



Portville Central School District Financial Condition

Report of Examination

Period Covered:

July 1, 2012 — November 13, 2013

2013M-384



Thomas P. DiNapoli

Table of Contents

	Page
AUTHORITY LETTER	2
INTRODUCTION	3
Background	3
Objective	3
Scope and Methodology	3
Comments of District Officials and Corrective Action	3
FINANCIAL CONDITION	5
Fund Balance	6
Reserves	7
Recommendations	9
APPENDIX A Response From District Officials	10
APPENDIX B OSC Comment on the District’s Response	12
APPENDIX C Audit Methodology and Standards	13
APPENDIX D How to Obtain Additional Copies of the Report	14
APPENDIX E Local Regional Office Listing	15

State of New York Office of the State Comptroller

Division of Local Government and School Accountability

April 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 Portville 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 Portville Central School District (District) is located in the Towns of Clarksville and Genesee in Allegany County and the Towns of Olean and Portville in Cattaraugus County. The District is governed by an elected nine-member Board of Education (Board) that 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 other administrative staff, for the District's day-to-day management under the Board's direction. The Business Manager is responsible for accounting for all District funds and preparing financial reports for the Board.

There is one school in operation within the District, with approximately 1,000 students and 200 employees. The District's budgeted general fund expenditures for the 2013-14 fiscal year are approximately \$16 million, funded primarily with State aid and real property taxes.

Objective

The objective of our audit was to review the District's financial condition. To accomplish this objective, our audit addressed the following related question:

- Did the Board ensure that fund balance was maintained within legal limits and properly plan for, fund and use reserve accounts?

Scope and Methodology

We examined the District's financial condition for the period July 1, 2012 through November 13, 2013. We extended our audit back to the 2008-09 fiscal year to review certain budgetary practices and reserve fund trends.

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 C 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. Except as specified in Appendix A, District officials generally agreed with our recommendations and indicated they planned to initiate corrective action. Appendix B includes our comment on the issue raised in the District's response letter.

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 this plan 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 budgeting and planning rests with the Board and the Superintendent. 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,¹ but must do so within the legal limits established by Real Property Tax Law. A district can also set aside and reserve portions of fund balance to finance future costs for a variety of specified objects or purposes. The Board and District officials are responsible for adopting annual budgets that contain realistic estimates of appropriations and the resources available to fund them and for ensuring that fund balance does not exceed the amount allowed by law and that taxes are not levied unnecessarily.

The Board failed to ensure fund balance was maintained within legally established limits and that residents were not taxed more than necessary. Although District officials appropriated on average \$630,000 of fund balance in each of the last five fiscal years to reduce the tax levy, the District had operating surpluses in four of the five² years reviewed. District officials then used excess fund balance to fund five reserves that, as of June 30, 2013, totaled over \$2 million. One of the District's reserve funds had approximately \$434,000 or 50 percent more than the amount needed for authorized purposes. Also, three of the District's reserves, with balances totaling approximately \$775,000, were not supported by a plan setting forth the amounts to be retained or when the balances would be used. As such, the District has not demonstrated a valid need for about 60 percent of the amounts set aside in these reserve funds.

¹ The Governmental Accounting Standards Board (GASB) issued Statement 54, which replaces the fund balance classifications of reserved and unreserved with new classifications: non-spendable, 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).

² An operating deficit occurred in 2010-11.

Fund Balance

Real Property Tax Law limits the amount of unexpended surplus fund balance school districts can retain to 4 percent of the ensuing year's appropriations. Any portion of unexpended surplus fund balance beyond this legal restriction can be transferred to reserves or used to lower the property tax burden for District residents.

Although an average of \$630,000 was appropriated in each of the five years reviewed, the District had operating surpluses in four of the five³ years and did not use the appropriated fund balance. We found that even though District officials were notified by their external auditors each year that the fund balance exceeded legal limits, they failed to take appropriate action to reduce this amount. As shown in Table 1, unexpended surplus fund balance exceeded the 4 percent statutory limit in each of the five fiscal years reviewed. The unexpended surplus fund balance was \$1.2 million in fiscal year 2008-09, or approximately 8 percent of the ensuing year's appropriations, and \$1.1 million in fiscal year 2012-13, or 7 percent of the ensuing year's appropriations.

Table 1: Fund Balance – Five-Year Analysis

Beginning of Fiscal Year	Unexpended Surplus Fund Balance ⁴	Amount Authorized by Law	Amount Exceeding Legal Limit
2009-10	\$1,224,798	\$631,245	\$593,553
2010-11	\$1,170,363	\$637,124	\$533,239
2011-12	\$893,651	\$627,051	\$266,600
2012-13	\$1,304,108	\$650,206	\$653,902
2013-14	\$1,132,966	\$657,630	\$475,336

Rather than using fund balance to reduce property taxes, District officials increased the levy by \$488,517, or approximately 12.5 percent over the past five years, or an average of 2.5 percent per year, as shown in Table 2. For this same period, the District's average annual tax levy increase was \$97,703.

Table 2: Tax Levy – Five-Year Analysis

Fiscal Year	Tax Levy	Increase Over the Previous Year
2009-10	\$3,894,771	-
2010-11	\$4,011,614	\$116,843
2011-12	\$4,152,021	\$140,407
2012-13	\$4,235,061	\$83,040
2013-14	\$4,383,288	\$148,227
Total		\$488,517

³ Ibid

⁴ Dollar amounts are as reported by the District on their annual financial report. These do not include amounts appropriated for the current year's budget that was unused: \$450,000 in fiscal year 2009-10, \$800,000 in fiscal year 2011-12 and \$800,000 in fiscal year 2012-13. An operating deficit was realized in the 2010-11 fiscal year totaling \$1,060,606 because less State Aid was received than anticipated, resulting in fund balance of \$650,000 actually being used.

As such, District officials routinely retained surpluses instead of using them to benefit taxpayers. The practice of maintaining fund balances that exceed the percentage allowed by law results in tax levies that are greater than necessary to fund operations.

Reserves

Reserves provide financing for specific purposes according to statutory provisions which set forth how reserves are established, funded, expended and discontinued. Funding reserves at greater than reasonable levels contributes to real property tax levies that are higher than necessary. Therefore, it is important that a board adopt a written policy that clearly communicates its rationale for establishing reserve funds, objectives for each reserve established, optimal or targeted funding levels and conditions under which each fund's assets will be used or replenished.

As of June 30, 2013, the District had five reserve funds with balances totaling in excess of \$2 million. The balances of the employee benefit accrued liability reserve, retirement contribution reserve, unemployment insurance reserve and tax certiorari reserve were higher than necessary to fund current obligations or were not supported by a plan or other documentation validating the amounts retained.⁵ These funds were over-funded by about \$1.2 million, or 60 percent of the total held in reserves.

Employee Benefit and Accrued Liability Reserve – General Municipal Law (GML) authorizes this type of reserve for the cash payment of accrued and unused sick, vacation and certain other leave time due employees upon separation from service and for the costs related to the administration of the reserve. This reserve was initially established by the District in 1999 and reported a balance of \$1,287,532 as of June 30, 2013. While the purpose and acceptable use of this reserve is identified in GML, the Board has not adopted a written policy or plan that establishes targeted funding levels and conditions under which the fund's assets will be used or replenished.

During our review, District officials provided us with a schedule reflecting present and future liabilities expected to be funded from this reserve. This schedule provided evidence of potential liabilities totaling \$853,827. As a result, this reserve is currently over-funded by a total of \$433,705, or 50 percent more than the amount needed for authorized purposes.

Retirement Contribution Reserve – GML authorizes this reserve for the payment of retirement contributions to the New York State and Local Employees' Retirement System (ERS). This reserve cannot

⁵ The workers' compensation reserve had a balance of only \$31,411 and was therefore not included in our analysis.

be used for contributions to the Teachers' Retirement System. This reserve was established by the District in 2009 and reported a balance of \$549,535 as of June 30, 2013. Over a five-year period,⁶ District officials paid a total of \$784,256, or an annual average of \$156,851, in ERS contributions, all of which were budgeted for and paid from real property taxes levied in the general fund. The District did not use any moneys from the reserve to pay the related obligations.

We question the need for this reserve given its lack of use and its substantial balance, as well as the Board's consistent funding of ERS contributions entirely from general fund appropriations, and the lack of a formalized plan detailing the need and expected use of these funds.

Unemployment Insurance Reserve – This reserve is authorized for the reimbursement to the State for payments made to unemployment claimants. The balance in this reserve, as of June 30, 2013, was \$200,000. The District incurred unemployment costs averaging approximately \$20,000 per year over the five-year period from fiscal years 2008-09 through 2012-13. All of these expenditures were paid directly from general fund appropriations, without using any moneys from the reserve.

We question the reasonableness of this reserve's funding level given that it represents approximately 10 times the average annual expenditure level, the Board's consistent funding for these costs through the real property tax levy and the absence of a formalized plan detailing the need and expected use of these funds.

Tax Certiorari Reserve – This reserve is authorized to pay judgments and claims resulting from tax certiorari proceedings and the balance may not exceed the amount reasonably necessary to fund related costs. Unused moneys must be returned to the general fund on or before the first day of the fourth fiscal year following their move to the reserve fund. According to District officials, this reserve was established in April 2008; however, the anticipated need never materialized. Given that more than five years have elapsed and there is no demonstrable need for this reserve, the balance of \$25,428 should be transferred back to the general fund.

By not adopting realistic budgets that make use of excessive fund balance and maintaining over \$1 million in excessive or unnecessary reserves with no policy or plan documenting the Board's intentions for these moneys, significant taxpayer resources were withheld from productive use.

⁶ Fiscal year 2008-09 through 2012-13

Recommendations

1. The Board should ensure that the amount of the District's unexpended surplus fund balance is in compliance with Real Property Tax Law statutory limits.
2. The Board should develop a plan for the use of the excess fund balance in a manner that benefits District taxpayers. Such uses could include, but are not limited to:
 - Paying off debt,
 - Financing one-time expenditures or
 - Reducing District real property taxes.
3. The Board should develop and implement a comprehensive policy for establishing and using reserve funds that includes optimal or targeted funding levels and the conditions under which reserve funds will be used or replenished.
4. The Board should review existing reserves, determine the amounts that are not necessary and reasonable and develop a plan for using the surplus balances identified in this report.

APPENDIX A

RESPONSE FROM DISTRICT OFFICIALS

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

Portville Central School

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Mrs. Pamela Sue Anderson

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High School Principal
Mr. Lawrence Welty
Elementary School Principal
Mr. Lynn Corder

April 1, 2014

Mr. Robert Miller, Chief Examiner
Office of the State Comptroller
295 Main Street, Suite 1032
Buffalo, NY 14203-2510

Dear Mr. Miller

Portville Central School wants to thank the Comptroller's Office for conducting a fair audit. We greatly appreciate the professional manner in which your staff conducted themselves while here at Portville Central School.

Regarding the two major findings related to reserves and unappropriated fund balance we offer the following:

- Unappropriated Fund Balance Limit of 4% - we recognize that the District is out of compliance with this requirement and we will work diligently to rectify this issue.
- Reserves – the District recognizes the value of the Comptroller's Office recommendation to have a written plan regarding the use of reserves. We will work to comply with this recommendation. We have lowered the 2014-2015 tax levy to return the Tax Certiorari Reserve now that the assessment dispute it was reserved for is resolved.

We will comply with these recommendations while we maintain the fiscal integrity of the District as we continue to struggle with the GEA and tax cap limit. It should be noted, had we done what is recommended in this report to resolve our being above the 4% limit, we would have been targeted by the Comptroller's Office as a *district under fiscal stress*.

See
Note 1
Page 12

We recognize this dichotomy. The Comptroller himself cited in his five-year report that schools are out of compliance with the law in regard to fund balance and reserves, but then followed with schools need more ways to reserve money. We grapple with the need to be both fiscally sound and functioning within the law, so we appreciate these competing forces.

Lastly, the State of New York continues to skirt and, more recently, blatantly ignore its own provisions regarding school funding. These actions appear to go largely unchallenged. This concerns us greatly and leads us to use substantial caution when using reserves and fund balance, for it is these funds that stand between us and insolvency if NYS school funding continues on the current course.

Sincerely,

Thomas J. Simon
Superintendent

TJS/cm

APPENDIX B

OSC COMMENT ON THE DISTRICT'S RESPONSE

Note 1

The recommendations in this report are for the District to reduce the amount of fund balance to within legally established limits and to develop a plan for the use of the excess fund balance in a manner that benefits District taxpayers. Many factors are involved when determining a district's susceptibility to fiscal stress. However, maintaining a level of fund balance that complies with the statutory limit is not one of them.

APPENDIX C

AUDIT METHODOLOGY AND STANDARDS

Our overall goal was to assess the adequacy of the internal controls put in place by District officials to safeguard District assets. To accomplish this, we performed an initial assessment of internal controls so that we could design our audit to focus on those areas most at risk. Our initial assessment included evaluations of the following areas: financial oversight, cash receipts and disbursements, purchasing, payroll and personal services and information technology.

During the initial assessment, we interviewed appropriate District officials, performed limited tests of transactions and reviewed pertinent documents, such as District policies and procedure manuals, Board minutes and financial records and reports.

After reviewing the information gathered during our initial assessment, we determined where weaknesses existed and evaluated those weaknesses for the risk of potential fraud, theft or professional misconduct. We then decided upon the reported objective and scope by selecting for audit the area most at risk. Our objective focused on evaluating the District's financial condition. To accomplish our objective, we performed the following procedures:

- We interviewed District officials to obtain an understanding of the District's internal controls over financial operations, budgeting and the use of fund balance and reserve funds.
- We reviewed the last five years of financial information submitted to the Office of the State Comptroller and compared the amounts reported with bank statements, Board minutes, externally audited financial statements and interviews to verify the reliability of the District's data.
- We reviewed Board minutes, policies, accounting records, audited financial statements, applicable statutes and activity within the reserves to determine if they were properly funded and used.
- We evaluated the methods used to fund the reserves and the level of fund balance remaining as unreserved and unappropriated in the general fund.
- We compared budgets with actual results for the last five completed fiscal years to determine whether the amounts appropriated from the reserves were used.

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.

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