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July 15, 2010

Jacklin Starks, District Superintendent  
Members of the Board of Education  
Madison-Oneida BOCES  
4937 Spring Road  
Verona, New York 13478

Report Number: S9-9-65

Dear Superintendent Starks 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 Madison-Oneida BOCES in this audit. Within the scope of this audit, we examined the policies and procedures of the Madison-Oneida 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 Madison-Oneida 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 Madison-Oneida BOCES (BOCES) retained \$7.3 million<sup>1</sup> in overfunded or unauthorized reserve funds allocated from school district moneys. During our audit period, BOCES used \$274,081 in budgetary appropriations to fund two of its three reserves – an unemployment reserve and a post-retirement benefit accrual reserve – without indicating to its districts that these appropriations were allocated to reserves, instead including them within budgeted expenditures. Further, BOCES officials established the post-retirement benefit accrual reserve, which included over \$6 million as of June 30, 2009, and used it to pay for retiree health insurance benefits without any statutory authority for this type of reserve.

BOCES officials also did not establish policies and procedures for the funding and use of the reserves. The unemployment reserve fund, which had a balance of \$674,000 at June 30, 2009, exceeded the Board's approved balance limit. The Employee Benefit Accrued Liability Reserve (EBALR) fund's balance of \$1.3 million was not realistic and, further, this reserve had no activity during the audit period. Finally, while BOCES officials appropriately allocated interest earned to the unemployment reserve during the period reviewed, they did not allocate interest to the EBALR during that time, but began doing so only in the 2008-09 fiscal year.

The failure of BOCES officials to ensure that all reserves were authorized by statute 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 nine component school districts in Madison and Oneida Counties. BOCES is governed by a nine-member Board of Education (Board) whose members represent the nine component school districts. BOCES' operating expenditures totaled \$60.9 million in the 2007-08 fiscal year. These costs are funded primarily by charges to school districts for services and Federal and State grants or aid. New York State Law and the Office of the State Comptroller provide guidance with respect to the establishment, funding, and use of BOCES reserves.

BOCES' primary function is to provide educational programs and services to component and participating<sup>2</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 780 employees working at two 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.

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<sup>1</sup> Includes the unauthorized post retirement health insurance reserve of \$6.4 million, the overfunded amount of the employee benefits accrued liability reserve of \$247,000, and the unemployment reserve balance in excess of BOCES' board-approved cap by \$624,000

<sup>2</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.

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>3</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 three reserve funds that totaled approximately \$8.4 million at June 30, 2009 (prior to year-end adjustments):

	June 30, 2006	June 30, 2007	June 30, 2008	June 30, 2009 <sup>4</sup>
Employee Benefit Accrued Liability Reserve	\$1,284,370	\$1,284,370	\$1,284,370	\$1,296,881
Unemployment Reserve	\$612,758	\$666,183	\$695,712	\$673,754
Post-Retirement Benefit Accrual Reserve	\$6,189,654	\$6,831,686	\$6,346,523	\$6,426,847
<b>Total Reserves</b>	<b>\$8,086,782</b>	<b>\$8,782,239</b>	<b>\$8,326,605</b>	<b>\$8,397,482</b>

BOCES properly established all three of the reserve funds by Board resolution and properly accounted for all reserve funds separately. However, BOCES has no legal authorization to

<sup>3</sup> For example, a career and technical equipment reserve. The Madison-Oneida BOCES does not have this type of reserve.

<sup>4</sup> June 30, 2009 data was unaudited and does not include year-end adjustments and transfers to reserves.

establish a post-retirement benefit accrual to be used for retiree health insurance. Our findings regarding the funding of these 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 monies. 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 clearly 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.

BOCES allocated \$274,081 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 of July 1, 2005 to June 30, 2007. In addition, BOCES does not have any policies, procedures or written plans for the funding and use of moneys allocated to reserves.<sup>5</sup> BOCES reported to each district 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. However, the amounts retained by the BOCES for funding reserves were not clearly identified as such, but instead were factored into the total expenditure amounts presented to the districts. 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 detailed Cooperative Services (CoSer)<sup>6</sup> budget, which they provide to the component and participating school districts<sup>7</sup> prior to the start of the fiscal year, and are also allocated from surplus. Allocations to the unemployment reserve are shown as a budgeted unemployment insurance expenditure in some of the individual CoSer budgets, and allocations to the post-retirement accrued liability reserve (which was established without statutory authority) are made from surplus. This practice does not clearly indicate that these moneys are allocated to reserves;

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<sup>5</sup> With the exception of a methodology for transferring funds to the post-retirement accrued liability reserve, which BOCES is not legally authorized to have (see Unauthorized Reserve section)

<sup>6</sup> The main vehicle for BOCES services provided to its school districts. CoSers programs must be approved by the State Education Department (SED).

<sup>7</sup> For the CoSers programs in which they participate

rather, they appear as budgeted expenditures. Such lack of disclosure compromises the transparency of BOCES operations, denying the school districts complete knowledge of how BOCES is ultimately using money paid by districts for BOCES services.

Some Board members, who represent the component school districts, told us that BOCES business officials are verbally communicating with them regarding reserves, but there was no written documentation of this communication, and therefore 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 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. However, the balances of the reserve funds were not adequately supported with related liability calculations. We also found that, while BOCES officials deposited interest earnings appropriately to the unemployment reserve, they did not begin doing so for the interest earned on funds in the EBALR until the 2008-09 fiscal year.

Employee Benefits Accrued Liability Reserve – This reserve was established in May of 2000, at which time \$1,284,370 was transferred to it. While the resolution establishing this reserve does not define its purpose, BOCES officials indicated to us that it was created per GML for paying employees' accrued leave when they separate from BOCES employment. As of June 30, 2009 (prior to year-end adjustments), the balance in this reserve was \$1,296,881.<sup>8</sup> Since it was established, the reserve has not been used or funded further, but has remained at a constant balance until the 2008-09 fiscal year when BOCES began depositing interest proceeds into the reserve. We estimate that the additional interest earnings which should have been previously deposited to the reserve during the audit period total approximately \$26,000.<sup>9</sup> Instead, these interest earnings were used as a funding source for BOCES operations.

While BOCES officials indicated they plan to deduct actual leave payments from this reserve, they have not established a specific documented plan for its funding and use. BOCES supports this reserve balance with a calculation for employee leave time payments, which uses the maximum rate<sup>10</sup> at which accrued sick leave days can be paid; as of June 2009, this calculation totaled \$1,049,807. Therefore, the reserve was overfunded by at least \$247,074. However, using the maximum rate to determine the valuation of sick leave for all employees in the calculation is

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<sup>8</sup> Original reserve deposit of \$1,284,370 plus interest added in the 2008-09 fiscal year of \$12,511, for a total of \$1,296,881

<sup>9</sup> For this calculation, we used a conservative interest rate of 2 percent, compounding annually. This interest rate was used to reflect the average interest rates for three-month certificates of deposit during the audit period; we obtained interest rate information from the Federal Reserve Statistical Release.

<sup>10</sup> BOCES collective bargaining agreements allow employees with ten years of service, who retire in their first year of retirement eligibility, to receive \$27 per unused sick day. Employees with ten years of service who retire after their first year of retirement eligibility receive \$17 per unused sick day.

not reasonable, as sick leave would only be paid at this rate to employees with ten years of service who retire in the first year of retirement eligibility. The BOCES' liability calculation includes employees who are past their first year of retirement eligibility (over age 62) and therefore would be paid at the lower daily rate. In addition, the liability calculation includes employees who are not currently entitled to any payment, as they have not reached ten years of service. The BOCES should review its calculation for this reserve and ensure it only includes actual payable amounts. The excess reserve funds can be transferred only to another legal reserve, as authorized by GML.

Unemployment Reserve – The Board established this reserve in 1977 for funding payments to reimburse the State Unemployment Insurance Fund for actual claims filed. A Board resolution dated December 1977 specifically states that the maximum amount for this reserve is to be \$50,000. However, the balance as of June 2009 (prior to year-end adjustments) was approximately \$674,000. BOCES officials could not provide any additional Board resolutions allowing an increase beyond the \$50,000 cap. BOCES has deposited into the reserve approximately 0.5 percent of actual salary expenditures from the general and Federal funds, and budgeted the added amounts as expenditures for unemployment insurance without identifying these moneys as reserve allocations. These allocations totaled \$56,863 during the audit period. In addition, during our audit fieldwork, BOCES officials did not have a specific documented plan for money in this reserve. Subsequent to the completion of our fieldwork, the Director of Finance e-mailed us a calculation of how many staff members' unemployment costs<sup>11</sup> could be funded from the reserve balance as of June 30, 2009. However, this calculation does not serve as an adequately documented plan for how the BOCES intends to fund the reserve and to what level.

BOCES officials believe the amount in the reserve is appropriate in the event that funding is discontinued to all BOCES or to a particular CoSer program, 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 \$35,000 a year) were in compliance with statute and directly related to the purpose of the reserve. However, without a Board resolution to modify the existing maximum balance allowed for this reserve, BOCES is not in compliance with its own policy. We also 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.

The BOCES' lack of a documented plan for the use of these two reserve funds – combined with the failure to report the allocations made to reserves, adequately justify the related liability, or follow Board policy regarding balance limits – demonstrates inadequate planning and a lack of transparency in BOCES' reporting to the school districts.

### **Unauthorized Reserve**

Currently there is no statute under GML or Education Law allowing the creation of a reserve for post-retirement health insurance premiums. However, BOCES established a post-retirement benefit accrual reserve by Board resolution in July 1995 and is using this reserve to accumulate money to pay for employees' post-retirement health insurance. During our audit period, BOCES

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<sup>11</sup> The calculation indicated that BOCES could fund the maximum unemployment insurance benefit to 63 staff members (\$405 per week for 26 weeks).

officials allocated \$217,218 to this unauthorized reserve without clearly identifying these allocations as reserve funding.

BOCES' expenditures from this reserve totaled \$741,000 during our audit period.<sup>12</sup> At the conclusion of our fieldwork, the balance in this reserve was over \$6 million. BOCES officials should return the moneys in this unauthorized reserve 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. BOCES officials should ensure that interest is appropriately allocated to reserve funds according to statutory requirements.
4. 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.
5. BOCES management should discontinue the use of its unauthorized post-retirement health insurance reserve. The funds in this reserve 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.

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<sup>12</sup> Expenditures for the 2008-09 fiscal year had not been recorded as of the end of fieldwork.

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**

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

MADISON-ONEIDA  
BOARD OF COOPERATIVE EDUCATIONAL SERVICES

*"Enabling Learners to Excel"*

4937 Spring Road, P.O. Box 168  
Verona, New York 13478-0168  
Phone 315-361-5510, Fax 315-361-5517

February 17, 2010

CONFIDENTIAL

[REDACTED]  
Office of the State Comptroller  
Division of Local Government and School Accountability  
Statewide and Regional Projects  
295 Main Street, Room 1050  
Buffalo, NY 14203-2510

Dear [REDACTED]

This letter sets forth our response to the draft report of examination letter ("the draft report"), as it was revised after the exit conference. We appreciate the consideration given to our comments during and after the exit conference, as reflected in the revised draft. There remain areas where our assessments differ from the Comptroller's, and we have tried to explain these below.

During the exit conference, we were advised that the audit did *not* find this BOCES to be in violation of any law or regulation. *We respectfully request that the final audit report include that statement.*

See  
Note 1  
Page 19

Your office conducted an audit of our operations about a year ago, and the report prepared after that audit contained no criticism of our reserve funds. We understand that you thereafter selected a total of six boards of cooperative educational services, including Madison-Oneida BOCES, to be examined as part of a state-wide review of reserve funds managed by boards of cooperative educational services.

See  
Note 2  
Page 19

The revised draft report shared with us states that the objective of your state-wide audit was to determine: (1) whether boards of cooperative educational services have been reserving "excessive" funds, and (2) whether boards of cooperative educational services have been doing so "without informing their component and participating school districts."

We have some general comments about how these global objectives are reflected in the revised draft report, and we also respond to your statements regarding the three reserve funds created by our board of education: an unemployment benefits reserve fund, an employee benefits accrued liability reserve fund, and an accrual for retiree health insurance.

## Transparency in Audit Standards

With respect to the first objective of the audit – determining whether boards of cooperative educational services have reserve funds that are “excessive” - we were told that the Comptroller does not have specific guidance on what is “excessive.” In other words, there is no transparent standard that boards of cooperative educational services can know in advance. Under this circumstance, as your prior published audit reports have recorded, school districts and boards of cooperative educational services have relied on the professional guidance of their independent external auditors. It was troubling, therefore, to hear during the exit conference that the Comptroller would not necessarily consider it “reasonable” for a board of education to rely on the opinion of the independent external auditor. The Legislature has directed that school districts and boards of cooperative educational services retain (and pay for) the professional services of both an external auditor and an internal audit function, and it presumably expects school district and BOCES officials to be guided by the professional advice for which they are paying.

See  
Note 3  
Page 19

See  
Note 4  
Page 19

The revised draft report does not use the word “excessive” to describe any of the three reserve funds maintained by this BOCES. It does use the words “not realistic” and “not reasonable” when discussing the employee benefits accrued liability reserve (EBALR) fund; but, when we asked what the Comptroller would consider “realistic” or “reasonable,” we were told there is no “set in stone” rule for determining this. During the exit conference the field audit team did not identify any particular laws, regulations, generally accepted accounting principles, or other published guidance they had used to evaluate our operations during the audit period. We believe that the standards by which the Comptroller measures performance should be more transparent.

See  
Note 5  
Page 19

See  
Note 6  
Page 19

Against this background, it appears to us that many of the comments in the draft report simply reflect a difference in professional opinion between the Comptroller’s staff and our independent external auditor, who regularly reviews these reserve funds with the Board’s Audit Committee. This seems to be acknowledged by the revised draft report on page 6, where it “encourages” BOCES to reduce the balance of the unemployment insurance benefits reserve only if, and to the extent that, our Board considers it “appropriate.”

See  
Note 3  
Page 19

## Standard of Transparency for BOCES Financial Reporting

Our concern with the second objective of the audit – determining whether boards of cooperative educational services have managed their reserve funds “without informing their component and participating school districts” – is that there are very specific existing standards for boards of cooperative educational services to follow, but the revised draft report seems not to recognize them.

The Legislature has addressed in detail the nature of the BOCES budgeting process, the role of component districts in that process, BOCES accounting, and the appropriate degree of financial reporting by boards of cooperative educational services. This has

been done in Education Law Sections 1950 and 1951. There are also Regulations of the Commissioner of Education, and, as required by Section 1951, a uniform system of accounts promulgated by the Commissioner in consultation with the Comptroller. A board of cooperative educational services that has complied with these standards of financial reporting and “communications with ... districts” has acted “adequately”, as defined by the Legislature and the Commissioner of Education.<sup>1</sup>

The revised draft report regarding the Madison-Oneida BOCES does not reflect any assessment by the audit team as to whether this BOCES was in compliance with the existing standards during the audit period. Therefore, during the exit conference, we asked the audit team whether it could point to any provision of these laws or regulations, or any other bulletin or guidance document issued by the Comptroller or Commissioner of Education, that was violated by this BOCES. We were told it could not.

Section 1950 requires that after each year’s operations BOCES prepare a report that shows for each school district that contracted for services, the district’s initial contracted amount, the cost of providing that service to that district, and the amount of surplus to be refunded to the district or additional charges due from the district to BOCES to balance that account. The revised draft report notes on page 4 that BOCES complies with this requirement. However, the revised draft report goes on to say that “the amounts retained by the BOCES for funding reserves were not clearly identified as such.” We have four comments regarding this statement:

See  
Note 7  
Page 20

- There is no requirement in Education Law, Commissioner’s Regulation, or the uniform system of accounts endorsed by the Comptroller that BOCES identify to a component or participating district those amounts retained by the BOCES to fund reserves, and the revised draft report does not identify any source for such an expectation other than the opinion now being expressed by the Comptroller;
- The primary cost of providing services to districts is the cost of employing staff; the cost of unemployment benefits, employee benefit accrued liability, and post-retirement health insurance is directly attributable to the employment of staff to provide services to a school district in any given year; and, therefore, amounts allocated to reserves to meet these expenses are properly “factored into the total expenditure amounts” for providing services to districts<sup>2</sup>;
- We were advised during the exit conference that the Comptroller “certainly” wasn’t creating a requirement that all cost components (e.g. utilities, rent, consumable materials, salaries, statutory benefits, etc.) be separately communicated to districts, but the audit team was unable to explain why this particular cost component (reserve allocations) should be separately communicated; and

See  
Note 7  
Page 20

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<sup>1</sup> We recognize, of course, that, if the Comptroller finds these standards inadequate, then the State Administrative Procedures Act provides a process for the Comptroller to adopt additional regulations.

<sup>2</sup> As expressed in several responses to other Comptroller audit reports, there is no “surplus” until after all expenses, including reserve fund allocations, have been accounted for.

- The Comptroller has previously stated that a BOCES may allocate money to a reserve fund “from operating surpluses available at the end of the fiscal year” (Monroe 2-Orleans BOCES, 2009M-219), and the amount of such a transaction, by definition, will not be known when the program budget is prepared.

See  
Note 8  
Page 20

We wish to correct the statement on page 4 of the revised draft report that “transfers to reserves are included as budgeted expenditures in each detailed Cooperative Services (CoSer) budget and the Central Administration budget, which [BOCES] provide[s] to the component and participating school districts prior to the start of the fiscal year.”

See  
Note 9  
Page 20

First, transfers to the EBALR and retiree health insurance reserves are *not* included as budgeted expenses in the program budgets, nor are they shown as budgeted expenses in the administrative budget, and we do not believe that we indicated otherwise. Second, non-component participating districts do not see the administrative budget, per the procedures established by Section 1950.

We also wish to correct the statement on page 4 of the revised draft report that “allocations to the post-retirement accrued liability reserve ... are shown as a retiree insurance expenditure in the Central Administration budget.” The only retiree health insurance expense included in the administrative budget is the anticipated expense to be incurred during the fiscal year in question to pay for that year’s health insurance premiums on behalf of current retirees. This is required by Commissioner’s Regulation 170.3. That regulation is very detailed regarding the components of the BOCES administrative budget, and it does not require that the administrative budget include anticipated transfers to reserve funds.

See  
Note 10  
Page 20

Under Education Law Section 1950, component districts are directly involved in the development of the program budgets and are, therefore, quite familiar with the cost structure of the services. The school boards of component districts also vote on the BOCES administrative budget, and the Madison-Oneida BOCES annually makes presentations to the school boards of component districts to gain their support for the administrative budget. We believe that our communications with component districts comply with not only the letter of the law, but the spirit of transparency the Comptroller espouses. As noted in the draft report, our board of education is composed of one representative from each component school district, and each existing reserve fund was created by affirmative action of the board. In addition, our District Superintendent meets monthly with the school superintendents of the component districts, and our Director of Finance meets monthly with the business officials of the component districts, to discuss matters of program and finance.

See  
Note 11  
Page 20

Education Law Section 1950 also describes the information that the Legislature considered adequate to enable component districts to decide whether they wished to purchase a particular service from a particular BOCES, viz. a local “unit cost ... based upon a uniform methodology approved annually by at least three-quarters of the participating component school districts after consultation by local school officials with their respective boards.” As mentioned above, our BOCES follows this transparent procedure to develop the program budget for each service, and each component district has an equal “voice” and complete information for making informed decisions about whether to purchase a particular service.

See  
Note 11  
Page 20

The revised draft report regularly refers to “participating districts,” i.e. those school districts that are not components of the Madison-Oneida BOCES but choose to purchase a service offered by this BOCES (cross-contract). Under Education Law Section 1950, these “participating districts” are not responsible for paying any part of the administrative budget for this BOCES, and therefore have no need for any information about what goes into the budget. Nor has the Legislature given them any role in the development of our program budgets.<sup>3</sup> “Participating districts” are informed of the unit cost for purchasing a particular service from this BOCES. We submit that this is all the information that a non-component district needs to make an informed decision about whether to spend its money to provide the service itself, purchase the service from another BOCES, or purchase the service from this BOCES.<sup>4</sup>

See  
Note 12  
Page 20

In view of this pattern of collaborative interactions with our component districts, and BOCES’ acknowledged compliance with existing legal requirements:

- we consider the revised draft report to be incorrect when it states that BOCES denies component or participating districts the information they need to make an informed decision about how to spend their money;
- we believe the phrase “BOCES’ failure to adequately report reserve allocations” should be removed from the Summary of Findings; and
- we believe the finding that “BOCES officials did not adequately report these reserve allocations to its districts” should be removed from the section on Funding Reserves and Disclosure to School Districts.

See  
Note 13  
Page 21

See  
Note 14  
Page 21

Furthermore, if the final report retains the Recommendation that “[t]he Board should ensure that ... districts are properly notified,” then we ask that the final report also identify the law, regulation, or published standard that defines “proper” notification so our Board can understand what action to take.

### Unemployment Insurance Reserve Fund

We appreciate the recognition in the draft report that this fund was authorized by existing law, properly created by Board resolution, properly allocated all interest earnings, and not used for any inappropriate expenditures.

We acknowledge that the 1977 Board resolution creating the fund set an upper limit of \$50,000 on the funding of the reserve. After consultation with our independent auditor, the Board will reexamine the authorized funding level. The reexamination will take into account at least: (1) the inflation-adjusted value of 1977 dollars, (2) the expansion since 1977 of unemployment benefits payable to each claimant, and (3) the expansion of the

<sup>3</sup> We note, however, that Madison-Oneida BOCES hosts a Regional Information Center (RIC) serving 52 school districts, and the program budgets for RIC-based services are developed by a committee that includes school superintendents from each of the three BOCES regions served by the RIC.

<sup>4</sup> No year-end allocation to reserves has ever resulted in a district paying a higher unit cost than was quoted at the beginning of the fiscal year.

BOCES workforce from approximately 200 employees to approximately 780 and the attendant increase in risk. Our preliminary calculations are that the 1977 value of \$50,000 is equivalent to a 2009 value of \$180,500, and applying a multiplier of 3.9 to reflect the increased workforce will produce a figure of \$703,950, or about 4.4% more than the June 2009 balance.

Keeping in mind that BOCES pays all unemployment benefits dollar-for-dollar, we calculate that the current balance in the fund would be exhausted after paying 26 weeks of benefits to 63 claimants. Given well-publicized pressures on the State budget, and the particular targeting of school spending, we believe it is not unrealistic to base our risk assessment on such a possibility. However, our Board will review this reserve, as recommended by the draft report.

### Employee Benefits Accrued Liability Reserve (EBALR) Fund

We appreciate the recognition in the draft report that this fund was authorized by existing law, properly created by Board resolution, and is currently being correctly allocated all interest earnings.

We note the Comptroller's concern that the Board resolution creating the fund did not fully spell out the purpose of the fund. We presume that the Board who adopted the resolution felt that using the same title as Section 6-p of the General Municipal Law sufficiently linked the fund to the purposes described in the statute. We anticipate that a supplemental resolution making this link explicit will be adopted by the Board in the near future.

The draft report refers to the current balance of this fund as "unrealistic." We were advised during the exit conference that the audit team knows of no generally accepted standard for calculating a "realistic" EBALR fund. Our Board has chosen to fund the reserve based on the conservative assumption that the maximum amount of benefits will be claimed, and this approach has been supported as reasonable by our independent auditor. Our Board is also aware of the historical experience that many people retire shortly after July 1, in order to receive separation payments for the additional vacation days and sick leave credited to their accounts on that date, meaning that risk assessments based on June 30 data (such as your audit) understate the potential liability.

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We acknowledge that interest earned by the funds prior to July 1, 2008 should have been added to the reserve, as is now done. The revised draft report states that the interest earned prior to that date was "used as a funding source for BOCES operations" (page 5). We believe that this statement should be changed to read, "used as a funding source for the BOCES administrative budget, thereby reducing the payments required from the component school districts (and their taxpayers) to fund the administrative budget."

### Protecting Taxpayers and Retirees From Escalating Health Care Costs

The Madison-Oneida BOCES has set aside money in a reserve fund to help meet future obligations to pay health insurance premiums on behalf of retirees, commonly called an Other Post-Employment Benefits (OPEB) reserve. Over the past two years, the

Comptroller has released final audit reports revealing that many other school districts and boards of cooperative educational services are currently holding some form of OPEB reserve. In each report, the Comptroller has noted that there is no explicit statutory authorization for an OPEB reserve, as this draft report does; and, in each such case, the audited entity has responded that it considered such a reserve to be not only prudent but also necessary. Madison-Oneida BOCES now joins that group.

Our decision to reserve funds for OPEB expenses is entirely consistent with the Comptroller's 2008 Report on "GASB 45: Reporting the True Cost of Other Post-Employment Benefits" ("the 2008 Report") and the recommendations of our independent external auditor. As substantiated by the 2008 Report, the unavoidable facts are that: (1) local governments such as the BOCES have legally-binding obligations to pay health insurance benefits for retirees, (2) the cost of health insurance premiums has historically increased faster than the general cost of living, and is expected to continue doing so, and (3) the number of retirees is increasing rapidly, as baby boomers leave the workforce, and retirees are living many years after retirement. We agree strongly with the Comptroller's statement in the 2008 Report that "[g]overnments should develop plans to address these costs [and] move thoughtfully but deliberately toward developing options to ... fund these costs."

As you know, BOCES is now required to conduct an actuarial study of its liability for OPEB, and to report that figure on its financial statements. This requirement is found in Statement 45 of the Governmental Accounting Standards Board (GASB). As the Comptroller summarized in the 2008 Report:

The annual OPEB expense to be reported by most employers will be based on actuarially determined amounts rather than on the "pay-as-you-go" method currently followed by most public entities...the OPEB information provided in the notes to financial statements must include funding (if applicable), costs and provisions of an OPEB plan.

The reported OPEB liability of the BOCES, as determined by an independent actuarial analysis, was \$68,163,456 as of July 1, 2008. The current reserve balance of \$6,360,695 represents only 9% of the total liability.

According to our independent external auditor's report and our GASB 45 actuarial study, the BOCES' Government Wide Statement of Net Assets as of June 30, 2009 reported total net assets of \$7,103,810 and a total of \$7,014,769 accrued for OPEB obligations. By the end of the 2009-10 fiscal year, the mandatory estimated accrual of \$7,014,769, will deplete the BOCES' net assets. This accrual will continue until the \$68,163,456 liability is recorded, resulting in a substantial deficit in net assets.

We understand that GASB 45 does not require BOCES to create a reserve fund. We take note, however, of the Comptroller's announcement in the 2008 Report that "[a] government which puts aside OPEB funds can substantially cut its long-term costs." In other words, the gradual accumulation of an OPEB reserve not only honors the promise

made to teachers, bus drivers, and other staff who retire from BOCES, it is also in the long-term best interest of the component districts' taxpayers. It "improve[es] operations" of the BOCES, and is a "good business practice," to borrow language from the initial paragraph of the draft report.

We also direct your attention to the Chapter 602 Report for the 2007-2008 School Year, issued by the Commissioner of Education in June 2009, reporting to the Legislature on the financial operations of boards of cooperative educational services. On page 13 of that Report, the Commissioner discusses the obligation of boards of cooperative educational services to budget for retirement costs, saying "BOCES must budget for the cost of health insurance and supplemental retirement for all of their staff who retire with benefits. These costs cannot be charged to the service budgets by law. *Some BOCES have established a reserve for this expense, while others are including the cost as a current expenditure in the budget. Both methods are appropriate...*" [emphasis added]. Thus, the Comptroller considers an OPEB reserve to be "unauthorized," while the Commissioner of Education considers an OPEB reserve to be "appropriate."<sup>5</sup>

See  
Note 16  
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The audit team was presented with documentation that BOCES had a definite methodology for calculating amounts allocated to the retiree health insurance fund, and that the component districts (through monthly chief school officer meetings) affirmatively approved the methodology and its annual implementation. In other words, BOCES has a documented plan for this reserve, and it is transparent to the component districts. Therefore, we ask that the phrase "without clearly identifying these allocations as reserve funding" be removed from the end of the first paragraph under the heading "Unauthorized Reserve" on page 6 of the revised draft report.

See  
Note 17  
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It is also important to realize that the OPEB expense for a particular employee, although it will be disbursed in the future after retirement, is a cost of employing that person today. When that employee provides a BOCES service to a participating district, the total cost of that service includes the OPEB expense for that employee. Therefore, developing a mechanism to defray future OPEB payments from present service revenue should be considered a "good business practice," as the Comptroller seems to suggest in the 2008 Report.

We appreciate the Comptroller's effort in 2008 to obtain explicit enabling legislation for the funding of OPEB liabilities, and the renewal of that effort this year. We understand that the Comptroller feels obligated to repeat the observation that there is no explicit statutory authorization for such a reserve fund. However, we think the Comptroller will be missing an opportunity to achieve needed corrective action if the overall report discussing his State-wide findings does only that, when it could serve as a platform from which to again exhort the Legislature to action. Optimistic about such an outcome, we ask that the following language be added to Recommendation 5: "Alternatively, if the State Legislature enacts legislation that would allow BOCES to create a reserve fund for

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<sup>5</sup> We note, also, the position taken by at least one other BOCES that general ledger account TA20 of the Uniform System of Accounts for BOCES is intended to hold a "balance [that] will represent amounts accumulated for payment of group insurance contracts," and therefore authorizes the "accumulation" of funds to pay the BOCES share of group insurance contracts that cover, *inter alia*, retirees. Cattaraugus-Allegany-Erie-Wyoming BOCES (2009M-151)

OPEB purposes, the BOCES Board should properly establish such a reserve and transfer to it that portion of the post-retirement health insurance reserve the Board determines to be necessary and reasonable.”<sup>6</sup>

Conclusion

Thank you for your anticipated careful consideration of our concerns. Upon receipt of your final report, our Board will prepare and submit the required response and action plan.

Sincerely,



Joan Sotherden  
Associate Superintendent



Douglas Gustin  
BOCES Board Audit Committee Chairperson

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<sup>6</sup> This language is based on a Comptroller Recommendation to the Clinton-Essex-Warren-Washington BOCES (2009M-58).

## **APPENDIX B**

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

#### Note 1

We did not make this statement. In fact, the audit found that the BOCES maintains a reserve for other post-employment benefits (OPEB) for which there is no statutory authority.

#### Note 2

The previous audit conducted of the BOCES (2009M-3) focused on internal controls over the audit of claims and adult education cash receipts, and did not include an examination of reserves.

#### Note 3

BOCES officials, at the exit conference, requested a written document that specified what is considered excessive in terms of reserve funding. However, to assess the adequacy of reserve funding, one must consider local needs and conditions. BOCES officials must assess the need for reserves based on supporting estimates and documentation, such as schedules of the liabilities the reserves are intended to fund, to justify withholding monies from school districts. Without such information, the intent of the reserve and the reasonableness of reserve balances cannot be adequately assessed.

#### Note 4

It is BOCES' responsibility to decide on an appropriate course of action. One source of advice comes from professionals like the external auditor. However, BOCES must ensure that such advice complies with all applicable laws.

#### Note 5

Our determination that balances in reserve funds are unreasonable or unrealistic is based on our review of relevant historical data, justification and support from BOCES officials, applicable statutory limitations, and other relevant guidance, all of which was discussed with BOCES officials during the audit and at the exit conference. With regard to the EBALR, GML Section 6-p states that "employee benefits" means the value of accrued and unliquidated time earned by municipal and school district employees and payable to those employees upon termination of service. Our audit determined, and our report clearly shows, that BOCES' calculation to support its EBALR balance included more than is allowed per GML Section 6-p.

#### Note 6

OSC issued guidance in 1994 for the implementation of GASB Statement 16, "Accounting for Compensated Absences." This guidance specifies what should be included in the liability and offers suggestions for calculating it. It also clearly states that funding of the liability is not required. Therefore, while there is clear guidance on how to calculate the liability, and clear

statutory limitations on what can be reserved to fund such a liability, there is no “set in stone” rule for determining excessiveness. The fact that BOCES’ own calculations fail to support the balance in the EBALR clearly indicates that the reserve balance is excessive.

#### Note 7

Reserve funds are mechanisms for accumulating cash for future capital outlays and other allowable purposes. They are not a current “cost of providing services;” therefore, reserves should be disclosed separately from operating expenditures when reporting year-end results to school districts. Actual results of operations should be reported with BOCES’ intent to fund reserves from such surplus clearly indicated, and not factored into the total expenditure amounts presented to the districts, as BOCES has done.

#### Note 8

The advice stated in the cited report, in its entirety, is consistent with the standards stated in this report. Specifically, Report 2009M-219 states the following: “While BOCES may retain surplus funds for reserves, good management practices require BOCES to obtain Board approval of allocations made to various reserve funds; such allocations may be appropriated annually in the budget, or made from operating surpluses available at the end of the fiscal year. Any operating surpluses used to fund the reserves must be clearly identified, apart from other expenditures, in BOCES’ reporting to its districts.”

#### Note 9

The report has been revised accordingly.

#### Note 10

The report has been revised accordingly. However, the fact that BOCES did not clearly identify the funding of reserves remains unchanged.

#### Note 11

BOCES officials could not provide any written documentation indicating that the funding of authorized reserves was reported to component or participating school districts. While our report acknowledges that there appeared to be verbal communication about reserve funding, verbal discussions regarding reserves and their funding do not adequately inform all interested parties about the BOCES’ use of district and taxpayer funds. Specific plans for the funding and use of reserve funds should be documented in writing.

#### Note 12

BOCES should report actual results of program charges versus program costs and clearly identify reserve funding from surpluses.

#### Note 13

We have revised the draft report to state the following, which we believe more clearly communicates our findings: "... 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."

#### Note 14

The report was amended and the word "adequately" was changed to "clearly." BOCES should be transparent in its reporting to component and participating school districts regarding BOCES' finances, including the use of reserve funds, regardless of whether there is a specific legal requirement to do so. BOCES operates with taxpayer money and has the responsibility to clearly report the intended use and ultimate disposition of all monies it collects from school districts.

#### Note 15

The audit team properly evaluated BOCES' supporting documentation and our audit report clearly illustrates the manner in which BOCES is calculating its liability to support this reserve. BOCES' assumption that the maximum benefit will be paid to employees who are no longer eligible for the maximum benefit is not reasonable. BOCES' calculation should include only actual payable amounts.

#### Note 16

State Education Department (SED) officials informed us that the statement included in their Chapter 602 report (Financial and Statistical Outcomes of the Boards of Cooperative Educational Services) was not meant to imply that BOCES can use any type of reserve or trust to accumulate funds for future health insurance costs. SED officials agreed that current law does not allow BOCES and school districts to accrue or reserve monies to pay for these costs.

#### Note 17

BOCES is not clearly identifying amounts used to fund this reserve; therefore, the statement in our report is accurate. Furthermore, because the BOCES is not authorized to maintain a reserve for retiree health insurance, the fact that BOCES officials have a plan for the funding of this reserve is irrelevant.