



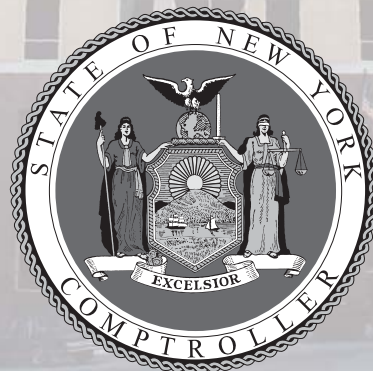
Port Byron Central School District Financial Condition

Report of Examination

Period Covered:

July 1, 2006 — January 31, 2008

2008M-206



Thomas P. DiNapoli

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State of New York Office of the State Comptroller

Division of Local Government and School Accountability

December 2008

Dear School District Officials:

A top priority of the Office of the State Comptroller is to help school district officials manage their districts efficiently and effectively and, by so doing, provide accountability for tax dollars spent to support district operations. The Comptroller oversees the fiscal affairs of districts statewide, as well as districts' compliance with relevant statutes and observance of good business practices. This fiscal oversight is accomplished, in part, through our audits, which identify opportunities for improving district operations and Board of Education governance. Audits also can identify strategies to reduce district costs and to strengthen controls intended to safeguard district assets.

Following is a report of our audit of the Port Byron Central School District, entitled Financial Condition. This audit was conducted pursuant to Article V, Section 1 of the State Constitution, and the State Comptroller's authority as set forth in Article 3 of the General Municipal Law.

This audit's results and recommendations are resources for district officials to use in effectively managing operations and in meeting the expectations of their constituents. If you have questions about this report, please feel free to contact the local regional office for your county, as listed at the end of this report

Respectfully submitted,

*Office of the State Comptroller
Division of Local Government
and School Accountability*

Introduction

Background

The Port Byron Central School District (District) is located in the Village of Port Byron and includes the Towns of Mentz and Montezuma and parts of the Towns of Aurelius, Brutus, Conquest, and Throop in Cayuga County; and part of the Town of Savannah in Wayne County. The District is governed by the Board of Education (Board) which comprises 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 the chief executive officer of the District and is responsible, along with other administrative staff, for the day-to-day management of the District under the direction of the Board.

There are three schools in operation within the District,¹ with approximately 1,100 students and 150 employees. The District's budgeted general fund expenditures for the 2006-07 fiscal year were \$16,049,128, which were funded primarily with State aid, real property taxes, and grants.

Objective

The objective of our audit was to examine the District's internal controls over selected financial activities. Our audit addressed the following related question:

- Did the District properly establish and appropriately maintain the Employee Benefit Accrued Liability Reserve and the Unemployment Insurance Reserve?

Scope and Methodology

We examined internal controls over certain financial operations of the Port Byron Central School District for the period July 1, 2006 to January 31, 2008. We expanded our scope for certain reserve fund transactions back to July 1, 2002.

We conducted our audit in accordance with generally accepted government auditing standards (GAGAS). More information on such standards and the methodology used in performing this audit are included in Appendix C of this report.

¹ During our audit period, the District operated three schools: Elementary School (Pre-K to grade 5), Middle School (grades 6-8), and High School (grades 9-12). Beginning in the 2008-09 fiscal year, the District reconfigured its operation to two schools: Elementary School (Pre-K to grade 6) and Junior-Senior High School (grades 7-12).

Comments of District Officials and Corrective Action

The results of our audit and recommendations have been discussed with District officials and their comments, which appear in Appendix A, have been considered in preparing this report. Except as indicated in Appendix A, District officials generally agreed with our recommendations and indicated they planned to initiate corrective action. An OSC comment on the District's response can be found in Appendix B.

The Board has the responsibility to initiate corrective action. Pursuant to Section 35 of the General Municipal Law, Section 2116-a (3)(c) of the Education Law, and Section 170.12 of the Regulations of the Commissioner of Education, a written corrective action plan (CAP) that addresses the findings and recommendations in this report must be prepared and forwarded to our office within 90 days. 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 Board should make the CAP available for public review in the District Clerk's office.

Financial Condition

A school district's financial condition is an important factor in its ability to fund public educational services for students within the District. The responsibility for effective financial planning and management of the District rests with the Board, the Superintendent, and the Business Administrator. One of the primary responsibilities of the Board and Superintendent is to ensure that budgets are prepared, adopted, and amended based upon reasonable estimates of appropriations and the resources available to fund them.

An important aspect of budget preparation is a reasonable estimate of fund balance that will be available at the end of the fiscal year. The District can legally reserve portions of fund balance (i.e., create reserves) for specific uses in compliance with statutory requirements. The District can also retain an amount of unreserved fund balance of up to 3 percent of the 2007-08 fiscal year's budget to help cash flow and to pay for unanticipated costs. Any additional unreserved fund balance should be appropriated to reduce the District's tax levy.

We found that, although the District's unreserved, unappropriated fund balance during our audit period was within the statutory limit, two of the District's reserves – the Employee Benefit Accrued Liability Reserve (EBALR) and the Unemployment Insurance Reserve – were overfunded by \$1.3 million and almost \$214,000, respectively. These unnecessary reserves would have increased the District's year-end accumulated fund balance to 12 percent of the 2007-08 fiscal year budget,² or four times the legal limit of 3 percent. The excess reserve funds of approximately \$1.5 million represent moneys that were unnecessarily raised in taxes and could have been used more productively to finance non-recurring expenses or to pay off debt.

Fund Balance

There are two types of fund balance: reserved and unreserved. Reserved fund balance represents moneys that the District has set aside and may only use for specific purposes; therefore, it is not available for the District to use for other purposes. Reserve funds are created under various laws and are used to finance the cost of a variety of objects or purposes. Such reserve funds are created under legal statutes that determine how the reserves may be funded, expended, transferred, and discontinued. While a District is not limited in the balance it can maintain in a reserve fund, prudent budgeting practices

² Calculated as the sum of reported unappropriated fund balance of \$518,097 plus \$1,322,195 excess EBALR funds plus \$213,915 excess Unemployment Insurance Reserve funds; divided by \$17,083,572 (2007-08 appropriations)

require that reserves correspond as closely as reasonably possible to the District's anticipated liabilities so that funds are not unnecessarily excluded from budgetary appropriations for other District purposes.

Unreserved fund balance is uncommitted and therefore available for funding District operations. The portion of the unreserved fund balance that is used (appropriated) to help finance the next year's budget is the appropriated fund balance. The portion of the unreserved fund balance that the District retains at the end of the fiscal year, known as the unappropriated fund balance, can be used for cash flow purposes and unanticipated expenditures. The Real Property Tax Law imposes legal limits on the amounts that a school district can retain as unappropriated fund balance.

The District increased its tax levy from \$5,005,028 in fiscal year 2006-07 to \$5,228,753 in 2007-08, a 4.5 percent increase. For both fiscal years, the District's reported unreserved, unappropriated fund balance was within the legal limits. At the end of the 2005-06 fiscal year, the unreserved, unappropriated fund balance of \$238,310 was within the then-allowed 2 percent of the 2006-07 budget (\$16,049,128). As of June 30, 2007, the reported unappropriated fund balance of \$518,097 was 3 percent of the ensuing year's appropriations of \$17,083,572, again in compliance with the statutory limit. However, our audit identified excess funds in two of the District's reserves which would have significantly raised the unreserved, unappropriated fund balance above the statutory limit. Because the excess funds in these reserves were not needed for the stated purposes, the taxpayers paid more than necessary to sustain District operations.

Employee Benefit Accrued Liability Reserve

General Municipal Law (GML) allows the District to establish an Employee Benefit Accrued Liability Reserve (EBALR) for the sole purpose of making cash payments to employees, upon separation of service, for unused sick leave, holiday leave, vacation time, time allowances granted in lieu of overtime compensation, and any other forms of payment for accrued leave time due. Interest earned on money in the EBALR becomes part of the reserve fund. Should the District determine that the EBALR is no longer needed, the moneys in the fund may be transferred to certain other reserve funds.

The District established an EBALR in August 2004 (retroactive to June 30, 2004) using \$1.3 million of excess fund balance.³ District officials told us that the initial purpose for this reserve, on the advice of the District's external auditor, was to fund the future costs of retiree

³ As of June 30, 2004, had the \$1.3 million been included in the unreserved, unappropriated fund balance, the amount of the District's accumulated fund balance as a percent of the 2004-05 budget (\$18,354,577) would have been 12.5 percent when the allowed limit was 2 percent.

health insurance to fulfill the requirements of the Governmental Accounting Standards Board's (GASB) Statement 45.⁴ However, the payment of retiree health insurance is not a permitted purpose of the EBALR fund, which may be established and used only to pay for accrued but unused leave time earned upon separation of service. None of the money in this reserve has been used since the fund was established, and the District paid compensated absence costs from operating funds as employees left District service.

The District has approximately 60 employees in administrative, custodial, and clerical (i.e., non-instructional) positions who are eligible to receive accrued benefit credits. The District's reported compensated absences liability for the 2006-07 fiscal year was \$182,239, and its last payment for such benefits was approximately \$14,000 in July 2006. The excess EBALR funds, accumulated at taxpayer expense, are not needed to fund accrued employee benefits. Additionally, the EBALR balance has increased by \$22,195 at June 30, 2007, from interest earnings. If the resulting \$1,322,195 balance had been included in the unreserved, unappropriated fund balance at June 30, 2007, the amount of the District's accumulated fund balance as a percent of the 2007-08 budget (\$17,083,572) would have been 10.8 percent when the allowed limit was 3 percent. Since the District has a practice of paying for accrued leave from annual operating funds, a reserve is not needed for this purpose.

Unemployment Insurance Reserve

Districts are authorized by law to establish an Unemployment Insurance Reserve to reimburse the State Unemployment Insurance Fund for payments made to claimants where the District has elected to use the benefit reimbursement method (rather than the payroll tax method). At June 30, 2007, the balance in this reserve totaled \$213,915. Most of the moneys in this reserve were not being used for the statutory purpose of the fund: since July 1, 2002, only about \$6,600 had been charged against this reserve, while approximately \$149,800 was charged to the general fund for unemployment expenses. Additionally, over \$137,000 has been added to the reserve over the same period.⁵ The District's excess funds in the reserve, totaling almost \$214,000, could have been budgeted for District operations and/or appropriated to reduce the tax levy. Amounts not reasonably needed to pay benefit reimbursements should be transferred to another reserve fund in accordance with statutory

⁴ Issued in June 2004, GASB 45 requires municipalities to report their Other Post-Employment Benefits (OPEB) liabilities similarly to the way they report pension liabilities, but does not require them to fund such benefits. OPEB are employee benefits other than pensions – primarily health care benefits – that are received after employment ends.

⁵ Approximately \$3,600 of this was from interest earnings.

restrictions.

A Board member informed us that District officials funded the reserves at the recommendation of the District's external auditor, as a mechanism to help reduce the year-end available fund balance to legal limits. However, reserving funds for expenditures that are paid from the general fund tax levy in order to shield the money from requirements to use it to reduce taxes is improper. This has resulted in taxpayers paying more than necessary to sustain District operations.

Recommendations

1. If the Board intends to set aside funds in an EBALR for the payment of unused leave credits to employees upon separation, it should calculate the necessary and reasonable amounts to reserve for this purpose. Excess funds in this reserve should be transferred to other reserves.
2. The Board should review the Unemployment Insurance Reserve and reduce its balance to a reasonable level.

APPENDIX A

RESPONSE FROM DISTRICT OFFICIALS

The District officials' response to this audit can be found on the following page.



THE PORT BYRON CENTRAL SCHOOL DISTRICT

30 Maple Avenue, Port Byron, New York 13140
Phone (315) 776-5728 Fax (315) 776-4050

Neil F. O'Brien
Superintendent

Gloria S. Dunton
Business Administrator

December 10, 2008

Mr. Edward V. Grant, Jr.
Chief Examiner of Local Government
Office of the State Comptroller
125 Saint Paul Street
Rochester, NY 14604

Dear Sir:

I would like to acknowledge receipt of the Port Byron School District draft audit completed by the New York State Comptroller's office. We are thankful and appreciative of the professionalism and thoroughness of the audit process done by your accountants. During the six months or so of the audit process, the auditor from your office delved deeply into many facets of district operations to determine that we were engaged in practices in concert with state law and best accounting principles. In addition, the auditor determined we were free from misuse of district funds. It is gratifying to see that the findings were positive.

In regards to the reserve funds that were cited in your report, the district simply states that we followed the direction of our external auditor and want the record to be noted that we received positive statements in regards to our management of district reserve funds. We do await State action to resolve the issue of the funding for health insurance for retirees as it relates to the post employment benefit reserve account. As your office is aware, we are one of 251 school districts to begin funding the GASB 45 requirement of health insurance for retirees. I am confident our legislators will work with the governor to find a solution that will acknowledge the Governmental Accounting Standards Board requirement to fund retiree health insurance liability on a current cash basis. When they do so, then your concern will become moot.

See
Note 1
Page 11

Again, on behalf of the district, I want to thank your office for their professionalism and effort. We have found the process to be positive and look forward to working with you in the future.

Sincerely,

Neil F. O'Brien
Superintendent

NFO/sr

APPENDIX B

OSC COMMENT ON THE DISTRICT'S RESPONSE

Note 1

GASB 45 does not require funding OPEB on a current basis. In fact, according to GASB, the most common misconception about Statement 45 is that it requires the funding of future OPEB liabilities. Instead, it establishes standards for accounting and reporting to more accurately reflect the financial effects of OPEB; how the benefits are funded is a management decision that must comply with statutory authority. The Comptroller is committed to the development of a mechanism that will help fund these costs. Using an EBALR fund to serve as this mechanism, however, is not allowed by law.

APPENDIX C

AUDIT METHODOLOGY AND STANDARDS

Our overall goal was to assess the adequacy of the internal controls put in place by officials to safeguard District assets. To accomplish this, we performed an initial assessment of the internal controls so that we could design our audit to focus on those areas most at risk. Our initial assessment included evaluations of the following areas: financial oversight, cash receipts and disbursements, purchasing, and payroll and personal services.

During the initial assessment, we interviewed appropriate District officials, performed limited tests of transactions, and reviewed pertinent documents, such as District policies and procedures manuals, Board minutes, and financial records and reports. In addition, we obtained information directly from the computerized financial databases and then analyzed it electronically using computer-assisted techniques. This approach provided us with additional information about the District's financial transactions as recorded in its databases. Further, we reviewed the District's internal controls and procedures over the computerized financial databases to help ensure that the information produced by such systems was reliable.

After reviewing the information gathered during our initial assessment, we determined where weaknesses existed, and evaluated those weaknesses for the risk of potential fraud, theft and/or professional misconduct. We then decided upon the reported objectives and scope by selecting for audit the area most at risk. We selected financial condition for further audit testing.

We reviewed the District's reported results of operations for the five most recently completed fiscal years (2003-04 through 2007-08) and budgets for the 2006-07 and 2007-08 fiscal years. Additionally, to determine the propriety of the District's reserve funds, we interviewed the District Superintendent and several Board members, reviewed supporting documentation, and reviewed Board minutes for pertinent Board resolutions. We also reviewed certain financial transactions and relevant statutory provisions.

We conducted our performance audit in accordance with generally accepted government auditing standards (GAGAS). 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 objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

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