



THOMAS P. DiNAPOLI
COMPTROLLER

STATE OF NEW YORK
OFFICE OF THE STATE COMPTROLLER
110 STATE STREET
ALBANY, NEW YORK 12236

STEVEN J. HANCOX
DEPUTY COMPTROLLER
DIVISION OF LOCAL GOVERNMENT
AND SCHOOL ACCOUNTABILITY
Tel: (518) 474-4037 Fax: (518) 486-6479

July 15, 2010

Dr. Mary Jean Marsico, District Superintendent
Members of the Board of Education
Rockland BOCES
65 Parrott Road
West Nyack, New York 10994

Report Number: S9-9-68

Dear Superintendent Marsico 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 Rockland BOCES in this audit. Within the scope of this audit, we examined the policies and procedures of the Rockland 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 Rockland 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 Rockland BOCES (BOCES) retained \$16.9 million¹ in reserves² that were either overfunded or were such reserves that BOCES does not have statutory authority to establish. These funds were allocated from school district moneys. During our audit period, BOCES used \$4.8 million³ in budgetary appropriations and operating surplus to fund four of its seven reserves – an unemployment insurance reserve, workers’ compensation reserve, teachers’ incentive reserve, and a post-employment retirement benefits accrual – without indicating to its districts that these appropriations were allocated to reserves, instead including them within budgeted expenditures. BOCES officials improperly accounted for future post-employment health insurance costs using a post-employment retirement benefit accrual by which they accumulated funds totaling \$14.7 million as of June 30, 2009. BOCES officials established a workers’ compensation reserve and a Section 803⁴ accrual reserve, with balances totaling \$964,000, as of June 30, 2009, and used the workers’ compensation reserve to pay for workers’ compensation benefits,⁵ without statutory authority for these types of reserves. Further, we determined that the June 30, 2008 general fund reserve for encumbrances balance was overstated by at least \$897,000 because the corresponding goods and/or services were not actually ordered or an excessive encumbrance amount was included for blanket purchase orders.

BOCES officials also did not establish policies and procedures for the funding and use of the reserves. The unemployment reserve fund, which had a balance of \$562,000 at June 30, 2009, exceeded the Board’s approved balance. As of June 30, 2009, the property and casualty insurance reserve and the property loss reserve had balances of \$4 million and \$942,000, respectively. In the past four years, the payments from the property and casualty insurance reserve accounts totaled \$28,000, and no payments were made from the property loss reserve. Finally, while BOCES officials appropriately allocated interest earned to the property loss reserve during the period reviewed, they did not allocate interest to the property and casualty insurance reserve and the unemployment insurance reserve during that same 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.

¹ Includes the post-employment retirement benefit accrual of \$14.7 million, the workers’ compensation reserve of \$931,000, the Section 803 accrual reserve of \$33,000, the unemployment insurance reserve balance in excess of BOCES’ board approved cap by \$362,000, and \$897,000 excess in reserve for encumbrance.

² Includes a liability accrual that BOCES is using to fund future post-employment health insurance costs, which is discussed later in the report under “Post-Employment Retirement Benefit Accrual.” Our discussion of reserves throughout the report includes this accrual.

³ For the period July 1, 2007 through June 30, 2009, the total includes the post employment retirement benefit budgetary appropriation of \$2.1 million, the unemployment insurance budgetary appropriation of \$85,000, the workers’ compensation budgetary appropriation of \$1.7 million, and \$900,000 in surplus to the teachers’ incentive reserve.

⁴ Retirement and Social Security Law Section 803 provided for retroactive membership for public employees who failed to file an application for retirement system membership.

⁵ The Section 803 Accrual Reserve was not used.

Background and Methodology

BOCES serves eight component school districts in Rockland County. BOCES is governed by a nine-member Board of Education (Board) whose members represent the eight component school districts.⁶ BOCES' operating expenditures totaled \$85 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 participating⁷ school districts. The Board is responsible for establishing policies and procedures including documented plans for the funding and use of reserves. BOCES has approximately 800 employees working at one campus and in schools throughout the region. We examined the minutes of Board proceedings, accounting ledgers, financial statements, BOCES policies and procedures, and other reserve support materials and documentation.

BOCES can legally reserve funds for specific future uses, helping reduce its reliance on operating funds or borrowed moneys. Reserves must be established by Board resolution and in some instances⁸ 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

⁶ There is currently one member at large.

⁷ 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.

⁸ For example, a career and technical equipment reserve. The Rockland BOCES does not have this type of reserve.

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 conforms to statutory requirements.

During the audit period, BOCES maintained seven reserve funds that totaled approximately \$21.2 million at June 30, 2009 (prior to year-end adjustments):⁹

	June 30, 2006	June 30, 2007	June 30, 2008	June 30, 2009¹⁰
Property & Casualty Insurance Reserve	\$4,083,212	\$4,083,212	\$4,083,212	\$4,055,212
Property Loss Reserve	\$854,403	\$900,081	\$934,250	\$942,147
Unemployment Insurance Reserve	\$616,573	\$569,541	\$560,094	\$562,656
Post-Employment Retirement Benefit (PERB) Accrual	\$11,769,412	\$12,845,506	\$13,771,363	\$14,670,719
Workers' Compensation Reserve	\$827,075	\$712,551	\$800,305	\$931,281
Section 803 Accrual Reserve ¹¹	\$32,976	\$32,976	\$32,976	\$32,976
Teachers' Incentive Reserve	\$198,303	\$198,303	\$1,100,928	–
Total Reserves	\$18,381,954	\$19,342,170	\$21,283,128	\$21,194,991

BOCES officials properly established three¹² of the seven reserve funds by Board resolution and properly accounted for all reserve funds separately. However, BOCES does not have legal authority to establish a workers' compensation reserve, a teachers' incentive reserve, a section 803 accrual reserve, or a post-employment retirement benefit accrual. Our findings regarding BOCES' funding of reserves, disclosure of reserve allocations to the school districts, maintenance of reserve fund balances, and use of the reserve funds are detailed below.

Funding Reserves and Disclosure to School Districts

Any governing board, including a BOCES Board, that is planning to establish and finance reserve funds on a regular basis should develop a detailed written policy that communicates to taxpayers why the money is being set aside, the board's financial objectives for the reserves, optimal funding levels, and conditions under which the assets will be utilized. All reserve fund transactions should be transparent to the public. Reserve funds are typically funded from amounts raised through the annual budget process, transfers from unexpended balances of existing appropriations, and surplus 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.

⁹ 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.

¹⁰ June 30, 2009 data was unaudited and does not include year-end adjustments and transfers to reserves.

¹¹ Retirement and Social Security Law Section 803 provides for retroactive membership in the New York State and Local Employees Retirement System for public employees who failed to file an application for retirement system membership.

¹² Includes the reserve for property and casualty insurance, the property loss reserve and the unemployment insurance reserve

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.

BOCES allocated \$4.8 million¹³ 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. 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)¹⁴ budget and the Central Administration budget, which they provide to the component and participating school districts¹⁵ prior to the start of the fiscal year. Allocations to the unemployment insurance reserve and the workers' compensation reserve (which was established without statutory authority) are shown as a budgeted fringe benefit expenditure in the individual CoSer budgets, and allocations to the post-employment retirement benefit accrual (which was also established without statutory authority) are shown as a retiree benefits health insurance expenditure in the Central Administration 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.

Although the Board members, who represent the component school districts, told us that BOCES business officials are verbally communicating with them regarding reserves, 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

¹³ Includes funding of the post employment retirement benefit accrual of \$2.1 million, the unemployment insurance reserve of \$85,000, the teachers' incentive reserve of \$900,000, and the workers' compensation reserve of \$1.7 million.

¹⁴ The main vehicle for BOCES services provided to its school districts. CoSers programs must be approved by the State Education Department (SED).

¹⁵ For the CoSers programs in which they participate

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 or documented plans for the funding and use of the reserves. We also found that, while BOCES officials deposited interest earnings appropriately to the property loss reserve, they did not do so for the interest earned on funds in the unemployment insurance reserve or the property and casualty insurance reserve.

Property and Casualty Insurance Reserve – This reserve was established in June 1985, by board resolution. While the resolution establishing this reserve does not define its purpose, BOCES officials indicated that it was created per GML for payments of employment related legal claims, actions or judgments, not covered by insurance or other reserve funds. As of June 30, 2009 (prior to final year-end adjustments), the balance in this reserve was \$4,055,212. Since July 2005, the reserve has not been funded and only used for one settlement payment in the 2008-09 fiscal year, in the amount of \$28,000. During the audit period, and the previous two years reviewed for historical reserve fund activity, interest earned was not allocated to this reserve. We estimate that the additional interest earned for our audit period, which should be included in the reserve fund balance, totaled approximately \$162,768.¹⁶ Instead, these interest earnings were used as a funding source for BOCES operations.

While BOCES officials indicated that they deduct uninsured legal claims, actions and judgments from this reserve, they have not established a specific plan for its funding and use.

Property Loss Reserve – The Property Loss reserve was properly established in June 1999, by a board resolution which stated the source of funds shall be amounts that may be legally provided by budgetary appropriation. The resolution also established that the purpose of the reserve was for property losses. As of June 30, 2009 (prior to fiscal year end adjustments), the balance in this reserve was \$942,147. During the audit period, the reserve fund has been accounted for separately and maintained in a separate bank account, with interest being recorded in the reserve account. During the four-year period July 1, 2005 through June 30, 2009, the Property Loss Reserve balance has increased by \$87,700 due only to interest earned; the reserve has not been used or otherwise funded.

While BOCES officials indicated that they plan to deduct property losses from this reserve, they have not established a specific plan for its funding and use.

Unemployment Insurance Reserve – The board established this reserve in December 1977 for funding payments to reimburse the State Unemployment Insurance Fund for actual claims filed. A Board resolution dated June 1990 specifically states that the reserve balance is limited to \$200,000. However, the actual balance in the account as of June 2009 (prior to fiscal year end adjustments) is \$562,098. BOCES officials could not provide any additional board resolutions allowing an increase beyond the \$200,000 cap. BOCES has deposited into the reserve 0.1

¹⁶ 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.

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 \$85,000 during the 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 \$22,444. Instead, these interest earnings were used as a funding source for BOCES operations. Further, BOCES does not have a specific documented plan for money in this reserve.

BOCES officials indicated that the unemployment insurance reserve account is intended to be used to pay actual unemployment insurance claims. We found that payments made from this reserve during our audit period (averaging \$47,900 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.

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

Reserve for Encumbrance

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

As of June 30, 2008,¹⁷ BOCES reported the reserve for encumbrance was approximately \$3.6 million. We reviewed the supporting documentation for ten encumbrances totaling approximately \$1.5 million and determined that five, totaling \$897,000 (59.8 percent), were improperly reported because the goods or services were not actually ordered until the 2008-09 fiscal year and in some instances were never ordered, or the amount of the encumbrance carried forward, for blanket purchase orders, was excessive. This improper recognition of encumbrances caused the total surplus¹⁸ for the fiscal year ending June 30, 2008 to be underreported by at least \$897,000, reducing the amount refunded to school districts.

¹⁷ We reviewed the reserve for encumbrances as of June 30, 2008 only because our fieldwork was conducted prior to year-end adjustments and the recording of reserve for encumbrances as of June 30, 2009.

¹⁸ BOCES are not authorized to have unreserved fund balance and therefore any unused funds become surplus and are returned to component school districts.

Statutory Authority

BOCES cannot create reserves that are not specifically authorized by statute. However, during our audit period, BOCES maintained over \$15 million in four reserves¹⁹ for which it lacked such authority.

Post-Employment Retirement Benefit Accrual – Currently, there is no statute under GML or Education Law allowing the creation of a reserve for post-retirement health insurance premiums. While BOCES officials have not established a reserve for this purpose, officials have improperly accounted for post-employment health insurance costs that will be paid in future years as a current liability funded by excess, accumulated funds, having the same effect. As of June 30, 2008, the BOCES financial statements reported a current liability of approximately \$13.8 million for retirees' future health insurance premiums. These premiums were not due or payable at fiscal-year end and not expected to be liquidated with expendable available financial resources. As a result of the improper accounting and reporting of these post-employment health insurance liabilities, there was an overstatement of liabilities and a corresponding understatement of fund balance by that amount at that year-end date.

Generally accepted accounting principles (GAAP) direct that expenditures for governmental funds, such as the general fund, be recognized in the period in which the related obligation becomes due for payment. For post-employment health insurance benefits, expenditures should be based on health insurance premiums received which relate to the current fiscal year. A year-end liability would exist only if BOCES received a bill for health insurance premiums for the current year but had not paid the bill by year-end. Post-employment health insurance costs that will be paid in future years are not expenditures or current year liabilities, and the district has no authority to fund these post-retirement health insurance costs in advance. During our audit period, BOCES officials increased this Post Employment Retirement Benefit liability by \$2.1 million and consequently increased the overstatement of fund balance to \$14.7 million.

Workers' Compensation Reserve – Currently there is no clear statutory authority for a BOCES to create a Workers' Compensation Reserve. However, BOCES established a Workers' Compensation Reserve without Board resolution to pay for the BOCES' cooperative workers' compensation program. During our audit period, BOCES officials allocated \$1.7 million to this reserve without clearly identifying these allocations as reserve funding. BOCES expenditures totaled \$1,558,730 a year during our audit period. At the conclusion of fieldwork, the balance in this reserve was \$931,000.

Section 803 Accrual Reserve – There is no authority for a BOCES to create a Section 803 Accrual Reserve. BOCES established this reserve without Board resolution to set aside funds for payments relating to Section 803 of Retirement and Social Security Law. This law provided for retroactive membership for public employees who failed to file an application for retirement system membership. During our audit period, this reserve was not used or funded by BOCES, but was maintained at a constant balance of approximately \$33,000.

¹⁹ Includes amounts retained in three established reserves and an inappropriately accrued and reported long-term liability, each of which is discussed in further detail below.

Teachers' Incentive Reserve – A teachers' incentive reserve was established²⁰ by the BOCES without board resolution; however, BOCES discontinued usage of this reserve in June 2008. The reserve balance was approximately \$198,000 during fiscal years 2005-06 and 2006-07. At the end of the 2007-2008 fiscal year, BOCES deposited approximately \$900,000 of surplus into this reserve for the payment of teachers' retirement incentives. The teachers' retirement incentives were paid in June 2008, leaving a balance of approximately \$198,000 in the reserve. BOCES used the balance in the reserve to reduce expenditures in various special education CoSers. BOCES could not provide documentation that the original funding came from these CoSers; however, BOCES officials indicated that they reduced these expenditures because they recalled the reserve funding originating from these accounts.

At the conclusion of our fieldwork, the balances in these reserves totaled over \$15.7 million.²¹ In the absence of clear statutory authority, BOCES officials should return the moneys in these reserves 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 officials should analyze year-end encumbrances to ensure that they are reasonable and supported. The Board should ensure that its independent auditors review the accounting for encumbrances as part of their audit.
6. BOCES officials should discontinue the improper recording of the post employment retirement benefits accrued liability in their financial statements. All funds that BOCES has accumulated to support such liability, with the exception of current health insurance coverage received but not paid for by year-end, should be properly apportioned to the component and participating school districts.

²⁰ BOCES officials were unable to provide the date the reserve was established. However, based on financial data reviewed, we were able to determine that the reserve was established prior to 1997.

²¹ Includes \$14.7 million for post employment retirement benefit accrual, \$931,000 for workers' compensation reserve and \$33,000 for the Section 803 claim reserve.

7. BOCES management should discontinue the use of its workers' compensation reserve and Section 803 claim reserve. The funds in these reserves should be returned to operating funds and properly apportioned to the component and participating school districts.

The Board has the responsibility to initiate corrective action. Pursuant to Section 35 of the General Municipal Law, Section 2116-a (3)(c) of the Education Law, and Section 170.12 of the Regulations of the Commissioner of Education, a written corrective action plan (CAP) that addresses the findings and recommendations in this report must be prepared and provided to our office within 90 days, with a copy forwarded to the Commissioner of Education. To the extent practicable, implementation of the CAP must begin by the end of the next fiscal year. For more information on preparing and filing your CAP, please refer to our brochure, *Responding to an OSC Audit Report*, which you received with the draft audit report. The Board should make the CAP available for public review in the Clerk's office.

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

Sincerely,

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

APPENDIX A

RESPONSE FROM BOCES OFFICIALS

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



ROCKLAND BOCES

BOARD OF COOPERATIVE EDUCATIONAL SERVICES

65 Parrott Road, West Nyack, NY 10994-0607 | www.rocklandboces.org

Mary Jean Marsico, Ed.D.

District Superintendent / CEO

(845) 627-4701 | Fax: (845) 624-1764

mmarsico@rboces.org

"It is today that we create the world of the future."

– Eleanor Roosevelt

March 11, 2010

Ms. Ann C. Singer
Chief Examiner – Statewide and Regional Projects
Division of Local Government and School Accountability
Office of the State Comptroller
State Office Building
44 Hawley Street, Room 1701
Binghamton, New York 13901-4417

Re: Rockland County Board of Cooperative Educational Services
Report No. S9-9-78

Dear Ms. Singer:

The purpose of this letter is to respond to your Draft Report of Examination letter containing findings and recommendations specific to the Rockland BOCES.

Introduction

The recently completed audit follows an earlier one conducted by your office covering the period July 1, 2007 through August 31, 2008 (2008M-241). That report addressed internal controls over selected operations for the prescribed period. Based upon that audit experience, we expected that the current audit would have provided us with specific recommendations to assist us in meeting our statutory and contractual obligations in such matters as post-employment retirement benefits and workers' compensation in a fiscally prudent manner. Instead, the recommendations are actually "directives" to discontinue our current procedures even though they are fully consistent with Generally Accepted Accounting Principles (GAAP) and the Governmental Accounting Standards Board (GASB), and have been examined and approved by our external auditor.

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Note 1
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Note 2
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Overview

In reviewing the New York State Comptroller website, we note the following: "The audits help ensure that programs achieve their established goals, funds are used efficiently, and assets are adequately protected against fraud, waste and abuse."

We note that your Draft Report of Examination letter makes no reference to having found any fraud, waste or abuse in Rockland BOCES. We are not surprised by that since we take great pride in making sure we use every dollar entrusted to us consistent with our mission.

Rockland BOCES, in partnership with our eight local school districts, is known as a leader in providing quality, cost-effective, educationally focused programs and services throughout the region.

In the area of Special Education, we work in cooperation with schools, parents and professionals to provide the best possible service to classified and non-classified students from our component districts as well as from school districts in Westchester, Orange and Putnam counties. We provide quality programs and services on a daily basis to students with educational, physical, behavioral, and mental health challenges. We have been recognized repeatedly for our use of educational strategies that develop each child's potential.

In the area of Career and Technical Education, we recognize that today's workplace is a highly competitive market and that employers are looking for a skilled and knowledgeable workforce. The career training that takes place for our students occurs in state-of-the-art shops and in newly renovated classrooms on our campus, and in internship programs throughout the region. Our students are taught by certified, industry-experienced teachers and they are well prepared for the workforce that will follow their BOCES experience.

In the area of Educational Services, we provide direct instructional services to students, and comprehensive staff development programs for professional educators throughout our region.

In the area of Adult Education, we provide business and industry training, adult literacy resource centers, career training and continuing education.

In 2002, our Hilltop School program, which provides educational programs for young children with severe emotional and learning disabilities, was one of 25 winners nationally of the 8th Annual Magna Award from the *National School Board Journal*.

Later in 2002, our BOCES won a \$600,000 grant from the State Education Department to provide services to students with emotional and mental disabilities. We were recognized because of our leadership in providing a continuum of services for children with special needs. This program continues to lead the way in providing local school districts with the necessary strategies to help educate children who are failing because of problems that have nothing to do with their ability to understand the curriculum but rather which are due to emotional and mental disabilities. This program meets the needs of students who are emotionally fragile and we have been providing leadership in that area ever since.

In 2004 our Direct Care program was also honored with a second Magna Award from the *National School Board Journal*. The achievement of winning a second Magna Award

demonstrates the high caliber of programs and services being delivered by Rockland BOCES.

As the BOCES District Superintendent, I, in concert with the Chairwoman of the County Legislature, act as leads in the only county-wide initiative in New York State that provides for Family Resources Center services to support children and families. This exemplifies the collaborative and well recognized expertise of this BOCES.

We do all of the above in a highly cost-efficient manner while at all times being mindful of our duty to protect against fraud, waste and abuse of taxpayer dollars.

Recommendations and Responses

Recommendation No. 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.

Response No. 1

Since the completion of your audit, our senior management team has met with its business officials, attorney and external auditor. There will be additional meetings by this group. We are in the process of reviewing all (1) Board policies, (2) statutory and regulatory requirements and (3) your draft report.

Prior to the start of your audit, we entered into an agreement with the New York State School Boards Association for a full review of our entire policy manual. We will be providing our Board with recommendations for the implementation and/or modification of policies and procedures, where necessary, and we will be consulting with the New York State School Boards Association over the next several months. As part of that process, we will be reviewing all existing reserves and accruals as addressed in your draft report.

Recommendation No. 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.

Response No. 2

Our BOCES has a long tradition of having an interactive and transparent relationship with our component school districts. The District Superintendent meets with the Superintendent of Schools of the eight component districts on a monthly basis throughout

the school year. The BOCES business officials meet monthly with their counterparts in the eight component school districts as well.

We also have a program each December to explain our programs and services to all of our components and in April we hold our Annual Meeting at which time we have an interactive presentation regarding our budget. Beyond that, the District Superintendent visits the component school districts during the course of the school year for the purpose of meeting with each board of education.

We are now working on our annual budget presentation that will contain an even more extensive disclosure of the monies budgeted for the purpose of funding reserves and accruals. Information pertaining to fund reserves and accruals will be specifically identified in our written presentation at our annual meeting next month.

Recommendation No. 3

BOCES officials should ensure that interest is appropriately allocated to reserve funds according to statutory requirements.

Response No. 3

We agree with this recommendation and we will see to it that interest is appropriately allocated to reserve funds according to statute.

The Property Loss Reserve is maintained in a separate bank account and interest is accrued separately.

As far as the Property and Casualty Reserve and the Unemployment Insurance Reserve, we will allocate interest earned based upon prevailing bank rates.

Recommendation No. 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.

Response No. 4

Subsequent to the audit, we have been engaged in a process of reviewing the balances in our various reserves. Our plan of action with regard to them is as follows:

- a. Property and Casualty Insurance Reserve. This reserve, more commonly known as the Insurance Reserve Fund, created pursuant to General Municipal Law 6-n, will be reduced and the remaining funds will be returned to the component and participating school districts.

b. Property Loss Reserve. This reserve is established pursuant to Education Law §1709(8-c). We have reviewed the current balance and, at this time, believe it is reasonable, necessary and appropriate.

c. Unemployment Insurance Reserve. This reserve has been established pursuant to General Municipal Law 6-m. The audit disclosed to us that a Board resolution limited the amount of the reserve to \$200,000 which was inadequate. We have determined that the reasonable and necessary reserve should be \$500,000. Last month, the BOCES Board adopted a resolution increasing the limit to \$500,000. We anticipate that there will be a significant increase in unemployment insurance claims as a result of a reduction in force in the BOCES staff.

d. Teachers' Incentive Reserve. This reserve has been dissolved and the remaining funds were returned to the component school districts.

Recommendation No. 5

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

Response No. 5

Prior to the commencement of the audit, BOCES officials reviewed all of the encumbrances as of June 30, 2008. Several of the encumbrances were based upon estimates of the amount to be expended and/or the timing of the particular expense. The review resulted in the liquidation, in 2008/09, of any encumbrance for which the expenditure was not anticipated to occur in a short period of time. Those funds were returned to the component school districts in the year ending June 30, 2009. All year-end encumbrances are reviewed annually by BOCES officials and are subject to testing by our external auditor. The Board will ensure that its independent auditor does review the accounting for encumbrances as part of the audit process.

Recommendation No. 6

BOCES officials should discontinue the improper recording of the post employment retirement benefits accrued liability in their financial statements. All funds that BOCES has accumulated to support such liability, with the exception of current health insurance coverage received but not paid for by year-end, should be properly apportioned to the component and participating school districts.

Response No. 6

In December 2009, the State withheld \$715 million, approximately 15%, of scheduled State Aid payments, in order to keep the State solvent. A month later, when the State received tax receipts, it then made the State Aid payments that were due the previous month.

Recent reports indicate that the State was expected to be \$1.4 billion short of necessary cash to make payments this month. Revised estimates indicate that the actual shortfall will be \$2.1 billion, a full 50% increase. The possibility exists that due to the State's cash shortfall, State Aid payments could be delayed once again.

On January 22, 2010, Comptroller DiNapoli issued a press release with the following information:

“DiNapoli also released the January 2010 Cash Report. The report found the General Fund ended the month with a balance of \$3.2 billion, which was \$28.6 million lower than projected. General Fund revenue collections, including transfers from other funds, through January 31 of \$41.5 billion were \$10.8 million below projections updated in the 21-day amendments released February 9 and \$4 billion or 8.7 percent lower than collections for the same period in SFY 2008-09. General Fund spending of \$40.2 billion was \$18.3 million higher than projections updated in the 21-day amendments or \$2.3 billion or 5.5 percent lower than the same period last year.”

Last month The Pew Center on the States issued a report captioned “The Trillion Dollar Gap.” Among its findings was that while New York State has the best funded pension system in the country, the State has failed to set aside any funds to cover a bill coming due of \$56.3 billion over the long term for retiree health care and other non-pension benefits.

With the above as backdrop, we do not agree with this recommendation. BOCES has very clear legal responsibilities in terms of its retiree health insurance obligations.

BOCES had an actuarial study done in February 2009 to ensure that it had an objective GASB 45 actuarial valuation. The actuarial valuation showed an OPEB liability of \$55.7 million. Consistent with Generally Accepted Accounting Principals (GAAP), BOCES has accrued \$14.67 million to partially account for its OPEB obligation.

See
Note 2
Page 20

Pursuant to a report issued by the State Education Department captioned Financial and Statistical Outcomes of the Boards of Cooperative Educational Services (June 2009), Rockland BOCES has properly made provision for OPEB.

See
Note 4
Page 20

The aforesaid SED report provides: “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, but the BOCES including the cost in administration will have a greater administration budget than the BOCES which have established a reserve.”

See
Note 4
Page 20

Accruing for OPEB is consistent with GAAP and GASB. BOCES does not agree with the Comptroller that the accrual for OPEB is unauthorized; rather, our external auditor has advised us as follows:

See
Note 2
Page 20

- a. A liability can be recorded for any contractual obligations that are due at a later date. OPEB is such an obligation. Since BOCES matches its expenses with its revenue on a yearly basis and records its liabilities using a full accrual method, it must have an OPEB accrual.
- b. An OPEB accrual is fiscally prudent since it ensures that the expenses are shared on an equitable basis.
- c. BOCES has “internally” funded its OPEB obligation, at least partially, by recording an OPEB liability. This is consistent with GASB 45.

See
Note 2
Page 20

While there is no current legislation making provision for an OPEB reserve, an accrual for OPEB is consistent with GAAP, GASB and the professional opinion of our external auditor.

BOCES believes that it has the implied authority to have an accrual for its post-employment retirement benefits because it has a legal obligation to fund those benefits.

See
Note 2
Page 20

We have been advised by our attorney that the issue of implied authority recently came before the Court of Appeals in Consedine v. Portville Central School District, 12 N.Y.3d 286, 879 N.Y.S.2d 806 (2009). The matter then before the court was whether a school district could waive its statutory right to discharge a probationary school administrator at any time during the three-year probationary term by entering into a durational, three-year employment contract.

While those facts are totally different from the matter under review in the audit, the finding of the Court of Appeals on the legal issue is directly on point. The Court of Appeals held, in pertinent part, that “. . . in performing their normal administrative and managerial functions, school boards and districts necessarily enter into different types of contracts that are not expressly authorized by statute.”

In like manner, since Rockland BOCES has statutory and contractual responsibilities for both post-employment retirement benefits and workers’ compensation, our external auditor and attorney believe that we do have the implied authority to accrue for these obligations even though it is not expressly authorized by statute.

See
Note 2
Page 20

Recommendation No. 7

BOCES management should discontinue the use of its unauthorized workers’ compensation reserve and section 803 claim reserve. The funds in these reserves should be returned to operating funds and properly apportioned to the component and participating school districts.

Response No. 7

Education Law §1950 provides that a BOCES is authorized to provide worker's compensation coverage. Rockland BOCES is part of a consortium with its component school districts for the provision of worker's compensation insurance. This is permissible under Comptroller's Opinion No. 83-202. While admittedly improperly labeled as a Worker's Compensation Reserve, the money actually is an accrual for expenditures. The only amounts reported in this accrual are for current year obligations paid out in the next fiscal year. BOCES will refund any amount that is in excess of its obligation to its component districts at the end of the fiscal year.

See
Note 5
Page 21

Since the purpose of Retirement and Social Security Law §803 is no longer an issue, we agree with the recommendation and will be dissolving this reserve and returning any remaining funds to the component districts.

Conclusion

We will be preparing a corrective action plan that will be presented to the BOCES Board for approval at an upcoming meeting. Once we have done so, we will file it as required.

We will strive to continue providing an outstanding level of programs and services to our component school districts, their students and families, and will do so in a cost-efficient and fiscally prudent manner.

We certainly agree with the Comptroller who has stated publicly that having a mechanism in place to fund the OPEB liability would be fiscally prudent.

While we await a decision of the State Legislature in terms of the possibility of establishing OPEB trusts to fund the cost of future retirees' health insurance and other benefits, we must be fiscally prudent ourselves to make sure that we meet our statutory and contractual obligations in a manner that best meets the needs of our component school districts.

Very truly yours,



Mary Jean Marsico, Ed.D.
District Superintendent/CEO

MJM:cb

copy: BOCES Board of Education

APPENDIX B

OSC COMMENTS ON BOCES' RESPONSE

Note 1

BOCES' current practice involves maintaining a workers' compensation reserve, a section 803-claim reserve and a post-employment retirement benefits accrual that are not allowed by law. Therefore, our recommendations to meet statutory requirements are to discontinue reserves or accruals that lack statutory authority.

Note 2

Generally accepted accounting principles (GAAP) require that general fund financial activities be accounted for and reported on a modified accrual basis of accounting, which provides for recognizing expenditures when they are expected to draw on current spendable resources. In essence, GAAP allows for liabilities (and the related expenditures) to be recognized in the general fund only to the extent that they are normally expected to be liquidated with expendable available financial resources. Long-term liabilities are to be reported only in the entity-wide financial statements.

In the BOCES financial statements for the fiscal year ending June 30, 2009, the reported general fund balance sheet accounts for \$14.7 million in accrued post-employment retirement benefits, none of which are due or payable at fiscal year-end and/or expected to be liquidated with expendable available financial resources. This amount is a long-term liability that would be properly reported in the BOCES' financial statements or the notes to the financial statements. Further, the BOCES' has no legal authority to accrue funds to pay for retiree health insurance benefits, otherwise known as other post-employment benefits (OPEB).

Note 3

The objective of the audit was limited in scope and was specifically intended to determine if BOCES have been reserving excessive funds without informing their component and participating school districts.

Note 4

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 5

The BOCES practice of reserving funds for workers' compensation is currently not authorized by statute. If BOCES officials wish to accrue current liabilities for workers' compensation, they should account for them in an accrual that is liquidated at the end of each fiscal year. BOCES can choose to pursue changes to the statute through the State Legislature.