

# Andover Central School District

## Financial Management

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OCTOBER 2018

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

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# Report Highlights

## Andover Central School District

### Audit Objective

Determine whether the Board adopted realistic budgets and took appropriate action to address the reasonableness of fund balance and reserves.

### Key Findings

- The Board annually appropriated fund balance that was not used to finance operations and adopted budgets that overestimated appropriations by a total of approximately \$3 million (13 percent) from 2014-15 through 2016-17.
- District officials improperly restricted nearly \$1.2 million in a debt reserve in the debt service fund from 2014-15 through 2016-17, which made it appear that unrestricted fund balance was within the statutory limit each year. When these funds are added back to the general fund, recalculated unrestricted fund balance exceeded the 4 percent limit each year by 12 to 14 percentage points.
- Reserve funds are generally not being used as intended.<sup>1</sup> Three reserves are overfunded and one reserve appears to be unneeded.

### Key Recommendations

- Adopt budgets that include reasonable estimates for appropriations and the amount of fund balance that will be used to fund operations.
- Reduce unrestricted fund balance to within the statutory limit and use the excess funds in a manner more beneficial to taxpayers.
- Review and fund reserve balances to reasonable levels in accordance with applicable statutes.

District officials disagreed with certain aspects of our findings and recommendations, but indicated they planned to initiate some corrective action.

<sup>1</sup> With the exception of the unemployment and capital reserves

### Background

The Andover Central School District (District) serves the Towns of Alfred, Andover, Independence, Ward and Wellsville in Allegany County and the Town of Greenwood in Steuben County.

The District is governed by an elected five-member Board. The Superintendent of Schools (Superintendent) is responsible, along with other administrative staff, for managing day-to-day operations and developing and administering the budget. The Business Administrator is responsible for the administration and supervision of financial activities.

#### Quick Facts

Employees	79
Enrollment	339
2018-19 Appropriations	\$9.5 million

### Audit Period

July 1, 2014 – June 5, 2018

# Financial Management

## What is Effective Financial Management?

The Board, Superintendent and Business Administrator are responsible for adopting realistic budgets and ensuring fund balance does not exceed the amount allowed by law. Fund balance represents the cumulative residual resources from prior fiscal years. New York State Real Property Tax Law<sup>2</sup> currently limits unrestricted fund balance to no more than 4 percent of the next year's budget. Any unrestricted fund balance over this percentage must be used to fund needed reserves or reduce the upcoming year's real property tax levy.

Districts are legally allowed to establish reserves and accumulate reasonable funds for certain future purposes (e.g., capital project, retirement expenditures). District officials should plan for the funding and use of reserves by balancing the desire to accumulate funds for future needs with the obligation to make sure real property taxes are not higher than necessary. Therefore, it is important that the Board adopt a written policy that states its rationale for establishing reserve funds, objectives for each reserve, maximum targeted funding levels and conditions under which reserves will be used or replenished.

## The Board Overestimated Appropriations and Appropriated Unneeded Fund Balance

The Board and District officials should improve budgeting practices to ensure that budgets are realistic and take action to address the reasonableness of fund balance.

We compared budgeted appropriations and estimated revenues with actual operating results for 2014-15 through 2016-17 and found that while revenue variances were generally reasonable (underestimated by \$391,000 in total over the three-year period or 1.5 percent), appropriations were overestimated by nearly \$3 million (13 percent).

**Figure 1: Overestimated Appropriations<sup>a</sup>**

	2014-15	2015-16	2016-17	Totals
<b>Appropriations</b>	\$8,600,000	\$8,600,000	\$9,182,475	<b>\$26,382,475</b>
<b>Actual Expenditures</b>	\$7,551,164	\$7,655,002	\$8,202,529	<b>\$23,408,695</b>
<b>Overestimated Appropriations</b>	\$1,048,836	\$944,998	\$979,946	<b>\$2,973,780</b>
<b>Percentage Overestimated<sup>b</sup></b>	14%	12%	12%	<b>13%</b>

a Does not include transfers to the capital projects fund  
b Overestimated appropriations divided by actual expenditures

<sup>2</sup> New York State Real Property Tax Law, Section 1318

The most significant budget variances were found in health insurance (\$1.9 million or 27 percent), retirement contributions (\$593,000 or 44 percent), special education services (\$433,000 or 27 percent) and fuel (\$205,000 or 232 percent). We reviewed the 2017-18 budget and found the same pattern of overestimating these appropriations. Based on our review of the 2018-19 budget, these budgeting practices appear to have continued.

The former Business Administrator<sup>3</sup> told us that she budgets for a planned operating surplus by overestimating appropriations in these budget lines. However, budgeting practices that annually overestimate appropriations can result in real property tax levies that are higher than necessary and budgets that are not an effective tool for financial management.

Because the Board overestimated appropriations, it appeared the District needed to use appropriated fund balance to close projected budget gaps. The Board annually appropriated an average of \$250,000 of fund balance as a financing source in the 2014-15 through 2016-17 budgets,<sup>4</sup> which should have resulted in planned operating deficits equal to the amount appropriated and decreased fund balance. However, due to overestimated appropriations, the District realized annual operating surpluses, and fund balance increased by more than \$863,000 (35 percent) over these years.

**Figure 2: Unrestricted Fund Balance at Year-End**

	2014-15	2015-16	2016-17
<b>Beginning Fund Balance</b>	\$2,435,972	\$2,773,889	\$3,553,447
<b>Add: Operating Results</b>	\$337,917	\$779,558	\$351,787
<b>Less: Transfers Out<sup>a</sup></b>	\$0	\$0	\$605,755
<b>Ending Fund Balance</b>	\$2,773,889	\$3,553,447	\$3,299,479
<b>Less: Reserve Funds</b>	\$2,097,888	\$2,909,007	\$2,655,409
<b>Less: Nonspendable Fund Balance</b>	\$100,000	\$39,613	\$39,613
<b>Less: Encumbrances</b>	\$0	\$5,527	\$0
<b>Less: Appropriated Fund Balance</b>	\$232,000	\$232,000	\$232,000
<b>Unrestricted Fund Balance at Year-End</b>	\$344,001	\$367,300	\$372,457
<b>Next Year's Budget</b>	\$8,600,000	\$9,182,475	\$9,311,400
<b>Unrestricted Fund Balance as a Percentage of the Next Year's Budget</b>	4%	4%	4%

<sup>a</sup> Transfer to the capital projects fund to help finance voter approved capital project and purchase a bus.

<sup>3</sup> The Business Administrator retired May 31, 2018.

<sup>4</sup> District officials appropriated \$286,000 in fund balance as a financing source for the 2014-15 budget.

The District's practice of 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 a circumvention of the statutory limit imposed on the level of unrestricted fund balance.

Because the District did not actually use the appropriated fund balance, unrestricted fund balance exceeded the statutory limit. When unused appropriated fund balance is added back, unrestricted fund balance exceeded the limit each year by 2 to 3 percentage points (Figure 3).

**Figure 3: Recalculated Unrestricted Fund Balance at Year-End**

	2014-15	2015-16	2016-17
<b>Unrestricted Fund Balance</b>	\$344,001	\$367,300	\$372,457
<b>Unused Appropriated Fund Balance</b>	\$232,000	\$232,000	\$232,000
<b>Recalculated Unrestricted Fund Balance</b>	\$576,001	\$599,300	\$604,457
<b>Next Year's Budget</b>	\$8,600,000	\$9,182,475	\$9,311,400
<b>Percentage</b>	7%	7%	6%

Based on our analysis of the 2017-18 adopted budget and year-to-date operations, officials budgeted similarly to previous years and the District will likely experience an operating surplus and fund balance will continue to increase. Based on our review of the 2018-19 budget, these budgeting practices appear to have continued.

The Board increased the tax levy by a total of \$54,000 or 2 percent from 2014-15 to 2016-17. The tax levy decreased by approximately \$26,000 (1 percent) for 2016-17 and decreased by an additional \$20,000 (less than 1 percent) in 2017-18. However, had the Board adopted more accurate budgets, it could have considered using excess funds to fund one-time expenditures, fund needed reserves, pay off debt or further reduce the levy and provide an even greater benefit to taxpayers.

### **Funds Were Improperly Restricted in the Debt Service Fund**

The District accounts for and reports a debt reserve in the debt service fund, which is separate from the general fund. As of June 30, 2017, this reserve had a reported balance of nearly \$1.2 million. While certain funds are required by law to be set aside and used to pay related debt, District officials told us that these funds were not related to current outstanding debt and were not required to be legally restricted.

Further, debt service expenditures averaged approximately \$913,000 annually for 2014-15 through 2016-17 but officials have only used \$30,000 in total from this reserve to help pay for these costs.

Without a valid legal requirement to restrict these funds, District officials do not have the statutory authority to choose to reserve or otherwise set aside surplus fund balance in this reserve. Therefore, these funds should be added to unrestricted fund balance in the general fund. When these funds are added back, unrestricted fund balance exceeded the limit each year by 12 to 14 percentage points.

**Figure 4: Restated Unrestricted Fund Balance at Year-End**

	2014-15	2015-16	2016-17
<b>Unrestricted Fund Balance</b>	\$344,001	\$367,300	\$372,457
<b>Debt Service Funds</b>	\$1,182,854	\$1,183,261	\$1,153,611
<b>Recalculated Unrestricted Fund Balance</b>	\$1,526,855	\$1,550,561	\$1,526,068
<b>Next Year's Budget</b>	\$8,600,000	\$9,182,475	\$9,311,400
<b>Percentage</b>	18%	17%	16%

### The Board Adopted an Inadequate Reserve Fund Policy and Unreasonably Funded Reserves

Although the Board adopted a reserve fund policy, the policy did not address the maximum funding levels for each reserve, the conditions necessary for using the reserve funds to finance the related costs or the circumstances under which reserve funds would be replenished.

As of June 30, 2017, the District reported approximately \$2.6 million in nine general fund reserves.<sup>5</sup> We analyzed the reserves for reasonableness. We found that the balance in the retirement contribution, unemployment and tax certiorari reserves were excessive and the property loss and liability reserve may not be needed. The remaining five reserves were reasonably funded. In addition, with the exception of the capital and unemployment reserves, the reserves are not being used as intended.

- The Board established a retirement contribution reserve to fund payments to the New York State and Local Retirement System. The balance as of June 30, 2017 was \$787,000, sufficient to cover almost seven years of contributions, which averaged \$116,000 over the past three years. District officials have not used any reserve funds to pay for these expenditures and instead paid them from general fund appropriations during our audit period.

<sup>5</sup> Reserve funds included three capital reserves totaling \$1.2 million, retirement contribution (\$787,000), property loss and liability (\$216,000), unemployment (\$198,000), employee benefit and accrued liability (\$142,000), tax certiorari (\$48,000) and repair reserve (\$19,000).

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- The unemployment insurance reserve is overfunded, with a balance of \$198,000 as of June 30, 2017. Over the last three fiscal years, unemployment expenditures have averaged \$6,500 per year and officials have used the reserve to pay unemployment claims totaling approximately \$19,375. However, based on this level of expenditure, the District could fund related expenditures with the reserve balance for 30 years.
  - The tax certiorari reserve was established to pay for judgments and claims resulting from tax certiorari proceedings and had a balance of approximately \$48,000 as of June 30, 2017. New York State Education Law<sup>6</sup> requires that any funds not reasonably required to pay any such judgment or claims must be returned to the general fund on or before July 1 of the fourth fiscal year following the deposit into the reserve. The reserve was established and funded in 2008 and the District currently has no claims or judgments outstanding. Therefore, the balance of this reserve should be returned to unrestricted fund balance in the general fund.
  - A property loss and liability reserve may be established and funded in an amount not to exceed three percent of the annual budget, to cover property loss and liability claims. As of June 30, 2017, the amount in this reserve was below three percent and totaled \$216,000. Officials told us that this reserve was established in case they need it for unanticipated losses. Given the fact that this reserve was not used during the last 10 years and in the absence of a formalized plan detailing the need and expected use of these funds, we question the need for this reserve.

While it is prudent to provide for unforeseen circumstances, overfunding and/or not using reserves for their intended purpose results in property taxes being higher than necessary because the funds are not being used to fund operations.

## 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. Transfer money improperly residing in the debt service fund to unrestricted fund balance in the general fund.

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<sup>6</sup> New York State Education Law, Section 3651

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3. Develop a plan to reduce the amount of unrestricted fund balance to comply with the statutory limit. Surplus funds can be used as a financing source for:
    - Funding one-time expenditures;
    - Funding needed reserves;
    - Paying off debt and;
    - Reducing District property taxes.
  4. Adopt a more comprehensive reserve policy to include targeted funding levels and conditions under which reserves will be used and replenished.
  5. Review reserve balances and develop a plan to reduce balances to reasonable levels in accordance with applicable statutes.
  6. Transfer money in the tax certiorari reserve to unrestricted fund balance in the general fund.

# Appendix A: Response From District Officials

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**SCHOOL DISTRICT**

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October 2, 2018

Mr. Jeffrey D. Mazula  
Chief Examiner of Local Government  
And School Accountability  
295 Main Street, Suite 1032  
Buffalo, NY 14203-2510

Dear Mr. Mazula:

This letter is the response from the Andover Central School District regarding the Draft Audit Report for the period covering July 1, 2014 through June 5, 2018. On behalf of the Andover Central School District, we appreciate the opportunity to review our financial management practices and are pleased that the areas under review found no evidence of fraud or professional misconduct. We would also like to thank you for the professionalism exhibited during the audit process.

The District, our auditors and financial advisors have carefully reviewed the findings and understand and recognize the recommendations of the report. The audit report's key findings state that: 1) The Board overestimated appropriations and appropriated unneeded fund balance; 2) funds were improperly restricted in the debt service fund; and 3) the Board adopted an inadequate Reserve Fund Policy and unreasonably funded reserves. We are always seeking to improve and feel these recommendations are appropriate to examine. While the District respects the recommendations made in the audit, the Andover Central School District believes that our financial management practices provide long-term financial stability for our school district. The Board reviews its financial management practices and positions regularly, taking advice and counsel from our external auditors and financial advisors. These advisors examine our financial

*The Andover Central School District Takes Every Day To Maximize the Opportunities and Full Potential of Every Child*

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position regularly and make recommendations to the Board and Administration which we act appropriately on to best serve our school district and our taxpayers.

The Board and the Administration face daily and yearly uncertainties of school aid, tax caps, continued unfunded mandates, increases in employee benefit costs, retirement system contributions, and the unbudgeted, unexpected cost for a large increase in the number of high need students who come to our school district, and the high cost services that we are legally obligated to provide to them. Last year there was a proposal from the Governor's office that school districts with less than 100 employees may have to go out on their own to purchase health care insurance for their employees which would have had added an astronomical cost and financial burden to our small school District. We hold reserves to use for these unexpected expenses that we cannot control or predict so we do not have to place an undue, and unexpected burden on our taxpayers.

To ensure that Andover Central School District remains financially secure we have always budgeted conservatively. With a limited tax base due to the small size of our rural district and uncertainty of the funding from New York State each year, we must always plan for decreased revenues or unanticipated expenses. Through smart financial planning we have been able to keep the tax levy on average below zero for the last four years and are managing District funds responsibly for our taxpayers. We cannot anticipate a surplus at the end of each fiscal year. Our reserves are set aside in case of emergencies or unexpected, unbudgeted expenses. The Board and Administration are committed to using tax payer funds reasonably and prudently.

The District's utilization of our reserves is fully consistent with the regulations that these reserves are intended to hold monies for future needs. The Board's position is that it is in compliance with the State regulations on the establishment of its reserve funds. The laws that authorize the reserves do not establish a statutory limitation on the balance of each reserve. The reserves are formally reviewed by the Board on an annual basis. At the February 12 and February 26, 2018 Board of Education meetings, the Board of Education reviewed the District's Reserve Summary Booklet and discussed the recommendations of the state auditor that were verbally presented to the former business official during the audit process. As a result of those

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discussions, the Board made changes to the Reserve Summary Booklet, reviewed each reserve, and proposed to close the repair reserve which the voters approved at the May 15, 2018 budget vote.

In closing, the District will make every effort to implement a financial plan that we feel is realistic and in the best interest of the District and our taxpayers. We will continue to work with our independent financial advisors and external auditors to ensure that we continue to use taxpayer funds appropriately and prudently to provide a sound educational program and fiscal stability for our school district.

Sincerely,

Lawrence E. Spangenburg  
Superintendent

Cindy Baker  
Board of Education President

## Appendix B: Audit Methodology and Standards

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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 policies and procedures to gain an understanding of the budgeting and financial management processes and procedures, including the rationale for determining the levels to maintain for unrestricted fund balance and reserves.
- We compared budgeted appropriations and estimated revenues to actual results for three fiscal years and identified significant variances.
- We calculated operating results for the past three years and assessed if appropriated fund balance was used as budgeted.
- We calculated unrestricted fund balance as a percentage of the next year's appropriations to assess District compliance with statute.
- We recalculated unrestricted fund balance as a percentage of the next year's appropriations after adding back unused appropriated fund balance and an inappropriate debt reserve.
- We reviewed the 2017-18 and 2018-19 adopted budgets to assess whether the District budgeted similarly to the previous three years.
- We analyzed reserve fund balances to determine whether balances were reasonable and/or being used as intended.

We conducted this performance audit in accordance with GAGAS (generally accepted government auditing standards). 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.

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 2116-1(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 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. We encourage the Board to make the CAP available for public review in the District Clerk's office.

## Appendix C: Resources and Services

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### **Regional Office Directory**

[www.osc.state.ny.us/localgov/regional\\_directory.pdf](http://www.osc.state.ny.us/localgov/regional_directory.pdf)

### **Cost-Saving Ideas** – Resources, advice and assistance on cost-saving ideas

[www.osc.state.ny.us/localgov/costsavings/index.htm](http://www.osc.state.ny.us/localgov/costsavings/index.htm)

### **Fiscal Stress Monitoring** – Resources for local government officials experiencing fiscal problems

[www.osc.state.ny.us/localgov/fiscalmonitoring/index.htm](http://www.osc.state.ny.us/localgov/fiscalmonitoring/index.htm)

### **Local Government Management Guides** – Series of publications that include technical information and suggested practices for local government management

[www.osc.state.ny.us/localgov/pubs/listacctg.htm#lmgm](http://www.osc.state.ny.us/localgov/pubs/listacctg.htm#lmgm)

### **Planning and Budgeting Guides** – Resources for developing multiyear financial, capital, strategic and other plans

[www.osc.state.ny.us/localgov/planbudget/index.htm](http://www.osc.state.ny.us/localgov/planbudget/index.htm)

### **Protecting Sensitive Data and Other Local Government Assets** – A non-technical cybersecurity guide for local government leaders

[www.osc.state.ny.us/localgov/lgli/pdf/cybersecurityguide.pdf](http://www.osc.state.ny.us/localgov/lgli/pdf/cybersecurityguide.pdf)

### **Required Reporting** – Information and resources for reports and forms that are filed with the Office of the State Comptroller

[www.osc.state.ny.us/localgov/finreporting/index.htm](http://www.osc.state.ny.us/localgov/finreporting/index.htm)

### **Research Reports/Publications** – Reports on major policy issues facing local governments and State policy-makers

[www.osc.state.ny.us/localgov/researchpubs/index.htm](http://www.osc.state.ny.us/localgov/researchpubs/index.htm)

### **Training** – Resources for local government officials on in-person and online training opportunities on a wide range of topics

[www.osc.state.ny.us/localgov/academy/index.htm](http://www.osc.state.ny.us/localgov/academy/index.htm)

## Contact

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