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July 15, 2010

Donald A. Ogilvie, District Superintendent  
Members of the Board of Education  
Erie 1 BOCES  
355 Harlem Road  
West Seneca, New York 14224

Report Number: S9-9-67

Dear Superintendent Ogilvie and Members of the Board of Education:

A top priority of the Office of the State Comptroller is to help officials manage their resources efficiently and effectively and, by so doing, provide accountability for tax dollars spent to support operations. The Comptroller oversees the fiscal affairs of local governments statewide, as well as 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 operations and governance. Audits also can identify strategies to reduce costs and to strengthen controls intended to safeguard assets.

In accordance with these goals, we conducted an audit of six BOCES throughout New York State. The objective of our audit was to determine if these BOCES have been reserving excessive funds without informing their component and participating school districts. We included the Erie 1 BOCES in this audit. Within the scope of this audit, we examined the policies and procedures of the Erie 1 BOCES, the documentation to support reserve balances, and the reporting to component school districts for the period July 1, 2007 to June 30, 2009. For historical reserve fund activity, we reviewed reserve fund data for the period July 1, 2005 through June 30, 2007.

This report of examination letter contains our findings and recommendations specific to the Erie 1 BOCES. We discussed the findings and recommendations with BOCES officials and considered their comments in preparing this report. At the completion of our audit of the six BOCES, we will prepare a global report that summarizes the significant issues we identified at all BOCES audited.

## Summary of Findings

Our audit found that the Erie 1 BOCES (BOCES) retained \$880,000<sup>1</sup> in reserves that were either overfunded or were such reserves that BOCES does not have statutory authority to establish. These funds were allocated from school district moneys. During our audit period, BOCES used approximately \$4.7 million<sup>2</sup> in budgetary appropriations and surplus to fund four reserves<sup>3</sup> – a workers’ compensation reserve, an unemployment insurance reserve, an employee benefit accrued liability reserve, and retirement incentive reserve – without indicating to its districts that these appropriations and surplus were allocated to reserves. In addition, the workers’ compensation reserve, which included over \$330,000 as of June 30, 2009, and, the retirement incentive reserve, which included over \$300,000 as of June 30, 2009, were both established without statutory authority for these types of reserves. Further, we determined that the June 30, 2008 general fund reserve for encumbrances balance was overstated by at least \$254,469 because the corresponding goods and/or services were not actually ordered or an excessive encumbrance amount was included for blanket purchase orders.

BOCES officials also did not establish adequate policies and procedures for the funding and use of the reserves. BOCES officials created written procedures for some of the reserves; however, these procedures were not Board approved, and with the exception of the Employee Benefit Accrued Liability Reserve, were written during our fieldwork. The CTE equipment reserve fund was not properly established by majority vote from the component school districts, as required by statute, and the activity was not reported to the New York State Education Department.

The failure of BOCES officials to ensure that all reserves were properly established and reasonably funded has increased the risk of the school districts’ moneys not being used in a productive manner and/or in accordance with legal requirements. Further, BOCES’ failure to clearly report reserve allocations to the component and participating school districts has compromised the transparency of BOCES operations and denies the school districts complete knowledge of how BOCES is ultimately using money paid by districts for BOCES services.

## Background and Methodology

BOCES serves 20 component school districts in Erie County. BOCES is governed by a seven-member Board of Education (Board) whose members were elected by the 20 component school districts. BOCES’ operating expenditures totaled \$134.6 million in the 2007-08 fiscal year. These costs are funded primarily by charges to school districts for services and Federal and State grants. New York State Law and the Office of the State Comptroller provide guidance with respect to the establishment, funding, and use of BOCES reserves.

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<sup>1</sup> Includes the Workers’ Compensation Reserve of \$330,000, Retirement Incentive Reserve of \$300,000, and \$250,000 in Excess Reserve for Encumbrance

<sup>2</sup> Includes funding of the following reserves: Workers’ Compensation Reserve of \$840,000, Unemployment Insurance Reserve of \$120,000, Employee Benefit Accrued Liability Reserve of \$3,340,000, and Retirement Incentive Reserve of \$370,000. There was no funding of the CTE Equipment Reserve during audit period.

<sup>3</sup> This excludes Reserve for Encumbrances, which is an accounting designation for funds that are committed for goods or services ordered but not yet received by the end of the fiscal year in which they were ordered. There were no allocations made to the CTE Equipment Reserve.

BOCES' primary function is to provide educational programs and services to component and participating<sup>4</sup> school districts. The Board is responsible for establishing policies and procedures including documented plans for the funding and use of reserves. BOCES has approximately 1,080 employees working at campuses and in schools throughout the region. We examined the minutes of Board proceedings, accounting ledgers, financial statements, BOCES policies and procedures, and other reserve support materials and documentation.

BOCES can legally reserve funds for specific future uses, helping reduce its reliance on operating funds or borrowed moneys. Reserves must be established by Board resolution and in some instances<sup>5</sup> require approval by a majority of the component school districts' Boards of Education. BOCES officials are responsible for developing policies and procedures to ensure that reserves comply with applicable laws, regulations, and good management practices concerning reserve establishment, funding, use, and reporting to the school districts. These policies and procedures should clearly indicate BOCES' plans for reserve funds, including the specific purpose for each reserve and the Board's intended method and level of funding.

We conducted this performance audit in accordance with generally accepted government auditing standards (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 objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

### **Established Reserves**

Education Law and General Municipal Law (GML) define the types of reserves that can be established by a BOCES. Additionally, the law requires reserves to be established by Board resolution and in some instances requires approval by a majority of the component school districts' Boards of Education.

Most reserve funds are established to provide resources for an intended future use. An important concept to remember is that a reserve fund should be established with a clear intent or plan in mind regarding the future purpose, use and, when appropriate, replenishment of funds from the reserve. Reserve funds should not be merely a "parking lot" for excess cash or fund balance. Local governments, school districts and BOCES should balance the desirability of accumulating reserves for future needs with the obligation to make sure taxpayers are not overburdened by these practices. There should be a clear purpose or intent for reserve funds that aligns with statutory requirements.

During the audit period, BOCES maintained five reserve funds that totaled approximately \$8.5 million at June 30, 2009:<sup>6</sup>

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<sup>4</sup> Component school districts (BOCES members) provide most of the funding for BOCES facilities and services. BOCES also serves "participating" school districts which elect to participate in one or more selected BOCES programs and are billed accordingly.

<sup>5</sup> For example, a career and technical equipment reserve

<sup>6</sup> This excludes Reserve for Encumbrances, which is an accounting designation for funds that are committed for goods or services ordered but not yet received by the end of the fiscal year in which they were ordered.

<b>Reserve Title</b>	<b>June 30, 2006</b>	<b>June 30, 2007</b>	<b>June 30, 2008</b>	<b>June 30, 2009<sup>7</sup></b>
Workers' Compensation Reserve	\$107,013	\$128,513	\$148,306	\$331,227
Unemployment Insurance Reserve	\$1,026,571	\$1,083,552	\$1,029,841	\$1,044,030
CTE Equipment Reserve	\$25,690	\$26,243	\$26,645	\$26,873
Employee Benefit Accrued Liability Reserve <sup>8</sup>	\$3,630,435	\$4,114,120	\$5,371,392	\$6,782,741
Retirement Incentive Reserve	\$160,100	\$115,414	\$292,535	\$302,499
<b>Total Reserves</b>	<b>\$4,949,809</b>	<b>\$5,467,842</b>	<b>\$6,868,719</b>	<b>\$8,487,370</b>

BOCES officials established the reserve funds in July 2008<sup>9</sup> by Board resolution and properly accounted for these reserve funds separately. However, the CTE Equipment Reserve was improperly established, as no vote was taken of the component school districts' Boards of Education, as required by statute. In addition, although both were established by Board resolution, BOCES does not have legal authority to establish a workers' compensation reserve or a retirement incentive reserve. Our findings regarding the funding of reserves, disclosure of reserve allocations to the school districts, maintenance of reserve fund balances, and use of the reserve funds are detailed below.

### **Funding Reserves and Disclosure to School Districts**

Any governing board, including a BOCES Board, that is planning to establish and finance reserve funds on a regular basis should develop a detailed written policy that communicates to taxpayers why the money is being set aside, the board's financial objectives for the reserves, optimal funding levels, and conditions under which the assets will be utilized. All reserve fund transactions should be transparent to the public. Reserve funds are typically funded from amounts raised through the annual budget process, transfers from unexpended balances of existing appropriations, and surplus moneys. Ideally, amounts to be placed in reserve funds should be included in the annual budget. By making provisions to raise resources for reserve funds explicit in the proposed budget, the BOCES board gives its school districts and those districts' voters and residents an opportunity to know the board's plan for funding its reserves.

Operating surpluses and/or budgetary appropriations used to fund reserves should be labeled as such and clearly communicated to BOCES' component and participating school districts, and consequently those districts' taxpayers. Although there is no statutory limit on the amount in most reserves, the balances in statutorily authorized reserves should be reasonable and based on intended future expenditures or estimable liabilities. Withdrawals from the reserves should comply with statute and be directly related to the purpose of the reserve.

<sup>7</sup> June 30, 2009 data was unaudited

<sup>8</sup> In BOCES financial records, the Employee Benefit Accrued Liability Reserve (EBALR) is separated into a Contingency Fund Reserve (EBALR for active employees) and a Retiree Health Insurance Reserve (EBALR for retirees, based on accrued and unused leave time).

<sup>9</sup> The original Board resolutions that created the reserves could not be located by BOCES officials.

BOCES allocated \$4.7 million<sup>10</sup> to reserves during our audit period. However, we found that BOCES officials did not clearly report these reserve allocations to its districts during this time or for the prior two-year period July 1, 2005 to June 30, 2007. BOCES officials prepared limited written procedures for the funding and use of moneys allocated to reserves but these procedures were not Board approved, and with the exception of the Employee Benefit Accrued Liability Reserve, were written during our fieldwork. BOCES provides component school district superintendents and business officials with a verbal presentation of BOCES' yearly budget and provides them with supporting written documentation. The supporting documentation includes the balance of the CTE Equipment Reserve; however, no other reserve information, such as other reserve fund balances or reserve fund activity, was provided in the presentation or in the written supporting documentation. Amounts retained by the BOCES for funding reserves were not identified to the component school districts as such. Therefore, these reserve fund allocations were potentially made without the knowledge of component and participating school districts, and consequently those districts' taxpayers.

BOCES officials stated that transfers to reserves are included as budgeted expenditures in each Cooperative Services (CoSer)<sup>11</sup> budget and the Central Administration budget, which they provide to the component and participating school districts<sup>12</sup> prior to the start of the fiscal year. Budgeted allocations to the reserves are included under the benefits expenditure in the Central Administrative budget and under the total expenditures in the individual CoSer budgets. This practice does not clearly indicate that these moneys are allocated to reserves; rather, they appear as budgeted expenditures. In addition, they do not provide a surplus report indicating the cost allocated to that district in the past year's budget, the actual expenditures associated with providing shared services to the district during the year, and any surplus or refund due and payable to that district. Therefore, money allocated to reserves is not clearly identified. Such lack of disclosure compromises the transparency of BOCES operations and denies the school districts complete knowledge of how BOCES is ultimately using money paid by districts for BOCES services.

Some Board members, who represent the 20 component school districts,<sup>13</sup> told us that BOCES business officials provide monthly Treasurer's reports which include information on reserves. However, we reviewed a sample of monthly Treasurer's reports and although these reports included information on transfers to and from reserve accounts, they did not include reserve balances. Board members indicated that they verbally communicate the information on reserves to their component school district superintendents and business officials; however, there is no written documentation of this communication and therefore there is no evidence that all component and participating school districts have knowledge of BOCES' allocations to reserves.

### **Reserve Balances and Use of Funds**

Although there is no statutory limit on the amount in most reserves, the balances in statutorily authorized reserves should be reasonable and based on intended future expenditures or estimable

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<sup>10</sup> Includes funding of the following reserves: Workers' Compensation Reserve of \$840,000, Unemployment Insurance Reserve of \$120,000, Employee Benefit Accrued Liability Reserve of \$3,340,000, and Retirement Incentive Reserve of \$370,000. There was no funding of the CTE Equipment Reserve during audit period.

<sup>11</sup> The main vehicle for BOCES services provided to its school districts. CoSers programs must be approved by the State Education Department (SED).

<sup>12</sup> For the CoSers programs in which they participate

<sup>13</sup> Although the seven Board members represent all 20 component school districts, each originates from one of the BOCES' component school districts.

liabilities. In addition, reserve funds should be accounted for separately and interest earnings should be allocated to the reserves. Also, withdrawals from the reserves should comply with statute and be directly related to the purpose of the reserve.

Expenditures from BOCES reserves were in compliance with statute and directly related to the purpose of the reserve. In addition, BOCES properly accounted for each reserve separately and appropriately deposited interest earnings to each reserve. However, the balances of two reserve funds were not adequately supported with documented funding and use plans.

Unemployment Insurance Reserve – The Board established this reserve in July 2008<sup>14</sup> for funding payments to reimburse the State Unemployment Insurance Fund for actual claims filed. As of June 2009, the balance of this reserve was over \$1 million. During our audit period, BOCES deposited \$120,000 into the reserve, without identifying these moneys as reserve allocations. In addition, although BOCES officials prepared limited written procedures for the unemployment reserve during our fieldwork, BOCES officials do not have a specific documented plan for money in this reserve.

BOCES officials believe the amount in the reserve is appropriate in the event that there was a decrease in demand for services by component school districts, which would result in layoffs and a large increase in unemployment claims and expenses. We found that payments made from this reserve during our audit period (averaging \$99,752 a year) were in compliance with statute and directly related to the purpose of the reserve. We encourage BOCES officials to monitor ongoing expenditures from this reserve and, if appropriate, reduce the balance by transferring excess funds to BOCES operating funds or to another legal reserve as authorized by GML.

CTE Equipment Reserve – This reserve was established by Board resolution in July 2008.<sup>15</sup> However, there was no vote of the component school district's boards of education, as required by statute. While the resolution establishing this reserve does not define its purpose, BOCES officials provided limited written procedures, prepared during fieldwork, for the funding and use of moneys allocated to this reserve, which indicated that the purpose was to purchase future equipment. However, these procedures were not Board-approved. As of June 30, 2009, the balance in this reserve was \$26,873. Since the beginning of July 2005, the reserve has only increased due to interest earned; the reserve has not been used or otherwise funded.

In addition, BOCES officials have not established a specific documented plan for the funding and use of this reserve. Furthermore, according to the New York State Education Department (NYSED), a BOCES who is operating a CTE equipment reserve fund is required to submit report of the financial status of the fund to SED on an annual basis, due on October 1<sup>st</sup>. BOCES officials stated that they had not submitted reports on the CTE equipment reserve to NYSED. If there are any excess funds in this reserve account, with the approval of the BOCES board, they can be distributed to the component districts in proportion to the value of contributions to the fund, as authorized by Education Law.

The BOCES' lack of a specific documented plan for the use of these reserve funds, combined with the failure to report the allocations made to reserves, demonstrates inadequate planning and a lack of transparency in BOCES' reporting to the school districts.

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<sup>14</sup> The Board resolution that originally created this reserve could not be located by BOCES officials.

<sup>15</sup> BOCES officials could not find documentation of the original establishment of the reserve; either by Board resolution or vote of component school districts.

## **Reserve for Encumbrance**

Encumbrances are commitments related to unperformed contracts for goods or services and are intended to help prevent a BOCES from exceeding approved appropriations. In order for BOCES officials to maintain budgetary control and to arrive at an accurate estimate of its uncommitted appropriations, it is necessary to establish an encumbrance when a contract is approved or a purchase is authorized. At the end of the fiscal year, moneys are set aside to carry forward appropriations for these commitments into the next fiscal year so that the following year's budget may be increased by these amounts. These restricted moneys are known as the reserve for encumbrances.

As of June 30, 2008, the BOCES reported reserve for encumbrance was approximately \$4.6 million. We reviewed the supporting documentation for twenty encumbrances totaling approximately \$1.7 million and determined that six, totaling \$254,469 (15 percent), were improperly reported because the goods or services were never ordered, or the amount of the encumbrance carried forward for blanket purchase orders was excessive. This improper recognition of encumbrances caused the total surplus<sup>16</sup> for the fiscal year ending June 30, 2008 to be underreported by at least \$254,469 and reducing the amount refunded to school districts.

## **Statutory Authority**

BOCES cannot create reserves that are not specifically authorized by statute. However, during our audit period, BOCES maintained over \$630,000 in two reserves for which it lacked such authority.

Workers' Compensation Reserve - Currently there is no clear statutory authority for a BOCES to create a Workers' Compensation Reserve. However, BOCES established a Workers' Compensation Reserve by Board resolution in July 2008<sup>17</sup> to pay for workers' compensation claims. During our audit period, BOCES officials allocated \$843,932 to this reserve, without clearly identifying these allocations as reserve funding. BOCES expenditures averaged \$320,708 a year during our audit period. At the conclusion of our fieldwork, the balance in this reserve was \$331,227.

Retirement Incentive Reserve - There is no authority to create a reserve for retirement incentive payments. However, BOCES established a retirement incentive reserve by Board resolution in July 2008<sup>18</sup> and is using this reserve to accumulate money to pay teachers' retirement incentives. During our audit period, BOCES officials allocated \$369,964 to this reserve. BOCES' expenditures from this reserve averaged \$94,357 a year during our audit period. At the conclusion of our fieldwork, the balance in this reserve was \$302,499.

At the conclusion of our fieldwork, the balances in these reserves totaled \$633,726.<sup>19</sup> In the absence of clear statutory authority, BOCES officials should return the moneys in these reserves

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<sup>16</sup> BOCES are not authorized to have unreserved fund balance and therefore any unused funds become surplus and are returned to component school districts.

<sup>17</sup> The Board resolution that originally created this reserve could not be located by BOCES officials.

<sup>18</sup> Ibid.

<sup>19</sup> Includes Workers' Compensation Reserve of \$331,227 and Retirement Incentive Reserve of \$302,499.

to operating funds and apportion the excess funds to the component and participating school districts.

## **Recommendations**

1. The Board and BOCES officials should develop written policies and procedures to ensure that reserve funds are legally authorized and properly established by Board vote in compliance with statutory requirements. These policies and procedures should include a specific plan for the funding and use of reserve funds.
2. The Board should ensure that participating and component districts are properly notified of BOCES' intent to fund reserves. Amounts budgeted for the purpose of funding reserves should be clearly identified.
3. The Board should review BOCES' legally established reserves and determine if the balances are necessary and reasonable. To the extent that they are not, BOCES officials should reduce the reserves to reasonable levels in compliance with statutory restrictions.
4. BOCES officials should analyze year-end encumbrances to ensure that they are reasonable and supported. The Board should ensure that its independent auditors review the accounting for encumbrances as part of their audit.
5. BOCES management should discontinue the use of its workers' compensation reserve and retirement incentive reserve. The funds in these reserves should be returned to operating funds and properly apportioned to the component and participating school districts.

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 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 Clerk's office.

Our Office is available to assist you upon request. If you have any further questions, please contact Ann Singer, Chief of Regional and Statewide Projects, at (607) 721-8310.

Sincerely,

Steven J. Hancox  
Deputy Comptroller  
Office of the State Comptroller  
Division of Local Government  
and School Accountability

## **APPENDIX A**

### **RESPONSE FROM BOCES OFFICIALS**

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

January 22, 2010

[Redacted]

Chief Examiner of Local Government & School Accountability  
295 Main Street, Room 1032  
Buffalo, NY 14203

Dear [Redacted]

This letter is in response to the NYS Office of State Comptroller’s draft report 59-9-67 on BOCES Reserve Funds for the period covering July 1, 2007 through July 30, 2009.

The report included evaluation of Erie 1 BOCES reserve funds and is part of a statewide evaluation on how BOCES operates their reserves.

Listed below are Erie 1 BOCES (E1B) responses to the five recommendations listed in the draft audit report:

Recommendation

1. The Board and BOCES officials should develop written policies and procedures to ensure that reserve funds are legally authorized and properly established by Board vote in compliance with statutory requirements. These policies and procedures should include a specific plan for the funding and use of reserve funds.

**Implementation Action(s)**

Erie 1 BOCES Board of Education will develop written policies and procedures detailing how all properly established reserve funds will be funded and maintained.

**Implementation Date:** These policies will be approved by the Board of Education and procedures to implement these policies will be established by June 30, 2010.

**Person Responsible for Implementation:** Director, Finance Services/Board of Education

Recommendation

2. The Board should ensure that participating and component districts are properly notified of BOCES’ intent to fund reserves. Amounts budgeted for the purpose of funding reserves should be clearly identified

**Implementation Action(s)**

Erie 1 BOCES Board of Education will develop a communication plan to ensure that component districts are notified in writing, at least annually, of the most current balances in the properly authorized reserve funds and how they are being funded.

**Implementation Date:** These policies and procedures will be established by June 30, 2010.

**Person Responsible for Implementation:** Director, Finance Services/Board of Education

Recommendation

3. The Board should review BOCES' legally established reserves and determine if the balances are necessary and reasonable. To the extent that they are not, BOCES officials should reduce the reserves to reasonable levels in compliance with statutory restrictions.

**Implementation Action(s):**

Erie 1 BOCES Board of Education will review the balances of each reserve on an annual basis to determine if the balances are necessary and reasonable. If necessary, adjustments will be made by the Finance Office to ensure the reserve levels are in compliance with statutory restrictions.

**Implementation Date:** These policies and procedures will be established by June 30, 2010.

**Person Responsible for Implementation:** Director, Finance Services/Board of Education

Recommendation

4. BOCES officials should analyze year-end encumbrances to ensure that they are reasonable and supported. The Board should ensure that its independent auditors review the accounting for encumbrances as part of their audit.

**Implementation Action(s):**

Erie 1 BOCES will review and analyze year-end encumbrances to ensure that proper documentation is maintained to support the encumbrances. The independent auditor does currently review the encumbered purchase orders, however, he will be asked to look at them more carefully.

**Implementation Date:** These policies and procedures will be established by June 30, 2010.

**Person Responsible for Implementation:** Director, Finance Services/Board of Education

Recommendation

5. BOCES management should discontinue the use of its unauthorized worker's compensation reserve and retirement incentive reserve. The funds in these reserves should be returned to operating funds and properly apportioned to the component and participating school districts.

**Implementation Action(s):**

Erie 1 BOCES would like further clarification on whether a workers' compensation reserve is authorized to operate by a BOCES. Section 6-J of the General Municipal Law clearly identifies in paragraph 5 "Board of Cooperative Education Services" as an entity under this

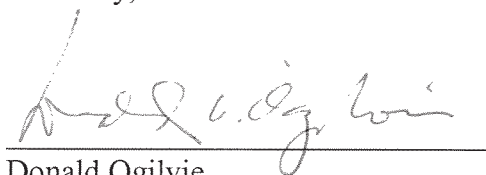
section in law. It is this language in the law that makes it confusing. If possible, we ask that the language in the law be amended to clarify/identify a Board of Cooperative Education Services as authorized to establish and maintain such a reserve. Our request is based on the premise that every other municipal corporation, town, village, and school district in New York State is allowed to have such a reserve established and that the omission of BOCES from the law was an oversight.

See  
Note 2  
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**Implementation Date:** BOCES will discontinue the use of any unauthorized reserves. Any funds in unused reserves as of June 30, 2010 will be returned to the districts.

**Person Responsible for Implementation:** Director, Finance Services

Sincerely,



Donald Ogilvie  
District Superintendent

Comptrollers 59-9-67 report

## **APPENDIX B**

### **OSC COMMENTS ON BOCES' RESPONSE**

#### Note 1

To further promote transparency regarding their reserves, BOCES officials should ensure that their written communication to component school districts clearly identifies all the amounts intended to be used to fund reserves so that districts' taxpayers, as well as school districts, are aware of the fiscal impact of funding BOCES reserves.

#### Note 2

Placing money in a reserve for Workers Compensation by a BOCES is currently not authorized by statute. BOCES can choose to pursue changes to the statute through the State Legislature.