



Falconer Central School District Financial Management

Report of Examination

Period Covered:

July 1, 2012 – February 11, 2016

2016M-146



Thomas P. DiNapoli

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State of New York Office of the State Comptroller

Division of Local Government and School Accountability

July 2016

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 district operations and Board of Education governance. Audits also can identify strategies to reduce district costs and to strengthen controls intended to safeguard district assets.

Following is a report of our audit of the Falconer Central School District, entitled Financial Management. 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 New York State 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 Falconer Central School District (District) is located in the Towns of Carroll, Ellicott, Ellington, Gerry and Poland, in Chautauqua County. The District is governed by the Board of Education (Board), which is composed of 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 District's chief executive officer and is responsible, along with the Business Manager and other administrative staff, for the day-to-day management of the District under the Board's direction.

The District operates three schools with approximately 1,100 students and 200 employees. The District's budgeted appropriations for the 2015-16 fiscal year totaled \$21.3 million and were funded primarily with State aid and real property taxes.

Objective

The objective of our audit was to evaluate the District's financial condition. Our audit addressed the following related question:

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

Scope and Methodology

We examined the District's financial condition for the period July 1, 2012 through February 11, 2016.

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 are 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 generally agreed with our findings and recommendations and indicated they planned to initiate corrective action.

The Board has the responsibility to initiate corrective action. Pursuant to Section 35 of General Municipal Law, Section 2116-a (3)(c) of New York State 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 Management

The Board, Superintendent and Business Manager are responsible for accurate and effective financial planning and management. The Board and District officials are responsible for adopting annual budgets that contain realistic estimates of revenues and appropriations 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 subsequent fiscal year. A school district may retain a portion of fund balance referred to as unrestricted fund balance, but must do so within the legal limit established by the New York State Real Property Tax Law (RPTL).¹ A school district can legally set aside and reserve portions of fund balance to finance future costs for a variety of specified objects or purposes. The Board should balance the intent for accumulating money for future identified needs with the obligation to ensure that residents are not overburdened.

District officials did not prepare accurate budgets for the 2012-13, 2013-14 and 2014-15 fiscal years. The District overestimated appropriations by an average of \$2.5 million each year. While the District appropriated fund balance to help finance operations, the amounts appropriated were generally not used. Furthermore, unrestricted fund balance has exceeded the legal limit annually. As of June 30, 2015, unrestricted fund balance was \$2.6 million (12 percent of the ensuing year's budget) or approximately \$1.7 million over the legally allowable limit. Finally, the District retained \$5.7 million in a debt reserve and overfunded the employee benefit accrued liability reserve (EBALR) by \$220,000 (20 percent).

Budgeting

The Board and District officials are responsible for accurately estimating revenues and appropriations in the annual budget. Accurate budget estimates help ensure that the real property tax levy is not greater than necessary.

We compared the District's estimated revenues and appropriations with actual results of operations for 2012-13 through 2014-15 and found that, while the revenue variances were minimal, the District overestimated appropriations by an average of \$2.5 million each year (Figure 1).

¹ RPTL limits the amount of unrestricted fund balance to no more than 4 percent of the subsequent year's budget.

Figure 1: Overestimated Appropriations			
	2012-13	2013-14	2014-15
Appropriations	\$20,819,476	\$21,352,772	\$21,306,970
Expenditures ^a	\$18,397,335	\$18,869,378	\$18,757,292
Variance	\$2,422,141	\$2,483,394	\$2,549,678
Variance Percentage	13.2%	13.2%	13.6%

^a Excludes expenditures charged to reserves.

Over the three fiscal years, District officials annually appropriated more than the District actually spent for employee benefits² and instructional salaries.³ Because these costs are determined by contractual agreements, District officials should be able to reasonably estimate these appropriations. Because the District overestimated appropriations in its budgets by approximately \$2.7 million for salaries and benefits, it has levied more real property taxes than necessary to fund operations.

Fund Balance

The estimation of fund balance is an integral part of the budget process. RPTL currently limits unrestricted fund balance to no more than 4 percent of the ensuing fiscal year’s budget. Any surplus fund balance over this percentage should be used to reduce the upcoming fiscal year’s tax levy.

When fund balance is appropriated as a funding source, the expectation is that there will be a planned operating deficit in the ensuing fiscal year equal to the amount of fund balance appropriated. This allows a school district to return excess fund balance that it accumulated in prior years back to the residents. Due to the District’s practice of overestimating appropriations, it has realized an operating surplus in two of the last three fiscal years (Figure 2). As a result, the District did not use most of the appropriated fund balance it budgeted to help finance operations.

Furthermore, the District retained unrestricted fund balance in excess of the legal limit. As of June 30, 2015, unrestricted fund balance was 12.2 percent of the next year’s budget and exceeded the statutory limit by approximately \$1.7 million.

The District has realized operating surpluses and retained excessive fund balance. It also levied real property taxes averaging \$6.8 million over the last three completed fiscal years.⁴

² Includes retirement contributions, health insurance and employer Social Security contributions.

³ The variances totaled \$1.66 million for employee benefits and \$1.04 million for instructional salaries over the three-year period.

⁴ 2012-13 through 2014-15

Figure 2: Unrestricted Fund Balance at Year-End			
	2012-13	2013-14	2014-15
Beginning Fund Balance	\$12,993,026	\$12,609,092	\$12,632,648
Add (Less): Operating Surplus/(Deficit)	(\$122,090)	\$57,987	\$779,127
Less: Use of Reserve Funds	(\$261,844)	(\$34,431)	(\$228,937)
Ending Fund Balance	\$12,609,092	\$12,632,648	\$13,182,838
Less: Reserve Funds	\$8,279,806	\$8,340,431	\$8,167,612
Less: Encumbrances	\$61,444	\$181,881	\$112,854
Less: Appropriated Fund Balance for the Ensuing Year	\$2,725,000	\$2,300,000	\$2,300,000
Unrestricted Fund Balance at Year-End	\$1,542,842	\$1,810,336	\$2,602,372
Ensuing Year's Budgeted Appropriations	\$21,352,772	\$21,306,970	\$21,332,799
Unrestricted Fund Balance as Percentage of Ensuing Year's Budget	7.2%	8.5%	12.2%

The District appropriated an average of \$2.7 million⁵ in fund balance as a financing source in the annual budget for 2012-13 through 2014-15. This reduced unrestricted fund balance at the end of each fiscal year. However, the District did not need to use most of the appropriated fund balance to finance operations. When unused appropriated fund balance was added back, recalculated unrestricted fund balance exceeded the legal limit by 15 to 19 percentage points (Figure 3).

Figure 3: Unused Fund Balance			
	2012-13	2013-14	2014-15
Unrestricted Fund Balance at Year End	\$1,542,842	\$1,810,336	\$2,602,372
Add: Appropriated Fund Balance Not Used to Fund Ensuing Year's Budget	\$2,725,000	\$2,300,000	\$2,300,000
Recalculated Unrestricted Fund Balance	\$4,267,842	\$4,110,336	\$4,902,372
Recalculated Unrestricted Funds Balance as a Percentage of Ensuing Year's Budget	20.0%	19.3%	23.0%

We anticipate that the District will realize similar budget variances as previous years and an operating surplus for 2015-16. Therefore, the \$2.3 million of fund balance appropriated in the 2015-16 budget will not be needed and unrestricted fund balance will likely continue to exceed the statutory limit. Furthermore, the District's practice of appropriating fund balance that is not needed to finance operations is, in effect, a reservation of fund balance that is not provided for by statute and a circumvention of the statutory limit imposed on the level of unrestricted fund balance. We reviewed appropriations for instructional salaries and employee benefits in the 2016-17 adopted budget. While appropriations for employee benefits decreased from the previous year, appropriations for instructional salaries increased and could be higher than necessary.

⁵ In 2011-12, the District appropriated \$3.1 million in fund balance as a financing source for the 2012-13 budget.

The District's independent auditor also noted in its annual audit report that unrestricted fund balance was in excess of the statutory limit. However, officials did not take corrective action in response to this finding as unrestricted fund balance has continued to increase.

Reserve Funds

School districts may establish reserve funds to retain a portion of fund balance to finance a variety of objects or purposes, but must do so in compliance with statutory requirements. When school districts establish reserves for specific purposes, it is important that a formal plan is developed for how to fund the reserves, how much should be accumulated in the reserves and when the money will be used to finance related costs. While school districts are generally not limited as to how much money can be held in reserves, the balances should be reasonable. The District's reserve fund policy indicates that the Board "will periodically review all reserve funds," and "make the necessary decisions to adequately maintain and manage the District's reserve fund balances, while mindful of its role and responsibility as a fiduciary of public funds."

As of June 30, 2015, the District reported six reserves in the general fund totaling approximately \$8.1 million. We found that the District retained \$5.7 million in a debt reserve and overfunded the employee benefit accrued liability reserve by \$220,000.⁶ There was no evidence in the minutes to indicate that the Board periodically reviewed all the reserve funds, or otherwise maintained and managed the reserves in accordance with the adopted policy.

Debt Reserve – In certain circumstances, money must be restricted for debt service. For example, unexpended debt proceeds and related interest earnings must be restricted and used to pay debt service on that debt issue or for the related capital expenditures. School districts are not allowed to establish a debt reserve for any other purpose.

The District maintains a debt reserve in the general fund with a balance of \$5.7 million as of June 30, 2015. District officials indicated that the reserve was established prior to 1996, the cash in the reserve was from an old completed capital project, and the associated debt has been paid off. At this point, the funds in this reserve should have been returned to unrestricted fund balance and used for operations or to reduce the tax levy.

In November 2012, the Board, by resolution, "reestablished" the reserve. The resolution indicates the District planned to use the funds to pay for existing debt service obligations starting in the 2018-19 fiscal year, when State building aid associated with the outstanding debt would cease, or

⁶ The four remaining reserves in the general fund consisted of the unemployment (\$110,000), retirement contribution (\$560,000), tax certiorari (\$210,000) and repair (\$250,000) reserves.

use the funds to address budget shortfalls. There is no authority for the District to create a debt reserve for this purpose. For perspective, total outstanding bonds payable at the end of the current (2015-16) fiscal year is expected to be approximately \$6.3 million, excluding interest expense.

EBALR – This reserve can be used to fund the cash payment of accrued and unused sick, vacation and certain other accrued but unused leave time owed to employees when they separate from District employment. As of June 30, 2015, the EBALR cash balance was approximately \$1.3 million. However, the District’s calculation of the corresponding liability included costs that cannot be legally paid from the EBALR.⁷ We estimate the liabilities that can be financed with an EBALR to be approximately \$1.08 million. As a result, the EBALR is overfunded by approximately \$220,000 (20 percent).

By maintaining excessive reserves, combined with ongoing budgeting practices that generated operating surpluses, the Board and District officials have levied higher taxes than necessary.

Recommendations

The Board and District officials should:

1. Develop realistic estimates of appropriations and the use of fund balance in the annual budget.
2. Ensure that the amount of unrestricted fund balance is in compliance with the statutory limit and develop a plan to use excess fund balance in a manner that benefits residents. Such uses could include:
 - Funding one-time expenditures;
 - Funding needed reserves; and
 - Reducing District property taxes.
3. Transfer money residing in the debt reserve to unrestricted fund balance.
4. Review all reserves at least annually to determine if the amounts reserved are necessary and reasonable. Any excess funds should be transferred to unrestricted fund balance (where allowed by law) or to other reserves established and maintained in compliance with statutory directives.

⁷ We also commented on this deficiency in our prior Report of Examination, dated May 2009.

APPENDIX A

RESPONSE FROM DISTRICT OFFICIALS

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



Falconer Central School District

2 East Avenue, N., Falconer, NY 14733

Phone: 716-665-6624

Fax: 716-665-9265



June 17, 2016

Jeffrey D. Mazula, Chief Examiner
Office of the State Comptroller
295 Main Street, Room 1032
Buffalo, NY 14203-2510

Dear Mr. Mazula:

We appreciate the assistance your field auditor provided in the assessment of fund balance and reserves of the Falconer Central School District. [REDACTED] was very diligent and insightful in providing guidance to better assess the business operations of our District. Our Board of Education and administration will review the guidance offered in your Report of Examination and prepare a Corrective Action Plan in accordance with statutory regulations.

Your Report of Examination provides direction and a level of expectancy for the fiscal operation of the Falconer Central School District. The Board of Education concurs in the observatory assessment of the Report for the three-year period culminating at the end of the 2014-15 school year.

The Board of Education and administration, after open dialogue, submit the following response to the Report of Examination (*OSC Concern/District Response*):

Budgeting:

The District agrees that the proposed budget should more closely reflect the expected expenditures of the District and will take steps to assure that this occurs. Although the appropriations reflect higher than normal expected expenses, the revenues are generally understated by a similar amount.

Fund Balance:

The District understands the statutory limitations on fund balance and will assess the excess to determine necessary steps to bring this level closer to the 4% allowed.

We received a similar recommendation following the Office of the State Comptroller's audit in 2008 and reduced taxes in each of the subsequent two years with the anticipation that Foundation Aid would continue to flow; however, Foundation Aid was frozen, the Gap Elimination was instituted and the legislature approved the 2% tax cap, eroding our main revenue sources. Now that the Gap Elimination has been fully restored, the District will again be attempting to build future budgets without the

Superintendent : Stephen Penhollow
Director of Instruction & Staff Development, Coordinator
of District Data : Judith Roach
Director of Special Education : Julie Possai

Paul B.D. Temple Elementary, Principal : Holly Hannon
Harvey C. Fenner Elementary, Principal : Gary Gilbert
Falconer Middle School, Principal : Terry English
Falconer High School, Principal : Jeffery Jordan

expectation of aid it had been promised and/or able to raise.

Reserve Funds:

The District is aware of the excess level of reserved balances in its Debt Reserve and Employee Benefits Accrued Liability Reserve and will assess these amounts to determine acceptable levels.

The Falconer Central School District Board of Education and administration would like to thank you for the opportunity to respond to your Report and welcome further dialogue to better the financial operations of its governance.

Very truly yours,

Stephen M. Penhollow
Superintendent

cc: Brent Agett, Business Executive
Todd Beckerink, BOE President

APPENDIX B

AUDIT METHODOLOGY AND STANDARDS

To achieve our audit objective and obtain valid evidence, we performed the following procedures:

- We interviewed District officials to gain an understanding of the District's financial management practices.
- For the three most recently completed fiscal years we compared budgeted appropriations and estimated revenues with actual results of operations, and evaluated budget variances in selected appropriation and revenue accounts.
- We reviewed the 2015-16 budget and compared it to the 2014-15 budget. Based upon these comparisons we projected revenues and expenditure trends for the remainder of the 2015-16 fiscal year.
- We analyzed the appropriation of fund balance in the adopted budgets to determine if it was used as intended.
- We calculated unrestricted fund balance as a percentage of the next year's budget. We included both appropriated fund balance and unrestricted fund balance in our calculation.
- We evaluated the reserve fund balances for reasonableness.

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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