OFFICE OF THE NEW YORK STATE COMPTROLLER

DIVISION OF LOCAL GOVERNMENT
& SCHOOL ACCOUNTABILITY

Penfield
Central School District

Financial Management

Report of Examination

Period Covered:

July 1, 2011 – May 7, 2015

2015M-162

Thomas P. DiNapoli

Table of Contents

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 Penfield Central School District, entitled Financial Management. 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

State of New York
Office of the State Comptroller

EXECUTIVE SUMMARY

The Penfield Central School District (District) is located in the Towns of Penfield, Brighton, Perinton and Pittsford in Monroe County and the Towns of Macedon and Walworth in Wayne 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 has an Assistant Superintendent for Business who is responsible for managing the District's finance-related operations under the direction of the Superintendent and the Board.

There are six schools in operation within the District, with approximately 4,500 students and 900 employees. The District's budgeted appropriations for the 2014-15 fiscal year were $89.17 million, funded primarily with State aid and real property taxes.

Scope and Objective

The objective of our audit was to evaluate the District's financial management for the period July 1, 2011 through May 7, 2015. Our audit addressed the following related question:

- Did the Board and District officials effectively manage the District's finances by ensuring that budget estimates and fund balances are reasonable?

Audit Results

From fiscal years 2011-12 through 2014-15, the Board and District officials adopted budgets with overestimated expenditures and appropriated fund balance to finance operations that was not actually used. Instead of using approximately $8.01 million in appropriated fund balance as planned during these four years, the District used only $2.14 million (27 percent) in the 2013-14 fiscal year to finance operations. As a result, the District's fund balance has remained excessive.

As of June 30, 2015, two reserves which have balances totaling $8.08 million are overfunded and potentially unnecessary. The District has not used the retirement contribution reserve and instead budgets and levies general fund taxes to fund retirement costs. The District has used the insurance reserve twice ($55,460) in the last four years and purchases liability insurance to limit the need for a reserve. In addition, the District typically funds reserves with year-end surpluses, not through the budget. Therefore, the taxpayers have not been provided an opportunity to vote on what their taxes are being used to fund.

By appropriating fund balance that was not actually used and overfunding reserves during the last four years, the District has managed to keep its unrestricted unappropriated fund balance within the statutory limit of 4 percent of the ensuing year's budget. However, when adding back unused appropriated fund balance and overfunded reserves, the District's fund balance actually exceeded the statutory limit, ranging between 10 and 12 percent of the ensuing year's budget. Therefore, District officials are levying more taxes than necessary to sustain District operations.

District officials also transferred money from the general fund to subsidize the school lunch fund that was not actually needed. As a result, the school lunch fund's total fund balance increased from $422,868 in 2011-12 to $519,390 in 2013-14, which exceeded the federally regulated limit by over $45,000. Fund balance further increased to $580,017 at the end of 2014-15.

For each of the four fiscal years reviewed, there was a balance of approximately $5 million in the debt service fund that was not allocated to any specific debt. Because of transfers from the general fund each year, the debt service fund is not being used and its balance continues to grow due to compounding annual interest. Using these funds for debt service would allow for general fund resources to be used to reduce the real property tax burden.

We also reviewed the voter-approved 2015-16 budget and determined that the District continued its unrealistic budgeting practices. The general fund will continue to subsidize the school lunch fund and pay for debt service payments even though these funds have available resources to pay for their related costs. Therefore, the District will continue to levy more taxes than necessary in the general fund.

Comments of District Officials

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 have begun, and will continue, to initiate corrective action.

Introduction

Background

The Penfield Central School District (District) is located in the Towns of Penfield, Brighton, Perinton and Pittsford in Monroe County and the Towns of Macedon and Walworth in Wayne 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 has an Assistant Superintendent for Business who is responsible for managing the District's finance-related operations under the direction of the Superintendent and the Board.

There are six schools in operation within the District, with approximately 4,500 students and 900 employees. The District's budgeted appropriations for the 2014-15 fiscal year are $89.17 million, funded primarily with State aid and real property taxes.

Objective

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

- Did the Board and District officials effectively manage the District's finances by ensuring that budget estimates and fund balances are reasonable?

Scope and Methodology

We examined the District's financial management for the period July 1, 2011 through May 7, 2015.

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.

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 have begun, and will continue, to initiate 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 Management

The Board, Superintendent and Assistant Superintendent for Business are accountable to District taxpayers for the use of District resources and are responsible for effectively planning and managing the District's financial operations. One of the most important tools for managing the District's finances is the budget process. District officials must ensure that budgets are prepared, adopted and modified in a prudent manner, accurately depict the District's financial activity and use available resources to benefit District taxpayers.

Prudent fiscal management includes maintaining sufficient and appropriate balances in reserves that are needed to address long-term obligations or planned future expenditures. In doing so, District officials should adopt a detailed policy or plan governing the establishment, use and funding levels/goals of reserve funds. 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. Any remaining fund balance, exclusive of the amount allowed by law to be retained to address cash flow and unexpected occurrences, should be used in a manner that benefits District taxpayers, such as to reduce the tax levy or pay down debt.

The Board consistently adopted budgets with overestimated expenditures that generated operating surpluses and resulted in excessive general fund balance. Further, although District officials reserved money to prepare for future contingencies, they did not always include the funding of reserves in the budgets voted on by taxpayers. Instead, the Board allocated amounts to reserves at the end of each fiscal year to reduce unrestricted fund balance to the statutory limit. These actions diminish the transparency of District finances to the taxpayers. As a result, two of the District's eight general fund reserves, which have balances totaling $8.08 million, are overfunded and potentially unnecessary. The District generally does not use the reserves and instead covers related costs with tax levies and liability insurance.

The District has also made it a practice to over-subsidize the school lunch fund, resulting in 2013-14 year-end fund balance of $519,390, which exceeded the federally regulated limit by over $45,000. Fund balance grew to $580,017 at the end of 2014-15. Additionally, the District maintained an unsubstantiated balance of $5 million in the debt service fund that should be used to pay off debt or otherwise reduce the general fund tax levy. By maintaining excessive balances in its various funds and reserves, the District is not using its resources in a way that is most beneficial to taxpayers and is raising more taxes than needed to fund operations.

General Fund Budgeting

In preparing the general fund budget, the Board is responsible for estimating what the District will spend and what it will receive in revenue (e.g., State aid), for estimating how much fund balance will be available at the fiscal year end for use to help fund the budget and for balancing the budget by determining the expected tax levy. Accurate estimates help ensure that the tax levy is not greater than necessary. New York State Real Property Tax Law allows the District to retain a limited amount of fund balance (up to 4 percent of the ensuing year's budget) for unexpected events and to provide for cash flow. Fund balance in excess of that amount must be used to fund a portion of the next year's appropriations, thereby reducing the tax levy, or used to fund legally established reserves.

The Board and District officials adopted budgets that overestimated expenditures by 5 to 7 percent from fiscal years 2011-12 through 2014-15.[1] The District also appropriated a total of $8.01 million in fund balance to finance operations in fiscal years 2011-12 through 2014-15. However, it only used $2.14 million of fund balance (27 percent) during this time. Fund balance was not used in fiscal years 2011-12, 2012-13 and 2014-15 due to operating surpluses generated from overestimated expenditures (see Figure 2). As a result, the District's fund balance has remained excessive. Furthermore, the District's practice of consistently appropriating fund balance that is not needed to finance operations is, in effect, a reservation of fund balance that is not provided for by statute and a circumvention of the statutory limit imposed on the level of unrestricted, unappropriated fund balance.

Additionally, the apparent $2.14 million operating deficit in 2013-14 was the result of several large unbudgeted transfers to the capital projects fund (from both reserved and unreserved fund balance) totaling approximately $7.3 million.[2] Had these transfers not been made, the District would have ended 2013-14 with an operating surplus of $5.1 million. Similarly, the District made unbudgeted transfers of approximately $4 million to the capital projects fund in 2014-15, which significantly reduced the reported operating surplus.

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1 For an updated perspective, we obtained 2014-15 reports from District officials in October 2015.

2 These transfers were not budgeted but were all Board-approved and for voter-approved projects through propositions for the following: purchase of buses, security project, lights project, repairs and capital updates made at Bay Trail and Scribner buildings and the Indian Landing emergency project funding.

The Board should include transfers for known capital projects in its adopted budgets to increase transparency and avoid the appearance of moving money to reduce fund balance to the statutory limit, while continuing to overtax property owners.

Figure 1: Budget to Actual Results

	2011-12	2012-13	2013-14	2014-15	Totals
Estimated Revenues[a]	$83,167,956	$85,070,685	$87,096,396	$89,174,836	**$344,509,873**
Actual Revenues	$82,269,725	$87,361,174	$86,895,970	$88,558,219	**$345,085,088**
Variance	($898,231)	$2,290,489	($200,426)	($616,617)	**$575,215**
% Variance	(1.09%)	2.62%	(0.23%)	(0.69%)	**0.17%**
Appropriations	$78,059,620	$79,904,105	$82,746,664	$84,899,289	**$325,609,678**
Actual Expenditures	$73,085,461	$75,995,652	$77,831,425	$79,931,816	**$306,844,354**
Variance	$4,974,159	$3,908,453	$4,915,239	$4,967,473	**$18,765,324**
% Variance	6.81%	5.14%	6.32%	6.21%	**6.12%**

[a] All revenue and expenditure amounts included are net of interfund transfers.

Three expenditure accounts (Teaching-Regular School, Program for Students with Disabilities-Med Eligible and Hospital, Medical and Dental Insurance) were significantly overestimated by $14.7 million (9 percent) between fiscal years 2012 and 2015 and further contributed to the District's growing fund balance. District officials stated that these variances were due to staffing changes and contract negotiations. The teachers had been operating with an expired contract since July 1, 2014, and District officials anticipated retroactive payments to be included as part of any contract negotiated. Therefore, the District continued to factor salary increases and benefits into the budgets in the interim to account for this. District officials also explained that program expenditures are subject to changes based on enrollment of special needs students and tuition paid for students to be sent to other schools if the District is unable to meet the students' needs.

Finally, as of June 30, 2015, two reserves with balances totaling $8.08 million are overfunded and potentially unnecessary. Specifically:

- 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. The Retirement Contribution Reserve has grown from $2.42 million as of July 1, 2010 to a balance of $6.02 million as of June 30, 2015, which is four times the average annual expenditures of $1.51 million. Further, the Board has not used this reserve to pay for retirement costs. Instead, it budgeted for retirement costs in the general fund and levied taxes to fund them.

- Insurance Reserve[3] – This reserve was established under General Municipal Law on June 4, 1996 to fund certain uninsured losses, claims, actions or judgments for which the District is authorized or required to insure. The balance as of June 30, 2015 was $2,064,784. The District purchases liability insurance to limit the need for substantial reserves to fund insurance claims. Over the last four fiscal years, the District has used $55,460 from the reserve. District officials stated that they have not reduced the amount of funds in this reserve because it is unknown when a disaster may occur and these funds may be needed. The District did not fund the insurance reserve during fiscal years 2012 through 2015; the reserve balance's increases are related to interest. Because the District has used such a small amount in proportion to the reserve balance in the last four years, we question the excessive balance and necessity of this reserve. The Board can discontinue this reserve if it determines the reserve is unnecessary. Money from the discontinued reserve can be transferred only to another reserve as authorized by Education Law.

The District typically funds reserves with year-end surpluses, not through the budget. This method of funding reduces transparency and does not provide the taxpayers with an opportunity to vote on what their taxes are being used for.

Figure 2: Fund Balance Analysis

	2011-12	2012-13	2013-14	2014-15
Beginning Fund Balance	$26,873,439	$28,703,320	$32,735,409	$30,599,429
Prior Period Adjustments	($6,662)	$5	$3	$0
Operating Surplus/(Deficit)[a]	$1,836,543	$4,032,084	($2,135,983)	$252,438
Ending Fund Balance	$28,703,320	$32,735,409	$30,599,429	$30,851,867
Less: Restricted Funds	$20,445,562	$24,287,790	$22,301,168	$22,767,762
Less: Nonspendable Fund Balance	$1,389,228	$1,389,228	$751,115	$751,115
Less: Appropriated Fund Balance (in Ensuing Year's Budget)	$1,800,000	$2,071,599	$2,071,599	$2,071,599
Less: Encumbrances	$1,665,703	$1,581,917	$1,908,554	$1,628,312
Unassigned Ending Fund Balance	$3,402,827	$3,404,875	$3,566,993	$3,633,079
Unassigned Fund Balance as a Percentage of the Ensuing Year's Budget	4.00%	3.91%	4.00%	4.00%
Unused Appropriated Fund Balance	$1,800,000	$2,071,599	$0	$2,071,599
Excessive Reserves	$7,132,433	$8,111,412	$8,825,691	$8,084,278
Total Excessive Fund Balance as a Percentage of Ensuing Year's Budget	10.50%	11.69%	9.90%	11.18%

[a] Operating surplus/(deficit) calculation (revenues less expenditures) includes interfund transfers.

[3] This reserve is currently accounted for as the "Liability Reserve," but District officials confirmed the actual intent for which this reserve was established is an insurance reserve and should be accounted for and reported as such.

By maintaining excessive fund balance, both restricted and unassigned, and not using the fund balance appropriated in adopted budgets, District officials are levying more taxes than necessary to sustain District operations. In addition, some current budgeting practices circumvented statutory controls and resulted in excessive fund balance that significantly exceeded the statutory limitation of 4 percent of the ensuing year's budget. District officials have tried to be transparent in their actions related to budgeting and finances, including presenting details in public forums and on the District website. However, they have taken little to no action to remedy the excessive fund balances caused by inaccurate budgeting practices. As a result, the District ended the 2014-15 fiscal year with another operating surplus of $252,438 and the 2015-16 budget continues the pattern of overly conservative budgeting.

School Lunch Fund

According to New York State Education Department (SED) guidelines, the school lunch fund's budgeted appropriations must balance with its estimated revenues. Its budget is not submitted to the voters for approval. Only the budgeted subsidy, if any, from the general fund requires voter approval. In addition, federal regulations limit the allowable school lunch fund balance to three months' average operating expenditures.

From fiscal years 2011-12 through 2014-15, District officials budgeted for planned deficits in the school lunch fund to be subsidized by budgeted transfers from the general fund. However, these budgets included overestimated appropriations totaling over $342,500, or 5 percent, for the four years. Thus, the District made transfers that exceeded the school lunch fund's actual operating deficits.[4] As a result, as indicated in Figure 3, the school lunch fund's total fund balance has increased from $422,868 in 2011-12 to $580,017 in 2014-15, which is 35 percent of its annual budget.

Figure 3: School Lunch Fund Results of Operations

	2011-12	2012-13	2013-14	2014-15
Estimated Revenues	$1,433,750	$1,498,620	$1,519,045	$1,489,250
Actual Revenues	$1,463,027	$1,491,216	$1,436,472	$1,409,906
Variance – (Over)/Under Estimated	$29,277	($7,404)	($82,573)	($79,344)
Percentage Variance	2.0%	(0.5%)	(5.4%)	(5.3%)
Appropriations	$1,579,792	$1,667,522	$1,712,133	$1,680,703
Actual Expenditures	$1,563,703	$1,612,558	$1,580,596	$1,540,732
Variance – Over/(Under) Estimated	$16,089	$54,964	$131,537	$139,971
Percentage Variance	1.0%	3.3%	7.7%	8.3%
Budgeted and Actual Interfund Transfers	$146,042	$168,902	$193,088	$191,453
Fund Operating Surplus/(Deficit)	$45,366	$47,560	$48,964	$60,627
Total Fund Balance	**$422,868**	**$470,427**	**$519,390**	**$580,017**

4 Revenues minus expenditures, before interfund transfers from the general fund

Because the District continues to adopt unrealistic school lunch fund budgets and subsidize the school lunch fund by more than necessary each year, the fund balance in this fund has grown to an excessive level. Rather than continuing to make excessive transfers, the District could use these funds to reduce the general fund taxes levied each year.

In September 2014, the District's external auditor identified the excess balance in the management letter for fiscal year 2013-14. However, the Board failed to take adequate corrective action in response to this finding and has continued to overestimate appropriations and budget for additional transfers to the school lunch fund from the general fund. The Board slightly reduced its budgeted transfer (by 4 percent) to the school lunch fund in the 2015-16 budget to $184,241 from $191,453 in 2014-15. However, in the District's long-term budget forecast, District officials anticipated increasing the contribution by approximately 6 percent in each of the next four years starting with 2016-17.[5]

After we completed fieldwork, District officials provided documentation that the Board had approved a budget amendment for the purchase of $82,000 in food service equipment for the school kitchens[6] and received SED's approval of this fund balance reduction plan on July 8, 2015.[7] The 2014-15 year-end fund balance exceeded three months' average expenditures for that year by $117,798, or 25 percent. However, that fund balance included encumbrances for the food service equipment that was ordered in May 2015 and paid for in July and August of the current fiscal year. The actual cost of the equipment was $67,713,[8] which reduces the excess fund balance, over the three months' average expenditures, to $50,085, or 11 percent. Therefore, the Board must also reduce its budgeted contribution to the school lunch fund in future years to avoid generating additional excessive fund balance.

Debt Service Fund

A debt service fund must be established and maintained to account for proceeds of a sale of a capital improvement with outstanding debt, or if State or federal aid is received for a capital improvement for which there is outstanding debt. This money should be used for debt service payments on that debt or, in certain cases, other outstanding debt.

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5 During our exit conference on October 5, 2015, District officials told us that they base the general fund subsidy amount primarily on the Food Service Director's salary and related benefits.

6 In February 2015, in response to the external auditor's finding related to excess fund balance

7 The District received SED notice of the excessive fund balance and required reduction plan on June 6, 2015.

8 We received supporting purchase order and payment documentation for the equipment on October 14, 2015.

In addition, if a district has residual bond proceeds and/or interest earned on bond proceeds, those moneys must be used only to pay for debt service on the related obligations. They also may be used for capital expenditures associated with the project for which the debt was issued and must be accounted for in the debt service fund.

We found that District officials budget for and make transfers (approximately $4.1 million in the 2014-15 fiscal year) from the general fund to the debt service fund to make annual principal and interest payments on long-term debt. For each of the four fiscal years reviewed, there was a balance of approximately $5 million in the debt service fund that was not allocated to any specific debt. Because of the transfers from the general fund, the debt service fund is not being used and its balance continues to grow, due to compounding annual interest. District officials were aware of the large fund balance in the debt service fund. However, they could not specify which capital improvement(s) or debt issue(s) it was associated with, except that a portion reflected interest earned on bond proceeds from the District's large 2006-07 capital project. District officials have not planned for the use of these unidentified funds. Using these funds for debt service would allow for general fund resources to be used to reduce the real property tax burden.

Upon review of the voter-approved 2015-16 budget, it appears that the District has made limited changes to its budgeting practices to address the preliminary findings and recommendations we discussed with District officials throughout our audit fieldwork. The District budgeted for a general fund transfer of $475,000 to the capital projects fund for the high school lights project, which is a positive step toward more transparent planning. However, the District is continuing to subsidize the school lunch fund, with another budgeted transfer of $184,241, which will further increase the excessive school lunch fund balance. Additionally, the District again budgeted for the debt payment from the general fund rather than using available fund balance in the debt service fund. As a result, the District once again overtaxed District property owners.

Recommendations

The Board and District officials should:

1. Adopt budgets that reflect the District's actual needs and include realistic estimates based on historical trends or other identified analysis.

2. 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 in compliance with statutory requirements.

3. Fund reserves and capital projects through budgeted transfers from the general fund, as part of the voter-approved budgets.

4. Ensure that the school lunch fund budget is balanced, consider utilizing the excessive school lunch fund balance to fund school lunch operations and only make transfers as necessary to this fund.

5. Use the debt service fund's balance for debt payments as appropriate. This will reduce the need for general fund transfers to the debt service fund and will reduce the general fund's tax levy.

APPENDIX A

RESPONSE FROM DISTRICT OFFICIALS

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

PENFIELD
CENTRAL SCHOOL DISTRICT
Building a Bright Future

THOMAS K. PUTNAM, Ed.D.
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October 13, 2015

Mr. Edward V. Grant, Jr., Chief Examiner
Office of the State Comptroller
The Powers Building
16 West Main Street – Suite 522
Rochester, New York 14614

Dear Mr. Grant:

The Penfield Central School District has received and reviewed the draft Financial Management Report of Examination for the audit period July 1, 2011 – May 7, 2015. On behalf of the Board of Education and administration, we appreciate this opportunity to respond to the findings and to provide our responses to the audit recommendations.

During the course of the audit, the Comptroller's Office conducted a comprehensive examination of the District's financial practices. We are pleased that no fraud, waste or abuse was identified by this examination. Further, we appreciate the courteous and professional manner in which the auditors worked with us during the audit.

This audit, the third in the last eight years, focused on the District's financial management practices. The Board of Education and District administration strive to maintain the highest standard of fiscal management, balancing the needs of the instructional program with the community's desires, aspirations and ability to pay. A commitment to long-range and responsible planning has allowed the District to weather state aid reductions, unfunded mandates and dramatic pension cost increases while maintaining an average levy increase of 1.85% over the past eight years. Our commitment to, and partnership with, our taxpayers precedes the legislative tax cap.

This letter includes both the District's response as well as the corrective action plan. The corrective action plan was reviewed and approved by our audit committee October 15, 2015 and was approved by our Board of Education at its October 22, 2015 meeting.

Audit Recommendation #1: *Adopt budgets that reflect the District's actual needs and include realistic estimates based on historical trends or other identified analysis.*

<u>District Response:</u>
The District uses a multi-year budget model to identify revenue and expenditure trends, establish short and long-term budget priorities, and assess the impact of current budget decisions on future budgets.

By law, the District may not overspend its budget – good budget practice indicates that a budget should be conservative enough to meet its obligations. For example, state law allows contingency appropriations of up to 10% for counties, towns and villages. Education Law does not contain provisions relative to school district contingency accounts and no state agency has established guidance. The District expended, on average, 94% of the budgeted expenditures during the audit period.

The District budgets conservatively, reviews budget documentation extensively in open session and works to ensure that it is financially prepared to sustain its operations, manage emergencies and meet students' needs with programs the community values. Moody's Investor Services has commended our budget practices in granting Penfield an Aa3 rating, in the top tiers of the rating system.

In the tax cap environment, District decisions regarding budget and levy are extraordinarily consequential. Each year forms a new base, and a budget deficit is not easily corrected. Our community values and has been extraordinary supportive of our schools. We honor the trust they place in us by communicating clearly and making decisions that are in the best interest of the community.

Plan of Action:
The District will continue to utilize a five-year planning model to forecast revenue and expenditure trends. Additionally, as part of the 2016-17 budget process, the Board will formally establish reasonable targets for budget variance.

Audit Recommendation #2: *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 in compliance with statutory requirements.*

District Response:
In accordance with Board Policy, the District annually reviews and adopts a reserve plan as part of its budget process. This review encompasses the statutory requirements, funding levels, activity in the reserve, the Board adopted target level for the reserve and a plan for use of the funds. After adoption by the Board, this plan is posted on the District website.

This audit review identified two reserves as being potentially overfunded: the retirement contribution reserve and the insurance reserve.

Insurance Reserve: The District established this reserve in 1996 to cover uninsured losses. This reserve is not intended for use on an ongoing basis; rather, it protects the District in the case of a catastrophic event. Disbursements have been made in recent years as the District has used the reserve to fund uninsured, unanticipated losses. However, based on the size of these losses, we concur with the auditors that the reserve could be reduced.

Plan of Action:
As part of the 2015 reserve planning process, the Board will examine the funding level in this reserve. Input will be solicited from the District's attorney and insurance company as to the appropriate amount of the reserve. Any funds determined to be in excess of a reasonable balance will be transferred in accordance with Education law.

Retirement Contribution Reserve: This reserve was authorized by the state legislature in reaction to the significant increases in retirement contribution rates faced by municipalities and school districts. Its purpose is to set aside funds to limit the property tax impact of increases in employer contribution rates for the Employees' Retirement System. The District anticipates funding this reserve when retirement rates are below long-term averages and utilizing it when rates exceed long-term averages.

No state agency has provided guidance on the appropriate level of funding in this reserve. However, the District had previously determined that it was fully funded as part of its annual reserve planning process.

Plan of Action:
As part of the 2015 reserve planning process, the Board will examine the funding level in this reserve. It is anticipated that draws from this reserve will be necessary as the District navigates the anticipated 0% tax cap in 2016-17. This process will continue annually.

Audit Recommendation #3: *Fund reserves and capital projects through budgeted transfers from the general fund, as part of the voter-approved budgets.*

District Response:
The District's commitment to transparency and long-range planning is exemplified by its approach to both reserves and capital projects. In accordance with our Board Policy, the District annually reviews and adopts a reserve plan as part of its budget process. This review encompasses the statutory requirements, funding levels, activity in the reserve, the Board adopted target level for the reserve and a plan for use of the funds. This plan is reviewed at a televised public meeting and is posted on our website. Transfers to the reserves are discussed during at least two Board meetings and are made within the overall framework of the adopted plan.

We are also proud of our process for development and communication of capital projects. The District adopts a five-year facilities plan, which is a tool we actively use to manage our capital improvement program to preserve, protect and improve our community's capital investment. The plan forms the basis for annual public discussions and decisions regarding the scope and nature of our capital projects. We have budgeted for smaller capital projects within the general fund budget. Larger capital projects are offered as separate propositions. This allows focused conversation and improved clarity regarding these projects.

Plan of Action:
The District is in the process of developing its five-year capital plan and anticipates its adoption by the Board in January/February 2016. This plan will be expanded to include projected financing means and sources for each of the phases of the plan.

Audit Recommendation #4: *Ensure that the school lunch fund is balanced; consider utilizing the excessive school lunch fund balance to fund school lunch operations, and only make transfers as necessary to this fund.*

District Response:
The statutory fund balance in the food service program as per 7CFR Part 210.14(b) is three months of expenses or $464,586. Accordingly, when the 2014-15 total fund balance reached $572,129 ($107,543

over the limit), the District auditor noted this in the annual independent audit. In the next year, the District implemented a State Education Department approved plan to purchase necessary equipment which reduced the excess fund balance to $40,190.

Plan of Action:
The Board of Education will continue to monitor and manage the school lunch fund balance to stay within the limit. The remaining excess balance will be reduced by the end of the 2015-16 school year.

Audit Recommendation #5: *Use the debt service fund's balance for debt payments as appropriate. This will reduce the need for general fund transfers to the debt service fund and will reduce the general fund's tax levy.*

The debt service fund is used for the accumulation of resources for the payment of principal and interest on long-term debt. These funds are derived from interest earnings on monies obligated to capital projects and may only be used for the reduction of debt.

This fund has increased significantly through interest earnings on the funds used for the District's recent $73,025,000 capital project. Our financial advisor has recommended that the District maintain funds against potential state aid changes as final cost reports are filed. During the last year, the final cost reports have been filed. Accordingly, we agree with the audit comment that it is appropriate to begin using these funds to pay debt, offsetting the tax burden.

Plan of Action:
As part of the 2015 reserve planning process, the Board will examine the funding level in this fund and establish a long-term plan for the payment of debt from the reserve. It is anticipated that this plan will use balances in the fund to offset outstanding bonds, as well as to reserve against the outstanding debt schedule to avoid creating a future funding "cliff."

This plan will be adopted by the Board of Education as part of the 2016-17 budget process.

The Penfield Central School District appreciates the hard work, thorough effort and communication with the auditors throughout the process. We are committed to the use of or taxpayer resources in an efficient, effective and thoughtful manner. Your audit is an important perspective on our work and will provide guidance as we work to make the best decisions possible for our community and our children.

Sincerely,

John Piper
President, Board of Education

Dr. Tom Putnam
Superintendent of Schools

APPENDIX B

AUDIT METHODOLOGY AND STANDARDS

Our overall goal was to assess the District's financial management for the period July 1, 2011 through May 7, 2015. To accomplish our objective, we interviewed appropriate District officials and employees, tested selected records and examined pertinent documents.

Our examination included the following:

- We interviewed District officials to gain an understanding of the budget process. We reviewed financial information provided to the Board and reviewed the Board minutes to determine the reports provided to the Board.

- We reviewed the results of operations for the general and school lunch funds for fiscal years 2011-12 through 2014-15.

- We compared the budgeted revenues and expenditures to the actual revenues and expenditures for the general fund for fiscal years 2011-12 through 2014-15 and identified any budget categories with significant variances.

- We analyzed the trend in total fund balance, including the use of reserves, in the general fund for the fiscal years 2011-12 through 2014-15. We also compared the unrestricted fund balance to the ensuing year's budgeted expenditures to determine if the District was within the statutory limitation during the same fiscal years.

- We reviewed the District's multiyear financial and capital plans for adequacy.

- We analyzed the debt service fund balance and activity to determine amounts that accounted for the balance in this fund and whether the District was using this fund to make debt payments.

- We reviewed District reserve accounts and related expenditures to determine if reserves were properly and legally established, if they were being funded or used and if their balances were reasonable.

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 C

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APPENDIX D

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