

Worcester Central School District

Fund Balance Management

SEPTEMBER 2022



OFFICE OF THE NEW YORK STATE COMPTROLLER
Thomas P. DiNapoli, State Comptroller

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Report Highlights

Worcester Central School District

Audit Objective

Determine whether the Worcester Central School District (District) Board of Education (Board) and officials effectively managed fund balance.

Key Findings

The Board and District officials did not effectively manage the District's fund balance.

- The Board annually overestimated appropriations from 2016-17 through 2020-21 by an average of \$943,000, or 8 percent.
- District officials budgeted for operating deficits totaling \$4.7 million from 2016-17 through 2020-21, but experienced net operating surpluses totaling \$1.2 million, an operational shift of \$5.9 million.
- The District's surplus fund balance exceeded the 4 percent statutory limit in each of the last five fiscal years by \$490,000 to \$1.8 million, or 4.3 to 15.7 percentage points.
- Real property tax levies were higher than necessary, in part, because surplus fund balance in excess of the statutory limit was maintained.

Key Recommendations

- Use reasonable estimates when developing the budget.
- Comply with the statutory fund balance limit.

District officials generally agreed with our findings and recommendations and indicated they will take corrective action.

Background

The District serves the Towns of Decatur, Maryland, Westford and Worcester in Otsego County and the Town of Harpersfield in Delaware County.

The District is governed by an elected five-member Board 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 and is responsible, along with the Treasurer and other administrative staff, for the day-to-day management of the District under the Board's direction. The Treasurer and Superintendent prepare the annual budget and present it to the Board for approval.

Quick Facts

2021-22 Appropriations	\$11.7 million
Total Fund Balance	\$4.1 million
Enrollment	333
Employees	79

Audit Period

July 1, 2016 – January 31, 2022. We extended our audit period to June 22, 2022 to review the Board resolution authorizing a transfer of surplus fund balance to a capital reserve.

Fund Balance Management

How Should Officials Effectively Manage Fund Balance?

Fund balance is the difference between revenues and expenditures accumulated over time. To effectively manage a school district's fund balance, a board should adopt accurate and structurally balanced budgets based on historical data or known trends in which recurring revenues finance recurring expenditures. In preparing the budget, a board must estimate the amounts a school district will spend and receive, the amount of fund balance that may be available at fiscal year-end to use towards the next year's budget and the expected real property tax levy. Accurate budget estimates help ensure the tax levy is not greater than necessary.

A school district may retain a portion of surplus fund balance for cash flow needs or unexpected expenditures.¹ New York State Real Property Tax Law Section 1318 limits the amount of surplus fund balance that a school district can retain to no more than 4 percent of the next year's budgeted appropriations. Any surplus fund balance over this percentage must be used to reduce the next year's real property tax levy or fund needed reserves. When fund balance is appropriated in the budget to finance operations, a school district is budgeting for a planned operating deficit (expenditures exceeding revenues) equal to the amount of fund balance appropriated.

A school district is required to establish a debt reserve when unexpected bond proceeds remain on a capital improvement, or when a capital improvement has outstanding debt remaining at the time of sale. If there is any remaining unexpended balance in this reserve fund when all of the outstanding obligations have been retired, the excess may be used for any lawful school district purpose.

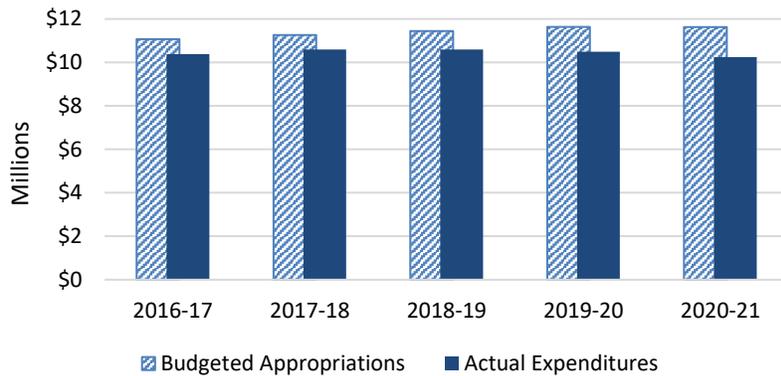
The Board Overestimated Appropriations

We compared the estimated revenues and budgeted appropriations with actual operating results between 2016-17 and 2020-21. We found that estimated revenues were generally reasonable, but budgeted appropriations were overestimated by an average of \$943,000, or 8 percent each year (Figure 1).

¹ Surplus fund balance is defined as unrestricted fund balance minus appropriated fund balance and encumbrances included in committed and assigned fund balance. Refer to our accounting bulletin at <https://osc.state.ny.us/localgov/pubs/releases/gasb54.pdf>.

FIGURE 1

Overestimated Appropriations



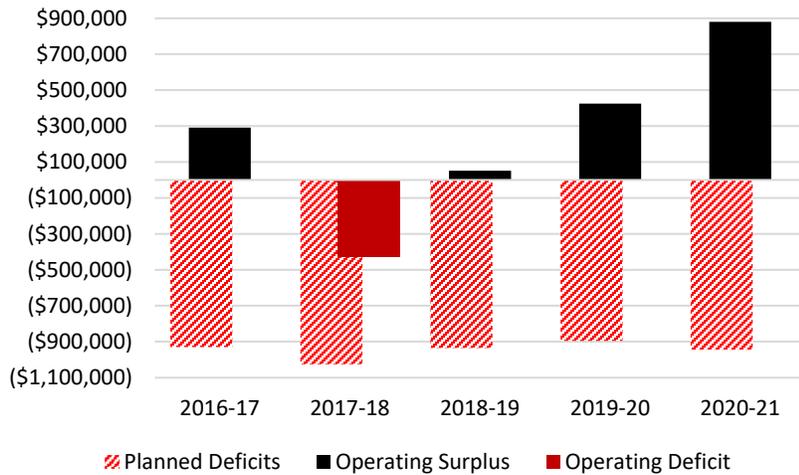
In aggregate, these variances contributed to an increase in surplus fund balance between 2016-17 and 2020-21. The Superintendent and Treasurer told us the District experienced larger than normal expenditure variances because of school closures and reduced expenditures as a result of the COVID-19 pandemic; however, the Board has continually overestimated appropriations over the last five years. For example, during this period, the Board overestimated expenditures for tuition for daytime programs for students with disabilities each year by an average of \$142,900 (28 percent) and health insurance each year by an average of \$128,200 (9 percent). Because the Board overestimated appropriations, it appeared that more funds were needed to maintain a structurally balanced budget. Had the Board and officials used previous years' actual results of operations to develop their budget estimates, they would have likely estimated more accurately.

The Board Appropriated Unneeded Fund Balance and Exceeded the Statutory Limit

The Board adopted budgets that appropriated fund balance totaling more than \$4.7 million over the last five fiscal years. However, the Board and officials' budgeting practices resulted in variances that offset the planned operating deficits created by the amounts appropriated. As a result, the District incurred operating surpluses totaling more than \$1.2 million (Figure 2).

FIGURE 2

Planned Operating Deficits vs. Actual Operating Results



Furthermore, District officials reported surplus fund balance that exceeded the 4 percent statutory limit in each of the last five fiscal years. As of June 30, 2021, surplus fund balance was 19.7 percent of the next year’s budgeted appropriations.

In addition, the balance in the District’s debt service fund has increased each year since 2004-05 while the District continued to budget for and pay debt principal and interest payments out of the general fund. The June 30, 2021 reserved balance (i.e., debt reserve) in the debt service fund of \$301,000 consisted of excess bond proceeds from previous years’ bus purchases and closed capital improvement projects. The Treasurer told us that they intend to use these funds towards upcoming capital projects to ensure there is no real property tax increase to the taxpayers. However, because the outstanding obligations relating to these funds have been retired, there is no statutory requirement to maintain a debt reserve and the balance in the debt service fund should be transferred to the general fund as surplus fund balance. The funds may then be used for any lawful school district purpose. After adding back unused appropriated fund balance and the unused debt reserve, the surplus fund balance exceeded the statutory limit by 24.6 percentage points (Figure 3).

Figure 3: Recalculated Surplus Fund Balance

	2016-17	2017-18	2018-19	2019-20	2020-21
Surplus Fund Balance at Fiscal Year-End	\$1,042,000	\$948,000	\$1,091,000	\$1,525,000	\$2,300,000
Add: Unused Appropriated Fund Balance	597,000	935,000	895,000	945,000	\$750,000 ^a
Unused Debt Reserve	102,000	102,000	123,000	137,000	301,000
Recalculated Surplus Fund Balance	\$1,741,000	\$1,985,000	\$2,109,000	\$2,607,000	\$3,351,000
Surplus Fund Balance as a Percentage of Next Year's Budgeted Appropriations - Legal Limit 4 Percent -					
District Calculated/ Reported	9.3	8.3	9.4	13.1	19.7
OSC Recalculated	15.5	17.4	18.1	22.4	28.6 ^a
a) We estimated the appropriated fund balance that will not be used to finance the 2021-22 fiscal year based on the previous five-year total of unused appropriated fund balance as a percentage of total budgeted appropriated fund balance.					

The Board increased the real property tax levy by \$329,000 (10.2 percent) from 2016-17 through 2021-22 despite the repeated operating surpluses and excessive surplus fund balance. With voter approval, the Board exceeded the real property tax cap limit by \$131,000 in 2019-20 and by \$27,000 in 2021-22.² In addition, annually 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 circumvents the statutory limit imposed on the level of surplus fund balance.

Maintaining surplus fund balance that exceeded the statutory limit resulted in real property tax levies being higher than necessary. According to the Superintendent, District officials were hesitant to reduce surplus fund balance in recent years because of a potential merger with a nearby school district which, if approved, could have resulted in additional expenditures and debt service payments. This potential merger, which had been in consideration for several years, was ultimately rejected by voters in the 2021-22 fiscal year. On June 22, 2022, the Board passed a resolution authorizing a transfer of \$1 million from surplus fund balance to a newly created capital reserve fund for capital improvements and equipment.

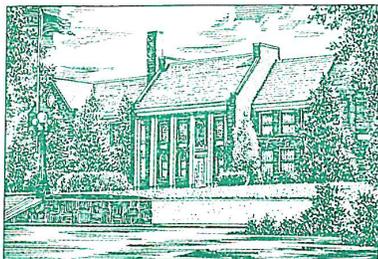
² New York State General Municipal Law Section 3-c established a tax levy limit on school districts. The law generally precludes a school district from adopting a budget that requires a tax levy that exceeds the prior year's tax levy by more than 2 percent or the rate of inflation, whichever is less, unless at least 60 percent of the school district's voters approve a budget that requires a tax levy that exceeds the statutory limit.

What Do We Recommend?

The Board and District officials should:

1. Develop and adopt budgets that include reasonable estimates for appropriations and the amount of fund balance that will be used to fund operations.
2. Discontinue the practice of appropriating fund balance that is not needed or used to fund operations.
3. Transfer the debt reserve in the debt service fund to the general fund as surplus fund balance.
4. Develop and adopt a plan to reduce surplus fund balance in a manner that benefits District taxpayers. Surplus funds can be used for funding one-time expenditures such as capital improvements, funding needed reserves, paying off debt or reducing District property taxes.

Appendix A: Response From District Officials



WORCESTER CENTRAL SCHOOL

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August 18, 2022

Ms. Ann C Singer
Office of the State Comptroller
Division of Local Government and School Accountability
Binghamton Regional Office, Suite 1702
44 Hawley Street
Binghamton, NY 13901-4417

Dear Ms. Singer:

This letter serves as the official response and action plan regarding the audit report from July 1, 2016, to January 31, 2022. We would like to thank the Office of the New York State Comptroller's (OSC) audit team for their time and effort in reviewing the District's financial management procedures. We welcome the suggestions and recommendations that will improve our operations and which considers the district's educational needs.

While the audit report indicates the Worcester Central School District (WCSD) maintained operating surpluses totaling \$1.2 million over the most recent five years, we believe a closer look demonstrates that WCSD had a deficit of \$85,000 for the three years preceding the-COVID-19 pandemic. As a result of the pandemic, the extraordinary 2019-2020 and 2020-2021 years were undoubtedly the main reasons a surplus was identified over the five-year span.

As you will consistently find with most school districts, WCSD has been conservative in our budgeting process. While the audit report references an average overestimation of \$142,900 in Special Education tuition, that figure represents an average of just two children moving into the district and the programs necessary to provide them with an appropriate education to meet their needs. In addition, the health insurance overestimation identified in the report of \$128,900 can be a matter of five employees changing from a contractual health insurance buy out option to participating in a family insurance plan.

Overall, the numerous and constant shifts to student programming and the ripples across the district of COVID-19 had a significant impact on actual expenses and proved difficult to anticipate when budgeting. Therefore, the budgeted funds vs the actual funds expensed looks much larger than expected due to COVID-19 pandemic, which greatly reduced expenses since the spring of 2020.

It is also important to note that the relatively large, appropriated fund balance toward recent budgets is a direct result of the Gap Elimination Adjustment (GEA), which took more than \$1.8 Million in aid from Worcester Central School District since its inception. Prior to the 2009-2010 year, our fund balance

allocation toward the budget was a nominal amount of \$150,000. With the reduction in State Aid in 2009-2010 and implementation of the GEA in subsequent years, the District felt compelled to use reserves, reduce staffing and allocate increasingly significant amounts of fund balance toward the respective budgets.

In recognition of the situation, we are committed to reducing the amount of fund balance we appropriate to our annual budget, and it should be noted the District began to reduce the appropriated amount in 2018-2019. We continue to do so, and we have reduced the amount by over 35% from its high point of 2014-2015. Currently, the appropriated fund balance is the lowest amount since the 2010-2011 school year. This practice to reduce the appropriated amount will remain as a WCSD priority moving forward.

As we recognized the District has exceeded the 4% limit of unassigned fund balance, the District began planning to move a significant portion to reserves over the past couple of years. However, these planned adjustments were delayed for two significant reasons.

The first reason affected all schools as Governor Cuomo warned all districts that a State Aid cut as high as twenty percent was pending during the 2020-2021 school year. School districts never received clear direction as to the actual reduction amount or the timing of the cuts. Using the original 20% from the governor's remarks the district feared our potential loss to be up to a million dollars and budgeted accordingly.

The second reason was specific to WCSD as we were involved with the Schenevus Central School District regarding a possible annexation merger from July of 2019 until December of 2021. With the uncertainty surrounding the merger and the financial deficit of the Schenevus school district, WCSD determined it was not prudent to move funds into various reserves during that time period. Once the merger was rejected in the final vote of December 1, 2021, the district shifted back on course to reduce fund balance. Most recently, the District established a new capital reserve in May of 2022, transferring one million dollars to that reserve just one month later. These funds, along with the Debt Service Reserve, will be used to help with a pending building project.

Our financial advisors have confirmed that such actions would allow the District to plan a building project of approximately seven million dollars and will not have to ask the taxpayers for any tax increase. We believe that is partly due to our careful management of our funds and steady, reasonable tax levy increases. It is the District's opinion that by being financially responsible the Worcester taxpayers will be pleased that a project of this size, which will improve the educational environment for our students, will have no overall tax impact or burden on them.

As a final note, the District would like to mention that tax levy increases have ranged from 1.14% to 2.17% since the tax cap was implemented for the 2012-2013 school year. In six of the past eleven years, the Worcester Central School District has been below the tax cap. The District has been equal to the tax cap in three years, and has only exceeded the tax cap two of those eleven years.

In closing, the Worcester Central School District is committed to being good stewards for the tax payers of the Worcester Community and avoiding large levy increases in any given year. We believe the levy support we have asked from our taxpayers has been reasonable to meet the educational needs of our students. We would like to thank the Office of the New York State Comptroller audit staff for its professionalism, assistance, suggestions and recommendations. We will take them under advisement and appreciate their diligence in reviewing our situation.

Regarding the OSC recommendations, please see our action plan below.

OSC Recommendation:

1. Develop and adopt budgets that include reasonable estimates for appropriations and the amount of fund balance that will be used to fund operations.

***WCSD Action:* The district will develop and adopt budgets monitoring for reasonable appropriations and use of fund balance.**

2. Discontinue the practice of appropriating fund balance that is not needed or used to fund operations.

***WCSD Action:* The district will continue to monitor the amount of annually appropriated fund balance to ensure that it is reduced.**

3. Transfer the debt reserve in the debt service fund to the general fund as surplus fund balance.

***WCSD Action:* The District will use the existing debt reserve on our pending building project planned in a December 2022 vote.**

4. Develop and adopt a plan to reduce surplus fund balance in a manner that benefits District Taxpayers. Surplus funds can be used for funding one-time expenditures such as capital improvements, funding needed reserves, paying off debt or reducing District property taxes.

***WCSD Action:* The district will review its surplus fund balances and develop plans for expending and funding reserves in the future. The District has already moved \$1 Million into a Capital Reserve Fund.**

Sincerely,

Timothy Gonzales
Superintendent

Appendix B: Audit Methodology and Standards

We conducted this audit 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. To achieve the audit objective and obtain valid audit evidence, our audit procedures included the following:

- We interviewed District officials and reviewed Board meeting minutes and policies to gain an understanding of the financial management policies and procedures.
- We reviewed the adopted general fund budgets from 2016-17 through 2020-21 to determine whether they were reasonable and structurally balanced by comparing adopted budgets with the actual results of operations.
- We calculated surplus fund balance as a percentage of the next year's appropriations for 2016-17 through 2020-21 to determine whether it was within the statutory limit.
- We recalculated surplus fund balance as a percentage of the next year's appropriations by adding back the unused appropriated fund balance and unused debt reserve for 2016-17 through 2020-21. We estimated the amount of unused appropriated fund balance to finance the 2021-22 fiscal year based on the previous five-year total of unused appropriated fund balance as a percentage of total budgeted appropriated fund balance.
- We reviewed the District's tax cap filings for the past five years to determine whether the District exceeded the real property tax cap limit.

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 objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

Unless otherwise indicated in this report, samples for testing were selected based on professional judgment, as it was not the intent to project the results onto the entire population. Where applicable, information is presented concerning the value and/or size of the relevant population and the sample selected for examination.

The Board has the responsibility to initiate corrective action. 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, 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. 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 CAP should be posted on the District's website for public review.

Appendix C: Resources and Services

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