

Galway Central School District

Fund Balance Management

JUNE 2018



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

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Report Highlights

Galway Central School District

Audit Objective

Determine if officials effectively managed the District's general fund balance.

Key Findings

- The District's unrestricted fund balance at the end of 2016-17 was approximately \$2.5 million or 11.7 percent of the ensuing year's budgeted appropriations, exceeding the statutory limit by 7.7 percentage points.
- The District's budgets included appropriated fund balance that was not used to fund operations.
- The budgets overestimated appropriations by more than \$7 million or 10.1 percent from 2013-14 through 2016-17.

Key Recommendations

- Ensure that the District's fund balance is in compliance with statutory limits and use surplus funds as a financing source to fund one-time expenditures and needed reserves or reduce District property taxes.
- Discontinue the practice of appropriating fund balance that is not needed or used to fund District operations.
- Adopt realistic annual budgets based on historical trends or other known trends and appropriate realistic amounts of fund balance to fund operations.

District officials generally agreed with our recommendations and have initiated, or indicated they planned to initiate corrective action.

Background

The Galway Central School District (District) is located in the counties of Saratoga, Montgomery, Fulton and Schenectady.

The District is governed by a Board of Education (Board) which has 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 responsible for the District's day-to-day management. The Superintendent is also responsible for budget development and administration, and is assisted by the Business Administrator with these responsibilities.

Quick Facts

Employees	175
Enrollment	808
2017-18 Appropriations	\$21.1 million

Audit Period

July 1, 2013 – July 31, 2017

Fund Balance Management

What Is Effective Fund Balance Management?

To effectively manage a district's financial condition, a board must adopt realistic and structurally balanced budgets based on historical data or known trends, in which recurring revenues finance recurring expenditures and reasonable levels of fund balance are maintained. A district may retain a portion of fund balance, referred to as unrestricted fund balance.

Districts should ensure the unrestricted fund balance does not exceed the amount allowed by New York State (NYS) Real Property Tax Law (RPTL), which limits unrestricted fund balance to no more than 4 percent of the following year's appropriations. Any unrestricted fund balance over this percentage must be used to reduce the real property tax levy by appropriating fund balance to lower the unrestricted fund balance. When fund balance is appropriated to finance operations, the District is budgeting for a 'planned operating deficit' equal to the amount of the appropriated fund balance. Sound budgeting practices provide that District officials should not appropriate significant amounts of fund balance that will not be used.

Unrestricted Fund Balance Exceeded the Statutory Limit

District officials need to improve budgeting practices to more effectively manage the general fund balance. The District has accumulated unrestricted fund balance of more than \$2.4 million as of June 30, 2017, or 11.7 percent of the 2017-18 budgeted appropriations and exceeded the statutory limit by about 7.7 percentage points. While District officials appropriated fund balance annually to finance operations, none of the appropriated fund balance was used for operations for the 2013-14 through 2015-16 school years.

In 2016-17, District officials appropriated \$1.2 million of fund balance to finance operations, but realized an operating deficit of only \$328,490. However, during the year, the District transferred \$1.75 million from a capital reserve to the capital fund which was not included in the adopted budget.¹ While the general fund experienced a reduction in its total fund balance due to the interfund transfer, the \$1.75 million was transferred from restricted fund balance. As a result, the unrestricted fund balance actually increased during 2016-17 because total revenues exceeded operating expenditures, not including that transfer. Without it the District would have realized an operating surplus of about \$1.4 million.

¹ The \$1.75 million transfer was for a voter-approved building project.

Figure 1: Unrestricted Fund Balance at Year-End

	2013-14	2014-15	2015-16	Unaudited 2016-17
Total Beginning Fund Balance	\$3,622,137	\$3,706,655	\$4,205,166	\$5,012,484
Add: Operating Surplus / (Deficit)	\$84,518	\$498,511	\$807,318	(\$328,490)
Total Year-End Fund Balance	\$3,706,655	\$4,205,166	\$5,012,484	\$4,683,994
Less: Non-spendable Fund Balance	\$6,000	\$0	\$0	\$0
Less: Restricted and Assigned Funds	\$1,027,605	\$1,830,045	\$2,320,572	\$676,180
Less: Appropriated Fund Balance for the Ensuing Year	\$1,100,000	\$1,200,000	\$1,200,000	\$1,550,254
Total Unrestricted Funds at Year-End	\$1,573,050	\$1,175,121	\$1,491,912	\$2,457,558
Ensuing Year's Budgeted Appropriations	\$18,704,120	\$19,551,380	\$20,159,607	\$21,058,918
Unrestricted Funds as Percentage of the Ensuing Year's Budget	8.4%	6.0%	7.4%	11.7%

When fund balance is appropriated as a funding source, it reduces the amount of unrestricted fund balance subject to the statutory limit. Although District officials appropriated fund balance each year to finance operations, the fund balance was not always used because the officials consistently overestimated appropriations. By including significant amounts of appropriated fund balance that was not needed to finance operations, the Board made it appear the District has less unrestricted fund balance than it actually had. In effect, it is a reservation of fund balance that is not provided for by statute and a circumvention of the statutory limit allowed by RPTL.

As shown in Figure 2, when the amount of appropriated fund balance that was not used is added back, the unrestricted fund balance exceeded the 4 percent statutory limit by amounts ranging from 8.2 to 14.8 percentage points.

Figure 2: Unused Fund Balance

	2013-14	2014-15	2015-16	Estimated 2016-17
Unrestricted Fund Balance at Year-End	\$1,573,051	\$1,175,121	\$1,491,912	\$2,457,558
Add: Appropriated Fund Balance Not Used to Fund Ensuig Year's Budget	\$1,100,000	\$1,200,000	\$1,200,000	\$1,500,000
Recalculated Unrestricted Fund Balance at Year-End	\$2,673,051	\$2,375,121	\$2,691,912	\$3,957,558
Recalculated Unrestricted Fund Balance as a Percentage of Ensuig Year's Budget	14.3%	12.2%	13.4%	18.8%

We compared the District's budgeted revenues and appropriations with actual results of operations from 2013-14 through 2016-17. While revenue estimates were reasonable, the Board-adopted budgets overestimated appropriations by more than \$7 million or 10.1 percent over the four-year period.

Figure 3: Overestimated Appropriations

	2013-14	2014-15	2015-16	Estimated 2016-17	Totals
Appropriations	\$17,944,933	\$18,707,968	\$19,601,057	\$22,224,983	\$78,478,941
Actual Expenditures	\$16,791,353	\$17,506,274	\$17,545,360	\$19,440,930 ^a	\$71,283,917
Overestimated Appropriations	\$1,153,580	\$1,201,694	\$2,055,697	\$2,784,053	\$7,195,024
Percentage Overestimated	6.9%	6.9%	11.7%	14.3%	10.1%

^a Includes \$1.75 transfer to the capital fund that was not included in the adopted budget

There is a trend of increasing total overestimated appropriations with certain individual accounts being materially overestimated. For 2016-17, total expenditures include the \$1.75 million transfer to the capital project fund which was not included in the adopted budgeted appropriations. Including that transfer and other budget modifications the appropriations were overestimated by almost \$2.8 million or 14.3 percent.

We analyzed expenditure accounts to determine whether the budget estimates were reasonable based on prior years' actual expenditures. Overestimated appropriations were spread among numerous accounts throughout the budgets. The most significant overestimations in fiscal year 2016-17 appropriations were for medical insurance at \$669,213 (35.3 percent). The Board consistently and significantly overestimated medical insurance costs by \$681,052 (40.3 percent) in 2013-14, \$342,089 (18.6 percent) in 2014-15 and \$610,883 (35.0 percent) in 2015-16.

The Board also consistently overestimated the appropriations for its annual obligations to the employees' retirement system. The overestimations totaled \$142,922 (48.5 percent) in 2013-14, \$175,796 (69.5 percent) in 2014-15, \$144,004 (47.8) in 2015-16, and \$190,291 (83.3 percent) in 2016-17. The appropriation for 2017-18 totals \$231,200 which appears to be reasonable when compared to the actual expenditure in 2016-17 of \$228,409.

The Board President informed us that the Board intentionally adopts budgets with overestimated appropriations in order to maintain a fund balance that can cover future adverse financial events like the reduction of revenue from federal and State aid. However, the District accurately budgets for the expected revenue each year so the practice of padding appropriations has resulted in increasing fund balance. We understand there has to be some allowance for unforeseen circumstances. This could come from a conservative budget, an accumulation of fund balance or reserve balances. However, maintaining a cushion in fund balance while continuing to raise extra taxes with overly conservative budgets is not prudent financial management because it results in tax levies that are higher than necessary.

We also reviewed the District's 2017-18 adopted budget totaling approximately \$21.1 million and found estimated revenues to be reasonable but appropriations continue to be overestimated. For example, even though the actual medical insurance costs in 2016-17 were \$1.9 million, the budgeted appropriation for 2017-18 was increased to \$2.9 million, an increase of nearly \$1 million or 52 percent with no indication that actual costs will increase by such magnitude. In addition, the Board appropriated \$1.5 million of fund balance to finance operations in 2017-18 even though it is unlikely the fund balance will be needed given the excess amounts budgeted for expenditures. As a result, the current level of fund balance will be maintained and likely continue to increase rather than decrease as budgeted by District officials.

The Board was aware of the excess amount of unrestricted fund balance the District accumulated and the Superintendent told us they have plans to use it for pending capital projects. The District is in the process of a \$26.7 million building project to be funded by \$19.2 million in State building aid, \$1.75 million transferred from the capital reserve and a \$5.75 million local share to be paid over 15 years of debt payments. The annual debt payments will be funded through the District's tax levy and likely will not require the use of unrestricted fund balance. If the Board did intend to fund capital expenditures with accumulated fund balance, they should create and fund a reserve for this intended use.

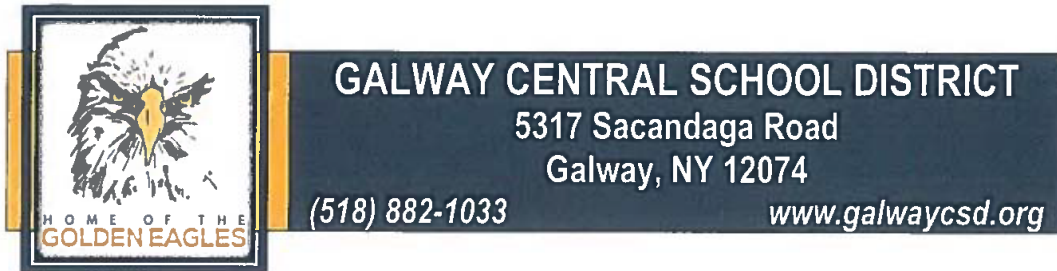
What Do We Recommend?

District officials should:

1. Develop and adopt annual budgets which are realistic based on historical trends or other known factors and appropriate realistic amounts of fund balance to fund operations.
2. Discontinue the practice of appropriating fund balance that is not needed or used to fund District operations.
3. Ensure that the amount of the District's fund balance is in compliance with statutory limits and use surplus funds as a financing source for:
 - Funding one-time expenditures.
 - Funding needed reserves.
 - Reducing District property taxes.

Appendix A: Response From District Officials

The District's response letter refers to an attachment that supports the response letter. Because the District's response letter provides sufficient detail of its actions, we did not include the attachment in Appendix A.



March 14, 2018


Jay Anderson – Board President

Overview

The following is our formal response to the Office of the State Comptroller's (OSC) transmittal dated February 22, 2018. The Board of Education and the Administration of the Galway Central School District appreciate the thoroughness of this report and its findings and value its recommendations. It is our intent to use the report and the subsequent corrective action plan as an outline for improving the Board of Education's financial oversight and assist in the implementation of Galway's multi-year financial plan. Items specified in the report have to date been addressed or will be addressed in the current fiscal year; those that have not will be addressed in the corrective action plan. We agree with the report's findings and believe that the report fairly presents the District's financial oversight and fiscal position. In addition to addressing the report's specific recommendations, we will look to develop a response and corrective action plan in the context of the District's ongoing multi-year financial planning process.

This response will focus on the following areas:

- Fund Balance Management
- Budgeting Practices
- Galway's Multi-Year Financial Plan
- Corrective Action Plan

Fund Balance Management

Unrestricted Fund Balance

Under *Key Findings*, the audit report states, "The District's unrestricted fund balance at the end of the 2016-17 was approximately \$2.5M or 11.7% of the ensuing year's budgeted appropriations exceeding the statutory limit by 7.7%." In preceding years, the unrestricted fund balance as a percentage of the ensuing year's budget was between 6% and 8.4% an average of 7.3% a year.

The increase to 11.7% was due to a transfer of \$1.75M from capital reserve to the capital fund. This amount was not included in the adopted budget the appropriation was included in a 2016 voter approved capital project. The \$1.75M was transferred from restricted fund balance increasing unreserved fund balance. Our external auditor stated, "The reason unassigned went up is the district had an overall loss for the year, but if you add back the \$1.75 transfer to capital fund, overall the district had a positive \$600K which went to unassigned since we did not increase reserves."

This situation has been addressed since the \$1.75M has been spent down to approximately 200,000 to cover initial capital project fees. Additionally, the District has used fund balance for the following one-time purchases:

- Playground \$ 93,000
- Track \$110,000
- Wrestling Mats \$ 50,000

We will further address the District's undesignated fund balance in the "Budgeting Practices" section of this report.

Appropriated Fund Balance

In the audit report *Key Findings*, the audit report states, "The District's budgets included appropriated fund balance that was not used to fund operations." On December 7, 2016, a multi-year financial plan (MFP) was presented to the Board of Education at a public meeting. The presentation was subsequently posted on the District's website. The MFP recommended to the Board of Education the District gradually reduce appropriated fund balance as illustrated below:

	2016-2017	2017-2018	2018-2019	2019-2020
Real Property Tax Items	8,570,477	9,000,000	9,248,688	9,433,662
Other Tax Items (includes STAR)	1,495,544	1,267,341	1,224,000	1,248,480
Non-Property Tax Items (PILOTS)	275,000	250,000	252,500	255,025
Assigned Fund Balance	1,200,000	1,000,000	800,000	600,000
State Aid	8,628,586	8,700,000	8,700,000	8,700,000

Reducing the appropriated fund balance can only be accomplished by reducing the budget. Since close to 70% of the budget is staffing and benefits, the MFP recommended right-sizing staff to enrollment. ATTACHMENT 1

2016-17 staffing levels were maintained in the 2017-18 budget and the appropriated fund balance was increased by \$350,254 to \$1,550,254. In preparing the 2018-19 revenue budget, we are looking to reduce the appropriated fund balance back to \$1.2M and continue to gradually reduce that amount in subsequent years.

Budget Development

Under *Key Findings*, the audit report states, "The budgets overestimated appropriations by more than \$7M or 10.1% from 2013-14 through 2016-17." In aggregate, this seems material. But if broken down by year the amounts are, an average increase of 2.65% and \$1.75M per year. In looking at the District's MFP, for the foreseeable future, revenues will not meet expenses. The plan stated revenues will not meet expenditures because of the following:

- Flat State Aid
- 2% Tax Levy Cap
- Staffing/salary costs rising by 3% a year
- Health insurance premiums rising annually by 5 – 10%

ATTACHMENT 2

If staffing levels are maintained and the budget is spent down, the District will soon be in a deficit situation with depleted fund balance. Even if the budget is reduced, which we are planning, a continuing rise in staffing and benefit costs project a 5% to 6% budget-to-budget increase while revenues will only increase by 2% to 3% annually. The only way to accommodate this situation is to have capacity in future budgets. An "appropriate" capacity is what needs to be determined.

We also need to maintain a healthy unreserved fund balance. As stated, this year's 11.7% unreserved fund balance was due in large part to the \$1.75M transfer from the capital reserve. This will be corrected in the coming fiscal year. Additionally, we will continue to examine one-time expenditures as a means to support instruction and reduce fund balance.

The audit report states, "actual medical insurance costs in 2016-17 were \$1.9M, the budgeted appropriation for 2017-18 was increased to \$2.9M an increase of nearly \$1M or 52% with no indication that actual costs will increase by such magnitude."

In the 2017-18 budget, the initial cost estimates for health insurance showed an 18% increase from the previous year. In developing the 2017-18 health insurance budget we increased the budget by \$274,827 – 10.5%. Although the health insurance costs only increased 10%, we anticipated a 18% increase and if that occurred, we would have reduced that budget line.

Another rationale for overestimating Health Insurance costs is the volatility of the Health Insurance market place. It is conceivable that costs can rise 10% to 15% in one year. If this occurs, we are able to maintain budget stability by having budgeted more in health insurance costs than actual costs.

We also estimated that the District's retiree health insurance costs will rise significantly in the next three fiscal year. The 2016-17 health insurance increase was to address that problem.

The audit report also addresses overbudgeting in the ERS and TRS budget lines. The budget for each of these lines was significantly reduced from 2016-17 to 2017-18

	2016-17	2017-18
ERS	\$ 418,700	\$231,200
TRS	\$1,243,750	\$738,907

Even given the reduction in the percentage employer contribution rates, the 2017-18 budget numbers will more accurately reflect the actual expenses.

Conclusion

We appreciate the audit report findings and understand we must work within New York State laws and statutes. In the following Corrective Action Plan, we will address the issues presented in the audit report. In developing the District's budgets, we also understand we have an obligation to students and tax payers to maintain quality instruction and fiscal solvency. All of our budget efforts are towards those ends.

Corrective Action Plan

Recommendations and Corrective Action Plan	Timeline
<p>1. Develop and adopt annual budgets which are realistic based on historical trends or other known factors and appropriate realistic amounts of fund balance to operations</p> <p>To date the District has reduced the amount budgeted in the appropriation benefit lines: 9010 – ERS, 9020 – TRS and 9060 – Health Insurance to better reflect actual costs. This plan is referenced in the above audit response.</p> <p>The District will also analyze payroll information and staffing data to develop a more accurate assessment of staffing expenditures in relation to budgeting.</p> <p>Overall, budgets must have capacity to account for unexpected expenditures and to address the revenue to appropriation shortfall. We are looking to find an appropriate capacity for future budgets. “Appropriate” meaning a budget that supports instruction and is fair to taxpayers.</p>	<p>March 2018 – Ongoing</p>
<p>2. Discontinue the practice of appropriating fund balance that is not needed or used to fund District operations</p> <p>The 2018-19 revenue budget reduces appropriated fund balance by \$350,254 from \$1,550,254 to \$1,200,000. We plan to continue reducing the amount of appropriated fund balance. This plan is referenced above in the audit response.</p>	<p>May 2018 – May 2022</p>

3. Ensure that the amount of the District's fund balance is in compliance with the statutory limits and use surplus funds as a financing source for:
- Funding One Time Expenditures
 - Funding needed reserves
 - Reducing District property taxes

A list of one-time expenditures is listed above in the audit response. We plan on continuing the practice of one-time purchases in the coming years to address safety and instructional needs. Examples of these expenses include: using cash to purchase buses, textbook and software purchases.

The District's Multi-Year Financial Plan recommends using \$300K to fund the ERS reserve. The plan also calls for a \$100K increase in the funding of our debt service and repair, and employee benefit accrued liability reserve. This funding is contingent on an analysis of fund balance and the recommendation of our external auditors at the end of their audit in August of 2018.

The District has been reducing property taxes by appropriating over \$1.5M in fund balance to reduce the tax levy. While reducing the amount of appropriated fund balance, the District will look to keep the tax rate stable through the 2% Tax Levy Cap and conservative budgeting practices.

March 2018 - ongoing

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, our audit procedures included the following:

- We interviewed the Superintendent and other District officials to gain an understanding of the District's financial management policies and procedures and the District's budgeting practices.
- We analyzed the District's general fund financial records from 2013-14 through 2016-17 to determine whether unrestricted fund balance increased or declined. We also evaluated any factors contributing to the increase or decline identified.
- We reviewed the Board-adopted general fund budgets to determine whether they were realistic and structurally balanced by comparing the adopted budgets from 2013-14 through 2016-17 with actual results of operations.
- We reviewed the adopted general fund budget for 2017-18 to determine whether budgeted revenues and appropriations were reasonable based on historical data and supporting source documentation.
- We analyzed the general fund's financial condition to determine whether during the audit period fund balance increased or was in excess of statutory limit and whether operating deficits were incurred.

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 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.ny.gov

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GLENS FALLS REGIONAL OFFICE – Jeffrey P. Leonard, Chief Examiner

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