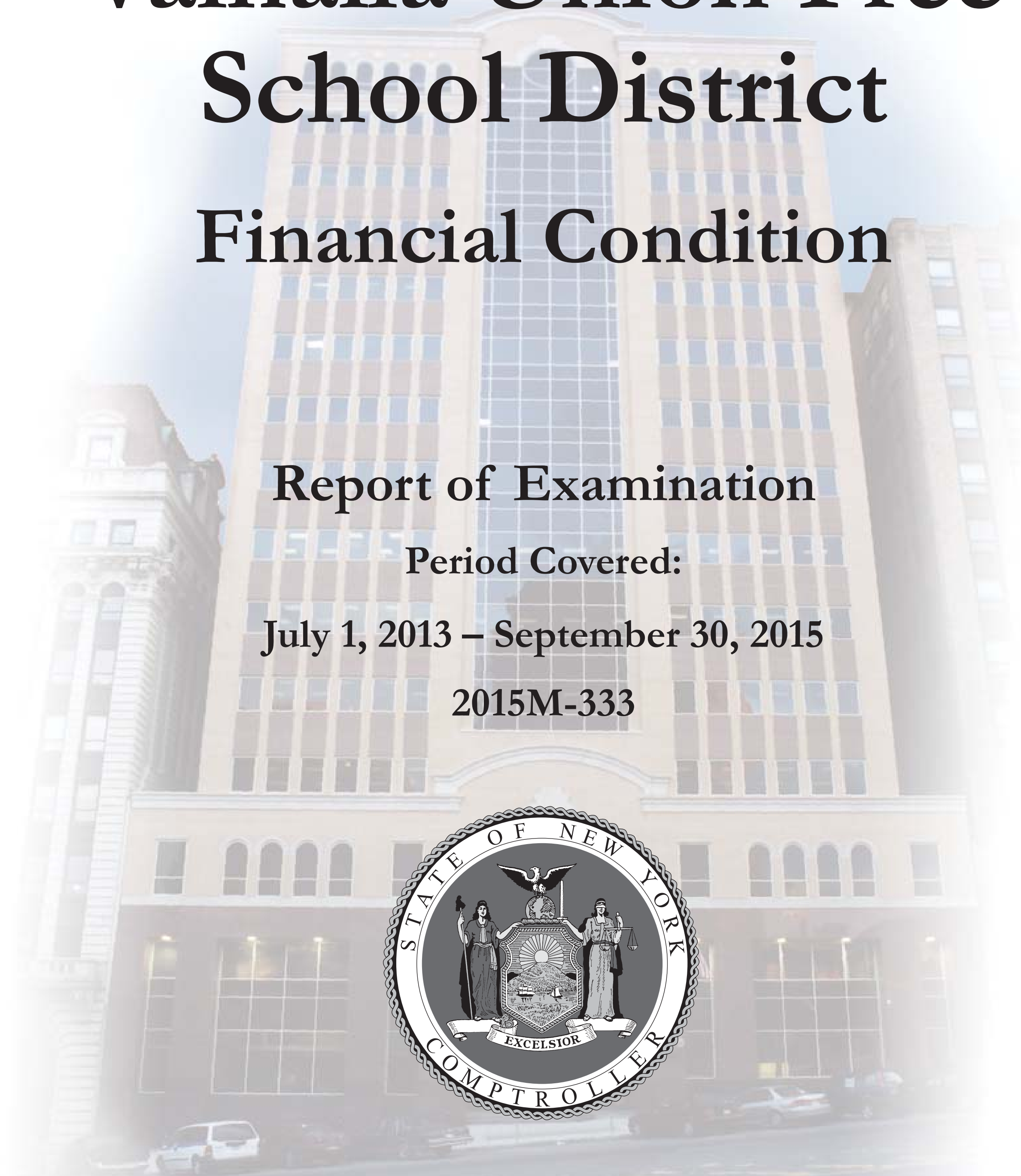
Office of the New York State Comptroller

Division of Local Government
& School Accountability

Valhalla Union Free School District

Financial Condition



Report of Examination

Period Covered:

July 1, 2013 – September 30, 2015

2015M-333

Thomas P. DiNapoli

Table of Contents

State of New York
Office of the State Comptroller

Division of Local Government
and School Accountability

March 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 Valhalla Union Free 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 Valhalla Union Free School District (District) serves parts of the Towns of Greenburgh, Mount Pleasant and North Castle in Westchester 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 day-to-day District management under the Board's direction.

The District operates four schools with approximately 1,520 students and 255 employees. The District's budgeted appropriations for the 2015-16 fiscal year are $47,345,709, funded primarily with real property taxes and State aid.

Objective

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

- Did the Board and District officials effectively manage the general fund balance and reserve funds?

Scope and Methodology

We examined the District's financial condition for the period July 1, 2013 through September 30, 2015. We extended our audit scope back through July 1, 2011 for trend analysis.

We conducted our audit in accordance with generally accepted government auditing standards (GAGAS). More information on such standards and the methodology used in performing this audit are included in Appendix C of this report. Unless otherwise indicated in this report, samples for testing were selected based on professional judgment, as it was not the intent to project the results onto the entire population. Where applicable, information is presented concerning the value and/or size of the relevant population and the sample selected for examination.

Comments of District Officials and Corrective Action

The results of our audit and recommendations have been discussed with District officials, and their comments, which appear in Appendix A, have been considered in preparing this report. District officials disagreed with some of our findings. Appendix B includes our comments on issues raised in the District's response.

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

A school district's financial condition is a determining factor in its ability to provide educational services to students. The responsibility for accurate and effective financial planning rests with the Board members and other District officials and includes the adoption of realistic budgets that are based on historical trends adjusting for known differences. A district may retain a portion of fund balance, referred to as unrestricted fund balance. A district can also reserve portions of unrestricted fund balance to finance future costs for a variety of specified purposes. District officials should ensure that reserve balances do not exceed what is necessary to address long-term obligations or planned expenditures.

The Board and District officials overestimated certain expenditure items for four consecutive fiscal years and underestimated revenues in two of the four fiscal years, creating cumulative operating surpluses of over $7.9 million.[1] In addition, the Board appropriated $650,000 of fund balance in each of the last four fiscal years to finance District operations, which was not used. These surpluses were then used to fund newly established reserves. By preparing budgets that are not based on realistic projections or estimates and on the most current and accurate information available, the Board and District officials retained fund balance more than the amount allowed by law and may have levied more taxes than necessary.

Fund Balance

Fund balance represents funds remaining from prior fiscal years. According to New York State Real Property Tax Law, the Board may retain up to 4 percent of the ensuing year's appropriations as unrestricted fund balance to serve as a financial cushion for unexpected events and to maintain cash flow. Realistic budget estimates and estimates of fund balance levels help the Board ensure that real property tax levies are not greater than necessary. School districts may also establish reserve funds to restrict a portion of fund balance for a specific purpose, in compliance with statutory requirements.

For fiscal years 2011-12 through 2014-15, the District reported that it stayed within the mandatory 4 percent statutory limit for unrestricted fund balance. District officials accomplished this, in part, by transferring the money in excess of the 4 percent limit to fund reserves, as authorized by the Board. However, during the same four-year period, the Board also appropriated $650,000 of fund balance annually to finance District operations in the ensuing year, but did

[1] In 2014-15 the District sold the Columbus Avenue School for $2.1 million, by voter approval, and designated that amount as one-time revenue to fund a newly established capital reserve.

not use it. This allowed the District to circumvent the statutory limit on unrestricted fund balance. After adding back the appropriated fund balance that was not used, the recalculated (actual) amount of unrestricted fund balance at year end ranged from 5.0 to 5.4 percent of the ensuing year's appropriations, as shown in Figure 1.

Figure 1: Fund Balance

	FY 2011-12	FY 2012-13	FY 2013-14	FY 2014-15
Total Unrestricted Funds at Year End	$1,534,212	$1,777,781	$1,849,580	$1,892,577
Add: Appropriated Fund Balance Not Used to Fund Ensuing Year's Budget	$650,000	$650,000	$650,000	$650,000
Total Recalculated Unrestricted Funds at Year-End	**$2,184,212**	**$2,427,781**	**$2,499,580**	**$2,542,577**
Ensuing Year's Budgeted Appropriations	$43,738,071	$45,541,353	$46,280,837	$47,345,709
Recalculated Unrestricted Funds as a Percentage of the Ensuing Year's Appropriations	5.0%	5.3%	5.4%	5.4%

District officials routinely overestimated certain expenditure items in the District's annual budget, resulting in additional funds. During the 2011-12 to 2014-15 fiscal years, personal service costs and employee benefits were overestimated by a total of nearly $7.2 million. The District also underestimated revenues by $630,000 for that period, creating operating surpluses totaling $7.9 million. As shown in Figures 2 and 3, personal service costs were overestimated by $4.5 million (5 percent) and employee benefits by $2.7 million (6 percent) over the four years. Estimates for these expenditure items should be readily available for the Board to make realistic projections, as they are based on employment contracts. Although the Board and District officials knew that certain expenditures had been overestimated in previous budgets, they continued to allocate additional funds to these line items in the 2014-15 budget.

Figure 2: Overestimated Personal Service Appropriations

Fiscal Year	Appropriations	Expenditures	Difference	Overestimated Percentage
2011-12	$21,381,540	$20,138,793	$1,242,747	5.8%
2012-13	$21,525,098	$20,229,005	$1,296,093	6.0%
2013-14	$22,235,376	$20,924,922	$1,310,454	5.9%
2014-15	$22,450,820	$21,810,771	$640,049	2.9%
Total	**$87,592,834**	**$83,103,491**	**$4,489,343**	**5.1%**

Figure 3: Overestimated Employee Benefit Appropriations

Fiscal Year	Appropriations	Expenditures	Difference	Overestimated Percentage
2011-12	$9,451,872	$9,137,386	$314,486	3.3%
2012-13	$10,081,066	$9,367,651	$713,415	7.1%
2013-14	$11,202,108	$10,349,561	$852,547	7.6%
2014-15	$11,550,350	$10,760,853	$789,497	6.8%
Total	**$42,285,396**	**$39,615,451**	**$2,669,945**	**6.3%**

Furthermore, while the Board adopted a budget for the 2014-15 fiscal year that included $650,000 in appropriated fund balance, expenditures were $1,724,646 (3.7 percent) less than appropriated. The 2015-16 budget again included $650,000 in appropriated fund balance, and an increase of $1.06 million, or 2.3 percent, in appropriations over the 2014-15 budget.

District officials cited several factors that contributed to personal service costs and employee benefits being overbudgeted. These include health insurance costs based on the calendar year, which differs from the District's fiscal year (July 1 through June 30), unanticipated contractual obligations to pay teachers two salary steps in one year, no requirement for advance notice of retirements, and uncertain funding of some positions previously paid by federal grants.

While there can be uncertainty due to various factors, District officials should use the most current information available and consider the District's historical expenditures for preparing budgets that are based on realistic projections and estimates. Retaining fund balance in excess of the amount allowed by law can result in tax levies that are higher than necessary.

Reserves

Reserve funds may be established by Board action or voter approval, pursuant to various laws, for specific purposes. The law determines how reserves may be funded, expended or discontinued. Generally, school districts are not limited in how much money they can maintain in reserves, but should maintain reserve balances that are reasonable. Funding reserves at high levels can result in real property tax levies being higher than necessary.

The District currently maintains seven reserves: unemployment, retirement contribution, tax certiorari, property loss, employee benefit accrued liability and two capital reserves. The total balance of the reserves in the last four years has increased from $1.8 million to $8.2 million. For the last four fiscal years ending June 30, 2015, the District generated approximately $7.9 million[2] in operating surpluses, which it used to fund reserves.

We reviewed the reserve funds for adherence to statutory requirements and reasonableness of the balances. Five of the reserves – the tax certiorari, property loss, employee benefit accrued liability and two capital reserves – had balances totaling $6.9 million as of the end of the 2014-15 fiscal year, and were properly established and reasonably funded. However, the balances of two reserves – the unemployment

2 In 2014-15 the District sold the Columbus Avenue School for $2.1 million, by voter approval, and designated that amount as one-time revenue to fund a newly established capital reserve.

insurance reserve and the retirement contribution reserve – were more than the potential costs and had not been used for their established purpose since being established in 2011. These excess funds could be transferred to other legally established reserves, as applicable, or used to reduce the tax levy.

Unemployment Insurance Reserve – New York State General Municipal Law (GML) authorizes the establishment of a reserve to reimburse the State Unemployment Insurance Fund (SUIF) for payments made to claimants. If, at the end of any fiscal year, the money in the reserve exceeds amounts required to be paid into the SUIF, plus any additional amounts required to pay all pending claims, the Board, within 60 days of the close of the fiscal year, may elect to transfer all or part of the excess amounts to another authorized reserve fund or apply all or part of the excess to the budget appropriation of the next fiscal year.

The Board established this reserve in March 2011 and funded it with $200,000. The District incurred a total of $119,870 in unemployment costs over the last four fiscal years, averaging $29,968 annually. However, all of these expenditures were paid directly from general fund appropriations with no use of the reserve funds. The highest payment was $74,164 in 2011-12. The lowest payments were for the last two completed fiscal years (2013-14 and 2014-15), totaling less than $5,500.

District officials told us that the reserve was established to address the District plan of eliminating 17 positions in fiscal year 2011, and that additional unemployment filings by temporary workers were expected in 2015-16. We question the need to maintain a reserve fund balance for this purpose when the associated costs are being paid entirely with operating funds.

Retirement Contribution Reserve – This reserve is for the payment of retirement contributions payable to the New York State and Local Retirement System (NYSLRS). The Board established this reserve in June 2011 and funded it with $693,351 in that fiscal year, and $410,463 in the last completed fiscal year (2014-15), for a total balance of $1.1 million. No reserve money has been used to pay retirement contributions; instead, the District budgeted for these costs in the general fund, using real property taxes to fund them.

The District receives a bill from NYSLRS annually. The latest bill, covering the period April 1, 2014 through March 31, 2015, was for $705,814. With a reserve balance of $1.1 million as of June 30, 2015, the District had sufficient funds to pay at least one and a half years' contributions at the current level. District officials said they established this reserve to help stabilize fluctuations in retirement contribution rates and that they anticipate drawing down the reserve funds starting in the 2016-17 fiscal year to stay within the State's tax cap.

By maintaining reserves with excessive balances and not using them for their established purpose, the Board and District officials have withheld funds from productive use.

Recommendations

The Board should:

1. Develop realistic budgets based on the prior year's actual results and anticipated operating costs and avoid raising more real property taxes than necessary.

2. Use the excess reserve funds identified in this report in a manner that benefits District residents. These purposes include:

   - Using the reserve funds for their established purpose.

   - Transferring excess reserve funds to unrestricted fund balance, where allowed by law, or to other, necessary 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 pages.

VALHALLA
UNION FREE SCHOOL DISTRICT
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Dr. Brenda Myers
Superintendent of Schools

Christina Howe
School Business Official

February 23, 2016

Ms. Tenneh Blamah
Chief Examiner of Local Government and
School Accountability
Office of the State Comptroller
Newburgh Regional Office
33 Airport Center Drive, Suite 103,
New Windsor, New York 12553

Dear Ms. Blamah:

The Valhalla Union Free School District is in receipt of the DRAFT Audit Report, Financial Condition for the period of July 1, 2013 – September 30, 2015. On behalf of the Valhalla UFSD, we would like to thank your team for their professionalism and courtesy during our audit. It was a thorough and extensive process requiring detailed information and documentation. The examiners were always professional and respectful of our staff and the daily work that needed to be completed to keep school running.

The first priority of the Valhalla UFSD is to ensure the consistency and integrity of our educational programs for students while safeguarding our community's resources. We take our fiduciary responsibility to this district and community very seriously and we appreciate the opportunity to continually improve our policies and procedures.

Over the last several years the Board of Education and Administration have taken very specific measures to ensure the fiscal stability and efficiency of the Valhalla UFSD. We have budgeted conservatively and carefully monitored our expenses every year. Specifically, our Teacher and Employee Retirement contributions and Health Insurance costs are unpredictable and fluctuate each year. We have worked collaboratively with our unions to negotiate contracts that were sustainable and to create efficiencies and to conserve resources in order to maintain quality programs for our students. Fiscal stability requires the district to forecast both revenues and expenditures in a highly unpredictable environment.

In the last five (5) years, the District has worked to create a strategic financial plan focused on financial stability. As a result, the District has received a nearly perfect score on the Comptroller's Fiscal Stress Monitoring Indicator that measures "year-end fund balances, operating deficits/surpluses, cash position, use of short-term debt for cash flow and fixed costs" in each of the three (3) years that the measurement has been in place. The District has received recognition of its improved financial position with two (2) Moody's credit rating upgrades which have saved our taxpayers millions of dollars in debt interest payments.

While the comments in the report are taken under advisement, it is of great concern that there seems to be a misinterpretation of the purpose of appropriated fund balance and the calculation of the 4% unappropriated fund balance. There is no language in the law that states that the 4% unrestricted fund balance includes the amount appropriated for reduction of the subsequent year's tax levy (used or unused – *See §1318[1] Real Property Tax Law*). It appears that during this audit a new formula for calculating an unappropriated fund balance was established and used as criteria. The district included in our revenue plan a $650,000 appropriated fund balance to help offset the tax levy to our community. This projected revenue calculation is done on an annual basis and the amount is not cumulative as the report implies. In addition, because our state aid payments are not finalized or received until after June 30th the revenue estimates may be modified because of changes to state aid not because of the appropriated fund balance. For example, within the period of review and just prior, the district received notice from the New York State Education Department (NYSED) that they would be deducting state aid in the amount of $355,388 and $186,050 from monies that were already allocated and spent for educational purposes.

See Note 1 Page 13

See Note 2 Page 13

It is for that and many other reasons such as unanticipated special education enrollments, uncertain and constantly changing state aid formulas; it is our responsibility to be conservative on revenue estimates. In both of the last two decades the State has implemented unanticipated State Aid reductions during recessionary times (i.e. Deficient Reduction in the 1990's and the Gap Elimination Adjustment in the 2000's) that supports the prudence of the District's financial planning strategies.

The Valhalla UFSD has made it a priority to adhere strictly to the laws and regulations of each of our governing agencies and each year working with our external auditors, review and agree to the calculation and amount of the next year's appropriations. The District appropriated $650,000 to be used for the ensuing year's budget. That amount has been a product of both conservative revenue estimates and strict spending monitoring calculated to ensure that we maintain a non-deficit financial position.

It is important to note that the Valhalla UFSD complied with the Property Tax Cap Limit as prescribed by law in each of the years since its enactment, keeping our tax levy at or below the allowable limit each year. In 2013-14, when the State Budget was enacted and state aid revenues for the District were increased, Valhalla UFSD used those additional revenues to reduce the tax levy, coming under the Maximum Allowable Limit by $100,000. The Valhalla UFSD's tax cap levy calculation was audited and approved by the Office of the State Comptroller in 2014-15. The Valhalla UFSD submitted and received approval of their Tax Efficiency Plan affording our residents their tax freeze refund checks in both years.

The Board of Education and Administration has been transparent during board meetings and budget presentations for the past five (5) years to ensure that our community is fully aware of and understands the fiscal constraints that we face. Valhalla UFSD has a multi-year forecast of our budget needs to ensure that even with our unpredictable expenses and a consumer price index (CPI) that falls far below the 2% tax levy cap, we will maintain a consistent levy projection while ensuring the quality programs for our students.

A key strategic principle of public school finance is to ensure the district has enough reserves to maintain fiscal stability long term and to live within the tax-payer's authorized budget. Each year the District articulates our plan for establishment and future use of the reserve funds based on forecasted needs. For example, beginning with the 2016-17 budget process the Valhalla UFSD will implement the use of the Employee Retirement reserve fund in accordance with the financial strategy that was outlined for the community. This will prevent the district from laying off four (4) positions.

In addition, we appreciate the community's support of our financial plan as they voted to establish each of our capital reserve funds which was funded primarily from the $2.1M proceeds from the voter authorized sale of property. The District has and will continue to articulate and include the community in the development of the multi-year plan designated for the use of the Capital Reserve funds. Truthfully, conducting a two year audit of reserve funds seems very short sighted. The district has a long term plan for each reserve fund and these funds are critical to the district's overall financial health as noted in Comptroller's Fiscal Stress Monitoring System.

See Note 3 Page 13

We greatly appreciate the time the examiners took to ensure the fiscal operations of the Valhalla UFSD are sound and in strict accordance with all rules and regulations as required by law. The Valhalla UFSD embraces the opportunity to improve our practices and recognizes that the comments provided in the report are recommendations. We will take them under advisement as we continue to work with our external and internal auditors and our community to continue to maintain the fiscal integrity of the District.

Sincerely,

Dr. Brenda Myers
Superintendent of Schools

APPENDIX B

OSC COMENTS ON THE DISTRICT'S RESPONSE

Note 1

To determine the actual or true amount that represented the total amount of unrestricted fund balance at the end of each year, we added back the fund balance District officials appropriated but did not use. The District's consistent appropriation of fund balance created the appearance of keeping unrestricted fund balance within the statutory limit.

Note 2

We revised the report to state that the Board appropriated $650,000 of fund balance in each of the last four fiscal years.

Note 3

As stated in the report, we reviewed the District's reserve funds for four complete fiscal years up to the end of our fieldwork on September 30, 2015.

APPENDIX C

AUDIT METHODOLOGY AND STANDARDS

Our overall goal was to determine if the Board was accumulating excessive fund balance by overbudgeting appropriations. To accomplish our objective, we interviewed appropriate District officials and staff, tested selected records and examined pertinent documents for the period July 1, 2013 through September 30, 2015. We extended our scope for testing of budgeted appropriations to the 2011-12 fiscal year. Our testing included the following steps:

- We interviewed District officials and staff regarding fund balance and budget appropriations.
- We reviewed Board minutes, adopted budgets for the 2011-12 through 2014-15 fiscal years, contracts, payments, audited financial statements and budget status reports.
- We reviewed District reserve accounts and supporting documentation to determine whether funding levels were appropriate and proper procedures were followed for establishment of those reserves.

We conducted this performance audit in accordance with GAGAS. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

APPENDIX D

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