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July 15, 2010

Dr. Thomas L. Rogers, District Superintendent  
Members of the Board of Education  
Nassau BOCES  
71 Clinton Road  
Garden City, New York 11530

Report Number: S9-9-69

Dear Superintendent Rogers 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 Nassau BOCES in this audit. Within the scope of this audit, we examined the policies and procedures of the Nassau 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 Nassau 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 Nassau BOCES (BOCES) retained \$25.9 million<sup>1</sup> in inappropriately used reserve funds allocated from school district moneys. During our audit period, BOCES used \$10.8 million<sup>2</sup> in budgetary appropriations to fund three of its five reserves<sup>3</sup> – an unemployment insurance reserve, employee retirement contribution reserve, and an employee benefits accrued liability reserve (EBALR) – without indicating to its districts that these appropriations were allocated to reserves, instead including them within budgeted expenditures. Further, BOCES officials established an employee benefit accrued liability reserve with a balance of \$33,478,545<sup>4</sup> as of June 30, 2009. BOCES did not have support for \$25.9 million of this reserve, which was inappropriately used to pay for retiree health insurance benefits.

BOCES officials also did not establish policies and procedures, or develop specific documented plans for the funding and use of the reserves. In addition, although BOCES officials began allocating interest earned to four of its reserve accounts during the 2008-09 fiscal year, they did not allocate any interest to the EBALR during our entire audit period.

The failure of BOCES officials to ensure that all reserves were properly established and reasonably funded has increased the risk of the school districts,' and therefore taxpayers, 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 56 component school districts in Nassau County. BOCES is governed by a nine-member Board of Education (Board) whose members were elected by the 56 component school district boards. BOCES' operating expenditures totaled \$227 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 specialized educational programs and services to component and participating<sup>5</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 3,400 full and part-time or substitute employees working at the nearly three dozen

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<sup>1</sup> Includes the Employee Benefit Accrued Liability Reserve of \$25.9 million.

<sup>2</sup> For the period July 1, 2007 through June 30, 2009, the total includes Employee Retirement Contribution Reserve of \$5 million, Employee Benefit Accrued Liability Reserve of \$5.2 million, and unemployment insurance reserve of \$567,000.

<sup>3</sup> The property loss reserve was funded from insurance payments and transfers from other reserves.

<sup>4</sup> This reserve was separated into three reserves on the BOCES financial records: Employee Benefits Accrual Reserve (\$25,905,866), Compensated Absences Reserve (\$6,552,278) and Excess Vacation Days Payable Reserve (\$1,020,401).

<sup>5</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.

locations 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>6</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 \$44.7 million at June 30, 2009 (prior to year-end adjustments):<sup>7</sup>

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<sup>6</sup> For example, a career and technical equipment reserve. The Nassau BOCES does not have this type of reserve.

<sup>7</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 or paid for by the end of the fiscal year in which they were ordered and the Debt Service Reserve required per the BOCES' agreement with the NYS Dormitory Authority.

	<b>June 30, 2006</b>	<b>June 30, 2007</b>	<b>June 30, 2008</b>	<b>June 30, 2009</b>
Employee Benefit Accrued Liability Reserve (EBALR) <sup>8</sup>	\$31,661,248	\$31,404,175	\$32,181,856	\$33,478,545
Employee Retirement Contribution	\$2,806,683	\$5,168,655	\$6,209,309	\$10,455,877
Unemployment Insurance Reserve	\$244,843	\$251,666	\$271,636	\$494,107
Property Loss Reserve	\$201,414	\$213,971	\$262,154	\$264,493
Liability Reserve	–	\$227,000	\$40,000	\$40,841
<b>Total Reserves</b>	<b>\$34,914,188</b>	<b>\$37,265,467</b>	<b>\$38,964,955</b>	<b>\$44,733,863</b>

BOCES officials reaffirmed the reserve funds by Board resolution, in July 2009<sup>9</sup> and properly accounted for all reserves separately. However, BOCES inappropriately used a portion of its employee benefit accrued liability reserve (EBALR) as a reserve for the payment of 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, a 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.

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<sup>8</sup> BOCES accounts for this reserve as three separate reserves in its financial records, although only one Board resolution established the Employee Benefit Accrued Liability Reserve: Employee Benefits Accrual Reserve, Compensated Absences Reserve, and Excess Vacation Days Payable Reserve.

<sup>9</sup> BOCES officials could not locate the Board resolutions for the original establishment of most reserves.

BOCES allocated \$10.5 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. In addition, BOCES does not have any policies, procedures or written plans for the funding and use of moneys allocated to reserves. Further, BOCES does not report to its districts that budgetary appropriations are used to fund the reserves. 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>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. Allocations to the unemployment insurance reserve and the employee retirement contribution reserve are shown as fringe benefit expenditures in the individual CoSer budgets. Allocations to the EBALR are shown as budgeted salary expenditures in the individual CoSer budgets and the Administrative operations budget. This practice does not clearly indicate that these moneys are allocated to reserves; rather, they appear as budgeted expenditures. 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.

In addition, BOCES officials reported in the annual budget advisory committee<sup>13</sup> report that they have used a 3 percent budget factor within the fringe benefit category of the program budgets to make EBALR reserve allocations. However, as all component school districts are not on the budget advisory committee, they do not all receive this report and therefore are not necessarily informed of these allocations, or any other reserve fund allocations.

The Board members, who represent the 56 component school districts,<sup>14</sup> stated that BOCES business officials are verbally communicating with school district officials regarding reserves; however, there is no written documentation of this communication.<sup>15</sup> Further, Board minutes include resolutions for approval of the BOCES Treasurer's report, which includes reserve balances. Although Board minutes are available for public access, there is no documentation that information on reserves is distributed to school districts.

## **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> For the period July 1, 2007 through June 30, 2009, the total includes Employee Retirement Contribution Reserve of \$4.7 million, Employee Benefit Accrued Liability Reserve of \$5.2 million, and Unemployment Insurance Reserve of \$567,000.

<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> All component school district representatives have the option of joining the budget advisory committee. However, it is only made up of a sample of component school district representatives.

<sup>14</sup> Although the nine Board members represent all 56 component school districts, each originates from one of the component school districts.

<sup>15</sup> BOCES provides some documentation on the allocations made to the unauthorized retiree health insurance reserve (titled Employee Benefit Accrued Liability Reserve).

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 the BOCES reserves were in compliance with statute and related to the purpose of the reserve, with the exception of the employee retirement contribution reserve, which was inappropriately used to fund other BOCES reserves. However, BOCES officials lacked specific documented plans for the funding and use of their reserves, and they are accumulating funds in one of their reserves for an inappropriate purpose.<sup>16</sup> We also found that BOCES officials did not record interest earnings appropriately to any reserves until the 2008-09 fiscal year, and did not appropriately allocate all interest earnings to the EBALR<sup>17</sup> for the entire audit period.

Employee Benefit Accrued Liability Reserve (EBALR) – BOCES established the EBALR by Board resolution in October 2003. The balance of this reserve as of June 30, 2009, was \$33,478,545. BOCES reports the EBALR as one reserve in their audited financial statements, but accounts for it as three separate reserves – a compensated absences reserve, an excess vacation days payable reserve, and an employee benefits accrual reserve – in its financial accounting system. BOCES officials provided adequate supporting liability calculations for the compensated absences, and the excess vacation days payable portions of the EBALR reserve, totaling \$7.6 million at June 30, 2009. However, BOCES intended use for the remaining \$25.9 million of the EBALR reserve – the employee benefits accrual reserve – is to pay for retiree health insurance, which is an inappropriate use of an EBALR.

- **Compensated Absences Reserve** – The balance of this portion of the EBALR reserve was \$6,552,278, as of June 30, 2009. BOCES officials stated that the purpose of this reserve is to accumulate funds for sick and vacation leave earned, and payable, to eligible employees upon separation from BOCES employment. BOCES has deposited into the reserve 1 percent of actual salary expenditures from the general and Federal funds and budgeted the added amounts as expenditures for salary without identifying these moneys as reserve allocations. These allocations to fund the reserve totaled \$2.2 million during our audit period. In addition, BOCES officials do not allocate interest earned to the reserve. We estimate that the additional interest earnings which should have been deposited to the reserve during the audit period totaled approximately \$250,050. Further, although BOCES officials provided a liability calculation to support the amount in the reserve, BOCES does not have a specific documented plan for the funding and use of this reserve. We found that payments made from this reserve during our audit period (averaging \$281,224 a year) were in compliance with statute and directly related to the purpose of the EBALR reserve.
- **Excess Vacation Days Payable Reserve** – The balance of this portion of the EBALR reserve was \$1,020,401, as of June 30, 2009. BOCES officials stated that the reserve account is used for the payment of excess vacation days<sup>18</sup> due to eligible employees upon

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<sup>16</sup> Refers to the Employee Benefits Accrual Reserve discussed on page 7.

<sup>17</sup> The interest allocation requirement and corresponding recommendation is not applicable to the Employee Benefits Accrual Reserve, which is unauthorized and is being inappropriately reported as part of the EBALR reserve.

<sup>18</sup> These vacation days are not the same as included in the compensated absences reserve. BOCES entered into new collective bargaining agreements in 2004, which established a limit of 40 vacation days. Employees who had

separation from service. The excess vacation days payable reserve account balance has been inappropriately funded by transfers from the employee retirement contribution reserve and by re-designating amounts from the employee benefits accrual portion of the EBALR reserve. These allocations totaled \$131,426 during our audit period. In addition, BOCES officials do not allocate interest earned to the reserve. We estimate that the additional interest earned which should have been deposited to the reserve during the audit period totaled approximately \$40,304. Further, although BOCES has a liability calculation to support the amount in this portion of the EBLAR reserve, BOCES does not have a specific documented plan for its funding and use. We found that payments made from this portion of the EBALR reserve during our audit period (averaging \$32,000 a year) were in compliance with statute and directly related to the purpose of the EBALR reserve.

- Employee Benefits Accrual Reserve – The balance of this portion of the EBALR reserve was \$25,905,866, as of June 30, 2009. BOCES intended use of this portion of their EBALR is to pay retiree health insurance, which is not a legally permissible use of the EBALR. During our audit period, BOCES officials allocated \$4,110,471 to this inappropriately used reserve, using a combination of budgetary appropriations (\$2,936,236), transfers from other reserves (\$1,160,000), and re-designating funds from the compensated absences portion of the EBALR (\$14,235). At the conclusion of our fieldwork, the balance in this reserve was over \$25.9 million. EBALR monies in excess of the fund’s liabilities can be transferred only to specific reserve funds. They cannot be used to pay for district operating expenses other than those associated with compensated absences.

Employee Retirement Contribution Reserve – BOCES reaffirmed the Employee Retirement Contribution reserve in July 2009, by Board resolution. While the resolution does not define the reserve’s purpose, BOCES officials indicated that the reserve was created for future liabilities associated with employer contributions that will be made to the New York State Employees’ Retirement System (ERS). As of June 30, 2009 (prior to year-end adjustments), the balance in the reserve was approximately \$10.5 million. BOCES has deposited into this reserve the difference between the projected and actual ERS payments, and budgeted these added amounts as expenditures for fringe benefits,<sup>19</sup> without specifically identifying these expenditures as allocations to reserves. Allocations to this reserve totaled \$4,662,754 during the audit period. In addition, BOCES officials did not allocate interest earned to the reserve until the 2008-09 fiscal year. We estimate that the additional interest earned for the 2007-08 fiscal year, which should be included in the reserve fund balance, totaled approximately \$124,186.<sup>20</sup> Instead, these interest earnings were used as a funding source for BOCES operations.

While BOCES officials indicated they plan to use the reserve to make payments to the ERS, BOCES does not have a specific documented plan for the funding and use of money in this

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mistakenly been credited with greater than 40 vacation days prior to the new collective bargaining agreements were allowed to maintain those excess vacation days. BOCES officials account for these excess vacation days separately in this portion of the EBALR reserve.

<sup>19</sup> The ERS expenditures are indicated in the individual CoSer budgets in combination with other fringe benefit expenditures.

<sup>20</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.

reserve. We found that BOCES inappropriately used funds from this reserve to fund other BOCES reserves. A transfer of \$1 million, in 2007-08 was used to fund the inappropriately used employee benefit accrual portion of the EBALR, while in 2008-09, approximately \$57,600 was transferred to the excess vacation days payable portion of the EBALR. GML states that moneys in a retirement contribution reserve fund can only be expended to finance retirement contributions.<sup>21</sup> BOCES officials should discontinue inappropriate transfers from this reserve.

Unemployment Insurance Reserve – The board reaffirmed this reserve in July 2009 to fund payments for unemployment claims. The balance of this reserve as of June 2009 is \$494,107. The BOCES has deposited into this reserve 0.075 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 \$567,000 during the audit period. In addition, BOCES did not allocate interest earned to the reserve until the 2008-09 fiscal year. We estimate that the additional interest earned for the 2007-08 fiscal year, which should be included in the reserve balance, totaled approximately \$5,433. Instead, these interest earnings were used as a funding source for BOCES operations.

Further, although BOCES officials feel that the balance of this reserve is appropriate, the BOCES does not have a specific documented plan for the funding and use of money in this reserve. We found that payments made from this reserve during our audit period (averaging \$57,370 a year) were in compliance with statute and directly related to the purpose of the reserve. BOCES officials indicated that they review and adjust the account balance to ensure an appropriate balance is maintained for the current economic climate. We encourage BOCES officials to continue 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 General Municipal Law.

Property Loss Reserve – BOCES reaffirmed the property loss reserve in July 2009, by Board resolution. Payments made from this reserve during our audit period (averaging \$61,853 a year) were in compliance with statute and directly related to the purpose of the reserve. As of June 30, 2009 (prior to final year-end adjustments), the balance in this reserve was \$264,493. Since July 2005, insurance claim reimbursements deposited and transfers of funds from the employee retirement contribution reserve account have funded the property loss reserve account balance. These allocations totaled \$157,658 during our audit period. BOCES did not allocate interest earned until the 2008-09 fiscal year. We estimate that the additional interest earned for the 2007-08 fiscal year, which should be included in the reserve balance, totaled approximately \$5,243. Instead, these interest earnings were used as a funding source for BOCES operations.

While BOCES officials indicated that the reserve was created to purchase replacement assets that were damaged, lost or stolen for which an insurance claim had been made but not paid, they have not established a specific plan for the funding and use of this reserve.

Liability Reserve – BOCES reaffirmed the liability reserve in July 2009, by Board resolution. BOCES officials indicated that the purpose of the reserve is for payments of legal claims and settlements. The balance in this reserve was \$40,840 as of June 30, 2009 (prior to final year-end

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<sup>21</sup> GML also allows for transfers to other reserves; however, GML does not authorize BOCES to create any of these reserves.

adjustments). Since July 2005, only one deposit was made to the reserve in the amount of \$227,000 based on a specific liability, by a transfer of funds from the employee retirement contribution and the unemployment insurance reserve accounts. After the related payments were made, a balance of \$40,840 remains. In addition, BOCES did not allocate interest earned to the reserve until the 2008-09 fiscal year. We estimate that the additional interest earned for the 2007-08 fiscal year which should be included in the reserve balance totaled approximately \$800. Instead, these interest earnings were used as a funding source for BOCES operations.

While BOCES officials indicated that the funds were to be used for a specific purpose, they did not establish a specific documented plan for its continued funding and use. Any excess funds in this reserve account can only be transferred to another legal reserve, as authorized by GML.

The BOCES' lack of a plan for these five reserve funds – combined with the failure to report the allocations made to reserves, or adequately justify the reserve balance – demonstrates inadequate planning and a lack of transparency in BOCES' reporting to the school districts.

## **Recommendations**

1. The Board and BOCES officials should develop written policies and procedures for reserve funds, including a specific plan for the funding and use of individual 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 all of its reserve funds according to statutory requirements.
4. BOCES officials should restrict transfer of funds between reserve accounts according to statutory requirements.
5. 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.
6. BOCES management should discontinue the inappropriate use of the Employee Benefits Accrual portion of the Employee Benefits Accrued Liability Reserve (EBALR). Funds in excess of the amount necessary to satisfy genuine EBALR liabilities can only be transferred to other reserves authorized by law.

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.

April 9, 2010

**Administration**

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**Members of the  
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Eric B. Schultz  
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*Vice District Clerk*

*Trustees*

Deborah Coates

Ronald Ellerbe

Martin R. Kaye

Gale Ross-Sruevich

Robert "B.A." Schoen

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Principal Examiner  
Office of the State Comptroller  
Division of Local Government and School Accountability  
Statewide and Regional Projects  
295 Main Street, Room 1032  
Buffalo, NY 14203-2510

Dear [REDACTED]

Thank you for the opportunity to comment on the draft audit of the Nassau BOCES reserve accounts. At the outset, we would like to thank you for the courteous and professional manner in which your staff conducted the entrance and exit interviews and the audit itself.

Thank you as well for the suggestions that will allow us to continue our policy of continuous improvement. We note that many of those recommendations reference new guidance issued by the Office of the State Comptroller (OSC) well after the audit period and the audit team's visit. Like the OSC, we too constantly reexamine and improve our operations in light of new information.

The OSC audit comprises two parts – the first is a "compliance audit" to ascertain whether we are in compliance with documented rules, regulations, and statutes. The second is a "performance audit" where OSC auditors evaluate "good business practices" based on their opinions. We will respond to the two parts separately.

In summary, however, we would state:

- We are pleased that OSC has confirmed that there is no waste, fraud or abuse at Nassau BOCES;
- The technicalities identified arose from this agency's efforts to reduce costs to component districts. It is important to note that we identified these issues and corrected them prior to the Comptroller's audit. Regrettably,

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compliance with these state mandates will result in additional costs to our component districts.<sup>1</sup>

- We appreciate the OSC's recommendations that we consider adopting additional policies with regard to our reserve funds to make our board's oversight more apparent and to add to the transparency with which we report all of our financial data to our component school districts. We will begin the process of reviewing these suggestions with our board immediately. We note that many of these recommendations mirror those issued in a guidance document that was newly revised by OSC in December of 2009 – well after our audit was completed.

Our more detailed response follows.

#### **Part 1: Compliance Audit**

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The OSC identified two compliance issues at Nassau BOCES. However, it is important to note that in both instances, funds were used for an appropriate public purpose related to the mission and obligations of the agency (i.e. there was no waste, fraud or abuse), the use of the funds reduced costs to our districts and their taxpayers, and the compliance issues were strictly technical in nature. Our response on each such issue is below:

- a. **Deposits of Interest** – The OSC noted that during the first part of the audit period, Nassau BOCES did not redeposit interest from certain reserves<sup>2</sup> as required by statute, because the reserves were fully funded. Instead, we used these interest earnings, totaling \$301,830, to significantly lower student tuition costs to component school districts – in effect refunding money to the taxpayers.

Regrettably, after reviewing OSC Report 2008-MS-3 issued in October 2008 (over a year before this OSC audit), Nassau BOCES discovered that using

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<sup>1</sup> Comptroller DiNapoli has recommended that the Legislature eliminate one of these two mandates – the prohibition on the creation of OPEB trusts. We strongly support his position on this matter.

<sup>2</sup> Compensated Absences Reserve, Unemployment Insurance Reserve, Liability Reserve, and the Excess Vacation Days Payable Reserve

interest to reduce tuitions was precluded by statute. We immediately took corrective action and properly allocated interest for the entire 2008-09 school year in order to comply. We are therefore disappointed that the OSC audit on pages 6 and 7 mistakenly indicates that this remains an ongoing practice, stating: “BOCES officials do not allocate interest earned to the reserve” (emphasis added). That statement has been factually inaccurate for almost 2 years.

- b. **EBALR** – OSC has noted that Nassau BOCES reserved a portion of its “Employee Benefits Accrued Liability Reserve” (EBALR) to pay for future retiree health insurance benefits (commonly referred to as OPEB). Although this practice is widespread (in at least 251 other school districts and BOCES<sup>3</sup>), OSC has noted that the legislative authority for this mechanism is not yet in place. The Comptroller has argued strenuously (first in May 2008<sup>4</sup> and again in March 2010<sup>5</sup>) for the creation of OPEB trusts through legislation he has proposed, calling them “fiscally prudent” and noting that failing to do so would result in additional taxes in the “billions”.

Nassau BOCES calculates that using our current balance in this EBALR account to defray future OPEB costs could save taxpayers \$2.6 million in annual required contributions, resulting in possibly hundreds of millions of dollars in future cost savings. Nevertheless, this amount still falls well short of defraying our required annual contribution for unfunded OPEB liabilities

<sup>3</sup> <http://www.osc.state.ny.us/localgov/audits/swr/ebalr.pdf>.  
<http://www.osc.state.ny.us/press/releases/oct08/102108.htm>.

<sup>4</sup> <http://www.osc.state.ny.us/press/releases/may08/052008.htm>

<sup>5</sup> “Some school officials have told us that they established and/or funded their districts’ employee benefit accrued liability reserve (EBALR) funds to set aside money for future other post-employment benefits pursuant to GASB 45. While this is not permissible within existing statutes, having a mechanism to begin to fund this long-term liability would be fiscally prudent. The State Comptroller has proposed legislation creating the authority to establish OPEB trusts for the state and local governments. The State Legislature could greatly assist schools in this effort by providing them with the authority to establish OPEB trusts to fund the costs of future retirees’ health insurance and other benefits. The legislation would restrict the use of the moneys placed in this trust solely for these purposes.” (emphasis added) <http://www.osc.state.ny.us/localgov/schoolsfa/sda09.pdf> pp. 19-20.

which totaled \$64 million in 2008-09<sup>6</sup>. The total unfunded liability for our Agency was \$423 million as of June 30, 2009. Accordingly, we remain significantly under-reserved for this future liability and concur with the Comptroller's pleas to the Legislature to create a mechanism to reserve additional funds in OPEB trusts.

Unfortunately, as the Comptroller has also noted, without Legislative action these funds will remain in a "locked box"<sup>7</sup> – they can neither be used for the fiscally prudent purpose of significantly reducing long-term liabilities to taxpayers, nor can they be used to reduce more immediate costs (though this would be a highly irresponsible<sup>8</sup> use). Accordingly, we will no longer add to this reserve nor can we disburse funds from it until the Legislature adopts the Comptroller's recommendations.

In addition, there seems to be some confusion about inter-fund transfers. OSC noted that "expenditures from the BOCES reserves were in compliance with statute and related to the purpose of the reserve, with the exception of the employee retirement contribution reserve which was inappropriately used to fund other BOCES reserves" (OSC audit page 6). We believe OSC has characterized correcting end-of-year journal entries needed for accounting purposes to be the same as "reserve fund transfers" even though they were part of the year-end closing entries. The outside auditing firm we hire to review our financial statements did not find fault with this practice. However, if the auditors at OSC differ with these independent auditors or find these journal entries to be too easily mistaken for actual reserve fund transfers, we have no objection to deferring to the position of OSC auditors in our future practices.

See Note 5 Page 24
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<sup>6</sup> As reported in the long-term liability section of our Statement of Net Assets – Governmental Activities as of June 30, 2009 (as required by GASB 45).

<sup>7</sup> <http://www.osc.state.ny.us/press/releases/oct08/102108.htm>

<sup>8</sup> "We're facing difficult times, and the impulse may be to push this issue aside. But almost two million working New Yorkers are counting on these benefits. The responsible thing to do is to start preparing for the future in order to protect health care benefits and save tax dollars. If we started this fund today, State government alone could save \$22 billion over the next 30 years." Statement of Comptroller Thomas DiNapoli, May 2008 (emphasis added). <http://www.osc.state.ny.us/press/releases/may08/052008.htm>.

## Part 2: "Performance" Audit

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The OSC also offered a number of opinions on the business practices of the BOCES with respect to funding, reporting, and use of reserves. We were delighted that OSC found that (except as discussed in the previous paragraph), "expenditures from the BOCES reserves were in compliance with statute and related to the purpose of the reserve" (p.6).

OSC did offer several suggestions for improvements in business practices. It is the policy of Nassau BOCES to continuously review its policies and procedures for compliance with new statutes, regulation or administrative guidance from state agencies. Accordingly, we welcome these recommendations for consideration during our regular policy review cycle.

However, we were disappointed that OSC felt the need to couch some of their recommendations in the form of criticisms we believe are either disproportionate or poorly substantiated. We will address the OSC's concerns which essentially fall into three categories:

- a. Funding of Reserves Through Surplus – In repeated locations (p.2, 5, 9), OSC makes the assertion that: "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." This statement is not only inaccurate, it seems an attempt to undermine the well established legal authority for BOCES to fund its reserves through surplus.

See  
Note 6  
Page 24

General Municipal Law Section 6-m indicates that budgetary appropriations as source of funds for Unemployment Insurance Reserve is permissible (OSC Guide 12/23/2009 page 20). Similarly, GML Section 6-r permits budgetary appropriations as source of funds for Employment Contribution Reserve as well as revenues not required by law to be paid into any other fund or account (OSC Guide 12/23/2009 page 25).

See  
Note 7  
Page 25

This is essential since the BOCES budget process would not support the type of allocation the OSC appears to be recommending. BOCES completes its budget in late January, in order to provide component districts with tuition estimates for their budget processes which continue through the spring and culminate in late May. Accordingly, BOCES will not know how many students will participate in any given program until many months after the BOCES budget and tuition estimates have long since been adopted. We strive to keep tuition estimates as low as possible to ensure broad student participation, while remaining mindful of our requirement to minimize the risk of any program ending in a deficit when the budgets are

closed some 15-18 months after the creation of the tuition estimates. We believe our practice, refined over many years, strikes the optimal balance between these two competing goals.

OSC appears to recommend instead padding tuition estimates with additional costs for reserve allocations. This approach would only serve to inflate tuition costs to districts unnecessarily, possibly resulting in children being denied important services.

See  
Note 8  
Page 25

Instead, at the close of the school year, BOCES identifies any surpluses due to programs with enrollments that exceeded the January estimates and allocates a portion of this surplus to reserves through board action at a public meeting whose minutes are posted online. But it is entirely possible that no surplus will exist at the end of any given year (because we keep our tuition estimates so low) which is why no “planned” transfer to reserve can be incorporated into the original tuition amounts.

See  
Note 9  
Page 25

Similarly, OSC appears to also suggest that benefit costs which are funded through reserves should not be identified along with other benefit costs<sup>9</sup>. We find this counterintuitive. Co-ser budgets are built using our estimates of staffing costs. Those costs are driven by our collective bargaining contracts and state laws or regulations. Some of those costs are recognized immediately: salary, for example. Some of the benefit costs are recognized immediately too (pension contribution, health insurance, etc.). Some of the benefit costs are not recognized immediately (unemployment insurance, post-retirement health insurance, etc.), but they nevertheless remain benefit costs driven by the same employee contracts that govern salary costs. Obviously, if the CoSer had no staff, there would be neither immediate nor long-term benefit costs. OSC’s criticism therefore suggests that not distinguishing between benefit costs based simply on their date or mechanism of payment “denies the school districts complete knowledge of how BOCES is ultimately using money paid by the districts for BOCES services” (page 5 – emphasis added). We believe the opposite is true. We are “ultimately” using all of these funds to pay for benefits – some near-term, some long-term. By expensing both future and current benefit costs

See  
Note 10  
Page 25

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<sup>9</sup> “Allocations to the unemployment insurance reserve and the employee retirement contribution reserve are shown as fringe benefits expenditures in the individual CoSer budgets. Allocations to the employee benefit accrued liability reserve are shown as budgeted salary expenditures in the individual CoSer budget and the Administrative operations budget. This practice does not clearly indicate that these moneys are allocated to reserves, rather they appear as budgeted expenditures” (OSC audit page 5).

together, we ensure that our component school districts have a full appreciation for the total benefits costs of staffing in our programs. To do otherwise would actually do our districts the disservice of understating these costs.

- b. Transparency of Disclosure or Reporting – The OSC also enumerates a number of criticisms that together imply that our component districts could be better informed regarding our business practices. It is important to note that OSC appears to base nearly all of these criticisms on guidance that did not emerge in its current form until 12/23/2009 – 2 months after the audit was completed, and 2.5 years after the beginning of the audit period. Moreover, during our exit interview, OSC staff conceded that this document was heavily revised before release because OSC had concluded that the pre-existing guidance to districts regarding reserves was not as detailed as they would prefer. Nassau BOCES has no problem with adopting new policies in line with new guidelines; however, we believe it inappropriate to have this new guidance apparently applied retroactively.

Nassau BOCES takes the following steps to inform our component districts of our business practices:

- i. Budget Hearings – Nassau BOCES held 3 public hearings during the development of its 2010/11 budget. The total number of attendees for the three hearings was 39. In prior years we did: 2 hearings in 2007/08, 2008/09, & 2009/10; 3 hearings in the years preceding 2007/08.<sup>10</sup>
- ii. Budget Handbook/Information—Nassau BOCES mails to every Board member, superintendent and district clerk in our 56 component school districts a copy of the budget handbook, along with information on the process for their vote on the Nassau BOCES Administrative Operations budget. There are three mailings

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<sup>10</sup> OSC contends that “as all component districts are not on the budget advisory committee, they do not all receive this report and therefore are not necessarily informed of these allocations, or any other reserve fund allocations” (page 5). However, any member of the public may participate on the budget advisory committee on their own initiative and in the development of the 2010/11 budget, 5 citizens of a component district initiated their own appointment to the committee and they obtained copies of the same written report (280 pages) shared with other members of the committee. We obviously cannot compel component board members to attend the meeting, thus we interpret the lack of universal attendance as one sign of satisfaction with our informational practices.

that go out to them during the winter months leading up to the budget vote. The budget handbook is also available online.

- iii. Nassau BOCES Board Minutes – Not only are these minutes available by request, they are also posted on our web site: <http://www.nassauboces.org/board/minutes/> or can be found with a simple Google search.
- iv. Budget Brochure and Directory of Services – These documents are also available online.
- v. Board Policy Manual – This is online in the Board section of our web site. Some of the policies relate to our business practices. Even more supporting detail can be found in the Administrative Regulations found in the employee section. The detail of our Business Practices is in the Administrative Regulations in “Section III – Non-instructional/Business Operations”.
- vi. Meetings with Component District Business Officials – The Nassau BOCES Associate Superintendent for Business meets with the Nassau County school district business officials at least 6 times per year.
- vii. Written Communication with Component District Business Officials – The OSC audit is internally inconsistent on this point. On page 5, the audit states “there is no written documentation of this communication” (emphasis added), then contradicts itself in the accompanying footnote (footnote 15): “BOCES provides some documentation on the allocations made to the unauthorized retiree health insurance reserve (titled employee benefits accrued liability reserve)” (emphasis added). The OSC footnote is accurate; the categorical statement in the audit body text is not. Additionally, as noted in the preceding footnote of this response, every member of the budget advisory meetings receives a written report that extends to 280 written pages.
- viii. Business Official Listserv – In addition, Nassau BOCES hosts a listserv for the business officials of the Nassau County districts. Topics have included BOCES aid, budget rates, Local Government Efficiency Grant, Cooperative bidding fee restructure, letter of intent questions, BOCES contract questions, etc.

See Note 11 Page 25
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- ix. State Reports – We file the SA-111 form with the State Education Department, which is a public document that is available upon request.

Despite these extensive efforts, someone could always claim we could add administrators to do still more. But additional staffing to perform these efforts will come at additional cost to our components, and ultimately we are responsible with balancing transparency with cost containment. Prior to the December 2009 guidance, we had been satisfied that our efforts:

See  
Note 12  
Page 25

- i. provide our component districts with multiple avenues to access our financial information (including information about reserves);
- ii. provide the public in our component districts with multiple opportunities to be informed about our budget practices and to offer direct citizen input into budget development;
- iii. provide accountability by making actions of the BOCES Board and the administration transparent and readily available in paper and electronic forms.

Accordingly, we have felt our extensive efforts were sufficient, but we will undoubtedly incorporate the new OSC guidance issued in December of 2009 with whatever additional cost ensues.

- c. Sufficiency of Board Policies Regarding Reserves – OSC observes in a number of places that BOCES does not have “specific documented plans for the funding and use of reserves” (page 6, 8, 9), and opines that this “demonstrates inadequate planning and a lack of transparency in BOCES’ reporting to the school districts” (page 9). We do not believe this is the case. BOCES did not adopt specific plans because: a) there was no statutory/regulatory requirement to do so, and b) because the statutes on the use of these funds are sufficiently detailed that locally adopted plans seem redundant. Accordingly, compliance with statute has always been our plan.

See  
Note 13  
Page 25

By OSC’s own analysis, this approach ensured that “expenditures from the BOCES reserves were in compliance with statute and related to the purpose of the reserve, with the exception of the employee retirement contribution reserve which was inappropriately used to fund other BOCES reserves” (OSC audit page 6). Our response to this sole exception is in Part 1 above.

See  
Note 14  
Page 26

It is important to note that the absence of a plan is unrelated to the EBALR exception also noted in Part 1. The OPEB issue and the costs of compliance with GASB 45 have been evolving quickly over the past several years. As late as May 2008, when the Comptroller expressed concern that the state, school districts and BOCES were under-reserved<sup>11</sup>, the impermissibility of such reserves was still very much in question. The OSC report accompanying the May 2008 press release indicated the following:

“New York State does not currently have a statute which expressly authorizes the State or its local governments to create trusts for OPEB purposes. In the absence of such a statute, it is questionable whether the State and local governments have the requisite authority to establish OPEB trusts. A State statute providing express authority would eliminate questions as to the underlying authority for the creation of such trusts” (Local Government Issues in Focus: A Research Series from the Office of the New York State Comptroller, Vol. 4 No. 1, May 2008, p. 12. Emphasis added.).

OSC has since concluded that OPEB trusts can only be created through legislation and we do not dispute this conclusion. Accordingly, we add our voice to the Comptroller’s in calling for this legislation.

### **Summary and Response to Recommendations**

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As noted above, two attempts at saving component districts’ taxpayer funds were identified as issues in the compliance audit, but had also already been identified and addressed to the extent legally possible by Nassau BOCES. In the performance audit, the OSC makes a number of recommendations and has issued new guidance in December 2009 regarding reserves. Nassau BOCES will diligently incorporate these suggestions and guidance in its policy framework. We differ with the OSC’s characterizations of inadequacies; but ultimately, such differences are immaterial as OSC found that “expenditures from the BOCES reserves were in compliance with statute and related to the purpose of the reserve” with one exception of one year-end reserve fund transfer as noted above (OSC audit page 6). We will henceforth conform to the new planning and policy structure OSC recommends.

The following does not constitute our formal corrective action plan, but rather serves as a contemporaneous response to the OSC recommendations:

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<sup>11</sup> <http://www.osc.state.ny.us/press/releases/may08/052008.htm>

OSC Recommendation	Planned Course of Action
<p><b>1. The Board and BOCES officials should develop written policies and procedures for reserve funds, including a specific plan for the funding and use of individual reserve funds.</b></p>	<p>The Board will consider the issue of reserves in order to determine appropriateness of amounts and sufficiency of policy documentation to comply with the December 2009 guidance document.</p>
<p><b>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.</b></p>	<p>BOCES will include in its annual budget brochure a section on Agency reserves and their funding.</p>
<p><b>3. BOCES officials should ensure that interest is appropriately allocated to reserve funds according to statutory requirements.</b></p>	<p>Nassau BOCES has been in compliance on this issue since the 2008-09 school year. We will remain in compliance.</p>
<p><b>4. BOCES officials should restrict transfer of funds between reserve accounts according to statutory requirements.</b></p>	<p>Nassau BOCES will adopt a policy restricting the transfer of funds between reserve accounts according to statutory requirements.</p>
<p><b>5. 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.</b></p>	<p>The Board will continue to ensure that reserve balances are appropriate.</p>

OSC Recommendation	Planned Course of Action
<p><b>6. BOCES management should discontinue the inappropriate use of the Employee Benefits Accrual portion of the Employee Benefits Accrued Liability Reserve (EBALR). Funds in excess of the amount necessary to satisfy genuine EBALR liabilities can only be transferred to other reserves authorized by law.</b></p>	<p>Nassau BOCES will not increase the level of funding in its EBALR reserve for future retiree health insurance until legislation permits a transfer to an OPEB Trust. We will seek advice of counsel on how to address the redeposit of interest which may accrue in order not to violate the requirement to redeposit interest in the reserve account in which it accumulates.</p>

Thank you again for the professionalism and courtesy of your staff, for the thoroughness of your efforts and for your recommendations for our continued improvement. We look forward to continuing our work together on behalf of the children, school districts, and taxpayers of Nassau County.

Sincerely,



Dr. Thomas Rogers  
District Superintendent of Schools

TR/ts

- cc: Nassau BOCES Board Members  
 Dr. Robert J. Hanna, Deputy Superintendent  
 Joan Siegel, Associate Superintendent  
 Mr. Steven J. Hancox, Deputy Comptroller

## **APPENDIX B**

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

#### Note 1

The entire audit was a performance audit conducted pursuant to Generally Accepted Government Auditing Standards.

#### Note 2

Our report addresses our specific audit objective and related questions; it does not confirm that there is no fraud, waste, or abuse at Nassau BOCES.

#### Note 3

The “technicalities identified” are instances of non-compliance with General Municipal Law, including the failure to allocate interest earnings to reserve funds and use of the employee benefits accrued liability reserve for purposes other than those authorized by statute. We amended our report to indicate that BOCES began depositing interest to four of its reserve funds in 2008-09, but it did not allocate any interest to its EBALR for the entire audit period.

#### Note 4

During our audit period, BOCES did not allocate interest to the appropriately used portion of the employee benefits accrued liability reserve (the compensated absences reserve) with a balance of almost \$6.6 million as of June 30, 2009. BOCES officials did allocate interest to the portion of the reserve (employee benefits accrual reserve) that BOCES officials used inappropriately to pay for retiree health insurance, which had a balance of almost \$26 million as of June 30, 2009. We did not credit BOCES with allocating interest to this portion of the reserve because BOCES' use of these funds was not a legally permissible use of the EBALR.

#### Note 5

There is no confusion about transfers from the employee retirement contribution reserve. The journal entries reduced the balance in this reserve and the cash was transferred to the EBALR, which is not statutorily allowable. Once money has been placed in a reserve, it becomes part of that reserve and cannot be withdrawn or transferred from the reserve for any purpose that is not authorized by statute.

#### Note 6

We have amended our report in one instance to state that “BOCES does not report to its districts that budgetary appropriations are used to fund the reserves.” However, our report does not state that reserves cannot be funded from surplus; rather, it states that all reserve funding, whether through budgeted appropriations or from surplus, should be clearly identified separately from actual operating expenditures in reports to component and participating school districts.

#### Note 7

The funding of the unemployment insurance reserve by budgetary appropriations is authorized; however, these budgetary appropriations should specifically indicate that these monies are used to fund the reserve instead of indicating that they are an appropriation for current unemployment expenditures. OSC provided sample reserve transactions to BOCES officials to show the appropriate methods for funding reserves from budgetary appropriations.

#### Note 8

OSC is not recommending the “padding” of tuition estimates; we are simply recommending that BOCES distinguish amounts used to fund reserves from amounts appropriated for current expenditures. Properly labeling reserve fund allocations will have no impact on tuition rates.

#### Note 9

The Board minutes that are “posted online” do not include any information about the funding of reserves.

#### Note 10

Monies placed in reserves to pay for future expenditures are not current year expenditures and, therefore, should not be recognized as expenditures in the current fiscal year. In addition, reserve fund allocations should be clearly identified as such.

#### Note 11

BOCES provides only limited documentation on the funding of the improperly used portion of the Employee Benefit Accrued Liability Reserve (employee benefits accrual reserve). BOCES does not provide transparency on the funding and use of all its reserve funds.

#### Note 12

Clearly identifying reserve funding in existing BOCES reports would not require additional staff or additional costs.

#### Note 13

Board-adopted plans for the purpose and funding of reserves provide information about the Board’s intent for the use of these funds, and procedures provide direction for ensuring compliance with statute and the Board’s plans. Fiscal transparency and accountability demand the development and use of plans for reserves, regardless of whether having such plans is required by statute.

#### Note 14

While this sentence is accurately quoted, the report goes on to state that BOCES officials lack specific documented plans for the funding and use of reserves, have accumulated significant amounts of money in reserves that they are not authorized to have, or have used those reserves for unauthorized purposes without transparently reporting such activity to school districts.