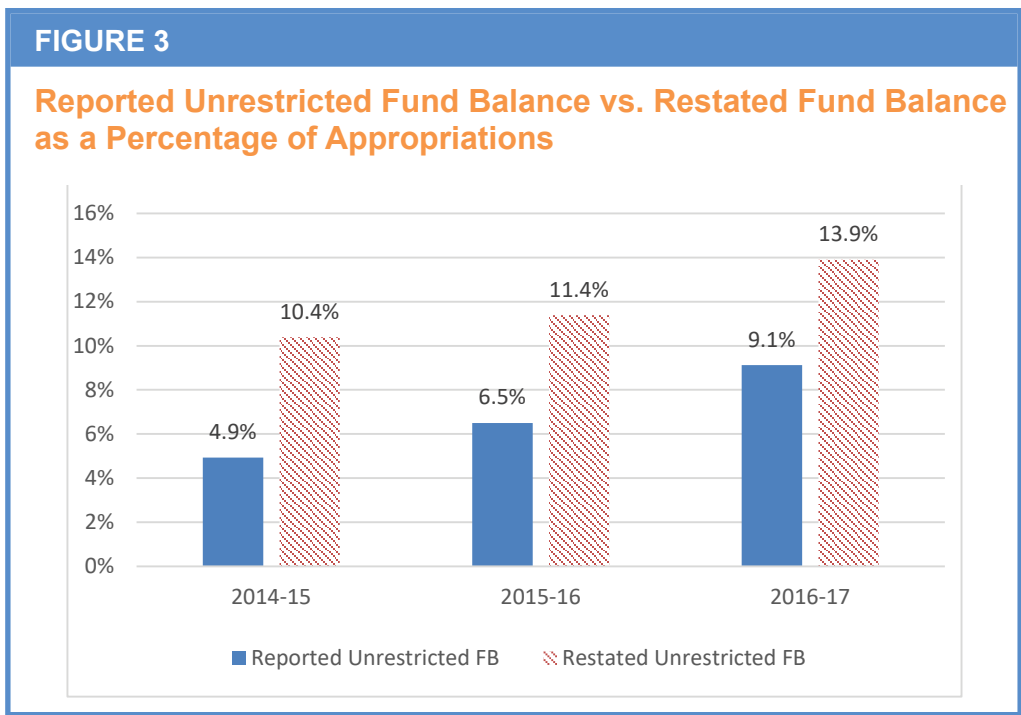
Annually appropriating fund balance that is not needed to finance operations is, in effect, a reservation of fund balance that is not provided for by statute and a circumvention of the statutory limit imposed on the level of unrestricted fund balance.

We reviewed the 2017-18 adopted budget for reasonableness, compared with accounting records as of February 28, 2018, including prior-year encumbrances, totaling approximately \$21 million. We analyzed the total expenditures as of February 28 for each year in our period and found that the current year expenditures were approximately \$450,000 higher than last year. This was due to increased costs for instructional and non-instructional salaries, employee benefits and special education. With the increased costs in these areas of operations and large outstanding debt payments, it appears that the current year's budgeted appropriations are more reasonable than in past years, but it is not likely that the District will reach the \$1.1 million planned deficit in the 2017-18 adopted budget.

We also reviewed the 2018-19 adopted budget for reasonableness. The total budgeted appropriations were approximately \$21.5 million and the budget included appropriated fund balance of approximately \$1.2 million. The increased appropriations were associated with maintaining educational programs and increased payroll costs. Similar to the 2017-18 adopted budget, the 2018-19 adopted budget appeared more reasonable.

Over the past three fiscal years, the District reported unrestricted fund balance that ranged from 4.9 percent to 9.1 percent of the subsequent years' appropriations. This exceeded the 4 percent limit allowed by RPTL⁷ by as much as 5.1 percentage points.

In 2014-15, the District did not use any of the \$1.1 million of unrestricted fund balance appropriated, and did not use any of the \$1 million appropriated for 2015-16 and 2016-17. When unused appropriated fund balance is added back to the reported unrestricted fund balance, the District's recalculated unrestricted fund balance ranged from 10.4 to 13.9 percent of subsequent years' appropriations. This exceeded RPTL by as much as 9.9 percentage points.



District Officials Did Not Follow the Reserve Policy and Reserves Were Overfunded

In 2011, the Board adopted a reserve policy requiring District officials to prepare and submit an annual report on the reserves to the Board identifying each reserve with their establishment date and funding record, interest earned, amounts withdrawn, and an analysis of the projected needs for upcoming fiscal years. The policy also requires District officials to make recommendations regarding funding

⁷ RPTL Section 1318

for the projected needs. Through our review of Board meeting minutes and interview with the Board President, we found District officials did not prepare or submit an annual report on reserve funds that met policy requirements. This was due in part to the turnover in the Business Administrator⁸ position and because the Board did not ensure the policy was being followed.

The Board properly established and funded six reserve funds in accordance with New York State General Municipal Law (GML). The reserves consisted of workers' compensation, unemployment insurance, retirement contribution, tax certiorari, employee benefit accrued liability (EBALR) and repair reserves to finance certain future expenditures.

Because the District did not follow its policy to have annual reports prepared and submitted to allow the Board to effectively monitor the District's reserves, we reviewed expenditures and reserve funding levels to determine if they were reasonable. As of June 30, 2017 the District reported \$2.8 million in reserves. The tax certiorari and repair reserve balances were reasonable. However, the retirement contribution, workers' compensation, EBALR and unemployment insurance reserves were overfunded and expenditures for their related purposes were paid from the operating budget.

- Retirement Contribution Reserve – The \$1.1 million retained in this reserve is sufficient to cover almost five years of retirement costs, which averaged \$229,340 over the three fiscal years from July 1, 2014 through June 30, 2017.
- Workers' Compensation Reserve – This reserve is used to fund workers' compensation expenses, related medical expenses and self-insurance administration costs. On average for the three-year period July 1, 2014 through June 30, 2017 these expenses were \$77,126 but the District maintained \$550,000⁹ in this reserve, which covers approximately seven years of expenditures.
- EBALR – GML¹⁰ authorizes the Board to establish this reserve to finance certain accrued "employee benefit" payments due employees upon termination of service. Fiscal prudence dictates that the balance of the EBALR should not exceed the long-term portion of the liability for

⁸ During our audit review period, the District employed four Business Administrators. The current Business Administrator started with the District on December 1, 2017.

⁹ The workers' compensation reserve balance was \$300,000 as of June 30, 2015 and increased to the current balance of \$550,000 during the 2015-16 year.

¹⁰ GML Section 6-p.

compensated absences.¹¹ As of June 30, 2017 the reserve balance was \$500,000, which exceeded the reported liability by approximately \$100,000. Additionally, the District made annual payments for related expenses ranging from \$25,005 to \$10,422 during the three-year period July 1, 2014 through June 30, 2017 with operating funds.

- Unemployment Insurance Reserve – The District made annual payments to the New York State Unemployment Insurance Fund ranging from \$11,282 to \$1,993 during the three-year period July 1, 2014 through June 30, 2017. The balance of \$50,000 is more than six times the District’s three-year average unemployment costs of \$7,386, which have been budgeted for and paid out of the general fund.

Without developing a long-term plan for reserve funds, the Board missed opportunities to pay certain expenditures with reserves. Instead, these expenditures were continually funded with operating funds. Additionally, we found two instances when the Board resolved to fund certain expenditures with reserves, including \$70,000 of retirement contributions to the employee retirement system and \$30,000 of workers’ compensation expenses during 2015-16, but this never occurred. The only reserve that was used to fund expenditures in accordance with GML during our period of review was the tax certiorari reserve. During 2015-16 and 2016-17 the District paid settlements for tax certiorari proceedings in the amounts of \$183,678 and \$148,312. Because District officials do not use reserves to fund related expenditures for the overfunded reserves, we question their need.

Given the restated fund balance levels and availability of reserve funds, the Board levied more taxes than necessary to sustain District operations in lieu of using reserves and excess unrestricted fund balance.

What Do We Recommend?

The Board and District officials should:

1. Develop realistic estimates of appropriations and the amount of fund balance to be appropriated in the annual budget.

¹¹ Compensated absences are commonly described as paid time off made available to employees in connection with vacation leave, sick leave and comparable types of compensated absences (such as personal leave, holiday leave). Compensated absences are not retirement incentives, health insurance for retirees or other post employment benefits, pension plan contributions, or most other employment-related contractual obligations (such as longevity bonuses).

-
2. Develop a fund balance policy and formulate a plan for the use of excess unrestricted fund balance in the general fund in a manner that benefits District residents. Such uses include, but are not limited to:
 - Reducing property taxes.
 - Establishing necessary reserves.
 - Financing one-time expenditures.
 - Paying debt service costs.
 3. Develop a long-term plan for the maintenance, funding and use of reserved funds.
 4. Assure that District officials comply with the annual reporting on reserves in accordance with Board policy.

District officials should:

5. Prepare and submit to the Board an annual report on reserve funds as required by the District's policy.

Appendix A: Response From District Officials



HADLEY LUZERNE CENTRAL SCHOOL

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BakerB@hlcs.org

Fax (518) 696-5884



Beecher Baker Sr.
Superintendent of Schools

*"Let us think of education as the means of
developing our greatest abilities." JFK*

October 2, 2018

State of New York Office of the State Comptroller
Division of Local Government and School Accountability
One Broad Street Plaza
Glens Falls, NY 12801
Attention: [REDACTED]

Re: Response to Comptroller's Audit of the Hadley-Luzerne Central School District
for the Period: July 1, 2014 – February 28, 2018 (2018M-103).

Dear [REDACTED]:

The Hadley-Luzerne Central School District is in receipt of the Comptroller's Audit of the Hadley-Luzerne School District for the period July 1, 2014 to February 28, 2018. The District would first like to express appreciation for the professionalism of the audit team and the constructive suggestions set forth in the draft Audit Report.

The Hadley-Luzerne School District, its Board of Education and its Administrative Officers (hereinafter referred to as "The Hadley-Luzerne Central School District" or "the District") have examined the aforementioned audit and respond as follows:

RESPONSE:

1. Response to Finding # 1. The district has built budgets that provide for contingent expenditures. There are many expenditures that the district has no control over, including fuel costs and special education costs. New special education students can move into the district without any notice and the district is obligated to provide services to these students that may cost the district tens of thousands of dollars. The district must provide for funds to pay for these potential costs in its budget. If these contingent expenditures do not materialize, the money that was not spent would be added to the district's fund balance.

The district would also like to point out that the comptroller's office has overestimated the amount of money accumulated through the use of appropriated fund balance by several million dollars. The appropriated fund balance did not accumulate in fund balance over multiple years as the comptroller's report suggests. The same appropriated fund balance was reused over several years. To say that it accumulated is similar to saying that \$ 1,000 that was saved in a household savings account and was not used over the course of five years was actually \$ 5,000 that was saved, when it is still just the same \$ 1,000 in the same account.

See
Note 1
Page 11

2. Response to Finding # 2. The district has built up fund balance in response to three issues. The district at one point had very little fund balance and few reserves, and district officials worked hard to build up sufficient fund balance and reserves. Secondly, in 2010-2011, New York State took back a substantial amount of promised state aid (the "Gap Elimination Adjustment") which put the district in a very precarious financial position. Thirdly, the District is very concerned about the impact of the Tax Cap on their future finances. In order to remediate these problems, the district built fund balance and reserves to protect their students and their taxpayers in the future. Many other districts in this area and throughout the state have identified the same issues and have taken similar actions to protect their students and their taxpayers.
3. Response to Finding # 3. The comptroller's office notes in its report that "...the Board properly established and funded six reserve funds in accordance with New State General Municipal Law". The district followed New York State Law in setting up and funding its reserves, and, before creating and funding the reserves, discussed them at great length.

See Note 2 Page 11

CORRECTIVE ACTION PLAN

1. Recommendation # 1. The district will continue to review its expenditures on an annual basis to determine a reasonable level of appropriations.
2. Recommendation # 2. The district has been putting forth budgets with tax increases that are lower than both the tax cap and the increase in the budget as a whole for several years, and will continue to do so, which will have the effect of lowering revenues. The district has also committed fund balance to the current capital project, and will consider the possibility of using fund balance to institute and fund a capital reserve to help reduce future local expenditures on capital projects.
3. Recommendation # 3. The district believes that its current level of reserves are reasonable. The district has considered the level of reserves at every point that it has instituted and funded reserve funds. The district will review the district policy for possible changes and to improve its compliance with the policy.

Thank you again for your consideration and professionalism throughout this process. If I or my staff may be of any further assistance to you, please feel free to contact us.

Sincerely,

Beecher Baker, Sr.
Superintendent of Schools

Appendix B: OSC Comments on the District's Response

Note 1

We did not overestimate the amount of fund balance accumulated by the District. While the District appropriated the same amount of fund balance annually, they also consistently realized operating surpluses which resulted in the accumulation of fund balance in excess of the 4 percent limit allowed by RPTL. As reported, the District's unrestricted fund balance increased from 4.9 percent as of June 30, 2015 to 9.1 percent, or 5.1 percentage points over the statutory limit, as of June 30, 2017. The statement that appropriated fund balance was reused is incorrect and misleading. Appropriated fund balance was included in the budget but was not used to reduce taxes because of the pattern of significantly over budgeting for expenditures.

Note 2

District officials must ensure that unrestricted fund balance does not exceed the amount allowed by law. Additionally, only necessary reserves should be established, funded and used for their intended purposes. Our report identified four reserves that were overfunded and not used during our audit period because expenditures for their related purposes were continually paid from appropriations provided in the annual operating budgets.

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 (GML). To achieve the audit objective and obtain valid audit evidence, our audit procedures included the following:

- We traced a judgmental sample of 10 significant general fund balance sheet accounts, five revenue accounts and five expenditure accounts from the annual update document to the audited financial statements and accounting records to determine whether figures reported were accurate and reliable.
- We traced a judgmental sample of 10 revenue accounts and 15 expenditure accounts in the accounting records for 2017-18 as of February 28, 2018 to supporting documentation to determine whether the data was supported, accurate and reliable.
- We compared total revenues and expenditures to revenue, appropriation and appropriated fund balance estimates in the 2014-15, 2015-16 and 2016-17 adopted and modified budgets to determine whether the budgets as a whole were realistic.
- We compared a judgmental sample of five significant general fund revenue accounts and 10 significant general fund expenditure accounts to revenue and appropriation estimates in the 2014-15, 2015-16 and 2016-17 adopted and modified budgets to determine whether significant account estimates were realistic.
- We reviewed 2017-18 budgeted revenues, appropriations and appropriated fund balance compared to historical results to determine whether current year estimates were realistic.
- We determined if reserve funds were funded and used in accordance with GML restrictions and determined if potential expenditures could have been funded with reserves.
- We interviewed District officials and reviewed adopted policies and long-term plans to determine if there were policies for the maintenance and use of reserves and if long-term plans were developed for reserved funds in accordance with District policies.
- We reviewed the District's fund balance classifications for appropriateness and calculated the year-end unrestricted fund balance as a percent of the ensuing year's appropriations to determine whether unrestricted fund balance was maintained in accordance with RPTL. Additionally, we recalculated unrestricted fund balance as a percent of ensuing year appropriations, including unspent appropriated fund balance in the unrestricted fund balance amount.
- We analyzed the District's tax levy, budget to actual results and use of appropriated fund balance and reserves to identify changes in the tax levy

and determine if the District only levied taxes in amounts needed to finance operations.

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 size of the relevant population 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 District Clerk's office.

Appendix D: 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

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