



# Holley Central School District

## Financial Condition

### Report of Examination

Period Covered:

July 1, 2008 — October 21, 2013

2013M-342



Thomas P. DiNapoli

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# **State of New York**

## **Office of the State Comptroller**

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### **Division of Local Government and School Accountability**

February 2014

Dear School District Officials:

A top priority of the Office of the State Comptroller is to help school district officials manage their districts efficiently and effectively and, by so doing, provide accountability for tax dollars spent to support district operations. The Comptroller oversees the fiscal affairs of districts statewide as well as districts' compliance with relevant statutes and observance of good business practices. This fiscal oversight is accomplished, in part, through our audits, which identify opportunities for improving operations and Board of Education governance. Audits also can identify strategies to reduce costs and to strengthen controls intended to safeguard district assets.

Following is a report of our audit of the Holley Central School District, entitled Financial Condition. This audit was conducted pursuant to Article V, Section 1 of the State Constitution and the State Comptroller's authority as set forth in Article 3 of the General Municipal Law.

This audit's results and recommendations are resources for district officials to use in effectively managing operations and in meeting the expectations of their constituents. If you have questions about this report, please feel free to contact the local regional office for your county, as listed at the end of this report.

Respectfully submitted,

*Office of the State Comptroller  
Division of Local Government  
and School Accountability*

# Introduction

## Background

The Holley Central School District (District) is located in the Town of Murray in Orleans County. The District is governed by a Board of Education (Board), which comprises seven elected members. The Board is responsible for the general management and control of the District's financial and educational affairs. The Superintendent of Schools (Superintendent) is the chief executive officer of the District and is responsible, along with other administrative staff, for the day-to-day management of the District under the direction of the Board. The Business Administrator is responsible for accounting for the District's finances, maintaining accounting records and preparing financial reports.

The District has two schools in operation, with an enrollment of approximately 1,150 students. The District's budgeted appropriations for the 2013-14 fiscal year total \$23 million and are funded primarily with real property taxes and State aid. As of June 30, 2013, the District had approximately \$9.7 million in fund balance.

## Objective

The objective of our audit was to examine the District's financial management practices. Our audit addressed the following related question:

- Did the Board properly manage District finances by ensuring budgets were realistic and by maintaining fund balance levels in accordance with statutory requirements?

## Scope and Methodology

We examined the District's financial management practices for the period July 1, 2008 through October 21, 2013. We expanded our scope back to the 2005-06 fiscal year as it related to certain financial activity.

We conducted our audit in accordance with generally accepted government auditing standards (GAGAS). More information on such standards and the methodology used in performing this audit is included in Appendix B of this report.

## Comments of District Officials and Corrective Action

The results of our audit and recommendations have been discussed with District officials and their comments, which appear in Appendix A, have been considered in preparing this report. District officials agreed with the findings and recommendations and indicated that they planned to take corrective action.

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 District Clerk's office.

## Financial Condition

A school district's financial condition is a factor in determining its ability to fund public educational services for students within the district. The responsibility for accurate and effective financial planning rests with the Board, the Superintendent and the Business Administrator. The Board and District officials are responsible for adopting annual budgets that contain realistic estimates of expenditures and the resources available to fund them and for ensuring that fund balance does not exceed the amount allowed by law. Fund balance represents the cumulative residual resources from prior fiscal years that can, and in some cases must, be used to lower property taxes for the ensuing fiscal year. A district may retain a portion of fund balance, referred to as unexpended surplus funds,<sup>1</sup> but must do so within the legal limits established by Real Property Tax Law. A district also can legally set aside and reserve portions of fund balance to finance future costs for a variety of specified objects or purposes.

For the last five fiscal years ending June 30, 2013, the Board and District officials consistently underestimated revenues by a total of \$7.2 million and overestimated expenditures by a total of \$4.4 million. These budgeting practices generated approximately \$6.7 million in operating surpluses, which caused unexpended surplus funds to significantly exceed the statutory limit each year. Although District officials annually appropriated fund balance to reduce the tax levy, these funds were not needed because the budgeting practices generated operating surpluses. As a result, the District's unexpended surplus funds exceeded the statutory limit of 4 percent of the ensuing year's budget by more than \$7 million, or 35 percent, as of June 30, 2013. Furthermore, District officials improperly accounted for certain financial activity which understated unexpended surplus funds by approximately \$1 million. Consequently the District has accumulated more than \$8 million in unexpended surplus funds. Due to these practices, the Board and District officials have withheld

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<sup>1</sup> The Governmental Accounting Standards Board (GASB) issued Statement 54, which replaces the fund balance classifications of reserved and unreserved with new classifications: nonspendable, restricted and unrestricted (composed of committed, assigned and unassigned funds). The requirements of Statement 54 are effective for fiscal years ending June 30, 2011 and beyond. To ease comparability between fiscal years ending before and after the implementation of Statement 54, we will use the term "unexpended surplus funds" to refer to that portion of fund balance that was classified as unreserved, unappropriated (prior to Statement 54) and is now classified as unrestricted, minus appropriated fund balance, amounts reserved for insurance recovery and tax reduction, and encumbrances included in committed and assigned fund balance (post-Statement 54).

significant funds from productive use, levied unnecessary taxes and compromised the transparency of District finances to the taxpayers.

The Board and District officials are responsible for accurately estimating expenditures, revenues and fund balance that will be available at fiscal year-end to reduce the ensuing year's tax levy. Accurate estimates help ensure that the levy of real property taxes is not greater than necessary. The estimation of fund balance is an integral part of the budget process. Unexpended fund balance represents uncommitted funds. The portion of the unexpended fund balance that is used to help finance the next fiscal year's budget is referred to as appropriated fund balance and the remaining portion, which can be used for cash flow purposes and unanticipated expenditures, is unexpended surplus funds. The Real Property Tax Law currently limits unexpended surplus funds to no more than 4 percent of the ensuing year's budget. Any surplus fund balance over this percentage should be used for nonrecurring expenditures, to fund prudently established and maintained reserve funds and/or to reduce the upcoming fiscal year's tax levy.

We compared the District's budgeted revenues and expenditures with actual results for the last five fiscal years and found that the Board and District officials underestimated revenues by more than \$7.2 million and overestimated expenditures by approximately \$4.4 million, resulting in a total budget variance of \$11.6 million – approximately 12 percent of the budgets. The most significant revenue variance was for State aid by a total of more than \$5 million during the five fiscal years reviewed. The most significant expenditure variance was approximately \$2.3 million for employee benefits<sup>2</sup> during the same period. The Board president indicated that the District's budgeting process is based on current year expenditures, by department, available at the time the budget is being developed.

Due to these budgetary practices, the District experienced a cumulative operating surplus totaling approximately \$6.7 million during the last five fiscal years. Although fund balance was annually appropriated to fund the next year's expenditures, the operating surpluses offset any actual benefit of appropriating fund balance in the budget. As such, District officials routinely retained these surpluses instead of using them to benefit taxpayers. Budgeting practices which produce operating surpluses and maintain fund balances that exceed the amount allowed by law result in real property tax levies that are greater than necessary to fund operations. As shown in Table 1, the District had significantly exceeded the statutory limit for fund balance in all five fiscal years.

<sup>2</sup> Includes retirement contributions, social security, workers' compensation, and unemployment and health insurance

**Table 1: Fund Balance Over Statutory Limit**

	FY 2008-09	FY 2009-10	FY 2010-11	FY 2011-12	FY 2012-13
Unexpended Fund Balance	\$5,180,756	\$6,935,942	\$5,532,557	\$5,922,134	\$6,290,601
Appropriated Fund Balance <sup>a</sup>	\$591,101	\$591,101	\$1,491,000	\$1,636,881	\$1,636,881
Unexpended Surplus Funds	\$5,771,857	\$7,527,043	\$7,023,557	\$7,559,015	\$7,927,482
Subsequent Year's Budget	\$19,935,461	\$19,408,461	\$19,750,599	\$19,967,841	\$22,976,429
Statutory Limit (4% of Subsequent Year's Budget)	\$797,418	\$776,338	\$790,024	\$798,714	\$919,057
<b>Unexpended Surplus Funds Over the Statutory Limit</b>	<b>\$4,974,439</b>	<b>\$6,750,705</b>	<b>\$6,233,533</b>	<b>\$6,760,301</b>	<b>\$7,008,425</b>
<b>Unexpended Surplus Funds as Percentage of the Subsequent Year's Budget</b>	<b>29%</b>	<b>39%</b>	<b>36%</b>	<b>38%</b>	<b>35%</b>

<sup>a</sup> Even though amounts were designated for subsequent year expenditures, they were never needed because of the District's budgetary practices. Therefore, they are considered unexpended surplus funds.

Unexpended surplus funds significantly exceeded the 4 percent statutory limit, in each of the five fiscal years reviewed, by amounts that ranged from \$5 million in the 2008-09 fiscal year up to \$7 million in the 2012-13 fiscal year. We also found that the District had improperly accounted for certain financial activity,<sup>3</sup> totaling approximately \$1 million as of June 30, 2013, which, if District officials had handled properly, would have further increased the amount that exceeded the statutory limit.

**Capital Projects Fund** — During the last five fiscal years, the District has transferred \$2.45 million from the general fund to the capital projects fund. We found that voters approved the transfer of \$2.05 million for specific capital projects the District has undertaken the last few years. However, the Board also annually transferred \$80,000 from the general fund to the capital projects fund without the required voter approval (i.e., for a capital reserve) or for a specific Board authorized purpose, such as financing a capital expenditure with operating funds. As such, approximately \$400,000 of general fund moneys are improperly residing in the capital projects fund.

**Debt Service Fund** — The District maintains a debt service fund with a balance of approximately \$314,000 as of June 30, 2013. District officials were unable to identify the source of these funds or demonstrate why these moneys should be restricted in the debt service fund. If these moneys are remaining bond proceeds, they must be used to pay the related debt. If these moneys are not statutorily required to be restricted in the debt service fund, they should be returned to the general fund. We reviewed financial statements back to the 2005-

<sup>3</sup> Financial activities related to the capital projects fund, the debt service fund and encumbrances

06 fiscal year and found the balance increased from \$418,000 in the 2005-06 fiscal year to \$451,000 in the 2010-11 fiscal year. In the 2011-12 fiscal year, the District transferred approximately \$143,000 from the debt service fund to the general and capital project funds.

Encumbrances — We also found that certain encumbrances were improperly recorded as of June 30, 2013. District officials reported encumbrances totaling \$377,000 for two health insurance premium payments for the subsequent fiscal year. Since the District accounted for all 12 monthly payments as expenditures during the 2012-13 fiscal year, these two monthly premium payments will be budgeted for and charged as expenditures in the subsequent fiscal year. They should not be reflected as fund balance committed as of June 30, 2013. By doing so, the District's unexpended surplus funds are improperly understated by \$377,000. We contacted the District's external auditor to discuss these encumbrances, who agreed that the encumbrances were not properly recognized.

If these funds were properly accounted for and were reflected in the unexpended surplus funds, the District would be exceeding the statutory limit of 4 percent of the ensuing year's budget by an additional \$1 million – or a total of more than \$8 million – as of June 30, 2013. By maintaining excessive and/or unnecessary fund balance, a result of ongoing budgeting practices that routinely generated operating surpluses, the Board and District officials have withheld significant funds from productive use and levied unnecessarily high taxes. These practices have placed an undue burden on, and compromised the transparency of District finances to, the taxpayers.

## **Recommendations**

1. The Board and District officials should develop realistic revenue, expenditure and fund balance estimates for the annual budget.
2. The Board and District officials should return moneys improperly residing in the capital projects fund to the general fund.
3. District officials should determine the source of moneys in the debt reserve fund and either use it to pay related debt, if required to do so by statute, or return the moneys to the general fund.
4. District officials should properly record and report encumbrances.
5. District officials should ensure that the amount of the District's unexpended surplus fund balance is in compliance with Real Property Tax Law statutory limits and develop a plan for the use of the general fund's excess unexpended surplus funds in a manner that benefits District taxpayers. Such uses could include, but are not limited to:

- Paying off debt,
- Financing one-time expenditures,
- Establishing and funding reserve funds prudently and transparently using the budget process and/or
- Reducing District property taxes.

## **APPENDIX A**

### **RESPONSE FROM DISTRICT OFFICIALS**

The District officials' response to this audit can be found on the following page.



# Holley Central School District

Robert C. D'Angelo  
Superintendent of Schools  
[rdangelo@holleycsd.org](mailto:rdangelo@holleycsd.org)

January 28, 2014

Mr. Robert Meller, Chief Examiner  
Office of the State Comptroller  
Local Government and School Accountability  
Buffalo Regional Office  
295 Main Street, Room 1032  
Buffalo, NY 14203-2510

Dear Mr. Meller:

On behalf of the Holley Central School District I hereby acknowledge receipt of the Holley Central School District Draft Financial Condition Report of Examination for the period July 1, 2008 – October 21, 2013. This letter shall serve as our official response.

We have thoroughly reviewed the draft report and the District agrees with the recommendations set forth in the draft audit report. The District is committed to ensuring that we have adequate resources to deliver the programs that the community desires. We also feel that it is important to be fiscally responsible to our students, our taxpayers and our employees.

The District has already made changes due to the findings and will endeavor to address in a timely and effective manner all of the recommendations included in the draft report.

We would like to extend our appreciation to [REDACTED] for her comprehensive review of our finances and the courteous and professional manner in which she conducted the interviews and audit. We have found it beneficial to have such a review of our financial management practices and we are thankful that this review found no fiscal misconduct or illegal practices.

Sincerely,

Robert C. D'Angelo  
Superintendent

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DIVISION OF LOCAL GOVERNMENT AND SCHOOL ACCOUNTABILITY

## **APPENDIX B**

### **AUDIT METHODOLOGY AND STANDARDS**

Our objective was to assess the District's financial management practices. To accomplish our objective, we performed the following procedures:

- We interviewed Board members and District officials to obtain an understanding of the District's financial management practices, including budgeting, accounting and use of reserve funds.
- We compared budgets with actual results for the 2008-09 through 2012-13 fiscal years to assess whether the budgets were realistic and supported.
- We reviewed the last five years of audited financial statements and analyzed certain balance sheet items, interfund activity and the debt service fund.
- We reviewed capital project proposals and approvals by the Board and voters.

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

## **APPENDIX C**

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# APPENDIX D

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