East Irondequoit Central School District

Financial Management

OCTOBER 2019

OFFICE OF THE NEW YORK STATE COMPTROLLER

Thomas P. DiNapoli, State Comptroller

Contents

Report Highlights

East Irondequoit Central School District

Audit Objective

Determine whether the Board effectively managed District finances by adopting realistic budgets and ensuring fund balance remained within statutory limits.

Key Findings

- District officials circumvented the statutory limit on surplus fund balance by not using $3.7 million in appropriated fund balance as a financing source, improperly booking $3.6 million in encumbrances and improperly reserving $7.7 million for debt service.
- Recalculated surplus fund balance exceeded the statutory limit by 10 to 12 percentage points for the fiscal years 2015-16 to 2017-18. The District also maintained 11 proper reserve funds totaling $34 million at June 30, 2018.
- During the last three fiscal years, District officials could have funded operations and reduced surplus fund balances which impact real property tax levies.

Key Recommendations

- Ensure that the District's fund balance complies with statutory limits and use surplus funds for one-time expenditures, paying down debt or applying it to the necessary property tax levy amount.
- Provide transparency by budgeting for operations and reserves more accurately, and accounting for encumbrances and debt service funds properly.

District officials disagreed with certain aspects of our findings and recommendations, but indicated they planned to implement some of our recommendations. Appendix B includes our comments on issues raised in the District's response letter.

Background

The East Irondequoit Central School District (District) serves the eastern portion of the Town of Irondequoit in Monroe County.

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

Quick Facts	
Employees	700
Enrollment	3,000
2018-19 General Fund Appropriations	$80.7 million

Audit Period

July 1, 2017 – January 31, 2019

We extended our audit scope period back to July 1, 2013 to review fund balance trends.

Financial Management

What Is Effective Financial Management?

To effectively manage a district's financial condition, the board should 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. To provide for cash flow and unanticipated events, a district may retain a portion of fund balance, referred to as unrestricted fund balance.

District officials should ensure that fund balance does not exceed the amount allowed by New York State Real Property Tax Law,[1] which currently limits surplus fund balance[2] to no more than 4 percent of the following year's appropriations. Any surplus fund balance that exceeds the statutory limit should be used to pay for one-time purchases, fund needed reserves, pay down debt or apply to the upcoming budget to offset the real property tax levy. Reductions to surplus fund balance should be accomplished by:

- Appropriating surplus funds for future spending and spending those funds,
- Ensuring that "encumbrances" are for actual commitments related to unperformed contracts for goods or services, and
- Reasonably sizing and managing reserves.

An operating surplus is created when actual expenditures are less than actual revenues. An operating surplus becomes part of the surplus fund balance, which is the accumulation of operating surpluses over prior years and can be used by earmarking that money as a source in the budget to offset the amount of the real property tax levy otherwise needed. This is called a "planned operating deficit."

Additionally, districts are allowed to encumber obligations in the form of unfulfilled purchase orders or contracts. Encumbrances that exist at fiscal-year end may be carried over to the next year, but must represent valid commitments for specific future expenditures and should not be established as a means of artificially reducing available year-end fund balance.

Districts are legally allowed to establish reserves for certain future purposes (e.g., capital projects, retirement expenditures). To be transparent, the Board should place the amounts to be reserved in its annual budget to ensure that taxpayers are aware of the board's future intentions.[3] District officials should plan for the funding and use of reserves by balancing the desire to accumulate funds for

1 New York State Real Property Tax Law Section 1318

2 As defined in Appendix D, surplus fund balance is unrestricted fund balance minus appropriated fund balance and encumbrances included in committed and assigned fund balance. See our accounting bulletin at https://www.osc.state.ny.us/localgov/pubs/releases/gasb54.pdf

3 Refer to our publication Reserve Funds available at www.osc.state.ny.us/localgov/pubs/lgmg/reservefunds.pdf

future needs with the obligation to make sure real property taxes are not higher than necessary.

A debt service fund is used to account for the accumulation of resources to pay principal and interest on long-term debt. For example, a debt service fund must be established and maintained to account for the proceeds of a capital asset's sale that has outstanding debt or if State or federal aid is received for a capital improvement for which there is outstanding debt. Districts are also required to account for and restrict unexpended bond proceeds and related interest earnings in accordance with statutory provisions. Officials should use the money in this fund to make the related debt service payments.

The Board Underestimated Revenues, Overestimated Appropriations and Appropriated More Fund Balance Than Needed

The Board and District officials need to improve budgeting practices to ensure that budgets are realistic and take action to address the reasonableness of fund balance. While the District's unrestricted fund balance was reported to the New York State Education Department as being within the legal limit for the past three years, we found the unrestricted fund balance was actually underreported during this time period.

The District budgeted for planned operating deficits by appropriating approximately $1.1 million in fund balance annually as a financing source for fiscal years 2013-14 through 2017-18. This appropriation of fund balance made it appear that surplus fund balance was within the statutory limit. However, because officials underestimated revenues by 1 to 3 percent and overestimated appropriations by 3 to 6 percent in three of these years, operating results did not generate the planned deficits.

We compared budgeted appropriations and estimated revenues with actual operating results for 2013-14 through 2017-18 and found that expenditures averaged about 3 percent[4] (about $2 million per year) less than budgeted appropriations and actual revenues[5] averaged 2 percent (about $1.5 million per year) more than budgeted. The most significant budgeted appropriation variances were in health insurance ($4.5 million or 9 percent), retirement ($5.7 million or 24 percent) and teacher salaries ($4 million or 6 percent), in each case significantly overestimating expenditures. The largest revenue variances were the refund of prior year expenditures ($1.1 million or 141 percent), sales tax distributions by the County ($673,000 or 5 percent) and day school tuition from other districts ($629,000 or 42 percent), in each case significantly underestimating revenues.

---

4 The variances ranged from a negative 1 percent to as much as a positive 6 percent.

5 Excluding budgeted transfers from reserves and appropriated fund balance

As a result of the operating surpluses, $3.7 million (67 percent) of the $5.5 million total appropriated fund balance went unused. The District's financial statements show operating deficits of approximately $1.5 million at fiscal year-end 2015-16 and $400,000 at fiscal year-end 2017-18. However, these deficits were not the result of transparent budgeting plans, but rather due to the use of unbudgeted transfers to the capital project fund of approximately $5 million and $2.2 million in the same years, respectively. In the interest of transparency, the Board should inform District taxpayers of its intention to set aside these funds for future capital projects.

The Deputy Superintendent told us that he budgets conservatively because they have to plan for the unexpected. However, budgeting practices that annually underestimate revenues and overestimate appropriations can result in real property tax levies that are higher than necessary and budgets that are not an effective tool for financial management. Presenting complete budget information to taxpayers also allows them the opportunity to make informed decisions when voting on the budget.

Funds Were Improperly Classified as Encumbrances

District officials encumbered between $1.9 million and $3.2 million at the end of each fiscal year 2015-16 through 2017-18, for a total of approximately $7 million. However, we found that approximately $3.5 million (50 percent) were not valid encumbrances. Encumbrances that are established without a genuine purchase or contractual commitment for the year in which they originate inflate assigned fund balance and misrepresent the District's budget, which can lead to a higher tax levy than necessary.

The unused appropriated fund balance discussed above and inappropriate encumbrances made it appear that the District had complied with the statutory 4 percent surplus fund balance limit. Because the District did not actually use the appropriated fund balance and it improperly classified encumbrances, surplus fund balance exceeded the statutory limit.

Funds Were Improperly Restricted in the Debt Service Fund

The District accounts for and reports a debt service reserve in the debt service fund, which is separate from the general fund, and separate from and in addition to the reserve funds discussed later in this report. As of June 30, 2018, the debt service reserve had a reported balance of $7.7 million. District officials could not provide us an accounting illustrating how these are related to current outstanding debt.

The District's debt service expenditures averaged about $8.3 million annually for 2013-14 through 2017-18. However, the District did not use the balance in the debt service reserve to pay debt service on current outstanding debt. Instead, the District appropriated additional funds to pay debt service. The debt service reserve could have been used to either pay down outstanding debt or to offset the real property tax levy.

Without a valid legal requirement to restrict these funds, District officials do not have the statutory authority to establish a reserve or otherwise set aside surplus fund balance in the debt service fund. Therefore, these funds should be added to unrestricted fund balance in the general fund. When these funds are added back, along with the previously discussed unused appropriated fund balance and improper encumbrances, the cumulative recalculated surplus fund balance exceeded the statutory limit by 10 to 12 percentage points.

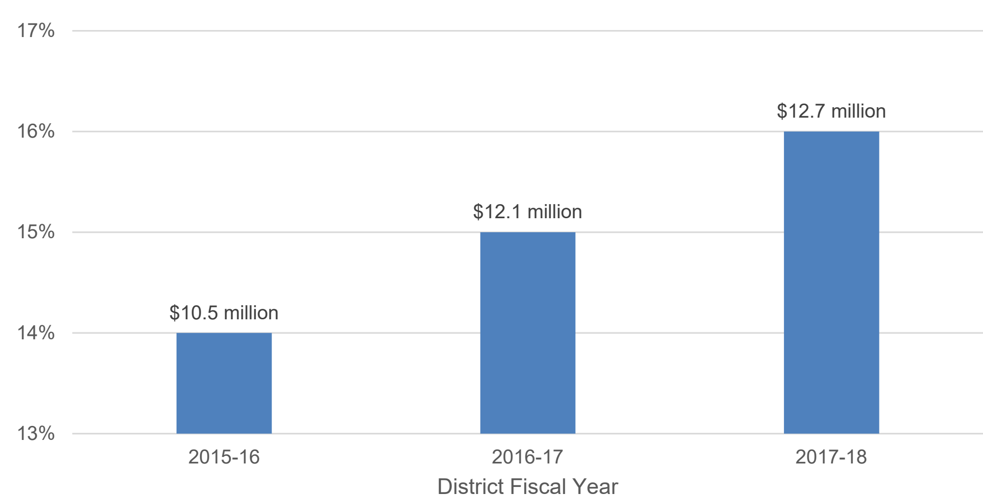
Figure 1: Recalculated Surplus Fund Balance at Year-End

	2015-16	2016-17	2017-18
Unrestricted Fund Balance	$3,051,505	$3,118,161	$3,226,739
Unused Debt Service Funds	$6,454,570	$6,483,289	$7,731,717
Restated Unrestricted Fund Balance	$9,506,075	$9,601,450	$10,958,456
Unused Appropriated Fund Balance[a]	$0	$994,098	$605,755
Improper Encumbrances[a]	$958,844	$1,440,160	$1,172,426
Recalculated Surplus Fund Balance	$10,464,919	$12,035,708	$12,736,637
Next Year's Budgeted Appropriations	$76,287,680	$77,954,087	$80,668,468
Percentage	14%	15%	16%

a See previous sections on budgeting and encumbrances for more information.

FIGURE 2

Recalculated Surplus Fund Balance as a Percentage of the Next Year's Budgeted Appropriations

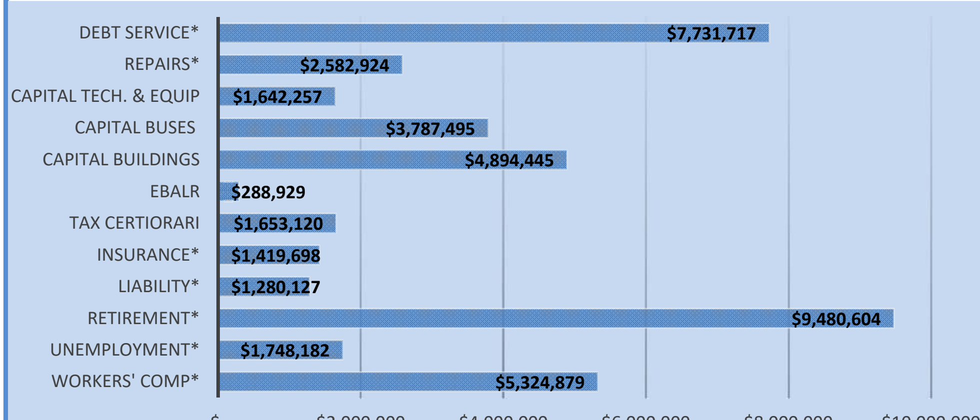


Excess Funds Were Accumulated As Reserves

The Board has not provided sufficient oversight of the District's reserve funds. The Board has not adopted a reserve policy and it included limited provisions in the annual budgets[6] for funding its reserves. Generally, District officials transferred money from operating surpluses to reserves at fiscal year-end to stay within the 4 percent limit rather than using the surpluses for tax relief.[7] As a result, general fund reserves increased by $3.9 million over the last five completed fiscal years.[8] The District had operating surpluses which were used to accumulate very large reserves. As of June 30, 2018, the District reported 11 reserves[9] and a debt service reserve with balances totaling approximately $42 million or 52 percent of the District's annual budget.

FIGURE 3

Reserve Balances on June 30, 2018



*Overfunded

We found seven reserves with balances totaling $29.6 million (71 percent of total reserves) at June 30, 2018 are overfunded.

- Debt Service Reserve[10] – The $7.7 million balance has been accumulating for more than 10 years. The District has funded debt service payments with transfers from the general fund.

---

6 The Board included an average of $554,000 in the District budgets for fiscal years 2013-14 through 2017-18.

7 New York State Real Property Tax Law Section 1318 limits surplus general fund balance to no more than 4 percent of the next year's budgeted appropriations.

8 Fiscal year-end unbudgeted transfers to reserves were $1.1 million in 2013-14, $1.75 million in 2014-15, $1.9 million in 2015-16, $1.2 million in 2016-17 and $1.6 million in 2017-18. The District also transferred $5 million out of reserves in 2015-16.

9 The reserves included the following: workers compensation, unemployment, retirement, liability, insurance, tax certiorari, employee benefit accrued liability reserve fund, buildings, bus purchases, equipment and technology, and repairs.

10 Refer to page 4 for additional discussion regarding the debt service reserve.

- Retirement Contribution Reserve – Recent legislation amended New York State (NYS) General Municipal Law (GML)[11] allowing the District to eventually fund a sub-account within this reserve for contributions to the NYS Teachers' Retirement System (TRS) of up to 10 percent of the prior year's total compensation or salaries of all teachers who are members of the TRS. Accounting for this new legislation, once fully implemented and funded by the Board, the District's TRS sub-account would have been capped for the current year at $2,276,591. The remaining $7.2 million of the $9.5 million in the retirement contribution reserve is sufficient to cover about six years of full retirement costs with the New York State and Local Retirement System (separate system), which averaged about $1.2 million over the last three years. District officials do not use this reserve to fund retirement contributions. Instead, they consistently budget for this expenditure to be funded fully through the District's annual budget appropriations.
- Unemployment Insurance Reserve – The District made payments to the NYS Unemployment Insurance Fund for the three-year period ending June 30, 2018, averaging $30,017 per year. The reserve's balance of $1.75 million is sufficient to cover 58 years of unemployment costs or 149 employees at the maximum benefit.[12]
- Workers' Compensation Reserve – The District made payments to the workers' compensation consortium averaging $562,000 per year. However, these expenditures were paid from the general fund operating budget and the reserve was not used. The reserve balance is sufficient to cover nine and a half years of workers' compensation costs. Therefore, we question the need for this reserve, with a balance of more than $5.3 million, to be funded at this level.
- Liability Insurance Reserve – The Board authorized the liability insurance reserve's balance to a maximum level of $1 million. However, at the end of June 30, 2018, the reserve's balance totaled $1.28 million, exceeding the Board's authorized level by $280,127. Additionally, the District has not used this reserve in the last five years.
- Repair Reserve – Over the last five years, the District has funded the repair reserve through budgeted appropriations totaling $100,000 each year. The reserve was not used during this time period. Therefore, we question if the reserve with a $2.6 million balance is necessary.
- Insurance Reserve – From 2013-14 through 2015-16, the activity in the insurance reserve was solely for the deposit of interest. At the end of 2015-16, the District held $1.35 million in this reserve. Beginning in 2016-17 the

11 New York State General Municipal Law Section 6-r

12 26 weeks at $450 per week

District began depositing other funds[13] into this reserve causing the balance to increase by an additional $63,500 for a total of $1.42 million. Due to the inactivity for several years, we question if the reserve with a $1.4 million balance is necessary.

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

Illustration of the Effect of District Officials' Budgeting Decisions

Through the budgeting practices identified for years 2015-16 through 2017-18, the District's actual tax levy exceeded the tax levy required to fund operations.

We developed a table (Figure 4) to illustrate the effect budgeting decisions could have on the tax levy.

Figure 4: Potential Effect on the Real Property Tax Levy with Improved Budgeting

	2015-16	2016-17	2017-18
Real Property Tax Levy (Tax Levy)	$40,279,495	$40,723,030	$41,414,124
Less: Overfunded Reserves[a]	$6,725,656	$31,025	$1,256,853
Less: Operating Surplus	$3,603,188	$3,723,922	$1,811,355
Tax Levy Required to Fund Operations	$29,950,651	$36,968,083	$38,345,916
Percent Change	(25.6%)	(9.2%)	(7.4%)

a We included the debt service reserve balance as of 2015-16 in full because this balance could have been used previously. We also included the increase in the debt service reserve for the following two years. For 2015-16 we also included the funding in the liability reserve that exceeded the Board-authorized value because it should not have been accumulated.

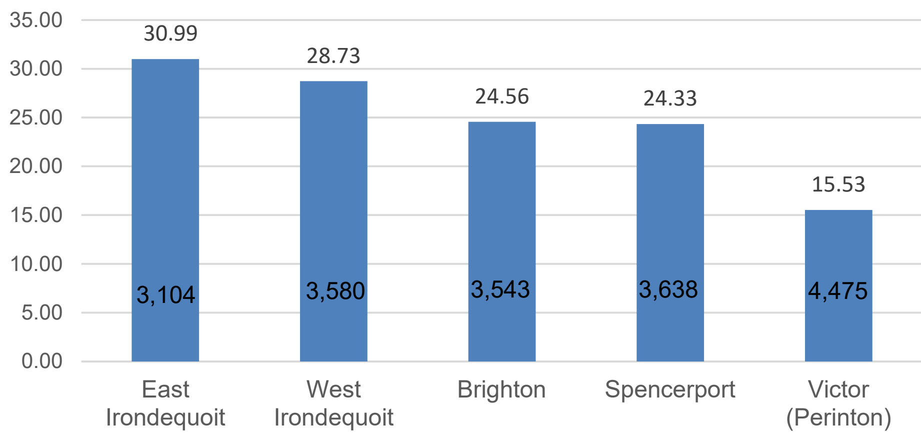
In addition to the property tax levy required to fund operations illustrated in Figure 4, the tax levy could have been further affected by utilizing the reserves previously mentioned as a funding source for current expenditures, to the extent the Board determines those reserves are overfunded.

The District also had the highest school district tax rate in Monroe County during this period. The illustration below shows the District compared to other similarly sized districts. The tax rates are per $1,000 of assessed valuation.

13 Fees collected from participation in a device protection plan. For purposes of this audit, the District's device protection plan and the collection of fees associated therewith were assumed to be legally permissible.

FIGURE 5

Tax Rate Comparison per $1,000 2017-18 (including the number of students)



What Do We Recommend?

To effectively manage the District's financial condition, the Board and District officials should:

1. Develop a plan to reduce the amount of surplus fund balance to comply with the statutory limit. Surplus funds can be used as a financing source for:
   - Funding one-time expenditures,
   - Funding needed reserves,
   - Paying off debt, and/or
   - Reducing District property taxes.
2. Use a multiyear financial plan based on reasonable estimates that project future revenues, expenditures, reserve balance amounts and fund balance amounts. Effective multiyear plans project operating and capital needs and financing sources over a three- to five-year period.
3. Develop and adopt budgets that include reasonable estimates for appropriations, revenues and the amounts of fund balance that will be used to fund operations.
4. Ensure that year-end encumbrances are valid and supported.
5. Transfer money that is improperly residing in the debt service fund to unrestricted fund balance in the general fund.

6. Adopt a comprehensive reserve policy that includes targeted funding levels and conditions under which reserves will be used and replenished.

7. Review reserve balances and develop a plan to reduce balances to reasonable levels in accordance with applicable statutes.

Appendix A: Response From District Officials

EAST IRONDEQUOIT CENTRAL SCHOOL DISTRICT
ADMINISTRATIVE OFFICES
600 PARDEE ROAD
ROCHESTER, NY 14609

(585) 339-1200 • FAX (585) 288-0713
http://eastiron.org

Mary E. Grow
Superintendent of Schools

John D. Abbott
Deputy Superintendent
(585) 339-1260
John_Abbott@eastiron.monroe.edu

August 6, 2019

Mr. Edward V. Grant, Jr., Chief Examiner
The Powers Building
16 West Main Street, Suite 522
Rochester, New York 14614-1608

Dear Mr. Grant:

Following a careful review of each and every point raised in your audit report we are prepared to offer our response. Several points merit further study on our part. However, there are portions of the report with which we must respectfully but strongly disagree.

Our School District financial practices were established and are maintained to provide long term financial stability for the District. Stability protects the financial interest of our community in our schools. It protects programs essential to student success for years to come. The Board of Education has long supported this approach by adopting a policy on fiscal practices sixteen years ago.

Some of the financial practices in which we strongly believe are inconsistent with the approach recommended by your audit are:

1. **We view budgeting as a multiyear process.** Decisions made in the short run can have serious implications for the long run. Reacting to surplus on a year to year basis can lead to significant future cuts in vital instructional programs.

See Note 1 Page 17

2. **We view reserves as a long-term financial tool.** Some reserves provide a means to plan for large future expenditures when planning is an option. Others provide protection against large, unexpected expenses. Still others will soften the blow of significant year to year increases in expenses. We do not determine appropriate reserve levels by looking back at their use during a strong economy.
3. **We view surpluses as desirable and believe that deficits must be avoided.** Our Board of Education has determined that surplus levels are appropriate as part of a strategy that recognizes that long term growth of District revenues will be significantly outpaced by growth of expenses. Following adoption, our budgets are administered conservatively.

See Note 2 Page 17

We have a responsibility to our taxpayers that we take very seriously. The record shows that our tax levy increases have been among the lowest in Monroe County. East Irondequoit's proposed tax levy increase for 2019-20 was 17th out of 17 districts. In 2018-19 it was 16th out of 17. In 2017-18 it was 14th out of 17.[1] This is an important measure of fiscal responsibility.

See Note 3 Page 17

We would like to provide our perspective on some of the specific points made in your audit.

[1] New York State database of property tax report cards.

Findings on Budget Surpluses Are Arbitrary and Sometimes Contrary to Sound Budget Practice

You contend that "the Board underestimated revenues, overestimated appropriations and appropriated more fund balance than needed". We have concerns with your analysis and disagree with many of the specific points that you use to support this contention. Specifically,

- Your position that the combination of appropriating fund balance and then having a budget surplus *fifteen months later* "made it appear" that fund balance was within the statutory 4% limit. You clearly imply that our fund balance was not within the 4% limit. Your position is a subjective opinion and is not supported by the statute nor by your own guidance[2] or that of the State Education Department.[3]

See Note 4 Page 17

- No standard exists for an appropriate level of surplus. Your field auditors told us that an appropriate level of surplus depends on the situation.

See Note 5 Page 17

- The field auditors were also quite clear that the determination of reasonable levels of surplus and reserves is the responsibility of the entity (the school district).

See Note 6 Page 17

- Your report finds that our average revenue surplus during the period from 2013-14 through 2017-18 was 2% and the average expense surplus was 3%. In your office's audit of the Marathon Central School District you found that a 3.7% revenue surplus and a 6.4% expense surplus were acceptable.[4] In fact, the Board of Education approved *Financial Management and Reserve Plan* refers to the acceptable levels of surplus found in the Marathon audit.

See Note 7 Page 17

- You suggest that the Board of Education did not inform District taxpayers of unbudgeted transfers of $5 million to the capital projects fund in 2015-16 and $2.2 million in 2017-18. This is inaccurate. The voters approved these transfers at special district votes held on December 1, 2015 and December 12, 2017.

See Note 8 Page 18

- Figure 5 seeks to compare tax rates of five dissimilar school districts. It oversimplifies a very complex topic. East Irondequoit is the second most diverse school district in upstate New York.[5] In order to meet the needs of so many different types of students we must offer a wide variety of programs. Significant investments are made in International Baccalaureate, Project Lead the Way and Advancement Via Individual Determination (AVID). We have a nationally recognized 1:1 program. Our population of English Language Learners is growing rapidly. We provide these opportunities so that each and every student has the chance to grow and succeed.

See Note 9 Page 18

---

[2] In the updated April 2011 OSC Memo on Generally Accepted Accounting Principles (GAAP), the Office of the State Comptroller clarified the requirements for fund balance under GASB 54. On page four of the document under Statutory Fund Balance Limitations, it is stated: "Real Property Tax Law §1318 limits the amount of unexpended surplus funds a school district can retain to no more than 4 percent of the next year's budgetary appropriations. Funds properly retained under other sections of law (i.e., reserve funds established pursuant to Education Law or GML) are excluded from the 4 percent limitation. In the context of previous fund balance reporting, an unexpended surplus was interpreted to be synonymous with unappropriated unreserved fund balance. Under Statement 54 fund balance classifications, the 4 percent limitation would be interpreted to be applied to unrestricted fund balance (i.e., the total of the committed, assigned, and unassigned classifications), minus appropriated fund balance, amounts reserved for insurance recovery, amounts reserved for tax reduction, and encumbrances included in committed and assigned fund balance."

[3] Reference Document for Audits of Financial Statements of New York State School Districts, New York State Education Department, appendix 4, page 6.

[4] Office of State Comptroller Report of Examination, Marathon Central School District Fund Balances (2017M-280)

[5] Top 30 most diverse school districts in Upstate NY, ranked for 2019, New York Upstate.com, October 10, 2018.

Programs and services cost money. Offering less would be a disservice to our student population and our community of learners.

While you may disagree with our philosophy and practice for management of reserves, your statement that the "Board has not provided sufficient oversight of reserve funds" is inaccurate. It is true that the Board of Education does not have a stand-alone reserve policy, but it does have a broader policy on fiscal practices that treats reserves as one part of the financial management of the District. That policy was adopted in 2003 and is reviewed by the board at least once each year. The board has also adopted a reserve plan that is reviewed and readopted annually. These documents demonstrate consistent board oversight of the District's financial management and a commitment to principles of responsible financial management. All reviews occur at public board meetings to ensure transparency.

See Note 10 Page 18

Reserve Funding Levels and Practices are Reasonable

First and foremost, we wish to emphasize that all funds were legally deposited in reserve funds.

Your audit refers to many of our reserves being overfunded. We disagree with this conclusion. Most of the reserves cited have been created and are managed as a hedge against large unexpected expenses and unusually large increases required in future budgets. The fact these reserves have had little or no activity in the past is not relevant. Reserves are funded in times when funds are available. The economy has been strong for a number of years providing funding opportunities. Money is expended from reserves when there is no other option. It is reasonable to expect that there will be a recession within the next several years. Recessions will inevitably depress state aid revenue and increase retirement contributions. The failure to plan for unfavorable conditions will force unacceptable reductions in programs that benefit our students.

See Notes 1 and 10 Pages 17 and 18

Just as the reasonableness of budget surplus levels is a matter of local determination, so are the levels of reserve funding. No guidance exists from your office on the appropriate size of most of the reserves you cite.

The School District agrees with the Comptroller's recommendation that fiscal planning is necessary to identify and facilitate efficient use of excess fund balance. The School District's Reserve Plan was created, and is annually reviewed by the Board of Education, for this purpose.

See Note 10 Page 18

We would like to respond to a few specifics in your audit:

- The intent of the Board of Education resolution establishing the Liability Reserve was to set the maximum amount of money that could be deposited in the reserve. The balance above that amount is due to interest revenue. It would have been impossible to determine future interest revenue when the reserve was established.

See Note 11 Page 18

- The draft Audit Report states that "we question if the [repair] reserve with a $2.6 million balance is necessary." The draft report does not allege the School District exceeded the legal limits governing contributions to the Repair Reserve[6]. To the contrary, the report "questions" whether the funds are needed. Given that repair

See Note 12 Page 18

[6] Section 6-d of the General Municipal Law permits the establishment of a repair reserve. When funding this type of reserve fund, Section 6-d provides that it may be funded by: (1) budgetary appropriation; or (2) such revenues as are not required by law to be paid into any other fund or account.

reserves are used for emergencies and repairs to capital improvements or equipment, setting aside such funds are necessary to fund unplanned costs which the School District may incur, and which cannot be planned (e.g. large one-time unplanned expenses such as the loss of a boiler). The School District has funded the repair reserve with voter approval and to the extent necessary to fund potential repairs and emergencies, and respectfully disagrees with the conclusion in the draft report that the reserve is overfunded.

- Use of the Insurance Reserve to account for repairs and losses in our 1:1 program anticipated the annual use of this reserve.

See Note 13 Page 18

The draft Comptroller Audit Report contends that "Due to inactivity for several years, we question if the [insurance] reserve with a $1.4 million balance is necessary."

Insurance reserve funds are authorized under Section 6-n of the General Municipal Law to pay any loss, claim, action or judgment for which a school district is authorized or required to purchase insurance. Annual contributions to this reserve may not exceed the greater of $33,000 or 5 percent of the total budget of the fiscal year.

The draft report does not allege the School District exceeded the legal limits governing annual contributions to its insurance reserve. Instead, the draft report "questions" whether the total amount in the fund is "necessary" given that there have not been expenditures from the fund in recent years. The School District's Reserve Plan dictates that surplus reserves are necessary to fund both planned liabilities, and unplanned external fiscal challenges which impact the School District each year. The School District recognizes that the majority of the "surplus" Insurance Reserve funds referenced in the draft Comptroller's Audit Report are funds allocated to cover insurance liabilities associated with laptops, iPads, and other equipment inventories.

There were no expenditures during the period of your examination because we transitioned high school students from iPads to laptops. Laptops were purchased with a service plan. iPads that had been used by students who received laptops were retained in inventory. This enabled us to replace damaged iPads from inventory rather than repairing them.

<u>A Change in Budget Practices as Recommended Would Have Catastrophic Consequences</u>

Figure 4 in your audit report is entitled "Potential Effect on the Real Property Tax Levy with Improved Budgeting". In fact, it precisely illustrates why applying surplus funds to an operating budget is an unsound practice. Your illustration would result in a 23.4% tax levy increase for the 2016-17 school year and 3.7% in 2017-18. Both increases would have required a 60% supermajority vote to override of the tax cap.

See Note 14 Page 18

We realize that this table is simply an illustration, but any application of surplus funds or reserves to balance a budget is deficit financing that eventually leads to a fiscal cliff and the need for significant program cuts or an override of the tax cap. We do not intend to subject our community to either one. That is why our board policy on fiscal practices strongly discourages the use of "one shot" revenues.

See Note 15 Page 19

Response to OSC Financial Management Audit – Page 5

Items That Merit Further Study

The Deputy Superintendent did not say that money in the Debt Service Fund was unrelated to current debt, only that he could not respond "off the top of his head" about where the entire balance came from. It is our intention to address the balance in the Debt Service Fund without doing financial harm to the District. We have developed a plan with the District's financial advisor to use funds not related to current outstanding debt for payment of a portion of the debt service on upcoming capital projects.

See Note 16 Page 19

Recent enactment of the Child Victims Act creates the potential for large liabilities that may not be covered by insurance. Some employers are even finding that they are unable to identify their insurer given the lengthy look back period. We believe that it is prudent to recommend to the Board of Education that when funds are available additional money be set aside in the Liability Reserve to cover claims that could arise. The resolution increasing the maximum amount of the Liability Reserve will also clarify how the maximum is to be calculated.

We do not know if your observation that some encumbrances are improperly classified is valid. Despite repeated requests, your office has not supplied us with specific information that would allow us to evaluate this claim. If we receive the necessary information from you, we will determine if any practices should be modified.

See Note 17 Page 19

Response to Specific Recommendations of Your Report

1. You recommend four uses of surplus funds.
    a. We already use them to fund one time expenditures.
    b. We already use them to fund needed reserves.
    c. Much of our outstanding bonds are not callable (cannot be refinanced or paid off) or will not be callable until sometime in the future. Much of our debt has already been refinanced to take advantage of the current interest rate environment. Advance refunding of debt is no longer permitted by law.
    d. As previously mentioned, using surplus funds to reduce property taxes will have extremely negative tax cap consequences. Deficit financing will subject us to "boom and bust" budget cycles and make us dependent on large state aid increases year after year, an unrealistic expectation.
2. We already have a multiyear financial plan that projects revenue and expenses over a longer period of time than you recommend.

See Note 18 Page 19

3. The Board of Education has and will continue to determine the reasonableness of revenue and expense budgets. We will endeavor to limit our dependence on fund balance to support future budgets.
4. We will review year end encumbrances to ensure that they are appropriate.
5. As described earlier, we will use a portion of the balance in the Debt Service Fund to reduce debt service payments for future capital projects.

See Note 16 Page 19

6. We already have a policy on fiscal practices and a comprehensive reserve plan. We will review it to determine where greater clarity may be required.

Response to OSC Financial Management Audit – Page 6

7. The Board of Education will make appropriate determinations of reasonable reserve levels through its annual approval of the reserve plan, adoption of the annual budget and action to fund specific reserves.

We expect to offer more specifics on several of your recommendations in our corrective action plan.

Sincerely,

Mary E. Grow
Superintendent of Schools

Appendix B: OSC Comments on the District's Response

Note 1

We are not recommending a year-to-year approach. The District reported total fund balance of $1.4 million in 1995 or 5 percent of the next years' budgeted appropriations of more than $28 million. In 2018, total fund balance had grown to $41 million or 51 percent of the next years' budgeted appropriations totaling $80.7 million. The long-run implication of these surpluses can have a significant impact on the District's taxpayers.

Note 2

While this statement may reflect management's attitude towards surpluses, it is not reflected in the budgets adopted by voters, which call for planned operating deficits. Because these budgets contained inaccurate revenue and appropriation estimates, the District realized operating surpluses and did not use its appropriated fund balance.

Note 3

The District's tax levy increased almost $1.9 million (4.7 percent) over the last three years, and was the highest tax rate in Monroe County for all three of these years.

Note 4

As stated in the report, the misleading practice of annually appropriating fund balance that is not needed to finance operations is, in effect, a reservation of fund balance that is not provided for by statute and is a circumvention of the statutory limit imposed on the level of surplus fund balance.

Note 5

School districts are bound by New York State Real Property Tax Law Section 1318 limiting surplus fund balance to no more than 4 percent of the following year's appropriations. Compliance with this statutory requirement is not merely aspirational, but rather is required as a matter of law.

Note 6

The District reported surplus fund balance at the statutory cap. We reiterate our belief that the Board should inform voters of its plans to increase reserves by including them in the budget submitted for voter approval.

Note 7

The cited school district was reducing its levels of surplus fund balance, so we believe the specific circumstances there are different than in the District, where continued operating surpluses have resulted in large amounts of fund balance.

Note 8

Any known expenditures or plans to transfer fund balance to reserves or capital projects should be clearly stated in budget documents for voter approval.

Note 9

The District was providing these services yet continued to raise real property taxes in excess of current needs.

Note 10

We were provided with a “Financial Management and Reserve Plan” that was not adopted by the Board. Additionally, the 2003 “Fiscal Practices” policy discusses reserves in one sentence as follows: “Reserve funds should be used to pay recurring expenses only if the amount of money on deposit in the reserve fund is clearly sufficient to support these expenses for a number of years and when it can reasonably be anticipated that funds in the reserve can be replenished before they are exhausted.” Reviewing this sentence annually does not demonstrate consistent Board oversight of reserves.

Note 11

The Board resolution authorizing this reserve states, “The maximum size of this reserve shall be $1 million.” This reserve was funded in excess of $1 million without consideration of interest revenue. Additionally, with voter authorization, the District may use these excess reserve moneys to reduce the tax levy.

Note 12

The District’s repair reserve was established in March 26, 2001 and first funded in 2002. The balance in this reserve has increased every year since. Items such as boilers are typically included in capital projects and therefore not paid from a repair reserve. This reserve has not been used for anything substantial in 16 years. Therefore, we question the necessity of a $2.6 million balance.

Note 13

Irrespective of the revenues and expenditures pertaining to the device protection plan (which account for less than 5 percent of the reserve funds available), the amount appears excessive.

Note 14

As stated, this illustration captures the potential effect that refunding excessive fund balance would have on the District’s tax levy. We did not recommend that all surplus fund balance be returned to taxpayers in one year. The Board and District officials should improve the District's financial management by adopting a realistic multi-year financial plan that reduces surplus fund balance over a period of years.

Note 15

By using a sound multi-year plan, the Board would understand the potential effects of using fund balance and reserves to pay debt service, finance one-time costs, and/or reduce real property taxes, both in the current and future years. Consequently, the Board could gradually reduce the District's surplus fund balance and avoid the need for program cuts, tax cap overrides or large future tax increases.

Note 16

We did not quote the Deputy Superintendent. However, we have modified this statement in our report to avoid any confusion. As stated in the report, debt service funds should be used to pay off specific outstanding debt not held for payments on future bond issues. Because the balance of the debt service fund was unaccounted for and not related to specific outstanding debt, the District should not restrict the money in a reserve fund. The reported funds actually are an unrestricted fund balance available for operations.

Note 17

We provided numerous documents to the Deputy Superintendent, upon his request, to support various findings contained in the reports. At no time did the Deputy Superintendent specifically indicate that he was waiting for further information regarding this specific issue. In addition, it is incumbent upon the District to support the validity of these encumbrances. For example, we were provided documents to support some of the encumbrances, however these actually illustrate the encumbrances are not valid because they pertain to future contracts and expenses not incurred the current fiscal year. Furthermore, we are not the only ones to note issues with the District's encumbrances. The management letter dated October 23, 2018 from the District's certified public accountant (CPA) audit included the following:

> *Encumbrances – During the course of our examination we noted a few items that were encumbered which appear to be for service contracts relating to the 2018-19 fiscal year. We recommend the District review their current encumbering procedures to ensure service contracts for a subsequent year are not encumbered at year end.*

Note 18

As stated the Board and officials should review these plans for their reasonableness to avoid large unplanned surpluses which only contribute to the District's already excessive fund balance.

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

- We interviewed District officials and reviewed policies and procedures to gain an understanding of the budgeting and financial management process and procedures, including the rationale for determining the levels to maintain for unrestricted fund balance and reserves.
- We compared budgeted appropriations and estimated revenues to actual results for five fiscal years and identified significant variances.
- We calculated operating results for the past five years and assessed if appropriated fund balance and reserves were used as budgeted.
- We calculated unrestricted fund balance as a percentage of the next year's appropriations to assess District compliance with statute.
- We recalculated unrestricted fund balance as a percentage of the next year's appropriations after adding back unused appropriated fund balance, improper encumbrances and an inappropriate debt reserve.
- We analyzed reserve fund balances to determine whether balances were reasonable and/or being used as intended.
- We calculated the property tax levy amount required to fund operations.
- We compared the District's tax levy rate per $1,000 of assessed valuation to other similarly sized districts in Monroe County.

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: Glossary of Terms

Encumbrances are commitments related to unperformed contracts for goods or services, representing only a commitment to expend resources. Encumbrances are an important part of the accounting system. Officials should guard against the creation of liabilities in excess of the appropriations approved by the governing board.

Fund Balance is the term used to describe the net position of governmental funds. In simple terms, it is the amount of funds remaining after paying all expenditures. The annual amount - operating surplus- is added to any accumulated money left over from prior years. This total is “fund balance.” It is essential that governments maintain adequate levels of fund balance to mitigate current and future risks (e.g., revenue shortfalls and unanticipated expenditures) and to ensure stable tax rates. In most cases, discussions of fund balance will properly focus on a government’s general fund. Nonetheless, financial resources available in other funds should also be considered in assessing the adequacy of unrestricted fund balance.

Reserve Funds are allowed pursuant to State statute, permitting most school districts to establish reserve funds for various purposes, e.g., capital, repair, debt, workers’ compensation. These statutes regulate the establishment, funding and use of these reserves, but generally do not require school districts to establish or fund them. Because the State regulates the establishment, funding and use of these reserves, generally, reserves will be classified as restricted fund balance on financial statement balance sheets. Reserve funds that authorize transfers to other reserve funds as stated in the controlling statute (which may require board action and/or voter approval) will still always be classified as restricted, because even though the purpose for the restriction may change, the level of constraint on spending does not.

Surplus Fund Balance is defined as unrestricted fund balance minus appropriated fund balance and encumbrances included in committed and assigned fund balance. See our accounting bulletin at https://www.osc.state.ny.us/localgov/pubs/releases/gasb54.pdf

Appendix E: 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#lgmg

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/pubs/cyber-security-guide.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

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

Local Government and School Accountability Help Line: (866) 321-8503

ROCHESTER REGIONAL OFFICE – Edward V. Grant Jr., Chief Examiner

The Powers Building • 16 West Main Street – Suite 522 • Rochester, New York 14614-1608

Tel (585) 454-2460 • Fax (585) 454-3545 • Email: Muni-Rochester@osc.ny.gov

Serving: Cayuga, Chemung, Livingston, Monroe, Ontario, Schuyler, Seneca, Steuben, Wayne, Yates counties

Like us on Facebook at facebook.com/nyscomptroller
Follow us on Twitter @nyscomptroller