



New Lebanon Central School District Financial Condition

Report of Examination

Period Covered:

July 1, 2013 — June 30, 2015

2015M-222



Thomas P. DiNapoli

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State of New York Office of the State Comptroller

Division of Local Government and School Accountability

December 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 New Lebanon 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 New Lebanon Central School District (District) is located in the Town of New Lebanon, Columbia County. The District is governed by the Board of Education (Board), which is composed of 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 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 District operates two schools with approximately 420 students. The District's budgeted appropriations for the 2014-15 fiscal year were \$12.4 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:

- Have District officials ensured that fund balance is maintained at a reasonable level?

Scope and Methodology

We examined the District's financial condition for the period July 1, 2013 through June 30, 2015. We extended our scope back to the 2010-11 fiscal year to evaluate financial trends.

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 B 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 generally agreed with our recommendations and indicated they planned to take corrective action.

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 responsibility for accurate and effective financial planning rests with the Board, the Superintendent and the Business Official. District officials must ensure that budgets are prepared, adopted and modified in a prudent manner that accurately depicts the District's financial activity while also using available resources effectively. Prudent fiscal management includes maintaining sufficient balances in reserves to address long-term obligations or planned expenditures. In doing so, District officials should adopt a policy or plan governing the use of reserve funds and ensure that residents are fully informed of all reserve funding and activity.

Over the last two years, the District's tax levy has not increased. However, District officials' budgeting practices generated \$1.2 million in net operating surpluses.¹ As a result of these operating surpluses, the accumulated unrestricted fund balance would have exceeded the statutory maximum of 4 percent of the ensuing year's budget. In order to reduce fund balance and stay within the statutory limit, District officials overstated liabilities and accumulated excessive reserve funds. In addition, the Board has repeatedly appropriated fund balance which has gone unused during the same period. When adjusting for those items, the effective percentage of unrestricted fund balance is 16 percent of the 2015-16 appropriations, which exceeds the 4 percent statutory limit. District officials' continued use of these budgeting and accounting practices resulted in taxpayers paying more than necessary to sustain District operations. As a result, the District's general fund's unrestricted fund balance increased to more than \$2 million as of June 30, 2015 (see Figure 1).

Budgeting and Use of Fund Balance

The Board is responsible for preparing and presenting the District budget to the public for vote. In preparing the budget, the Board must estimate what the District will receive in revenue (e.g., State aid), how much fund balance will be available at fiscal year-end (some or all of which may be used to fund the ensuing year's appropriations and to balance the budget) and what the expected tax levy will be. Accurate estimates help ensure that the levy of real property taxes is not greater than necessary.

The estimation of fund balance is an integral part of the budget process. Fund balance represents resources remaining from prior fiscal years that can be used to fund operations in the ensuing fiscal

¹ The District had operating surpluses of \$528,088 for 2013-14 and \$626,513 for 2014-15.

year. A district may retain a portion of fund balance, referred to as unrestricted fund balance, within the limits established by New York State Real Property Tax Law. Districts may also establish reserves to restrict a portion of fund balance for a specific purpose, also in compliance with statutory directives.

The District reported unrestricted fund balance that complied with the 4 percent limitation as required by statute. However, because the District has ended the last two fiscal years with operating surpluses, the appropriated fund balance included in each year’s budget was not needed to finance planned expenditures. Because of the operating surpluses, none of the \$662,000² of appropriated fund balance over the two-year period was used for expenditures. We also found that during our audit period, the District overstated year-end accrued liabilities averaging \$747,000³ and accumulated excess funds totaling \$444,895 in five reserves.

As shown in Figure 1, over the past two years the District has reported unrestricted fund balance at a level that complied with statute. However, when considering the unused appropriated fund balance, excess reserve fund amounts and overstated year-end liabilities, the recalculated unrestricted fund balance was \$2,031,806 for fiscal year 2013-14 and \$2,031,098 for fiscal year 2014-15, or 16 percent of the ensuing year’s appropriations each year, exceeding the statutory limit.

Figure 1: Unrestricted Fund Balance Recalculated		
	2013-14	2014-15
Reported Unrestricted Fund Balance	\$510,664	\$506,990
Reported Fund Balance as a Percentage of Ensuing Year’s Appropriations	4%	4%
Add: Unsupported Accrued Liabilities	\$745,247	\$748,413
Add: Unused Appropriated Fund Balance	\$331,000	\$331,000
Add: Excess Reserves	\$444,895	\$444,895
Recalculated Unrestricted Fund Balance	\$2,031,806	\$2,031,298
Recalculated Fund Balance as Percentage of Ensuing Year’s Appropriations	16%	16%

² The District appropriated \$331,000 of available fund balance for taxes during each fiscal year which was not used during the same period.

³ The District had unsupported year-end accrued liabilities at both June 30, 2014 and June 30, 2015 totaling \$745,247 and \$748,413, respectively.

District officials explained that the year-end accrued liabilities were recorded to account for contractual obligations agreed upon by the District and the teachers' union for post-employment and retirement incentives. However, District officials were unable to provide support to justify the amounts recorded and, as a result, the amounts did not constitute an accrued liability.⁴

The District's practice of consistently appropriating fund balance that was not needed to finance operations combined with operating surpluses, maintaining excess reserves and overstating year-end liabilities, in effect, resulted in the unrestricted fund balance exceeding the 4 percent statutory limitation of the ensuing year's appropriations and has distorted the District's financial records and financial condition. As a result of these practices, available assets have not been effectively utilized. If these moneys were properly accounted for as fund balance, they could have been used for one-time expenditures, reducing debt or reducing property taxes.

Reserves

Reserves may be established by the Board in accordance with applicable laws. Moneys set aside in reserves must be used in compliance with statutory provisions which designate how reserves are established and how they may be funded, expended and discontinued. Generally, school districts are not limited as to how much money can be held in reserves. However, reserve balances must be reasonable. Funding reserves at greater than reasonable levels contributes to real property tax levies that are higher than necessary because the excessive reserve balances are not being used to fund operations. The Board is responsible for developing a formal plan for the use of its reserves, including how and when disbursements should be made, optimal or targeted funding levels and why these levels are justified. The Board is also responsible for ensuring that appropriate documentation is maintained to account for and monitor reserve activity and balances.

As of June 30, 2015, the District had six general fund reserves totaling approximately \$1.1 million. We analyzed the historical trend of these reserves from July 1, 2010 through June 30, 2015 for reasonableness and adherence to statutory requirements. We found the funding of the capital reserve to be reasonable. However, two reserve funds,

⁴ Generally accepted accounting principles (GAAP) are uniform minimum standards of and guidelines to financial accounting and reporting. 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 upon current spendable resources.

tax certiorari and the employee benefit accrued liability reserve (EBALR), did not meet statutory requirements and therefore were not allowable. The remaining reserves for workers' compensation, unemployment insurance and retirement contributions were funded at levels that were generally higher than necessary, resulting in excess reserves totaling \$444,895 as of June 30, 2015 as shown in Figure 2.

Figure 2: Excess General Fund Reserve Balances

Reserve Fund	Fiscal Year Ended				
	6/30/11	6/30/12	6/30/13	6/30/14	6/30/15
Workers' Compensation	\$100,756	\$101,035	\$101,253	\$101,253	\$101,253
Unemployment Insurance	\$99,203	\$99,477	\$80,791	\$80,791	\$80,791
Retirement Contributions	\$116,698	\$117,021	\$117,274	\$117,274	\$117,274
Tax Certiorari ^a	\$51,260	\$30,017	\$30,082	\$30,082	\$30,082
EBALR ^a	\$114,928	\$115,246	\$115,495	\$115,495	\$115,495
Total Excess Reserves	\$482,845	\$462,796	\$444,895	\$444,895	\$444,895

^a These reserves did not meet statutory requirements.

Workers' Compensation Insurance Reserve – General Municipal Law authorizes this reserve for workers' compensation costs, related medical expenses 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.

No moneys have been expended from this reserve during the past four years. Instead, the Board budgeted for workers' compensation costs in the general fund and levied taxes to pay them. The District made payments for workers' compensation insurance totaling \$326,928 for the five-year period July 1, 2010 through June 30, 2015, or an average of \$65,386 a year. The District has not taken steps to reduce the balance of the workers' compensation reserve by using it to offset costs. The balance of the reserve was \$101,253 as of June 30, 2015, which is more than 1.5 times the average annual expenditures.

Unemployment Insurance Reserve – This reserve is allowed for reimbursing the New York State Unemployment Insurance Fund (SUIF) for payments made to claimants where the District has elected to use the "benefit reimbursement" method based on actual unemployment claims.

No moneys have been expended from the reserve during the past three years. The District made payments to the SUIF totaling \$116,866⁵ for the five-year period July 1, 2010 through June 30, 2015, or an average of \$23,373 a year. The reserve's balance was \$80,791 as of June 30, 2015, which is almost 3.5 times the average annual expenditures.

Retirement Contribution Reserve – By law, this reserve can only be used to pay benefits for employees covered by the New York State and Local Retirement System. The District cannot include the cost of financing contributions for employees covered by the New York State Teachers' Retirement System.

No moneys have been expended from the reserve during the past five years. Instead, the Board budgeted for retirement costs in the general fund and levied taxes to pay them. Annually, the District receives projected contributions and rates from the New York State and Local Retirement System. These projections are for the current and ensuing fiscal years. These payments have risen 52 percent, increasing from \$149,613 to \$227,267 from fiscal years 2010-11 through 2014-15. However, the retirement contribution reserve balance of \$117,274 has remained unchanged over the same period and could have been used to offset these increases.

Tax Certiorari Reserve – This reserve is for the payment of judgments and claims for tax certiorari proceedings for the tax roll in the specific year in which the money was deposited in the reserve. This reserve fund may not exceed the amount which might reasonably be deemed necessary to meet anticipated judgments.

No moneys have been expended from the reserve during the past four years. As of June 30, 2015, the tax certiorari reserve had a balance of \$30,082. The District could not provide supporting documentation for reserving these funds.

We were also informed that there are no current tax certiorari proceedings against the District and, while the District is anticipating potential proceedings or claims in lieu of the Town of Stephentown reassessment, we were provided with no evidence to support the amount reserved. We question why the District has not returned the funds to the general fund in accordance with statutory requirements.

EBALR – This reserve must be used only for cash payments of accrued and unused sick, vacation and certain other leave time

⁵ The SUIF expenditures were \$28,751 for the 2010-11 fiscal year, \$26,770 for the 2011-12 fiscal year, \$45,846 for the 2012-13 fiscal year, \$9,691 for the 2013-14 fiscal year and \$5,808 for the 2014-15 fiscal year.

(compensated absences) owed to employees when they leave District employment. The balance in this reserve must be reasonable and meet the requirements of the law.

No moneys have been expended from the reserve during the past five years. District officials did not maintain documentation for the current or anticipated liability supporting the June 30, 2015 reserve balance of \$115,495. Because the reserve balance was not supported by a plan documenting the need and expected use of these funds, this reserve did not meet statutory requirements and, therefore, was not allowable.

District officials do not have a formal plan for the use of reserves, including how and when disbursements should be made, or optimal or targeted funding levels, and why these levels are justified. District officials told us that they are aware of the excessive reserve fund balances and plan to develop written policies governing the funds to be adopted and reviewed by the Board. By maintaining excessive or unnecessary reserves, combined with ongoing budgeting practices that generate repeated operating surpluses along with the overstatement of year-end accrued liabilities, the Board and District officials have withheld more than \$1.5 million⁶ from productive use and reduced the transparency of District finances.

Recommendations

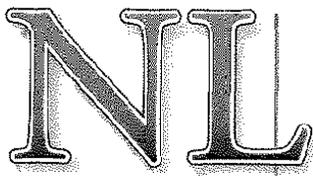
1. District officials should provide the appropriate transparency through the budget process with public disclosure and develop a plan to use the surplus fund balance identified in this report in a manner that benefits District taxpayers. Such uses could include, but are not limited to, reducing District property taxes or funding one-time expenditures.
2. The Board should review all reserves and determine if the amounts reserved are necessary, reasonable and in compliance with statutory requirements. To the extent that they are not, transfers should be made to fund balance, where allowed by law, or other reserves established and maintained in compliance with statutory directives.

⁶ Appropriated fund balance (\$331,000) + overfunded reserves (\$444,895) + unsupported accrued liabilities (\$748,413)

APPENDIX A

RESPONSE FROM DISTRICT OFFICIALS

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



New Lebanon
Central School
District

December 2, 2015

Tenneh Blamah
Chief Examiner of Local Government
And School Accountability
NYS Office of the State Comptroller
33 Airport Center Drive, Suite103
New Windsor, NY 12553

Dear Chief Examiner Blamah:

This letter is in response to the draft audit of the New Lebanon Central School District by the Office of the New York State Comptroller dated November 19, 2015. We appreciate your staff taking the time to look at many different areas of our school district, including purchasing, payroll, contributions to the New York State and Local Retirement System, Capital Projects, internal controls, inventory, fuel usage and controls, banking procedures and controls, fixed assets, and Capital Reserves. We were reassured to find that after a detailed review your office determined that none of these areas were out of compliance or required any further review. We thank you for your efforts.

The past several years have brought a great deal of uncertainty to school districts. Evidence of this can be seen in the number of school districts deemed to be under fiscal stress by your office. During this time we have tried to adjust by balancing the needs of our students and our taxpayers not only in our year to year annual budget process, but also with a long term approach to fiscal planning. As we have experienced a drop in enrollment, we have reduced staffing due to attrition in an effort to help "right size" the district. Over the past five years we have not only stayed below our calculated tax levy limit, but we have had a zero percent increase in tax levy. The 2015-16 school budget is actually a decrease in spending from the 2014-15 school year. Through these actions we believe that we have held the line for taxpayers and most importantly we have done so without sacrificing our instructional programs.

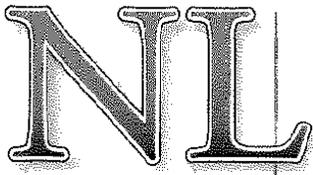
The current fiscal and political environments in New York State pose many potential financial challenges for school districts. This leaves many districts, particularly small school districts with little room for error. Some of the bigger potential issues we see on the revenue side are: changes to state aid (Foundation Aid in particular), Tax Cap limitations, and a stagnant tax base. On the expense side, as a small district we have unique program-loss vulnerabilities. A single teacher may carry an entire program, and that single salary is a higher percentage of our entire budget than in a larger district. Similarly, the enrollment of a single high-needs student or English Language Learner would require additional staffing. Other areas of concern are the prospect of a \$15/hour minimum wage and increases in health and pharmacy costs. Changes in any of



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New Lebanon
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these areas or a combination of them pose the potential to change the steady course New Lebanon has been on.

On an annual basis we review our funding of our Reserve Funds and we will continue to do so going forward. Upon your recommendation we will work with the Board of Education to create a written plan for district reserves. As part of our long term financial planning we will also look at the accrued liability to determine the best use of these funds.

Thank you for your thorough review of the New Lebanon Central School District's financial condition. As we move forward, we take this audit as a validation of the hard work we have done to put the district in a positive financial state. As previously mentioned we will consider your recommendations and the other factors that were discussed as we enter into the annual budget process and as we plan for the long term financial and instructional needs of the district. Thank you.

Sincerely:

Leslie Whitcomb
Superintendent of Schools

Michael J. Los
Business Administrator



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APPENDIX B

AUDIT METHODOLOGY AND STANDARDS

The objective of our audit was to determine if District officials ensured that fund balance was maintained at a reasonable level. We examined the District's financial condition from July 1, 2013 through June 30, 2015. We extended our audit period back to the 2010-11 fiscal year to evaluate financial trends.

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

- We reviewed and compared reported fund balance levels to the amounts appropriated in adopted budgets.
- We analyzed revenue and expenditure trends and budget-to-actual comparisons for the operating funds for fiscal years 2010-11 through 2014-15 and calculated the percentage of fund balance as compared to the ensuing years' budgeted appropriations.
- We compared the total fund balance to the adopted tax levy.
- We reviewed and analyzed any outstanding encumbrances reported at year-end during our audit period to determine the purpose, date paid and validity.
- We reviewed and analyzed outstanding amounts recorded as accrued liabilities at year-end during our audit period to determine the source, reason and legitimacy.
- We reviewed and analyzed all reserve funds maintained by the District to identify the reserve fund type and determine if the reserves were properly authorized in compliance with the statutory requirements, if reasonable and necessary amounts were being held, if the amounts held agreed with the existing accounting records and if any plans or policies existed governing the reserve funds' use and funding.
- We reviewed funds transferred to reserve accounts along with any funds transferred internally to ensure they conformed to statute and were necessary for District operations.

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.

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