



Chatham Central School District Financial Condition

Report of Examination

Period Covered:

July 1, 2013 – March 11, 2015

2015M-161



Thomas P. DiNapoli

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State of New York Office of the State Comptroller

Division of Local Government and School Accountability

October 2015

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 Chatham 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 New York State 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 Chatham Central School District (District) includes the Town and Village of Chatham and the Towns of Ghent, Canaan, Austerlitz, Kinderhook and New Lebanon located in Columbia County. The District is governed by the Board of Education (Board) which is composed of nine 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 District's chief executive officer and is responsible, along with other administrative staff, for the District's day-to-day management under the Board's direction. The Board employs a District Treasurer (Treasurer) who is responsible for the District's accounting functions and reporting financial information. The School Business Administrator is responsible for managing the District's overall business operations, including preparing all financial statements.

The District operates three schools, with approximately 1,160 students and approximately 330 employees. The District's budgeted appropriations for the 2014-15 fiscal year were \$29.5 million, which were funded primarily with State aid, real property taxes and grants.

Objective

The objective of our audit was to examine the District's financial condition. Our audit addressed the following related question:

- Did the District maintain fund balance in accordance with statutory requirements and appropriately establish, fund and use reserve funds?

Scope and Methodology

We examined the District's financial condition for the period July 1, 2013 through March 11, 2015. We extended our scope back to the 2009-10 fiscal year to evaluate financial trends and forward to April 30, 2015 to evaluate the current year's results.

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. 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.

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

The Board has the responsibility to initiate corrective action. 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, 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, with a copy forwarded to 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 Board should make the CAP available for public review in the District Clerk's office.

Financial Condition

The Board is responsible for making sound financial decisions that are in the best interests of the District, the students it serves and the taxpayers who fund the District's programs and operations. Reasonable fund balance management helps ensure that sufficient funding will be available to sustain operations, address unexpected occurrences and satisfy long-term obligations or future expenditures, and that taxpayers are not unduly burdened by unnecessary or excessive tax levies. Prudent fiscal management also includes maintaining sufficient balances in reserves to address long-term obligations or planned future expenditures. In doing so, District officials should adopt a policy governing the use of reserve funds and ensure that taxpayers are fully informed of all reserve funding activity.

We found that the District had more than \$2.9 million in excessive accrued liabilities and moneys in reserve funds. District officials employed budgeting practices that generated operating surpluses while simultaneously appropriating fund balance in the budgets. This caused fund balance appropriations to be unneeded. As a result, the District's corrected unrestricted fund balance was approximately \$4.1 million, or 14 percent of the 2014-15 budget, while the statutory limit for fund balance is 4 percent. In addition, the District overfunded its employee benefit accrued liability reserve (EBALR) and tax certiorari reserve by more than \$1.4 million. District officials also retained excessive balances in the workers' compensation, unemployment insurance, retirement contribution and insurance reserves.

Fund Balance

Fund balance represents moneys remaining from prior fiscal years that can be used to finance the next year's budget, set aside in reserve funds for specific purposes, or both. According to New York State Real Property Tax Law, the Board may retain up to 4 percent of the ensuing year's appropriations as unrestricted fund balance¹ to serve as a financial cushion for unexpected events and maintaining cash flow. Accurate budget estimates and estimates of fund balance levels help the Board ensure that real property levies are no greater than necessary. School districts may also establish reserve funds to restrict a portion of fund balance for a specific purpose, but must do so in compliance with statutory requirements.

The District's reported unrestricted fund balance as of June 30, 2014 was inaccurate because District officials overstated accrued liabilities

¹ For purposes of computing fund balance subject to the Real Property Tax Law, unrestricted fund balance is committed, assigned and unassigned fund balance minus appropriated fund balance and encumbrances included in committed and assigned fund balance.

by more than \$1.5 million (91 percent) and overfunded reserve funds by more than \$1.4 million (71 percent). With the inclusion of the unused appropriated fund balance and unused reserves, the total fund balance was actually in excess of the 4 percent statutory limit at 14 percent of the ensuing year's budget in 2014-15. Also, the District's real property tax levy was approximately \$400,000 more than necessary. Real estate taxes increased by an average of 2.7 percent each year from the 2009-10 (\$17.4 million) through 2013-14 fiscal years (\$19.3 million).

Excess funds resulted from the District's overbudgeting for medical insurance expenditures, grade 7-12 teacher salaries, social security and building contractual expenditures. District officials told us they used these accounts "as a control mechanism to provide for contingencies" – i.e., to retain additional funds – because they are able to control these accounts, unlike the other accounts that are controlled by District principals and department supervisors. As a result, taxpayers paid higher-than-necessary real estate taxes.

The District's accrued liability² as of June 30, 2014 was approximately \$1,594,000, which included about \$1.5 million for retiree health insurance costs for the 2014-15 fiscal year. This amount did not represent costs incurred in the 2013-14 fiscal year, but was for future costs that would be paid for using future revenue. The allocation for the 2014-15 health insurance costs should not have been included in the 2013-14 accrued liabilities because the District did not expect to incur the liabilities until the following fiscal year. The District also included these same costs in its 2014-15 budget.

District officials told us they did this for multiple prior years and believed this practice was appropriate based on advice of their external auditor and New York State Education Department (SED) approval of a comparable accrual for the Questar III Board of Cooperative Educational Services. District officials were unable to provide us with supporting documentation for the SED approval. In addition, District officials retained excessive funds in the EBALR of approximately \$1.4 million (70 percent) and unnecessarily reserved funds of approximately \$89,000 in the tax certiorari reserve.³

² Government funds use the modified accrual basis of accounting that recognizes increases and decreases in financial resources only to the extent that they reflect near-term inflows and outflows of cash. Under the modified accrual basis of accounting, expenditures are recognized when the fund liability is incurred and when they are expected to draw on current spendable resources.

³ Refer to the Reserves section for further information.

Figure 1: Fund Balance Adjustments (as of June 30, 2014)

	District Balance	Adjustments	Adjusted Balance
Accrued Liabilities	\$1,594,513	(\$1,470,624)	\$123,889
Tax Certiorari Reserve	\$89,106	(\$89,106)	\$0
EBALR	\$2,002,946	(\$1,403,906)	\$599,040
Total Adjustments		(\$2,963,636)	
Unrestricted Fund Balance	\$1,178,737	\$2,963,636	\$4,142,373
2014-15 Budgeted Appropriations	\$29,468,429		\$29,468,429
Unrestricted Fund Balance as % of Budget	4%		14%

By maintaining excessive and unnecessary reserves, combined with inappropriately accruing expenditures, the Board and District officials have withheld more than \$2.9 million from productive use, unnecessarily levied taxes and reduced the transparency of District finances.

Budgeting

In preparing the budget, the Board is responsible for accurately estimating revenues and expenditures and determining the amount of fund balance that will be available at the end of the fiscal year. Accurate estimates help ensure that the real property tax levy is no greater than necessary. If the District accumulates fund balance that exceeds 4 percent of the ensuing year's budget, it should reduce the fund balance to an appropriate level by paying off debt, financing one-time expenditures, increasing or establishing necessary reserves at reasonable levels, and/or funding a portion of the following year's appropriations.

During the 2011-12 through 2013-14 fiscal years, the Board adopted budgets that included the planned use of surplus fund balance to finance operations. When fund balance is appropriated to finance operations, the District is planning to have an operating deficit. Although the Board's adopted budgets included the appropriation of fund balance during those three fiscal years, the District actually realized operating surpluses totaling more than \$2 million in that period (Figure 2). Therefore, the District did not actually use fund balance that was appropriated to finance operations.

Figure 2: Appropriated Fund Balance

	2011-12	2012-13	2013-14	Totals
Budgeted Appropriated Fund Balance	\$1,299,660	\$1,341,600	\$1,341,600	\$3,982,860
Actual Results of Operations – Surplus	\$836,810	\$469,119	\$759,037	\$2,064,966

Operating surpluses occurred because the Board overestimated expenditures when developing the District's budgets. We compared the District's budgeted and actual expenditures for fiscal years 2011-12 through 2013-14 and found that the District overestimated

expenditures by a combined total of more than \$5 million in these budgets (Figure 3).

Figure 3 : Overestimated Expenditures				
Fiscal Year	Budgeted Appropriations	Actual Expenditures	Overestimated Expenditures	Percentage Overestimated
2011-12	\$27,138,001	\$25,480,531	\$1,657,470	6.5%
2012-13	\$28,297,344	\$26,360,481	\$1,936,863	7.3%
2013-14	\$29,175,016	\$27,542,814	\$1,632,202	5.9%
Totals	\$84,610,361	\$79,383,826	\$5,226,535	6.6%

The overestimated expenditures generally were spread throughout budget line items. The largest variances between budgeted and actual expenditures included medical insurance costs that were overestimated by a combined total of \$1,305,797 (6.9 to 11.6 percent) for all three fiscal years, grade 7-12 teacher salaries by \$762,819 (-1.1 to 11.6 percent),⁴ contractual building expenditures by \$545,917 (17.1 to 22 percent) and social security costs by \$326,970 (8.8 to 11.7 percent). District officials could have estimated these expenditures more realistically by referring to available information, including contracts and collective bargaining agreements, prior to preparing the budget. By overestimating expenditures, the District generated surpluses totaling \$2 million during our audit period, which District officials did not use to fund District operations.

In addition, District officials funded six reserves at greater-than-reasonable levels and, in some cases, did not pay related expenditures with those reserved moneys. These practices allowed District officials to appear to maintain the District’s unrestricted fund balance within the 4 percent statutory limit while at the same time increasing reserves. As a result, the Board and District officials have not accurately represented the District’s funding of reserves to the taxpayers, and the District has levied and collected more taxes than were necessary to fund District operations.

Reserves

Most reserve funds are established to provide resources for an intended future use. A reserve fund should be established with a clear intent or plan regarding the future purpose, use and, when appropriate, replenishment of funds into the reserve. Although school districts generally are not limited as to how much money they can maintain in reserves, they should ensure that all reserve funds have reasonable balances. The District should have a policy that addresses its need for maintaining reserve balances and the specific circumstances for when reserves will be used and replenished.

⁴ During our audit period, District officials both under- and overestimated this expenditure. It went from being underestimated by 1.1 percent to overestimated by 11.6 percent.

The District’s reserves have grown from about \$3.2 million to approximately \$5.9 million over four years (Figure 4). Despite this increase, the Board and District officials have not established a formal plan stating how much would be set aside in each reserve, how each reserve would be funded or when the reserve funds would be used. Although District officials established and presented a plan to the Board annually, it was not formally adopted by the Board. However, even if the plan had been formally adopted, it lacks specificity and detail because it does not include information on how much should be set aside in each reserve, how each reserve will be funded or when the reserve funds will be used.

	2009-10	2010-11	2011-12	2012-13	2013-14
EBALR	\$1,983,433	\$1,993,040	\$1,999,777	\$1,999,777	\$2,002,946
Workers' Compensation	\$221,873	\$226,963	\$612,055	\$499,863	\$834,557
Unemployment Insurance	\$450,019	\$895,079	\$385,427	\$335,776	\$351,266
Retirement Contribution	\$372,553	\$548,411	\$1,039,502	\$1,645,189	\$1,976,129
Insurance Reserve	\$0	\$618,343	\$620,433	\$621,338	\$622,323
Tax Certiorari	\$214,486	\$121,439	\$106,276	\$103,981	\$89,106
Total Reserves	\$3,242,364	\$4,403,275	\$4,763,470	\$5,205,924	\$5,876,327

As of June 30, 2014, we found that the District overfunded its EBALR by approximately \$1.4 million (70 percent); has excessive balances in its workers’ compensation, unemployment insurance, retirement contribution and insurance reserves; and has unnecessarily reserved funds in its tax certiorari reserve.

Employee Benefit Accrued Liability Reserve – Local governments, including school districts, are required to measure and report liabilities for compensated absences (i.e., annual and sick leave time accruals). However, they are not required to fund the liability. General Municipal Law (GML) allows local governments and school districts to establish an EBALR to pay costs associated only with compensated leave paid directly to or on the behalf of employees when they separate from District employment. GML does not set a limit on the amount of funds a school district can maintain in an EBALR. However, the balance in this reserve must be reasonable and meet specific legal requirements.

As of June 30, 2014, this reserve had a balance of approximately \$2 million. However, District officials provided supporting documentation for only approximately \$599,000 in long-term liability for compensated absences. District officials have not used the funds in this reserve to pay for compensated leave benefits for the last five years. Instead, the Board budgets for these costs in the annual budgets. Because District officials have not paid these costs from the EBALR during our audit period, this indicates that the District has

no current need to restrict these funds. As a result, this reserve was overfunded by more than \$1.4 million.

Workers' Compensation Insurance Reserve – GML authorizes this reserve for workers' compensation costs, related medical expenditures and self-insurance administrative costs. At the end of any fiscal year, if the funds in this reserve exceed the amount needed to satisfy all existing obligations and pending claims, the Board may transfer the excess amount to certain other reserve funds or apply the excess to the budgeted appropriations of the succeeding fiscal year.

As of June 30, 2014, this reserve had a balance of approximately \$834,000. The District has used funds in this reserve to pay an average annual cost of approximately \$102,000 for workers' compensation expenditures during the last five years. In 2013-14, the District paid expenditures of \$64,171 from the reserve and added \$400,000 to it in June 2014.

District officials told us that they are retaining funds in this reserve for losses that may exceed estimated amounts and for expected changes in the New York State Workers' Compensation Law that may result in premium increases. Based on the average annual level of expenditures made by the District from this reserve, the District's current reserve balance is sufficient to pay workers' compensation claims for approximately eight years. The District does not have a detailed written plan for this reserve indicating why the Board deems this funding level to be necessary.

Unemployment Insurance Reserve – This reserve is used to reimburse the New York State Unemployment Insurance Fund for payments made to claimants. If there are excess amounts after claims are paid and pending claims are considered, the Board can transfer all or part of the excess amounts to certain other reserve funds or apply all or part of the excess to the budgeted appropriations of the next fiscal year.

As of June 30, 2014, this reserve had a balance of \$351,266. The District has used funds in this reserve to pay average annual costs of \$19,525⁵ for unemployment reimbursements to the Unemployment Insurance Fund during the last five years. The highest payment the District made during this period was \$37,816 for the 2012-13 fiscal year. For the 2013-14 fiscal year, the District estimated that it would pay \$35,000 for these costs, but actually paid approximately \$5,000.

District officials told us they are holding these funds to help offset costs related to staff reduction. Based on the highest annual level of

⁵ Totaling \$97,625

expenditures made by the District from this reserve, the District's current reserve balance could pay for unemployment insurance costs for more than nine years. Although the District has used some of the funds, and plans to use the funds for potential upcoming staff reductions, District officials could not provide specific analysis of possible future claims.

Retirement Contribution Reserve – GML authorizes the Board to create a retirement contribution reserve to finance retirement contributions payable to the New York State and Local Retirement System (NYSLRS).

The District established this reserve during the 2009-10 school year to pay benefits for employees covered by the NYSLRS. As of June 30, 2014, the balance in this reserve was nearly \$2 million, which represents more than three times the District's 2013-14 expenditures for retirement contributions. District officials have not used the funds in this reserve to pay for the District's contributions to the NYSLRS. Instead, the Board budgets for these costs in the annual budgets.

According to the School Business Administrator, District officials plan to use the moneys in this reserve for significant unexpected increases in the District's required employer pension fund contributions and routine annual payments to balance budgets in the short term and provide educational programs and tax stability. However, the District does not have a detailed written plan indicating why the Board would deem this funding level to be necessary.

Insurance Reserve – An insurance reserve may be established to fund certain uninsured losses, claims, actions or judgments for which the District is authorized or required to purchase insurance coverage. In the 2010-11 fiscal year, the District established an insurance reserve with a balance of approximately \$620,000, which has remained unchanged since then. The Board established the reserve to pay potential losses for out-building replacement and bus replacement.

The School Business Administrator told us that when the District established this reserve, it planned to cancel the insurance on certain fully depreciated assets. In the event of a loss, the District would pay the cost of replacing buses or an out-building from the reserve. However, District officials never canceled the insurance on these assets, and they traded the fully depreciated buses for new buses. The Board has not documented the continuing need for this reserve.

Tax Certiorari Reserve – Education Law authorizes districts to establish a reserve fund for costs related to tax certiorari proceedings. Money held in such a reserve may not exceed the amount that might reasonably be deemed necessary to meet anticipated judgments and

claims arising out of such proceedings. Any amounts not used to pay judgments and claims must be returned to the general fund within four years of deposit.

As of June 30, 2014, this reserve had a balance of \$89,106. There are limited tax certiorari proceedings against the District, and the District does not anticipate any proceedings or claims over the next few years. The District used these reserve funds to pay small claims proceedings refunds on current reassessments, which is not an acceptable use of these funds according to Education Law. District officials could not provide documentation to support the need to reserve these funds.

By maintaining excessive and unnecessary reserves, the Board and District officials have withheld more than \$1.4 million from productive use, unnecessarily levied taxes and reduced the transparency of District finances.

Recommendations

The Board should:

1. Adopt realistic appropriations estimates in the District's budgets.
2. Develop comprehensive policies for establishing and using reserve funds. These policies should outline targeted funding levels, the need for these funding levels and the conditions under which the funds will be used or replenished.

District officials should:

3. Reduce the balances in the workers' compensation insurance reserve, unemployment insurance reserve, retirement contribution reserve and insurance reserve to more reasonable levels that reflect realistic future expenditure needs.
4. Evaluate potential tax claims to determine the appropriate amounts that will be needed in the tax certiorari reserve to settle claims and return additional moneys to the general fund.
5. Develop a plan for the use of the excess fund balance and reserve funds in a manner that benefits District taxpayers. Such uses could include, but are not limited to:
 - Reducing real property taxes.
 - Increasing other necessary reserves.
 - Paying off debt.
 - Financing one-time expenditures.

APPENDIX A

RESPONSE FROM DISTRICT OFFICIALS

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

CHATHAM CENTRAL SCHOOLS



October 7, 2015

NYS Office of the State Comptroller
33 Airport Center Drive, Suite 103
New Windsor, NY 12553

RE: Audit Response

Dear Auditor and Taxpayers of the Chatham Central School District:

The Chatham Central School District is in receipt of the Draft Audit Report *Financial Condition* for the period of July 1, 2013 through March 11, 2015, prepared by the Office of the State Comptroller. On behalf of the Board of Education and the District administration, we would like to thank the Comptroller's staff for their professionalism and courtesy in conducting their duties associated with this audit.

The Chatham Central School District is committed to providing an excellent educational program that prepares students for college and career success in the 21st century. To this end, our budget development is guided by the following principles, reviewed and adopted by the Board during each year's budget calendar:

- Provide a strong educational program that prepares students for college and / or career success
- New spending offset with budget reduction
- Maximize available resources
- Seek savings through efficiencies
- Staffing based on enrollment and program needs
- Sensitivity to current economic climate
- Do not use one-time funding sources for ongoing expenses
- Focus on long-term financial well-being of district

These principles have allowed us to maintain both educational excellence and financial stability through challenging economic times.

The Chatham Central School District has always welcomed the opportunity to review and strengthen our financial practices and oversight. We have worked diligently over the past several years to update policies, strengthen internal controls, and develop budgets that balance short-term financial priorities with the long-term financial well-being of the District. To that end, we have developed and maintained long-term financial projections that guide our decision

Chatham Central School District, 50 Woodbridge Avenue, Chatham, New York 12037

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School Business Administrator
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Illustration after
Louis Comfort Tiffany window
at the Chatham Public Library

making. Even prior to the tax levy cap, we have recently kept tax levy increases low, in the 2 to 3% range. We communicate clearly and often with the public about our financial strategies, and our annual budget newsletter has received awards for its quality and clarity.

The State Comptroller's office spent three months at Chatham Central School District reviewing our procedures, processes, and policies. As expected, the audit did not uncover any instances of fraud or malfeasance with our general business practices. The audit included a risk assessment of purchasing, information technology, payroll, internal controls, banking, transportation, cafeteria, inventory, fixed assets, business office, etc. We are pleased that the audit report contains no findings in these areas, which we interpret as confirmation of sound financial practices. We work closely with our outside independent auditors to review our management practices and oversight procedures. The District has reviewed the Comptroller's findings and recommendations of this audit and will take corrective action in certain areas. These will be outlined in our Corrective Action Plan.

The audit report focuses on the District's management of reserves, a topic on which the District and the Comptroller's office have a difference of opinion. The Comptroller is of the opinion that the School District should deplete its reserves. The School District and its external auditors respectfully disagree. The audit report contains a number of conclusions and broad statements that we believe reflect subjective opinions of the Comptroller's Office with respect to the District's financial management, specifically as they relate to financial planning, reserve funds, and fund balance management. The Chatham Central School District utilizes a long-term budgeting strategy in which the reserve accounts mentioned in Comptroller's audit play an important role. Schools in New York State continue to be underfunded by State Aid and face additional limits to their revenue posed by the New York State property tax cap. The District's reserves have served as a savings account to weather shortfalls in revenue and unexpected cost increases. As a result of the District responsibly utilizing reserves, Chatham has avoided drastic cuts to the educational program and kept the tax increases at or below the limit set by the property tax cap. The Comptroller's claim that taxpayers paid higher than necessary taxes fails to take into account that the District's current revenue is not sufficiently sustainable and that the District projects that the reserves will be entirely depleted in as little as eight years. As has been seen throughout the State, District's that have not had adequate reserves have been forced to make drastic cuts to programs and services and or levy tax increases that exceed the tax cap.

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The School Board and Administration are transparent with the public regarding the budget and finances of the District. The Board and Administration have addressed budget and long-term financial plans in numerous public and community meetings over the past few years, including Board meetings, budget presentations, Town Hall meetings, and long-term planning sessions. These meetings routinely include discussions about long-term financial projections and the use of reserves. This information regarding the District's long range plans and use of reserves is posted on the website and provided in an annual budget newsletter. The Board and Administration takes great pride in having open discussions with the public regarding the finances of the district.

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Note 4
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The Board of Education adopts a motion at the end of each year which requires that any balance in unassigned fund balance over the State allowed 4% goes into specific reserve funds, typically replenishing funds expended during the year. This mechanism prevents the district from exceeding the allowable amount in unassigned fund balance. The reserves are then used to cover certain expenses from savings instead of using our limited revenues. The School District's external auditors annually audit the School District records and have never criticized the School District's plan or use of reserves. The Comptroller's criticism regarding unassigned fund balance is premised upon the mistaken assumption that the money shown in **Figure 1** would be placed in the unassigned fund balance account, which is not the case. There are multiple other appropriate possibilities for use of funds in excess accounts, and the Comptroller is inaccurate in assuming that Chatham will exceed the 4% statutory limit for the unassigned fund balance. Indeed, the District has, per our annual resolution, done just the opposite.

See
Note 5
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When reviewing **Comptroller's Figure 1** the first item shown is the accrued liabilities for health insurance. The District, with our external auditor's acceptance, believes this is allowed under modified accrual accounting. Furthermore, the District follows the Questar III BOCES accrued liability plan which has been approved by the New York State Education Department. Based on the Comptroller's remarks, the District will review these practices and develop a plan to spend down the accrued liability over the next few years.

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Note 6
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The School District appreciates the Comptroller's comments regarding the tax certiorari reserve. The District annually receives challenges by taxpayers to their real property tax bills. This reserve allows the School District to set aside money to refund the taxpayer, if necessary, at the end of the proceeding. At the time of the audit, the District did not have a schedule of the pending claims for this reserve. The District has now established the schedule and currently there is potential exposure of \$63,000 worth of tax cases that may be resolved in the near future, in contrast to the \$0 reflected in the Comptroller's report.

The District agrees with the Comptroller findings regarding the EBALR reserve which is the third item shown in **Comptroller's Figure 1**. The District began correcting this issue prior to the Comptroller's State Audit. Our District's external auditor noted that the compensated absences needed to be calculated based on all of the current employee contracts rather than a daily rate based on salary. Over the past year, the District recalculated the EBALR correctly and reviewed the new figures with the district external auditor. By regulation, the District must next have the state review and certify the balance so the surplus can be used appropriately.

Recommendation 1:

The Board should adopt realistic appropriations estimates in the District's budgets.

Response:

The District budgets for expenses that may be volatile and subject to external forces beyond the District's control. The budget is expected to fund educational programs to meet the needs

of the students and community regardless of any changes in external factors which can lead to unexpected increases in the budget.

The Board of Education systematically reviews every budget line of the appropriations and adopts realistic estimates for expenditures. In addition, the Board of Education has built contingencies into the budget to account for unexpected expenses. The contingencies allow the District to be prepared for unforeseeable increases to the budget due to various items such as increases in the number of special education students, fluctuations in utility prices, or health insurance premium increases, etc. For example, last year the District had an unplanned cost increase of over \$200,000 resulting from the unanticipated enrollment of high needs special education students.

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Note 7
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The Board's philosophy is to leave enough flexibility in the budget to meet any worst case financial demands which may arise during the school year. Any contingent money that goes unspent is applied to reduce the taxpayers' burden the following year or is placed in a reserve account to offset expenses in future years.

The information in **Comptroller's Figure 3: Overestimated Expenditures** is more accurately represented in **District Figure 3A: Budget to Actual Expenses**, represented below. We have adjusted the Comptroller's numbers to reflect the contingent expenditures that were applied to reduce the tax levy increase in the following year's budget. As shown in **District Figure 3A's** revised numbers below, the percentage of budget to actual expenditure is only 1.57% for the three year timeframe.

See
Note 8
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District Figure 3A : Budget to Actual Expense						
Fiscal Year	Budgeted Expenditures	Actual Expenditures	Comparison Budget to Actual Expenditures	Appropriated Fund Balance to reduce taxes	Budget to Actual Expenditures	Percent age Budget to Actual
2011-12	\$27,138,001	\$25,480,531	\$1,657,470	\$1,299,660	\$357,810	1.40%
2012-13	\$28,297,344	\$26,360,481	\$1,936,863	\$1,341,600	\$595,263	2.26%
2013-14	\$29,175,016	\$27,542,814	\$1,632,202	\$1,341,600	\$290,602	1.06%
Totals	\$84,610,361	\$79,383,826	\$5,226,535	\$3,982,860	\$1,243,675	1.57%

The Comptroller's report stated that District levied and collected more taxes than necessary to fund District operations. The report mentioned operating surpluses in **Comptroller's Figure 2: Appropriated Fund Balance**. In addition to unforeseeable expenses, at times the District has received unforeseeable revenues. For example, the District was fortunate to experience unexpected revenue in the form of health insurance rebates twice over the past few years. The District demonstrated responsible budget development by only budgeting for reliable revenues. When unexpected amounts have been received, they have been expended appropriately or

placed in appropriate reserves. When the unanticipated revenues are removed from the Comptroller's figures, the surplus is significantly less.

The information in **Comptroller's Figure 2: Appropriated Fund Balance** is more accurately represented in **District Figure 2A: Appropriated Fund Balance**, represented below. The District has adjusted the Comptroller's numbers to include unanticipated health insurance rebates that the District received from its health plan. Since these revenues were unknown during the budget cycle, they were not budgeted surpluses, and therefore were subtracted from the surplus line. As shown below, the District has steadily reduced the budgeted surplus over the last three years. The 2013-14 surplus, after subtracting out the unanticipated revenue, was just over \$200,000 on a \$29.1 million dollar budget, or less than 1% --almost a break even budget. This declining surplus is one reason we anticipate needing to use our reserves in the coming years.

See
Note 9
Page 22

District Figure 2A: Appropriated Fund Balance				
	2011-12	2012-13	2013-14	Totals
Budgeted Appropriated Fund Balance	\$1,299,660	\$1,341,600	\$1,341,600	\$3,982,860
Actual Results of Operations – Surplus	\$836,810	\$469,119	\$759,037	\$2,064,966
Unanticipated One time Revenues	\$100,353		\$555,443	\$655,796
Actual Surplus Net Unanticipated Revenues	\$736,457	\$469,119	\$203,594	\$1,409,170

Recommendation 2:

The Board should develop comprehensive policies for establishing and using reserve funds. The policies should outline targeted fund levels, the need for these funding levels and conditions which funds will be used or replaced.

Response:

In our exit meeting, the Comptroller's office complimented the level of long-term planning that exists in Chatham, saying that it is more thorough than what they usually find. While there is no requirement to adopt a written reserve plan, Chatham does have a written plan for reserves and a long-term financial model. The plan discusses the reserves and how they will be utilized over the next 5 to 10 years to assist in balancing the budgets to maintain the educational programming of the District and stay within the tax cap.

See
Note 10
Page 22

In the exit meeting, the Comptroller's staff clarified that the policy they recommend is a more comprehensive reserve plan document. Based on the recommendation of the Comptroller, the District agrees that the reserve plan will be strengthened by including targeted reserve fund levels, and specifically detailing how the funds will be used based on the District's long-term

financial model. The District agrees with the Comptroller's recommendation of the value of taking that additional step to more thoroughly document our planned use of reserves.

Recommendation 3:

District officials should reduce the balances in the workers' compensation insurance reserve, unemployment insurance reserve, retirement contribution reserve and insurance reserve to more reasonable levels that reflect realistic future expenditure needs.

Response:

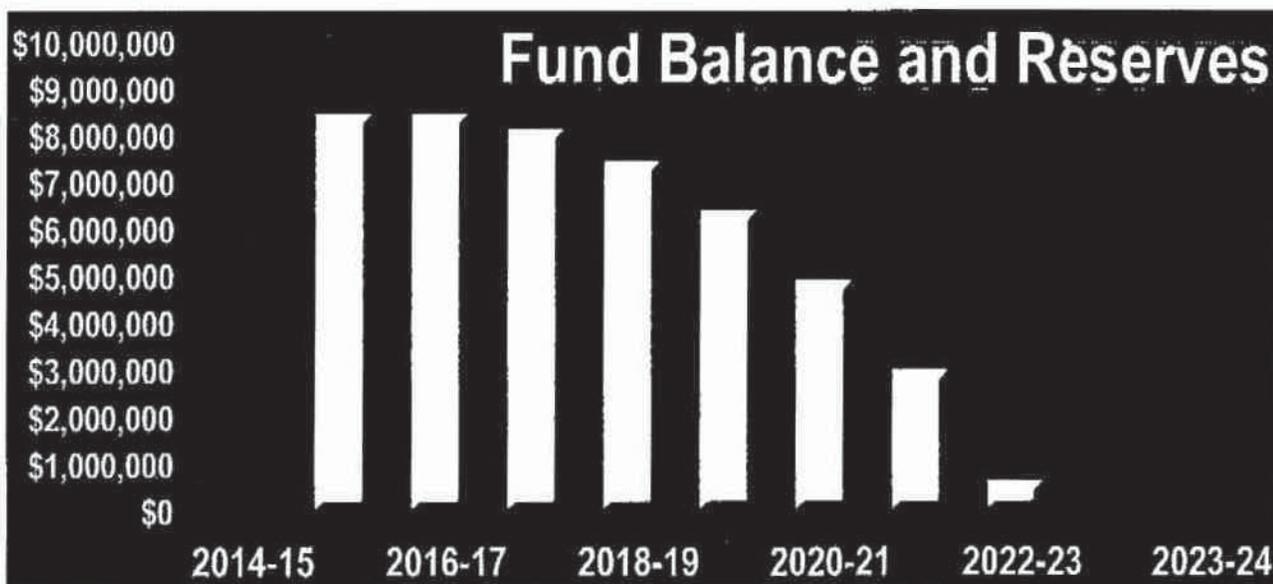
The District believes these reserves are appropriately funded and will be essential for long-term planning and the future financial stability of the District. Furthermore, the District has implemented numerous efficiencies and savings to reduce expenses and allow our reserve accounts to last longer.

See
Note 11
Page 22

The goal of having these reserves is to keep taxes at or below the tax cap and maintain strong educational programming for our students. As displayed in **District Figure A** from the District's financial model (shown below), Chatham is using its reserves, and absent significant reduction in expenses and/or substantial increases in revenue, the projection is the District will run out of reserves in 8 years. Given the preliminary 0% tax levy cap for the 2016-2017 budget year, Chatham's approach to utilizing reserves is prudent and responsible. Not having reserves would result in a "financial cliff" meaning that the District would not have enough funds to fully support our operations. This would lead to devastating cuts to the school program and/or a need to pass a high tax levy. Our concern with the Comptroller's recommendation is that if the District had pursued a strategy resulting in limited or no reserves, we could, like too many other districts, be facing this "financial cliff" now rather than in the future.

See
Note 1
Page 21

Figure A



The District currently uses the workers' compensation reserve for premiums, unemployment reserve to pay claims, and tax certiorari reserve to pay tax claims. The Comptroller's report provided helpful information about the insurance reserve. The audit noted that certain insurance policies were never cancelled due to a change of business office administration. The District will review and update the insurance reserve plan.

Recommendation 4:

Evaluate potential tax claims to determine the appropriate amounts that will be needed in the tax certiorari reserve to settle claims and return additional moneys to the general fund.

Response:

The Audit provided information to improve our record keeping for tax certiorari reserves, and which tax certiorari cases would be allowed to be funded by the reserve. The District has created a tax certiorari schedule which shows \$63,554 worth of potential cases yet to be resolved. Going forward, the District will review this schedule annually and fund the tax certiorari reserve accordingly. The audit brought forth that small claims assessment in tax reductions could not be paid out of this reserve, while the District assumed that such claims could be paid out of this reserve because they were for tax certiorari proceedings. Since the District cannot use this reserve for that reason the amount will be adjusted accordingly.

Recommendation 5:

Develop a plan for the use of excess fund balances and reserve funds in a manner that benefits District taxpayers. Such uses could include, but are not limited to:

- a. Reducing real property taxes
- b. Increasing other necessary reserves
- c. Paying off debt
- d. Financing one-time expenditures

Response:

The District respectfully disagrees with the Comptroller's opinion that the School District holds too much money in reserves. It is the Board and Administration's position that the School District's long range plan benefits taxpayers and students for the long term.

See
Note 11
Page 22

Because State Aid has not kept up with cost increases in recent years, the District has utilized reserves and fund balance in the budget to reduce property tax increases over the past few years. Along with efficiency measures, this has been the District's key strategy to keep tax increases at or below the property tax cap.

Last school year the District developed a plan to utilize a budget surplus due to one-time revenues to fund a capital reserve. This reserve will be used to address construction expenses for necessary upgrades and repairs as identified by our 2015 building condition survey report.

In the 2013-14 school year the District funded over \$200,000 for one-time computer purchases using the unassigned fund balance reserve.

Conclusion

We would like to thank the Comptroller's Office for their thoroughness and professionalism over the course of the three months that they spent in Chatham.

The audit provides us with strategies to clarify our reserves plan and better document our tax certiorari and insurance reserves. We have addressed in this response our plans regarding the accrued liability and EBALR reserve. However, the District does not believe that the purpose of the Comptroller's Audit should be to substitute their judgment for that of the Board of Education and its administration in terms of overall financial management for the District. We reassert that Chatham Central School District has a transparent and prudent approach to utilizing reserves and fund balance to maintain the financial stability and program opportunity in our District, now and in the future. While we respect the Comptroller's opinions as to appropriate reserve levels, we strongly feel that our approach has and will continue to provide the best possible education for our students in a fiscally responsible manner.

See
Note 12
Page 22

Sincerely,

CHATHAM CENTRAL SCHOOL DISTRICT
BOARD OF EDUCATION

Melony Spock
President

Cheryl A. Nucliforo
Superintendent of Schools

APPENDIX B

OSC COMMENTS ON THE DISTRICT'S RESPONSE

Note 1

The audit report does not state that the District should deplete its reserves. District officials should maintain reserves at reasonable levels.

Note 2

Reserve funds provide a mechanism for legally saving money and a degree of financial stability. A reserve fund should be established with a clear intent or plan regarding the future purpose, use and, when appropriate, replenishment of funds from the reserve. School districts should balance the desirability of accumulating reserves for future needs with the obligation to ensure taxpayers are not overburdened by these practices. There should be a clear purpose or intent for reserve funds that aligns with statutory authorizations. Reserves should not be used as a generic savings account.

Note 3

When the District plans for an operating deficit by appropriating fund balance and then realizes an operating surplus due to overestimated expenditures, taxpayers pay higher than necessary taxes. Our audit scope did not include a determination of the sustainability of the District's revenues or reserves.

Note 4

The information provided to taxpayers was incomplete. Without formally adopted long-term plans and budgets and policies for funding reserves, the District did not provide taxpayers with the necessary information to evaluate District budgets.

Note 5

The amounts in Figure 1 in the "Adjustments" column represent amounts that the District improperly retained as accrued liabilities and in the tax certiorari reserve and EBALR. Had the District retained only necessary amounts in these categories, the excess would have been correctly classified as unassigned fund balance. The report shows the effect of the excessive funding in certain District accounts on unassigned fund balance.

Note 6

Under modified accrual accounting, expenditures are recognized when the fund liability is incurred. The District's accrued liability is for costs that will be incurred in the following year.

Note 7

Budgeting for contingencies within the actual line items of the budget does not provide transparency to District taxpayers. Also, Education Law does not contain provisions to allow school districts to create a contingency account in their annual budgets. Unassigned fund balance is designated to be used for contingencies. By overestimating expenditures, the District generated surpluses totaling \$2 million during our audit period, which District officials did not use to fund District operations.

Note 8

Figure 3A in the District's response does not clearly represent the effect of overestimating expenditures. While "Appropriated Fund Balance to reduce taxes" would have theoretically reduced the amount of taxes levied, the District did not use the amounts appropriated because it had surpluses during each of the three fiscal years indicated. Therefore, the District did not use the amounts appropriated to reduce taxes.

Note 9

Regardless of whether the District received unanticipated revenues during any of the three fiscal years, it budgeted for operating deficits by appropriating fund balance in the budgets. Because the District had operating surpluses instead of deficits, it did not use any of the appropriated fund balance.

Note 10

A governing board that establishes and finances reserve funds on a regular basis should develop written policies that explain to taxpayers why the funds are being set aside, the board's financial objectives for the reserves, optimal funding levels and conditions under which the funds will be used. Upon reserving funds, the board should then periodically assess the reasonableness of the amounts accumulated in the reserves.

Note 11

District officials did not provide us with information to support the reasons why they believe funding levels in the reserves were necessary.

Note 12

By overestimating expenditures within line items in the budgets, the District did not use a transparent means of communicating the District's actual budget status to residents. Planning for operating deficits and appropriating fund balance, while overestimating expenditures and, therefore, not using appropriated fund balance, is not a transparent means of communicating the District's true financial condition to residents. By maintaining excessive amounts in reserves without a clear plan for targeted funding levels, the need for these funding levels and the conditions under which the reserved funds would be used or replenished, the District did not use a transparent means of communicating available funds to residents.

APPENDIX C

AUDIT METHODOLOGY AND STANDARDS

The objective of our audit was to examine the District's financial condition from July 1, 2013 through March 11, 2015. We extended our audit period back to the 2009-10 school year to evaluate financial trends and forward to April 30, 2015 to evaluate the current year's results.

To achieve our objective and obtain valid audit evidence, we performed the following audit procedures:

- We used electronic tools to evaluate the District's financial condition and traced significant accounts from the statements of assets and liabilities to supporting documentation.
- We corresponded with the Board concerning budgeting and reserve practices.
- We reviewed budget-to-actual expenditures for the 2011-12 through 2013-14 fiscal years.
- We reviewed employee contracts for benefits payable upon retirement.
- We reviewed Board minutes for establishment and funding of reserves.
- We reviewed reserve fund balances and trends for the 2009-10 through 2013-14 fiscal years.
- We reviewed the April 2015 budget status reports for major changes in revenues and expenditures.
- We reviewed payments made after June 30, 2014 for possible additional liabilities.
- We reviewed general ledger reports for selected accounts to document activity during our audit period.

We conducted this performance audit in accordance with 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 objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

APPENDIX D

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