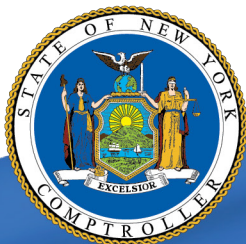


Monticello Central School District

Fund Balance Management

APRIL 2020



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

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Report Highlights

Monticello Central School District

Audit Objective

Determine whether the Board and District officials properly managed the general fund's fund balance.

Key Findings

- The Board overestimated appropriations from 2016-17 through 2018-19, helping result in \$12.1 million in appropriated fund balance not being used to finance operations.
- The District's recalculated surplus fund balance exceeded the statutory limit each of the last three fiscal years by 12.3 to 16.3 percentage points.
- As of June 30, 2019, the District overfunded one reserve by \$820,000.

Key Recommendations

- Adopt budgets that include reasonable estimates for appropriations and the amount of fund balance that will be used to fund operations.
- Review debt service and reserve funds and reduce balances to reasonable levels as necessary in accordance with applicable statutes.
- Reduce surplus fund balance in a manner that benefits District residents.

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

Background

The Monticello Central School District (District) serves the Towns of Bethel, Fallsburg, Forestburgh, Mamakating and Thompson in Sullivan County.

The District is governed by an elected nine-member Board of Education (Board). The 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 the Assistant Superintendent for Business and other administrative staff, for the District's day-to-day management under the Board's direction.

Quick Facts

Student Enrollment	2,850
Employees	600
2019-20 Budgeted Appropriations	\$91.2 million

Audit Period

July 1, 2018 through September 30, 2019.

We extended our audit period back to July 1, 2016 to analyze historical trends in encumbrances, budgeting, fund balance and reserves.

Fund Balance Management

What is Effective Fund Balance Management?

To properly manage financial condition, a board should adopt accurate and structurally balanced budgets based on historical or known trends in which recurring revenues finance recurring expenditures. In preparing the budget, a board must estimate the amounts a school district will spend and receive, the amount of fund balance that may be available at year-end to use towards the next year's budget and the expected real property tax levy. Accurate estimates help ensure that the tax levy is not greater than necessary.

A debt service fund is used to account for the accumulation of resources to pay principal and interest on long-term debt.¹ 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. District officials may also encumber obligations for unfulfilled purchase orders or contracts. Encumbrances may be carried over to the next year, but must represent valid commitments for specific current year expenditures. District officials should not establish encumbrances to artificially reduce available year-end fund balance.

A board is permitted to retain a specified amount of fund balance for cash flow needs or unexpected expenditures. Fund balance is the difference between revenues and expenditures accumulated over time. New York State Real Property Tax Law currently limits the amount of surplus fund balance that a school district can retain to no more than 4 percent of the next year's budget.² Any surplus fund balance over this percentage must be used to reduce the upcoming fiscal year's tax levy or to fund needed reserves.

District officials are legally allowed to set aside, or reserve, portions of fund balance to finance future costs for specific purposes (e.g., capital projects or retirement expenditures).³ The Board should develop a formal written policy for reserves that includes rationale for establishing a reserve, optimal or targeted funding levels, and when reserves will be used. Maintaining legally established and reasonably funded reserves that provide for unanticipated events and identified or planned needs helps to ensure that tax levies are not greater than necessary.

1 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.

2 New York State Real Property Tax Law Section 1318. Surplus fund balance is defined as unrestricted fund balance minus appropriated fund balance and encumbrances included in committed and assigned fund balance. Refer to our accounting bulletin at <https://osc.state.ny.us/localgov/pubs/releases/gasb54.pdf>.

3 See our *Local Government Management Guide – Reserve Funds*: <http://www.osc.state.ny.us/localgov/pubs/lgm/reservefunds.pdf>

The Board Overestimated Appropriations

We compared the 2016-17 through 2018-19 estimated revenues and budgeted appropriations with actual operating results and found that estimated revenues were generally reasonable, but budgeted appropriations were overestimated by an average of 3.2 percent (Figure 1). While these variances may appear small, in aggregate they helped result in an increase in fund balance over the past several years.

Figure 1: Overestimated Appropriations

	2016-17	2017-18	2018-19	Average
Budgeted Appropriations	\$84,139,614	\$85,299,550	\$89,826,369	\$86,421,844
Actual Expenditures	\$82,177,419	\$83,010,754	\$85,854,473	\$83,680,882
Dollar Variance	\$1,962,195	\$2,288,796	\$3,971,896	\$2,740,962
Percentage Variance	2.3%	2.7%	4.4%	3.2%

Because the Board overestimated appropriations, it appeared that more revenue and financing sources (fund balance) were needed to maintain a structurally balanced budget and address budgeted operating deficits (more expenditures than revenues), despite historical trends showing otherwise.

District Officials Improperly Restricted Funds

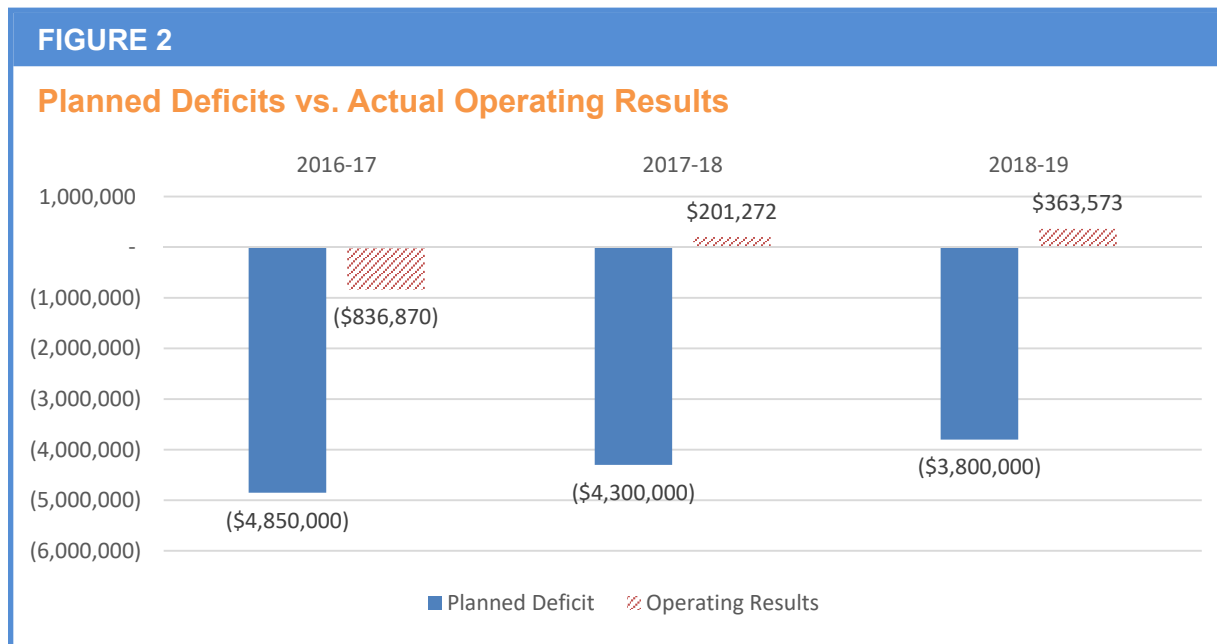
The District's debt service fund maintained a balance of approximately \$930,000 over the past three fiscal years while no funds were used from this fund during this period. While certain funds are required by law to be set aside and used to pay related debt, District officials told us that all principal and interest payments related to the debt had been paid. Without a valid legal requirement to restrict these funds, District officials do not have the statutory authority to set aside surplus fund balance in this fund.

District officials reported encumbrances between \$860,000 and \$1.2 million at the end of 2016-17 through 2018-19, for a three-year total of approximately \$2.9 million. We found that approximately \$1 million of the encumbered funds at the end of these years (averaging approximately \$350,000) did not represent valid commitments for current year expenditures and, therefore, should not have been encumbered.

Therefore, these debt service and encumbrance amounts should be added to the surplus fund balance in the general fund. See Figure 2 in the next report section.

The Board Appropriated More Fund Balance Than Needed and Exceeded the Statutory Limit for Surplus Fund Balance

Over the last three years, District officials adopted budgets that appropriated fund balance. Although property taxes remained relatively flat, the Board's conservative budgeting resulted in positive variances that were enough to offset the planned deficits created by the amounts appropriated. As a result, appropriated fund balance totaling more than \$12.1 million was not used. 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 circumvents the statutory limit imposed on the level of surplus fund balance.



Furthermore, District officials reported surplus fund balance that exceeded the 4 percent limit allowed by RPTL in each of the last three years. Surplus fund balance exceeded the statutory limit by over \$2.5 million, or 3 percentage points, at the end 2018-19. After adding back unused appropriated fund balance, unused debt service and overstated encumbrances (as previously discussed) the surplus fund balance furthered exceed the statutory limit.

Figure 3: Recalculated Surplus Fund Balance

	2016-17	2017-18	2018-19
Surplus Fund Balance at Year-End	\$8,158,806	\$9,019,500	\$6,226,401
Ensuing Year's Budgeted Appropriations	\$85,299,550	\$89,826,369	\$91,227,073
Surplus Fund Balance as a Percentage of Ensuing Year's Budgeted Appropriations	9.6%	10.0%	6.8%
Add: Unused Appropriated Fund Balance	\$4,300,000	\$3,800,000	\$3,798,472 ^a
Add: Money in Debt Service	\$929,879	\$931,801	\$937,098
Add: Overstated Encumbrances	\$472,832	\$328,200	\$249,528
Total Recalculated Surplus Fund Balance	\$13,861,517	\$14,079,501	\$11,211,499
Recalculated Surplus Fund Balance as a Percentage of Ensuing Year's Budget	16.3%	15.7%	12.3%

^a We estimated the appropriated fund balance that will not be used to finance the 2019-20 fiscal year based on the previous five-year total of unused appropriated fund balance as a percentage of total budgeted appropriated fund balance.

Officials explained that they believed that the excess surplus fund balance resulted from the closure of one of their school buildings midyear over 10 years ago. The budgeted appropriations for that building were therefore not needed, resulting in a large operating surplus that has been carried over each year since. Voters approved establishing a new capital reserve in May 2019, and officials transferred \$2 million into this reserve. Officials also stated that they were unaware that the encumbrances were overstated because they obtained these figures from the Sullivan County Board of Cooperative Educational Services.⁴

Maintaining surplus fund balance that exceeds the statutory limit and is higher than necessary increases the risk that tax levies will be greater than necessary.

The Employee Benefit Accrued Liability Reserve Balance Was Excessive

The Board established a reserve fund plan that states the purpose of each reserve, what the funds can be used for and the recommended funding levels for some of the reserves. It appears that all of the reserves were for legal purposes. We analyzed the balances of select reserve funds as of June 30, 2019 and determined that the balances in the reserves including the worker's compensation, retirement contributions and tax certiorari reserves were reasonable.

However, the balance in the employee benefit accrued liability reserve was excessive. The Board established this reserve to fund payments for unused,

⁴ The District contracts with the Sullivan County Board of Cooperative Educational Services for accounting services.

accumulated sick and vacation leave time contractually provided to employees at retirement. The reserve had a balance of \$1,008,940 at the end of 2018-19. Total compensated absences reported by the District as of June 30, 2019 were \$188,854, which means the balance in the reserve is more than five times the associated liability. Therefore, the District has overfunded this reserve by about \$820,000. District officials are aware that this reserve is overfunded⁵ and plan to use it to offset actual expenditures until levels are restored to an appropriate level.

Maintaining reserve funds in excess of the amount necessary or unanticipated events and identified or planned needs increases the risk that tax levies will be greater than necessary.

What Do We Recommend?

The Board and District officials should:

1. Develop and adopt budgets that include reasonable estimates for appropriations and the amount of fund balance that will be used to fund operations.
2. Review the debt service fund and other reserve fund balances and develop a plan to reduce balances to reasonable levels as necessary in accordance with applicable statutes.
3. Discontinue the practice of appropriating fund balance that is not needed or used to finance operations.
4. Develop a plan to reduce surplus fund balance in a manner that benefits District residents. Surplus funds can be used as a financing source for:
 - Funding one-time expenditures such as capital improvements.
 - Funding needed reserves.
 - Paying off debt.
 - Reducing District property taxes.

⁵ The balance exceeded the recommended funding level in the District's reserve fund plan. Therefore, officials deemed it as overfunded.

Appendix A: Response From District Officials



Dr. William Silver, Interim Superintendent
wsilver@k12mcsd.net

Monticello Central School District

60 Jefferson Street, Suite 3, Monticello, NY 12701

TEL: 845-794-7700 FAX: 845-794-7710

www.monticelloschools.net

Dr. William Silver, *Interim Superintendent of Schools*

Mrs. Lori Orestano-James, *President - Board of Education*

Mrs. Lisa Failla, *Asst. Superintendent for Business*

Dr. Paul Dorward, *Asst. Superintendent for School Administration*

March 25, 2020

New York State Office of State Comptroller
Binghamton Regional Office
Attn: Ann C. Singer, Chief Examiner
State Office Building, Suite 1702
44 Hawley Street
Binghamton, NY 13901-4417

Dear Ms. Singer:

The Monticello Central School District is in receipt of the New York State Office of the State Comptroller's draft audit report entitled "Monticello Central School District Fund Balance Management Report of Examination" covering the period July 1, 2018 – September 30, 2019. Key findings of the report include: (1) The Board overestimated appropriations from 2016-17 through 2018-19, helping result in \$12.1 million in appropriated fund balance not being used to finance operations, (2) The District's recalculated surplus fund balance exceeded the statutory limit each of the last three fiscal years by 12.3 to 16.3 percentage points, and (3) As of June 30, 2019, the District had overfunded one reserve by \$820,000. Key recommendations of the report include: (1) adopt budgets that include reasonable estimates for appropriations and the amount of fund balance that will be used to fund operations; (2) review debt service and reserve funds and reduce balances to reasonable levels as necessary in accordance with applicable statutes; (3) Reduce surplus fund balance in a manner that benefits District residents.

The District offers the following combined response and Corrective Action Plan (CAP).

The District's budgeting practices attempt to anticipate costs and revenues based on the information we have at the time, while taking into consideration changes that may take place during the upcoming school year. There are numerous contingencies that may occur during a fiscal year that could put significant financial strain on the District. Our financial results can be effected both positively and negatively by unanticipated costs such as required student special education services, mandated transportation services, increased health insurance costs and other employee benefits, or the need to implement programs to meet student needs. The Board of Education will review all budgeted appropriations for reasonableness and accuracy in order to keep variations to a minimum.

The debt service fund has been on the books for more years than the current personnel within the business office. Attempts to determine which borrowing resulted in the creation of the debt service fund were not successful. Since almost all of the district debt service has been paid, these funds will be used to offset the tax levy in the upcoming school year. In addition, carry over encumbrances have been reviewed by several individuals both at the district and at the Central Business Office at Sullivan BOCES. The District has been assured that all the carry over expenditures are valid. The Assistant Superintendent for Business will review the open encumbrance report prior to the end of the fiscal year to ensure that the encumbrances are accurate.

While the district has not needed to fully utilize the amount of appropriated fund balance in the adopted budget to meet expenditures, the district has reduced the unappropriated fund balance as evidenced in Figure 3 of the report. Over the last 3 years fund balance has been reduced by 4 percentage points. While the total is still in excess of the statutory limit, the current Board of Education has directed Central Administration to reduce the unappropriated fund balance to the statutory limit over the next few years. The voters have approved a Capital Reserve fund to help offset the cost of much needed repairs to district facilities. The Board will transfer as much of the unappropriated fund balance to this reserve as possible. The Board will also explore the potential for one-time expenditures such as repairing parking lots and driveways, upgrading district signage, and athletic field work in order to reduce the unappropriated fund balance. The district feels that these steps will put Monticello Central School District on a track that allows us to maintain the 4% statutory limit for unappropriated fund balance.

The Board recognizes that certain reserves are overfunded. The Employee Benefit Accrued Liability Reserve has been used appropriately and the district will continue to do so. The Board will continue to review all its reserve accounts and will transfer overfunded reserves to underfunded reserves as the law allows.

The District wishes to thank the New York State Comptroller's Office and the examiners that worked with the District for their professionalism and cooperation throughout the audit process. The District will continue to strive to ensure we are providing the best instructional programs, safe facilities and opportunities for our students while being respectful and transparent with our taxpayers.

Sincerely,

William Silver
Interim Superintendent of Schools

Lori Orestano-James
President, Board of Education

CC: Board of Education
Assistant Superintendent for Business

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 compared the dollar and percentage differences between budgeted revenues and appropriations to actual results to determine whether budgets were reasonable for 2016-17 through 2018-19. We also compared budgeted revenues and appropriations by line item to actual revenues and expenditures to determine what line items were causing variances between budgeted and actual amounts.
- We made inquiries of District officials to determine whether funds held in the debt service fund were legitimate.
- We reviewed documents to determine whether reported encumbrances were legitimate or if amounts were overstated and by how much.
- We reviewed the District's real property tax cap filings for 2016-17 through 2018-19 to determine whether real property tax levies were within the real property tax levy limit.
- We compared actual revenues to actual expenditures to determine whether the District ended with an operational surplus or deficit for 2016-17 through 2018-19.
- We compared the amounts of appropriated fund balance actually needed to amounts appropriated for 2016-17 through 2018-19. We further estimated the amount of appropriated fund balance that will not be used to finance the 2019-20 fiscal year based on the previous five-year total of unused appropriated fund balance as a percentage of total budgeted appropriated fund balance.
- We calculated surplus fund balance as a percentage of ensuing years' appropriations for 2016-17 through 2018-19 to assess compliance with statute.
- We recalculated surplus fund balance as a percentage of next years' appropriations after adding back unused appropriated fund balance for 2016-17 through 2018-19. We also added back debt service funds and overstated encumbrances into unassigned fund balance to determine whether surplus fund balance was reasonable.
- We reviewed Board policies to determine whether the Board had adopted a fund balance and reserve policy. We reviewed the reserve policy and compared targeted balances with actual balances in the reserves and discussed the potential uses of reserve funds with District officials.

-
- We made inquiries of District officials and reviewed Board resolutions and the District's website to determine the total cost of the voter-approved Phase I capital project. We also discussed the proposed Phase II capital project with officials to determine the cost of the project and how the project would be paid for.
 - We obtained and reviewed the Board adopted reserve policy to determine whether the Board annually reviews all reserve funds and to obtain an understanding of the Board's anticipated funding levels for each reserve. We then trended each reserve fund for 2016-17 through 2018-19 to determine whether each fund had increased or decreased. We also reviewed documentation to determine whether balances in reserves were reasonable.
 - We made inquiries of Board members and officials to determine whether the Board has developed and does use a five-year capital facilities plan.

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.

The Board has the responsibility to initiate corrective actions. 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-a (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 next fiscal year. For more information on preparing and filing your CAP, please refer to our brochure, *Responding to an OSC Audit Report*, which you received with the draft audit report. The CAP should be posted to the District's website for public review.

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#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

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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

BINGHAMTON REGIONAL OFFICE – Ann C. Singer, Chief Examiner

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

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

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