



# Red Hook Central School District Financial Management

Report of Examination

Period Covered:

July 1, 2014 – December 17, 2015

2016M-105



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# State of New York Office of the State Comptroller

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## Division of Local Government and School Accountability

June 2016

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 Red Hook 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*

# Introduction

## Background

The Red Hook Central School District (District) is located in the Towns of Red Hook, Rhinebeck and Milan in Dutchess County and the Towns of Clermont and Livingston in Columbia County. The District is governed by the Board of Education (Board), which is composed of five elected members. The Board is responsible for the general management and control of the District's financial and educational affairs. The Superintendent of Schools 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 four schools with approximately 1,900 students and 390 employees. The District's budgeted appropriations for the 2015-16 fiscal year are \$50.8 million, which are funded primarily with State aid and real property taxes.

## Objective

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

- Did District officials ensure that general fund budget estimates, reserves and fund balance were reasonable?

## Scope and Methodology

We examined the District's financial management for the period July 1, 2014 through December 17, 2015. We extended the scope back to July 1, 2010 to determine if the budget estimates, reserves and fund balance were reasonable.

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 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 Management

The Board is responsible for making sound financial decisions that are in the best interests of the District, the students it serves and the District's residents. Sound budgeting practices based on accurate estimates, along with prudent fund balance<sup>1</sup> management, help ensure that the real property tax levy is not greater than necessary. According to New York State Real Property Tax Law (RPTL), the amount of fund balance that the District can retain may not be more than 4 percent of the ensuing fiscal year's budget. Districts may use the remaining resources to lower real property taxes or establish reserves to restrict a reasonable portion of fund balance for a specific purpose.

District officials need to improve the budget process to ensure general fund budget estimates and fund balance are reasonable. From 2010-11 through 2014-15, District officials planned operating deficits and appropriated \$12.4 million of fund balance. However, because officials' consistently overestimated expenditures, the District experienced operating surpluses totaling more than \$4 million over these years and, therefore, used only \$115,765 (1 percent) of the appropriated fund balance to finance operations. District officials also set aside \$3 million in four reserves that have not been used. Unrestricted fund balance for these five years ranged between 13 and 15 percent of the ensuing year's appropriations, exceeding the statutory limit. As a result, District officials missed the opportunity to reduce the tax levy.

## **Budgeting and Fund Balance**

The Board and District management are responsible for accurately estimating revenues and appropriations in the District's annual budget. When preparing the budget, it is essential that District officials use the most current and accurate information to ensure that budgeted appropriations are reasonable and not overestimated. Accurate budget estimates help ensure that the real property tax levy is not greater than necessary. The estimation of fund balance is also an integral part of the budget process. RPTL currently limits unrestricted fund balance to no more than 4 percent of the ensuing fiscal year's budget. Any surplus fund balance over this amount can be used to reduce the upcoming fiscal year's tax levy.

District officials overestimated general fund appropriations by a total of approximately \$11 million during 2010-11 through 2014-15 fiscal years as shown in Figure 1.

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<sup>1</sup> Fund balance represents resources remaining from prior fiscal years.

**Figure 1: Overestimated Appropriations**

	2010-11	2011-12	2012-13	2013-14	2014-15	Five-Year Total
Appropriations	\$44,383,754	\$45,615,708	\$46,956,574	\$48,407,621	\$49,809,447	<b>\$235,173,104</b>
Actual Expenditures	\$41,964,440	\$43,259,373	\$45,459,890	\$46,342,134	\$47,070,172	<b>\$224,096,009</b>
Overestimated Expenditures	\$2,419,314	\$2,356,335	\$1,496,684	\$2,065,487	\$2,739,275	<b>\$11,077,095</b>
Percentage	5%	5%	3%	4%	6%	<b>5%</b>

Overestimated appropriations include employee benefits (\$4.3 million or 34 percent), salaries (\$4.3 million or 34 percent) and contractual expenditures (\$3.6 million or 29 percent).<sup>2</sup> District officials said that departments budget the same amount from year to year. However, officials should have prepared a budget-to-actual trend analysis to obtain more realistic budget estimates. For example, liability insurance has been budgeted at the same amount of \$168,688 for the fiscal years 2010-11 through 2014-15 totaling \$843,440. However, over the five years only \$360,026 has been paid; a total of \$483,414 (or 57 percent) has not been used. District officials told us that they tend to budget conservatively.

District officials said they did not consider how the overall actual results or trends compare to the current budget for departmental budgets. As a result, the Board adopted inflated budgets each year, excess fund balance levels increased and more property taxes were levied than necessary.

Due to the District’s practice of overestimating appropriations, it has experienced net operating surpluses totaling more than \$4 million<sup>3</sup> for the five-year period. District officials used some of the surpluses to fund various reserves.

<sup>2</sup> Other appropriations were underestimated.

<sup>3</sup> The District experienced an operating deficit in 2012-13 of \$115,765.

**Figure 2: Unrestricted Fund Balance at Year-End**

	2010-11	2011-12	2012-13	2013-14	2014-15
Total Beginning Fund Balance	\$4,068,500	\$6,439,128	\$7,573,227	\$7,457,462	\$7,829,473
Add: Operating Surplus/(Deficit)	\$2,370,630	\$1,134,097	(\$115,765)	\$372,011	\$281,822
Total Ending Fund Balance <sup>a</sup>	\$6,439,130	\$7,573,225	\$7,457,462	\$7,829,473	\$8,111,295
Less: Restricted Funds	\$1,860,530	\$2,808,054	\$2,612,062	\$2,890,155	\$2,952,839
Less: Encumbrances	\$272,503	\$460,187	\$425,127	\$481,740	\$652,363
Less: Appropriated Fund Balance for the Ensuing Year	\$2,500,000	\$2,450,000	\$2,480,000	\$2,470,000	\$2,465,000
<b>Total Unrestricted Funds at Year-End</b>	<b>\$1,806,097</b>	<b>\$1,854,984</b>	<b>\$1,940,273</b>	<b>\$1,987,578</b>	<b>\$2,041,093</b>
Ensuing Year's Budgeted Appropriations	\$45,615,708	\$46,956,574	\$48,407,621	\$49,539,447	\$50,797,627
Unrestricted Funds as Percentage of Ensuing Year's Budget	4%	4%	4%	4%	4%

<sup>a</sup> There was a \$2 prior period adjustment to decrease the 2011-12 beginning fund balance and \$2 prior period adjustment to increase the 2012-13 beginning fund balance.

The District appropriated an average of about \$2.5 million<sup>4</sup> in fund balance as financing sources in the annual budget in each of the last five years. However, the District used only \$115,765 of the appropriated fund balance in 2012-13 to finance operations over the same period (see Figure 2). As a result, the District's fund balance has increased. This appropriation of fund balance allowed the District to circumvent the statutory limit imposed on the level of unrestricted fund balance. When the unused appropriated fund balance is added back, the District's recalculated unrestricted fund balance ranged from 13 to 15 percent of the ensuing year's appropriations as depicted in Figure 3. As a result, the District retained \$5.4 million<sup>5</sup> more than the amount of unrestricted funds allowed and raised more taxes than needed to fund operations.

**Figure 3: Unused Fund Balance**

	2010-11	2011-12	2012-13	2013-14	2014-15
Total Unrestricted Funds at Year-End	\$1,806,097	\$1,854,984	\$1,940,273	\$1,987,578	\$2,041,093
Add: Appropriated Fund Balance Not Used to Fund Ensuing Year's Budget	\$2,500,000	\$2,334,235	\$2,480,000	\$2,470,000	\$2,465,000
Add: Unused Restricted Fund Balance	\$1,434,580	\$2,308,054	\$2,612,062	\$2,890,155	\$2,952,839
<b>Total Recalculated Unrestricted Funds</b>	<b>\$5,740,677</b>	<b>\$6,497,273</b>	<b>\$7,032,335</b>	<b>\$7,347,733</b>	<b>\$7,458,932</b>
Recalculated Unrestricted Funds as Percentage of Ensuing Year's Budget	13%	14%	15%	15%	15%

<sup>4</sup> Calculated average fund balance appropriated for fiscal years 2010-11 through 2015-16 was \$2,473,000.

<sup>5</sup> Sum of 2014-15 appropriated fund balance not used to fund ensuing year's budget and 2014-15 unused restricted fund balance.

The result of these budgeting practices made it appear that the District needed to both raise taxes and use fund balance to close projected budget gaps. The Board increased the tax levy from \$27.4 million in 2010-11 to \$31.3 million in 2015-16, an increase of about 14 percent. Furthermore, the Board’s practice of consistently appropriating fund balance that was not needed to finance operations circumvented the statutory limit imposed on unrestricted fund balance.

## Reserves

Fund balance may be restricted for particular purposes or appropriated to reduce the real property tax levy. When the Board establishes reserve funds for specific purposes, it is important that it develop a plan for funding the reserves, determine how much should be accumulated and determine how and when the funds will be used to finance related costs. School districts should fund reserves in a transparent manner and maintain reserve balances that are reasonable. Funding reserves at greater than reasonable levels essentially results in real property tax levies that are higher than necessary.

The District has four reserve funds that have not been used to fund any payments over the five-year period from 2010-11 to 2014-15.<sup>6</sup> In addition, these unused reserves have increased \$1.5 million or 106 percent, totaling approximately \$3 million at the end of 2014-15.

Account Description	2010-11	2011-12	2012-13	2013-14	2014-15
Retirement Contribution Reserve	\$0	\$425,000	\$515,000	\$1,090,000	\$1,250,000
Workers' Compensation Reserve	\$200,000	\$526,320	\$664,920	\$332,640	\$298,350
Unemployment Reserve	\$31,590	\$31,590	\$31,590	\$31,590	\$42,120
Employee Benefit Accrued Liability Reserve (EBALR)	\$1,202,990	\$1,325,144	\$1,400,552	\$1,435,925	\$1,362,369
<b>Total Unused Reserves</b>	<b>\$1,434,580</b>	<b>\$2,308,054</b>	<b>\$2,612,062</b>	<b>\$2,890,155</b>	<b>\$2,952,839</b>

The EBALR is in excess of the District’s liability by approximately \$700,000. The Board has budgeted for and made payments from the annual operating budget for retirement, workers’ compensation and unemployment expenditures. For example, the 2014-15 District budget included \$1,085,507 for the New York State and Local Retirement System, \$345,000 for workers’ compensation and \$49,000 for unemployment insurance even though the District had funds in these reserves.

The Board has consistently adopted budgets that generated operating surpluses and has chosen to retain excess funds in the reserves rather than put them to productive use.

<sup>6</sup> The District had a capital reserve and used funds from it in previous years.

## Recommendations

The Board should:

1. Adopt budgets with reasonable estimated appropriations, using a budget-to-actual trend analysis to project needs.
2. Discontinue the practice of adopting budgets that result in the appropriation of unrestricted fund balance that is not actually needed to fund District operations.
3. Develop a plan to use the surplus fund balance identified in this report in a manner that benefits District residents. Such uses could include, but are not limited to:
  - Using surplus funds as a financing source;
  - Funding one-time expenditures;
  - Funding needed reserves; and
  - Reducing District property taxes.
4. Review reserves to determine if the amounts reserved are justified, necessary and reasonable. To the extent that they are not, reserves should be properly reduced.

## **APPENDIX A**

### **RESPONSE FROM DISTRICT OFFICIALS**

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

**RED HOOK CENTRAL SCHOOL DISTRICT**  
9 Mill Road • Red Hook, New York 12571

Paul Finch, *Superintendent of Schools*

Bruce T. Martin, *Business Administrator*

Donna Gaynor, *Assistant to the Superintendent/Curriculum & Instruction*

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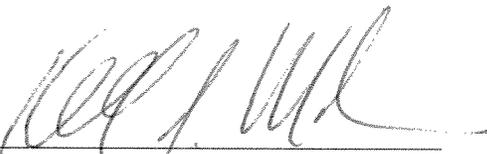
Fax: (845) 758 - 3366

District Response to Draft Report of Examination

The Red Hook Central School District would like to take this opportunity to thank the Office of the New York State Comptroller for the recent audit conducted related to the Financial Management of the District and for the resulting Draft Report of Examination. We would like to recognize the professionalism and integrity of all of the Comptroller's Office staff who participated in the audit, whether directly at the Red Hook Central School District or in one of the regional offices. From the perspective of the District the audit was conducted in a thorough and professional manner and with an overall tone and approach that was both helpful and informative.

While we are pleased with the positive outcome of the audit, we look forward to addressing the recommendations presented by the Office of the New York State Comptroller in the Report through the corrective action plan (CAP) process. The Red Hook Central School District will seek to work closely with the Comptroller's Office in the preparation and implementation of the CAP.

Again we would like to thank the Office of the New York State Comptroller for their professional approach to the audit of the Red Hook Central School District.



Kelly Mosher, Board President



Paul Finch, Superintendent



Bruce Martin, Business Administrator

## APPENDIX B

### AUDIT METHODOLOGY AND STANDARDS

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

- We interviewed officials to gain an understanding of the District's budgeting process.
- We reviewed the results of operations and analyzed changes in fund balance for the general fund for the period July 1, 2010 through June 30, 2015.
- We compared the adopted budgets to the actual operating results to determine if the budget assumptions were reasonable.
- We reviewed the appropriation of District's fund balance from July 1, 2010 through June 30, 2015.
- We reviewed expenditures based on the District's budget categories to identify significant expenditures and analyze trends.
- We tested the reliability of District accounting records, comparing them to the annual financial report filed with the Office of the State Comptroller and the District's independently audited financial statements.
- We reviewed meeting minutes and interviewed officials to determine whether the District's management is involved in financial matters by receiving and reviewing financial reports, analyzing the need for and establishing reserves and otherwise monitoring the District's financial condition.
- We reviewed the District's reserve fund balances for reasonableness.
- We reviewed the compensated absences liability for the 2014-15 fiscal year.

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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