



Royalton-Hartland Central School District Financial Condition

Report of Examination

Period Covered:

July 1, 2012 – September 4, 2015

2015M-275



Thomas P. DiNapoli

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State of New York Office of the State Comptroller

Division of Local Government and School Accountability

January 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 Royalton-Hartland 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 Royalton-Hartland Central School District (District) is located in the Towns of Royalton, Hartland and Lockport in Niagara County, the Town of Alabama in Genesee County and the Towns of Ridgeway and Shelby in Orleans County. The District is governed by an elected seven-member Board of Education (Board), which 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 day-to-day management under the direction of the Board. The Business Administrator is responsible for accounting for the District's finances, maintaining accounting records and preparing financial reports.

The District operates three schools with approximately 1,400 students. The District's budgeted appropriations for the 2015-16 fiscal year total \$22.9 million, which are funded primarily with State aid and real property taxes. As of June 30, 2015, the District had approximately \$9.6 million in fund balance.

Objective

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

- Did the Board properly manage District finances by ensuring that budgets were realistic and fund balance levels were maintained in accordance with statutory requirements?

Scope and Methodology

We examined the District's financial condition and budgeting practices for the period July 1, 2012 through September 4, 2015.¹

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 planned to initiate corrective action.

¹ We expanded our tax levy increase analysis back to July 1, 2010.

The Board has the responsibility to initiate corrective action. Pursuant to Section 35 of the General Municipal Law, Section 2116-a (3)(c) of the 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

A school district's financial condition is a factor in determining its ability to fund public educational services for students within the district. The responsibility for accurate and effective financial planning rests with the Board, the Superintendent and the Business Administrator. The Board and District officials are responsible for adopting annual budgets that contain realistic estimates of expenditures and the resources available to fund them and for ensuring that fund balance does not exceed the amount allowed by law. Fund balance represents the cumulative residual resources from prior fiscal years that can, and in some cases must, be used to lower property taxes for the subsequent fiscal year. A district may retain a portion of fund balance, referred to as unrestricted fund balance, but must do so within the legal limits established by New York State Real Property Tax Law (RPTL).² The portion of fund balance used to reduce the property tax levy is referred to as appropriated fund balance. A district also can legally set aside and reserve portions of fund balance to finance future costs for a variety of specified objects or purposes. However, 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.

District officials have not properly managed fund balance. As a result, unrestricted fund balance has consistently exceeded RPTL limits. As of June 30, 2015, the District's unrestricted fund balance was \$4.2 million (18 percent of the ensuing year's budget) or approximately \$3.3 million over the legally allowable limit and is projected to remain at nearly the same level (17 percent) at the end of 2015-16.³ Although District officials annually appropriated a portion of fund balance towards the subsequent year's budget, none of the amounts appropriated were used because District officials consistently overestimated appropriations resulting in operating surpluses. This trend is projected to continue through 2015-16.⁴ Moreover, once the appropriated fund balance not needed to finance operations is included in unrestricted fund balance, the District's unrestricted fund balance amounts in all three years ranged from \$4.4 million (20 percent) to \$5.6 million (24 percent). In addition, District officials

² RPTL limits the amount of unrestricted fund balance to no more than 4 percent of the subsequent year's budget.

³ The legal amount of unrestricted fund balance allowable for the District as of June 30, 2015 was \$919,031. The District retained a total unrestricted fund balance of \$4,187,411.

⁴ We project the District will not use the entire \$1.7 million that is appropriated towards the 2015-16 budget.

Budgeting and Fund Balance

consistently budgeted in the general fund for expenditures that could have been paid for with reserve funds. Although unrestricted fund balance continued to increase through June 30, 2015, District officials continued to raise the tax levy every year by an average of 2 percent, or a total of \$760,000 over the last four years.⁵ As a result, District officials may have missed opportunities to reduce taxes and return excess funds back to the taxpayers.

District officials are responsible for developing realistic estimates of appropriations and the use of fund balance in the annual budget and ensuring that the amount of unrestricted fund balance is in compliance with the statutory limit. Excess funds should be used in a manner that benefits taxpayers.

We compared budgeted appropriations and revenues with actual operating results from July 1, 2012 through June 30, 2015. While revenue estimates were generally reasonable, expenditures were overestimated by an average of \$2 million per year, or a cumulative total of \$5.9 million (9 percent) over the last three years, as shown in Figure 1. The most significant were found in operation of plant, pupil transportation and employee benefits⁶ at amounts that each averaged between \$355,000 and \$430,000 annually. Because some of these costs are determined by contractual agreements, anticipated expenditures should be reasonably estimated and not consistently overestimated.

	2012-13	2013-14	2014-15
Appropriations	\$22,057,939	\$22,020,002	\$22,363,886
Actual Expenditures	\$19,795,003	\$19,953,324	\$20,822,714
Under Budget	\$2,262,936	\$2,066,678	\$1,541,172
Percentage Overestimated	10.3%	9.4%	6.9%

We also analyzed the 2015-16 appropriations in comparison with the last three completed fiscal years of actual results and project a similar trend to continue. The District is projected to end 2015-16 with expenditures overestimated by approximately \$1.8 million (7.8 percent).

The overestimated appropriations contributed to the District generating operating surpluses totaling approximately \$1.3 million during the last three fiscal years. Although the budgets included appropriated fund balance that averaged \$1.7 million per year, because of the annual operating surpluses, none of the appropriated

⁵ Increases in the tax levy from 2012-13 through 2015-16

⁶ Includes retirement contributions, health insurance, Social Security, unemployment insurance and workers' compensation payments.

fund balance was used.⁷ It is not a realistic budgeting practice to routinely adopt budgets that appropriate fund balance that will not be used. Further, it is misleading to taxpayers because they are under the impression that surplus funds will be used to reduce their taxes. In reality, the District's fund balance⁸ continued to increase and was not used to benefit taxpayers; just the opposite, taxes were higher than necessary. As of June 30, 2015, the District's unrestricted fund balance was 18 percent of the next year's budget and exceeded the statutory limit by approximately \$3.3 million.

The District's last three independent audit reports contained findings related to unrestricted fund balance being in excess of the statutory limit. In addition, a District policy requires that the Board will attest that unrestricted surplus funds that exceed the statutory limit will be applied when determining the school tax levy. However, it appears officials have disregarded the audit findings and their policy because unrestricted fund balance has continued to increase. As shown in Figure 2, unrestricted fund balance significantly exceeded the statutory limit of 4 percent in all three years, ranging from 12 to 18 percent of the ensuing year's budget.

Figure 2: Unrestricted Fund Balance at Fiscal Year End			
	2012-13	2013-14	2014-15
Beginning Fund Balance	\$8,313,421	\$8,986,138	\$9,477,968
Add: Operating Surplus	\$672,717	\$491,830	\$86,781
Ending Fund Balance	\$8,986,138	\$9,477,968	\$9,564,749
Less: Restricted Fund Balance (Reserves)	\$4,431,728	\$3,836,366	\$3,545,456
Less: Encumbrances	\$162,414	\$152,212	\$78,842
Less: Appropriated Fund Balance for the Ensuuing Year	\$1,681,712	\$1,753,040	\$1,753,040
Unrestricted Fund Balance at Fiscal Year End	\$2,710,284	\$3,736,350	\$4,187,411
Ensuuing Year's Budgeted Appropriations	\$22,020,002	\$22,363,886	\$22,975,776
Unrestricted Fund Balance as a Percentage of Ensuuing Year's Budget	12%	17%	18%

We analyzed the 2015-16 budget and conservatively estimate that the District will not need approximately \$1.4 million of the more than \$1.7 million of fund balance that was appropriated. Once unneeded appropriated fund balance is included in unrestricted fund balance, the District actually exceeds the limit in all three years by amounts

⁷ When fund balance is appropriated towards the next year's budget, the expectation is that results of operations will end the year with a planned operating deficit equal to the amount of fund balance that was appropriated. This allows a district to return excess fund balance that has accumulated in prior years back to the taxpayers.

⁸ Unrestricted fund balance increased by approximately \$1.5 million from July 1, 2012 through June 30, 2015.

ranging from \$4.4 million (20 percent) to \$5.6 million (24 percent) as shown in Figure 3.

Figure 3: Unused Fund Balance			
	2012-13	2013-14	2014-15
Unrestricted Fund Balance at Fiscal Year End	\$2,710,284	\$3,736,350	\$4,187,411
Add: Appropriated Fund Balance Not Used for the Ensuing Year	\$1,681,712	\$1,753,040	\$1,400,000
Recalculated Unrestricted Fund Balance	\$4,391,996	\$5,489,390	\$5,587,411
Recalculated Unrestricted Fund Balance as a Percentage of Ensuing Year's Budget	20%	25%	24%

Furthermore, District officials continued to increase taxes⁹ despite annual operating surpluses. To illustrate, we estimated what the District's fund balance would have been if the tax levy had not been increased during the last four years,¹⁰ but remained at the same level as in 2010-11.¹¹ The outcome shows that taxpayers would have paid approximately \$2.7 million less in taxes with the District's fund balance reduced by an equivalent amount.¹² There still would have been two years of operating surpluses, but the District's unrestricted fund balance would have been reduced to a more reasonable level (6.5 percent of the ensuing year's budget), although still greater than the statutory limit.¹³ In this illustration, the District would have maintained the same amount of reserve balances and would have been able to return a portion of the excess fund balance back to the taxpayers while still providing the same level of instruction and educational services to District students.

District officials have again increased the tax levy for 2015-16 by an additional 2 percent, or \$202,048.¹⁴ We analyzed the 2015-16 budget and the last three completed fiscal years to develop projections of fund balance as of June 30, 2016. Although the District is projected to experience a planned operating deficit of approximately \$276,000 in 2015-16, the unrestricted fund balance will continue to significantly

⁹ Over the last four years, the tax levy has been increased by a total of approximately \$760,000.

¹⁰ 2011-12, 2012-13, 2013-14 and 2014-15 fiscal years

¹¹ The tax levy in 2010-11 was approximately \$8.7 million. In 2014-15, the levy increased to approximately \$9.6 million.

¹² Fund balance would have experienced a reduction of \$2.7 million (from \$9.6 million to \$6.9 million).

¹³ If reserves and appropriated fund balances were unchanged from current levels, unrestricted fund balance would be reduced to \$1.5 million. Unrestricted fund balance as a percentage of the ensuing year's budget would equal 6.5 percent (\$1.5 million/\$23 million). This is still greater than the statutory limit of 4 percent of the next year's budget.

¹⁴ The District did not exceed its tax cap limit.

exceed the 4 percent limit by ending at more than a projected \$3.9 million, or 17 percent of the ensuing year's projected budget.¹⁵

Reserve Funds

School districts may establish reserve funds to retain a portion of fund balance to finance a variety of objects or purposes but must do so in compliance with statutory requirements. When districts establish reserves for specific purposes, it is important that a formal plan be developed for how to fund the reserves, how much should be accumulated in the reserves and when the money will be used to finance related costs. While school districts are generally not limited as to how much money can be held in reserves, balances should 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.

As of June 30, 2015, the District reported five reserves in the general fund totaling approximately \$3.5 million. We analyzed the reserves for reasonableness and adherence to statutory requirements. We found the District properly established all five reserves and reasonably funded the following three reserves: capital (\$1 million), workers' compensation (\$84,010) and unemployment insurance (\$17,163). However, the remaining two reserves totaling approximately \$2.4 million appear overfunded.

Employee Benefit Accrued Liability Reserve (EBALR) — This reserve is authorized for the cash payment of accrued and unused sick, vacation and certain other accrued but unused leave time owed to employees when they separate from District employment. As of June 30, 2015, the EBALR balance was approximately \$1.6 million. However, the District's calculation included costs that cannot be legally included in an EBALR. In addition, it is recommended that the balance in an EBALR should not exceed the long-term portion of the liability for compensated absences. As such, we calculated that the balance should not exceed approximately \$1.4 million, which means this reserve is overfunded by approximately \$225,000 (16 percent).

We also found that the District annually recalculates the amount it intends to reserve in the EBALR and transfers funds from unrestricted fund balance to increase the reserve or improperly reduces the balance by transferring funds from the EBALR to unrestricted fund balance. From July 1, 2012 through June 30, 2014, the District made adjustments that increased the reserve by \$202,000 and in June 2015 transferred approximately \$191,000 back to unrestricted fund

¹⁵ We projected the 2016-17 budgeted appropriations by applying a 2 percent increase to the 2015-16 budget.

balance. Funds that are restricted in an EBALR can only be used toward their intended purpose (such as a terminal leave payout) or through an excess fund certification by our Office. We found no evidence that the funds that were removed were used for EBALR related expenses.

Retirement Contribution Reserve — This reserve is authorized to make contributions for employees covered by the New York State and Local Retirement System. As of June 30, 2015, the balance in this reserve was approximately \$824,000. District officials fund this reserve at an amount equal to almost three years of projected expenditures. This level of funding appears excessive because the Board annually levies taxes for these expenditures (which have averaged approximately \$315,000 per year), rather than budgeting to appropriate reserve funds. As a result, we question if the amount in this reserve is reasonable.

While officials have a documented process to determine the suitable balance for each of the reserves, a written policy has not been adopted by the Board to determine the suitable balance for each of the reserves or when these funds will be used. Additionally, when District officials calculate that a reserve should have its balance reduced, the excess funds are transferred back to unrestricted fund balance, which is not permissible. Furthermore, there is no evidence that officials have used reserve funds for their intended purpose because District officials routinely levy taxes for expenditures that could be funded with money from reserves. For example, in 2014-15 the District budgeted \$790,000 for employee retirement contributions, workers' compensation, unemployment and terminal leave payments to be paid using funds raised through taxes when, at the same time, over \$2.5 million sat in reserves that could have been used towards these payments. If the District intends to continue to levy taxes to pay for expenditures that could be paid for with reserve funds, we question the purpose of maintaining reserves in excess of amounts needed to fund unplanned spikes in the related expenditures.

Recommendations

The Board and District officials should:

1. Develop realistic estimates of appropriations and the use of fund balance in the annual budget.
2. Ensure that the amount of unrestricted fund balance is in compliance with statutory limits and develop a plan to use excess funds in a manner that benefits taxpayers. Such uses could include, but are not limited to:
 - Paying off debt.
 - Financing one-time expenditures.
 - Reducing District property taxes.

3. Develop a written policy indicating how much money will be reserved, how each reserve will be funded and when the balances will be used to finance related costs.
4. Review all reserves at least annually to determine if the amounts reserved are necessary and reasonable. Any excess funds should be transferred to unrestricted fund balance (where allowed by law) or to other reserves established and maintained in compliance with statutory directives.

APPENDIX A

RESPONSE FROM DISTRICT OFFICIALS

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



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January 6, 2016

Jeffrey D. Mazula, Chief Examiner
Buffalo Regional Office
Office of the State Comptroller
295 Main Street, Suite 1032
Buffalo NY 14203-2510

Dear Mr. Mazula:

Please allow this letter to serve as the school district's response to the audit recommendations shared with the district on December 16, 2015.

The district is in agreement with the audit findings and is in the process of preparing a Corrective Action Plan to outline how it will implement the audit recommendations in a positive manner to improve in the area of financial condition.

Sincerely,

Roger J. Klatt
Superintendent of Schools
Royalton-Hartland Central School District

*Royalton-Hartland
High School*

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*Royalton-Hartland
Middle School*

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*Royalton-Hartland
Elementary School*

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APPENDIX B

AUDIT METHODOLOGY AND STANDARDS

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

- We interviewed District officials to gain an understanding of the District's financial management practices.
- We analyzed the most recent three years (2012-13, 2013-14 and 2014-15) of budgeted appropriations and revenues and compared them to actual results. We calculated if there was an operating surplus or deficit for each of these years.
- We reviewed the 2015-16 budget and compared it to the 2014-15 budget. We documented any increases or decreases to selected appropriation and revenues codes. Based upon these comparisons, we identified potential and projected trends.
- We analyzed the District's fund balance for the most recent three years and determined if appropriated fund balance was used as budgeted.
- We evaluated selected appropriation and revenue codes for the most recent three years and compared them to actual results. We identified those that had high over or under budget variances.
- We calculated unrestricted funds as a percentage of the next year's budget. We included both appropriated fund balance and unrestricted fund balance in our calculation because the District has shown a pattern of not using appropriated fund balance.
- We forecasted the amount of unrestricted fund balance that would be available if the District did not increase the tax levy during the last four years (2011-12, 2012-13, 2013-14 and 2014-15) but maintained the same amount as the levy in 2010-11.
- We identified all reserves in place during the last three years and determined if they were properly established.
- We documented the flow of funds in and out of the reserves over the last three years and determined if reserve funds were used toward related expenditures
- We requested substantiation from District officials as to how they calculated the appropriate balances for each of the reserves. We evaluated the balances in the reserves for reasonableness and determined if the calculations appeared proper.

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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