

Gates-Chili Central School District

Financial Management

JUNE 2019



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

Contents

- Report Highlights 1**

- Financial Management. 2**
 - What Is Effective Financial Management?. 2
 - The Board Did Not Adopt Realistic General Fund Budgets 3
 - Funds Were Improperly Classified as Encumbrances 4
 - The Board Was Not Transparent When Funding Reserves and Projects 5
 - General Fund Surplus Fund Balance Exceeded the Statutory Limit 6
 - The Board Did Not Adopt a Multiyear Financial Plan 6
 - How Should the Board Establish, Fund and Use Reserves? 7
 - The Board Overfunded Reserves and Did Not Use or Improperly Used Reserved Funds 7
 - The Board Did Not Adopt an Adequate Reserve Plan 10
 - What Do We Recommend? 10

- Appendix A – Response From District Officials 12**

- Appendix B – OSC Comments on the District’s Response 18**

- Appendix C – Audit Methodology and Standards 22**

- Appendix D – Resources and Services. 24**

Report Highlights

Gates-Chili Central School District

Audit Objective

Determine whether the Board and District officials adopted realistic budgets and effectively managed fund balance and reserves.

Key Findings

- District officials circumvented the statutory limit on surplus fund balance by making more than \$12 million in unbudgeted year-end transfers to capital projects and reserves, overstating encumbrances by \$827,000 and not using \$5.3 million in appropriated fund balance as a funding source.
- The tax certiorari and unemployment insurance reserves were overfunded by \$2.86 million as of June 30, 2018.
- The Board increased real property taxes by \$2.6 million over the last three years despite having sufficient funds to finance the District's increased costs.

Key Recommendations

- Provide transparency by developing and adopting budgets that include reasonable estimates for revenues and appropriations and the amounts of fund balance and reserves that will be used to fund operations.
- 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 have begun to implement corrective action. Appendix B includes our comments on issues raised in the District's response letter.

Background

The Gates-Chili Central School District (District) serves the Towns of Gates and Chili in Monroe County.

The District is governed by an elected nine-member Board of Education (Board). The Superintendent of Schools (Superintendent) is responsible, along with other administrative staff, for managing day-to-day operations under the Board's direction. The Assistant Superintendent for Business is responsible for the administration and supervision of financial activities. The Board, Superintendent and Assistant Superintendent for Business are responsible for developing the budget.

Since July 1, 2015, there have been an Assistant Superintendent for Business and two interims prior to the current Assistant Superintendent for Business who started October 1, 2018.

Quick Facts

2018-19 Appropriations	\$107 million
Enrollment	4,100
Total Reserves	\$14.4 million

Audit Period

July 1, 2015 – January 16, 2019

Financial Management

What Is Effective Financial Management?

To effectively manage a district's financial condition, the board should adopt realistic and structurally balanced budgets based on historical data or known trends, in which recurring revenues finance recurring expenditures and reasonable levels of fund balance are maintained. To provide for cash flow and unanticipated events, a district may retain a portion of fund balance, referred to as unrestricted fund balance.

District officials should ensure that fund balance does not exceed the amount allowed by New York State Real Property Tax Law,¹ which currently limits surplus fund balance² to no more than 4 percent of the following year's appropriations. Any surplus fund balance that exceeds the statutory limit should be used to pay for one-time purchases, fund needed reserves, pay down debt or reduce the real property tax levy. When fund balance is appropriated to finance operations, the district is budgeting for a planned operating deficit equal to the amount of fund balance appropriated.

Additionally, districts are allowed to encumber obligations in the form of unfulfilled purchase orders or contracts. Encumbrances that exist at fiscal-year end may be carried over to the next year, but must represent valid commitments for specific future expenditures and should not be established as a means of artificially reducing available year-end fund balance. Expenditures for the next year should not be encumbered against the prior year's budget.

Districts are legally allowed to establish reserves for certain future purposes (e.g., capital projects, retirement expenditures). To be transparent, the Board should include the amounts to be reserved in its annual budget to give taxpayers the opportunity to know and approve the board's plans for funding reserves.³ 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.

It also is important for District officials to develop a comprehensive multiyear financial plan to estimate the future costs of ongoing services and future needs and plan for various methods or resources to finance them.

1 New York State Real Property Tax Law Section 1318

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

3 Refer to our publication Reserve Funds available at www.osc.state.ny.us/localgov/pubs/igmg/reservefunds.pdf

The Board Did Not Adopt Realistic General Fund Budgets

We compared appropriations and estimated revenues with actual operating results for 2015-16 through 2017-18 and found that the total budget variance was more than \$5 million each year.⁴

Revenues were annually underestimated by an average of \$2.7 million (2.8 percent). Revenue variances totaled \$8.1 million over three years and were mainly due to unbudgeted line items and underestimated refunds of prior year expenditures from BOCES (\$5 million, or 62 percent of revenue variances). State aid was also underestimated (1.1 to 3.6 percent) by a total of \$2.2 million over the three years (27 percent of the total 3-year variance).

Appropriations were overestimated by an average of \$3.1 million (3 percent) each year, and a total of \$9.3 million over three years. The most significant appropriation variances were for employee benefits (\$4.3 million, 6 percent), special education/occupational education (\$2.8 million, 4 percent), and transportation (\$1 million, 9 percent).

Because the Board included unrealistic estimates in its budget, the District generated operating surpluses each year, ranging from \$988,000 to \$1.8 million.

Figure 1: Budget Variances

	2015-16	2016-17	2017-18	Totals
Estimated Revenues	\$94,665,838	\$96,775,633	\$99,602,778	\$291,044,249
Actual Revenues	\$96,996,353	\$99,761,682	\$102,421,713	\$299,179,748
Underestimated Revenues	\$2,330,515	\$2,986,049	\$2,818,935	\$8,135,499
Percentage Underestimated	2%	3%	3%	
Appropriations	\$99,703,885	\$100,845,294	\$104,023,965	\$304,573,144
Actual Expenditures^a	\$96,007,730	\$97,911,799	\$101,348,349	\$295,267,878
Overestimated Appropriations	\$3,696,155	\$2,933,495	\$2,675,616	\$9,305,266
Percentage Overestimated	4%	3%	3%	
Total Budget Variance	\$6,026,670	\$5,919,544	\$5,494,551	\$17,440,765
Operating Surplus^a	\$988,623	\$1,849,883	\$1,073,364	\$3,911,870
Increase in Real Property Tax Levy	\$1,134,103	\$457,215	\$1,008,102	\$2,599,420

^a Excludes unbudgeted transfers to the capital project fund

By underestimating revenue and overestimating appropriations, the Board gave taxpayers the impression that it needed to both increase taxes and use appropriated fund balance and reserves to close projected budget gaps. The Board annually appropriated an average of \$1.8 million of fund balance as a

⁴ Prior to \$7.03 million in unbudgeted transfers to the capital projects fund in 2016-17, including \$5 million from the capital reserve.

financing source in the 2015-16 through 2017-18 budgets,⁵ which should have resulted in approximately \$1.8 million in planned operating deficits each year. However, due to underestimated revenue and overestimated appropriations, the District realized operating surpluses and did not use \$5.3 million of the \$5.5 million (97 percent) appropriated fund balance.

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 is a circumvention of the statutory limit imposed on the level of surplus fund balance.

District officials indicated that they intentionally budget conservatively. However, budgeting practices that annually underestimate revenue and 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.

Based on our analysis of the 2018-19 adopted budget, officials budgeted similarly to previous years for revenue, expenditures and appropriated fund balance. While the Board did make appropriate changes to a few specific appropriation line items, overall appropriations increased even though actual expenditures were less than budgeted the prior year. It is likely that the District will end 2018-19 with an operating surplus, appropriated fund balance will be unused and fund balance will continue to increase.

Funds Were Improperly Classified as Encumbrances

District officials also recorded year-end encumbrances, as provided for in their 2016 reserve plan, which they purported to represent valid purchase orders against the prior year's budget. However, they overstated encumbrances, in effect circumventing the 4 percent fund balance limit.

We reviewed the 87 purchase orders comprising the reported \$1.75 million in encumbrances for the last two years (2016-17 and 2017-18) and found they were overstated by \$827,353 (47 percent). Specifically, we found five purchase orders totaling \$351,327 (20 percent) did not have disbursements against them in the following year and seven purchase orders totaling \$476,026 (27 percent) were actually for the next year's expenditures and were inappropriately encumbered to hold prior year funds. These overstated encumbrances allowed an additional \$461,566 to be maintained at the end of 2016-17 and \$365,788 in 2017-18, in excess of the statutory fund balance limit.

⁵ \$2 million in 2015-16, \$1.5 million in 2016-17 and \$2 million in 2017-18

The Board Was Not Transparent When Funding Reserves and Projects

The District reported surplus fund balance that exceeded the 4 percent limit by \$143,485 in 2015-16. In 2016-17 and 2017-18, the District reported surplus fund balance at 4 percent in compliance with RPTL (Figure 2). However, this was achieved, in part, by making large year-end unbudgeted transfers to reserves and/or the capital projects fund to reduce the amount of reported surplus fund balance. Prior to these decisions, year-end surplus fund balance was approximately twice the allowed fund balance level.

Figure 2: Effect of Unbudgeted Transfers on Reported Surplus Fund Balance

	2015-16	2016-17	2017-18
Surplus Fund Balance Prior to Transfers	\$8,260,746	\$8,563,246	\$7,822,778
As a Percentage of the Next Year's Budget	8.2%	8.2%	7.3%
Less: Unbudgeted Transfer to Reserves	\$3,269,990	\$2,374,192	\$3,600,000
Less: Unbudgeted Transfer to Capital Project Fund	\$813,486	\$2,028,096	
Reported Surplus Fund Balance at Year-End	\$4,177,270	\$4,160,958	\$4,222,778
Next Year's Budget	\$100,845,294	\$104,023,965	\$106,693,649
As a Percentage of the Next Year's Budget	4.1%	4.0%	4.0%

Instead of including funding for projects and reserves in the annual budget, the Board annually authorized the year-end transfer of surplus fund balance to reserves at the end of June, without actual or estimated amounts. Actual amounts transferred to reserves were discussed at finance committee meetings (in September or October), but were not formally approved by the Board. We noted in June 2018 minutes that Board members requested they be provided with at least estimated amounts, going forward.

The 2016-17 and 2017-18 budgets did not include provisions for transferring \$2.8 million to the capital projects fund for the District's share of a BOCES capital project, even though District officials were aware of the project plans and proposed costs and funding sources.⁶ Therefore, District officials did not transparently communicate to taxpayers, in its budget and newsletter, their plans for funding the project expenditures with surplus fund balance.

Rather than clearly showing expected results and uses of fund balance and reserves, the Board included unrealistic estimates in its regular budget lines to generate operating surpluses to fund reserves and finance approved project costs.

⁶ As early as November 2014, as indicated in Board Finance Committee minutes

General Fund Surplus Fund Balance Exceeded the Statutory Limit

Because the District overstated encumbrances and did not use the majority of its appropriated fund balance, actual surplus fund balance exceeded the statutory limit. The District further circumvented the statutory limit by maintaining unnecessary or overfunded reserves.⁷ Figure 3 recalculates the District's surplus fund balance, which in total exceeded the statutory fund balance limit by more than 6 percentage points at June 30, 2018.

Figure 3: Recalculated Fund Balance at June 30, 2018

Reported Surplus Fund Balance	\$4,222,778
Unused Appropriated Fund Balance	\$2,000,000
Overstated Encumbrances	\$365,787
Overfunded/Unnecessary Reserves	\$2,864,708
Unused Debt Service Funds	\$975,501
Excess Capital Funds Not Moved to Debt Service Fund	\$402,153
Recalculated Surplus Fund Balance	\$10,830,927
2018-19 Budget Appropriations	\$106,693,649
Percentage	10.2%

Despite its budgetary surpluses, overstated encumbrances and excess reserves and fund balance, the Board continued to increase its tax levy by 1 to 2 percent each year. The Board increased the tax levy \$2.6 million (5 percent) over the last three years (Figure 1) despite having sufficient surplus funds to finance any increased costs. The Board also increased the tax levy \$1.3 million (3 percent) in adopting its 2018-19 budget.

The Board Did Not Adopt a Multiyear Financial Plan

The Board has not adopted a comprehensive written multiyear financial plan. Such a plan would help District officials address and plan for the use of fund balance, including reserve funds, and prioritize and plan for future capital needs. The lack of a multiyear plan inhibits the Board and District officials' ability to effectively manage finances and address future needs. As the District moves forward, well-designed written financial plans can assist the Board in making timely and informed decisions about programs and operations and help them effectively manage fund balance in the best interest of District taxpayers.

⁷ Refer to The Board Overfunded Reserves and Did Not Use or Improperly Used Reserved Funds.

How Should the Board Establish, Fund and Use Reserves?

The Board may establish various reserves in accordance with applicable laws to provide financing for specific purposes. Money set aside in reserves must be used in compliance with statutory provisions which determine how reserves are established and how they may be funded, expended and discontinued. Generally, school districts are not limited as to how much money can be held in reserves. However, reserve balances should be reasonable and necessary. The board should periodically analyze the reasonableness of the balances in its reserves. When conditions warrant (subject to legal requirements), the board should reduce reserve funds to reasonable levels or liquidate and discontinue a reserve fund that is no longer needed or whose purpose has been achieved.

A debt service reserve must be established if unexpended bond proceeds remain on a capital improvement financed with debt, or if State or federal aid is received for a capital improvement for which there is outstanding debt. The balance as well as any interest income earned on this money must be used to help finance related debt service costs. This money must be set aside and accounted for in the debt service fund.

It is important that the Board adopt a written plan that states its rationale for establishing reserve funds, objectives for each reserve, optimum funding levels and conditions under which reserves will be used or replenished. The District's reserve policy requires an annual detailed reserve plan be reviewed by the District's audit committee.

The Board Overfunded Reserves and Did Not Use or Improperly Used Reserved Funds

As of June 30, 2018, the District reported five general fund reserves, with balances totaling \$13.5 million⁸ and a debt service reserve totaling \$975,500. We analyzed the reserve balances and activity for reasonableness and adherence to statutory requirements and the District's reserve policy. We found that two general fund reserves are overfunded by \$2.86 million and not all reserves are being used as intended.

Unemployment Insurance Reserve – This reserve is to reimburse the State Unemployment Insurance Fund (SUIF) for payments made to claimants where the municipality has elected to use the “benefit reimbursement” method. If at the end of any fiscal year, the money in the fund exceeds amounts required to be paid into the SUIF, plus any additional amounts required to pay all pending claims, the governing board, within 60 days of the close of the fiscal year, may elect to

⁸ Unemployment insurance, retirement contribution, tax certiorari, employee benefit accrued liability, and capital

transfer all or part of the excess amounts to certain other reserve funds, or apply all or part of the excess to the budget appropriation of the next fiscal year.⁹

The \$2.9 million balance of this reserve as of June 30, 2018 would cover 203 years of unemployment insurance costs, based on the five-year average annual expenditures (\$14,300).

The Board’s most recent reserve plan¹⁰ established an ideal balance of \$400,000, but did not explain or justify the need for this sizeable balance, which would cover approximately 28 years of annual expenditures based on the five year average. Furthermore, it did not include a plan to reduce the June 30, 2016 balance of more than \$4.3 million - also listed in that plan - to the \$400,000 “ideal balance.”

In addition, while the Board annually appropriated funds from the unemployment insurance reserve to fund the budget, it then allocated year-end surplus to the reserve,¹¹ replenishing and further increasing the reserve as opposed to using and reducing it as communicated to taxpayers.

Figure 4: Unemployment Insurance Reserve Activity

	2015-16	2016-17	2017-18	Total
Transfer to General Fund for Operating Budget	\$1,224,149	\$1,000,139	\$1,821,187	\$4,045,475
Year-End Transfer of Surplus to Reserve	\$1,558,000	\$1,374,192		\$2,932,192
Funding in Addition to Replenishment	\$333,851	\$374,053		\$707,904

While this reserve was finally reduced as intended in 2017-18,¹² by \$1.8 million, it remains significantly overfunded. Despite the lack of justification for the District’s \$400,000 ideal balance, the reserve balance currently exceeds that balance, and is therefore overfunded, by at least \$2.5 million.

Tax Certiorari Reserve – This reserve is to pay for judgments and claims resulting from tax certiorari proceedings. Funds reserved, but not expended must be returned to the general fund on or before the first day of the fourth fiscal year following the deposit of such money to the reserve fund. The District’s pending tax certiorari claims as of June 30, 2018 eligible to be reserved totaled \$607,939. However, the District retained \$966,705 in this reserve. As a result, the reserve is

9 General Municipal Law, section 6-m

10 Refer to The Board Did Not Adopt an Adequate Reserve Plan.

11 Refer to The Board Was Not Transparent When Funding Reserves and Projects.

12 The District still had sizeable surpluses, but transferred them to the capital and retirement contribution reserves.

overfunded by \$358,766 (37 percent). This occurred because the District's listing of tax certiorari claims included claims that were not supported by Town provided claim information and claims older than the allowed three years. Additionally, the reserve was only used to pay \$1,067 (8 percent) of \$13,275 of qualifying expenditures made in 2015-16. The reserve was used for all of the 2016-17 claim settlements (\$92,670).

Retirement Contribution Reserve – This reserve is to fund payments to the New York State and Local Retirement System. The \$5.9 million retained in this reserve is sufficient to cover 3.5 years of expenditures, which averaged \$1.7 million over the last five years. District officials improperly used a portion of this reserve for non-retirement contribution expenditures. The Board appropriated \$1.81 million from the reserve in its 2015-16 budget, but incurred only \$1.74 million in retirement contribution costs. Therefore, the District improperly used reserve funds totaling \$71,596 for unauthorized purposes. Similarly, the Board appropriated \$1.57 million from the reserve in the 2016-17 budget, which again exceeded applicable expenditures by \$102,072. However, the Board also reallocated a total of \$2.1 million to the reserve at the end of the 2016-17 and 2017-18 fiscal years, replenishing and further funding the reserve.

Debt Service Reserve – The Treasurer told us that the \$975,501 balance, as of June 30, 2018, is required to be reserved to pay for existing debt. This balance was understated by \$402,153 as a result of unused debt proceeds being recorded in the capital projects fund for projects closed out several years previously. District officials did not maintain records of the composition of the balance allocated to specific debt. Lacking the ability to apply these funds (totaling \$1.37 million) to the debt issuances from which they arose, the District should utilize the balance to pay off other outstanding debt and reduce the current burden on the general fund taxpayers.

Also, the District has not used the debt service reserve to make annual debt payments, and the balance has increased by \$300,000 (44 percent) in the last three years. District officials budget for and make transfers from the general fund to the debt service fund to make annual principal and interest payments on long-term debt. The Treasurer told us that they have tried to make the transfers less than the payment amounts to use some of the accumulated funds towards debt payment, and plan to continue to do so. While transfers from the general fund for debt service payments have been slightly less than total expenditures (\$62,000 less in 2017-18), the reserve balance has increased due to premium and interest on obligations.

The Board Did Not Adopt an Adequate Reserve Plan

The Board and District officials have not developed a sufficiently detailed reserve plan. The most recent reserve plan is from October 2016. A detailed review of reserves has not been conducted for the last two years (2016-17, 2017-18) as required by Board policy. Additionally, the plan is not adequate because it does not include optimum funding levels for each reserve, the total eligible liability for the employee benefit accrued liability reserve or the total tax certiorari claims that support the reserve balance.

Instead, District officials provided a limited analysis that includes a list of the balances for each reserve for 2010 through 2017 with projections for 2018 use, funding and ending balance. It also lists the beginning balance for the retirement contribution and unemployment insurance reserves, the amount to be used in 2017-18 and the projected use in 2018-19 through 2024-25 and remaining balance each year with the projected use. However, this use is the appropriated reserve amount and does not consider the District's history of not using the appropriated reserve amounts, or additional funding that is routinely added to the reserves to reduce surplus funds to the statutory limit. Further, the analysis does not include or address the District's other reserves.

While it is prudent to plan and 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 revenues, appropriations and the amount of fund balance and reserves that will be used to finance operations.
2. Ensure that encumbrances are valid and supported.
3. Develop a plan to reduce the amount of surplus fund balance in the general fund 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 real property taxes.

-
4. Develop a multiyear financial plan.
 5. Review all reserves and determine if the balances are necessary, reasonable and in compliance with statutory requirements. To the extent that they are not, transfers should be made to unrestricted fund balance, where allowed by law, or to other reserves established and maintained in compliance with statute.
 6. Use reserve funds in accordance with statute and use the debt service fund's balance for debt payments as appropriate.
 7. Adopt a comprehensive reserve plan that includes optimum funding levels for each reserve and conditions under which reserves will be used and replenished.

Appendix A: Response From District Officials



BOARD OF EDUCATION

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ADMINISTRATION BUILDING

April 18, 2019

Edward V. Grant, Chief Examiner
The Powers Building
16 Main St., Suite 522
Rochester, N.Y. 14614-1608

Dear Mr. Grant;

The Gates Chili Central School District Board of Education and administrative team thanks the Office of the Comptroller for its review of the District's financial practices. We appreciate the work of the auditors and believe that this effort will benefit the taxpayers of the Gates Chili Central School District. The Gates Chili Central School District Board of Education has implemented some of the recommendations made by the auditors in the report. The District has adopted more stringent budget procedures, initiated better controls over year-end encumbrances, and has budgeted for the transfer of excess Unemployment Reserve to the Capital Reserve.

We offer the following responses to the finding in the Comptroller's Report:

Finding #1:

The Board did not adopt realistic General Fund budgets and "is a circumvention of the statutory limit"

"Because the Board included unrealistic estimates in its budget, the District generated operating surpluses each year, ranging from \$988,000 to \$1.8 million."

District Response:

The Board did adopt conservative budget estimates for the budgets from 2015-16 through 2017-18. It was an intentional surplus, not for the purpose of circumventing the statutory limit, but for the purpose of accommodating budget fluctuations and accruing capital reserves. The budget documents did not account for the plan of transferring excess fund balance to the Capital Reserve. The contributions were disclosed to the taxpayers throughout the planning for the \$68M capital project that is now underway.

The use of appropriated fund balance served to decrease the amount of tax levy needed for the operating budget by absorbing any variations in the operating budget. This variability is acknowledged in the Comptroller's website:

"Volatility of revenues and expenditures - The uncertainty of some revenue estimates (like sales tax) and some expenditure estimates (like social services costs, pending labor contracts, etc.) may justify an increased need for unappropriated unreserved fund balance." <https://www.osc.state.ny.us/localgov/pubs/releases/budfund.htm>

See
Note 1
Page 18

See
Note 2
Page 18

See
Note 3
Page 18

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As certain state aid revenues are estimates and not guaranteed revenue streams, the underbudgeting of revenues is fiscally responsible and the use of fund balance is prudent until the actual state aid reimbursements are determined, often months later. The use of fund balance throughout the years to offset the unknowns allowed the District to reduce the tax levy needed to balance the budget.

The implementation of the tax cap legislation places additional pressure on Districts to accumulate reserves to offset spending in future years when the costs of retirement, salaries and benefits exceed the allowable tax cap.

The Comptroller’s auditors have identified conservative budgeting practices and have noted that the District needs to be more transparent in the planning for reserves. The District agrees that the accumulation of fund balance for the purpose of transferring to the Capital Reserve should have been more transparent in the budgeting process. The report states that the annual appropriation of fund balance is a circumvention of the statutory limit, a conclusion that misrepresents the objective of the Board. As a result of the conservative budgeting practices, the District was able to pursue the capital improvements identified in our Building Condition Survey that address safety and security needs, improvements of instructional spaces for all buildings, and provide needed space for the performance arts that are so central to its academic program. This was done without significant increases in the tax levy and without risking academic programs. The District adhered to the guidelines established for Unappropriated, Unreserved Fund Balance as is stated and did not intend to circumvent the statute with the use of conservative budgeting techniques.

See
Note 4
Page 18

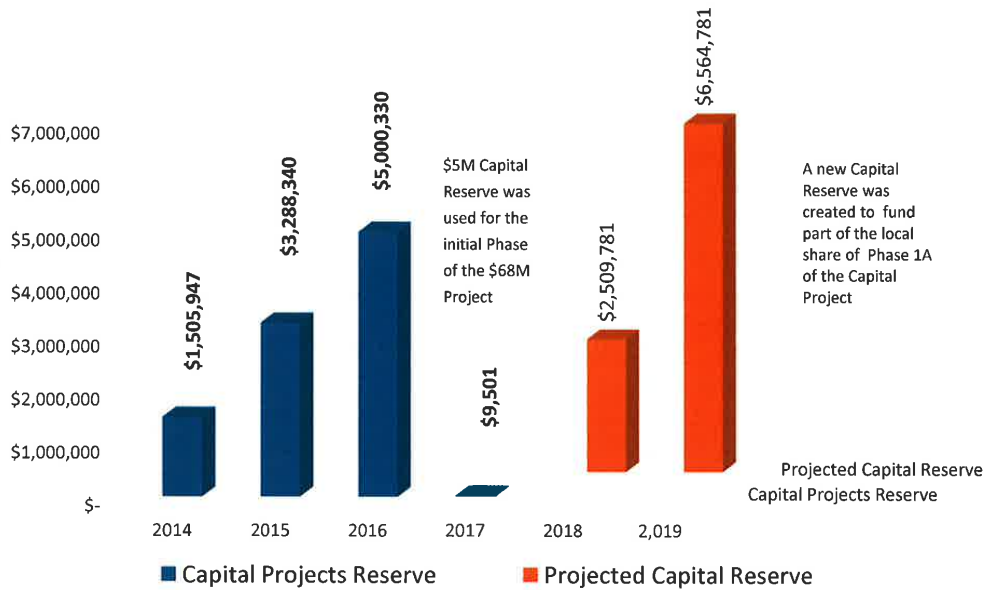
The District does not agree with the finding that the tax levies were “higher than necessary” and is able to demonstrate that the tax levies did, in fact, provide the necessary and prudent levels of funding in order to accomplish the goals as set out by the Board with the planning and inception of the capital project. The District agrees that the use of the tax levies could have been more transparent in the budget and will improve the budgeting allocations moving forward. The following is a graph of the Capital Reserves accrued, then applied, to the \$68M Capital Project between 2015 and 2019. The excess fund balance from 2015-2017 was used to finance the initial expenditures of the capital project. A new Capital Reserve has been established to fund Phase 1A of the capital project and will be funded with excess fund balance from 2018 and 2019.

See
Note 1
Page 18

See
Note 5
Page 18

Capital Reserves From 2014 through 2018 and Projected through 2019

See
Note 6
Page 19



Finding #2:

Funds were improperly classified as encumbrances.

District Response:

The District agrees with this finding and will be diligent in proper identification of encumbrances in the future. The encumbering of the funds in June 2018 was a precursor to expenditures made in 2019. The actual commitments to the vendors were delayed due to the transition of business managers in the Business Department. These funds were not encumbered for the purpose of circumventing the limits on fund balance.

See
Note 7
Page 19

Finding #3:

The Board was not transparent when funding reserves and projects

District Response:

The District partially agrees with this finding. The transfer of funds to the reserves should have been more transparent in the budget process. The funding of reserves and the use of those reserves in the capital project was disclosed throughout the planning stages with public presentations, exhibits, publications and discussions. The District will take steps to improve the transparency in the budgeting process so that it will reflect the ongoing planning for future capital projects.

See
Note 8
Page 19

Finding #4:

General Fund Surplus Fund Balance exceeded the statutory limit

The following is taken from the NYS Comptroller's website:

'An "unappropriated **unreserved fund balance**" is defined as the difference between the total assets for a **fund** and the total liabilities, deferred revenues, encumbered appropriations, amounts appropriated for the ensuing fiscal year's budget, and amounts reserved for stated purposes pursuant to law, as determined through application of the system of accounts prescribed by the **State Comptroller**" <https://www.osc.state.ny.us/localgov/pubs/releases/budfund.htm>

See
Note 3
Page 18

The District disagrees with the Comptroller's interpretation of the actions of the District in the report which claim that the actions of the District circumvent the law. The law states that the "unappropriated fund balance" should not exceed the statutory limit of 4%. It does not define "Unappropriated Fund Balance" as the amount inclusive of the appropriation for the following years' expenditures. Inasmuch as the District budgets conservatively, the allocated fund balance allows for the potential variations in the budget and uses the fund balance allocation in place of increasing the tax levy. This is sound financial planning, practiced statewide, and should be promoted as a best practice in forestalling fiscal stress, not as a violation of the statutory limit.

See
Note 9
Page 19

A more thorough examination of the overall reserves and fund balance indicates that total reserves, except for the Capital Reserve, have been decreasing. The allegation that the District has "sufficient surplus funds to finance any increased costs", is mis-aligned with the Comptroller's recommendation to adopt a multi-year financial plan. The use of the fund balance to offset increased costs will diminish the District's ability to offset increased costs in years when the operating costs exceed the tax cap limitations.

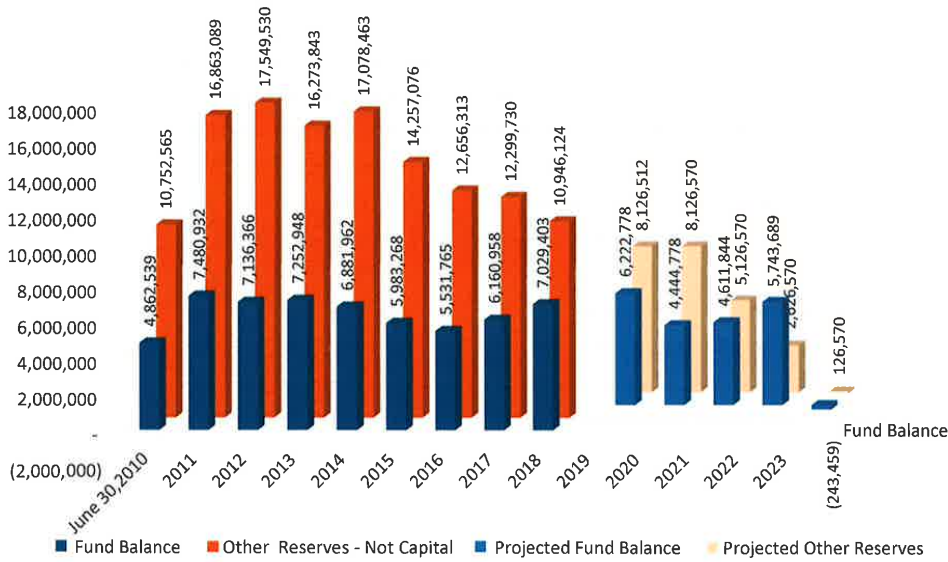
See
Note 10
Page 19

Finally, as the chart below indicates, the reserves and fund balances, excepting the Capital Reserve, have diminished over the last seven years to a level that indicates potential financial stress within the next two years.

See
Notes 11 and 12
Pages 19 and 20

Non-Capital Reserves and Fund Balances From 2010 through 2018 and Projected through 2023

See
Note 12
Page 20



Finding # 5:

The Board did not adopt a multi-year financial plan.

The District disagrees with the assessment under this finding. It did, in fact, have a plan for the capital project, the use of reserves and the maintenance of academic programs. The District agrees that it was not formally adopted. It is stated that the lack of the financial plan “inhibits the Board and District officials’ ability to effectively manage finances and address future needs” when, in fact the financial plan was in place and did address the future needs of the District. The financial plans allowed the District to move forward with the planned reserves and the planned use of those reserves, effectively delivering what was promised to the taxpayers.

See
Note 13
Page 20

Finding #6:

The Board overfunded reserves and did not use, or improperly used reserved funds.

The District agrees that Unemployment Reserve was overfunded. This could have been corrected at one time, but was, instead, moved to appropriate reserve accounts over several years pursuant to the

See
Note 14
Page 20

reserve plan presented to the Board. The Tax Certiorari Reserve should have been adjusted from \$967k to \$608K as the tax certiorari cases aged out. It will be adjusted to an appropriate level in 2020.

The retirement contribution reserve was allocated based on the budgeted expenditure for the Employee Retirement Reserve, resulting in the over allocation of \$102,072. The allocation was based on the expected expenditure. This was an unintentional overallocation.

The Debt Service Reserve was targeted for use in the \$68M project as an offset to spikes in the debt service schedule in 2020-21. This is part of the long-range financial plan that was crafted to keep the local share at a manageable level over twenty years.

See Note 15 Page 20

The District also disagrees with conclusion that the reserve plan presented to the Board did not consider the District's history of not using the appropriated reserve amounts. The statement presumes the thought process behind the reserve plan. The plan did, as indicated above, consider the balances of reserves available and the financial plan for the capital project and ongoing operations.

See Note 16 Page 20

Finding #7:

The Board did not adopt an adequate reserve plan

The Board did not adopt an adequate reserve plan in in 2016-17 or 2017-18 as required by Board policy. The Board will adopt a reserve plan in 2019. The plan will include the optimal level of all reserves, the eligible liability for the employee benefit accrued liability and the tax certiorari claims that support the reserve balance.

Again, we thank the Office of the Comptroller for its review of the District's financial practices. The District will implement recommendations that will increase transparency, maintain financial stability and continue quality academic programs for our students.

Jeffrey Pettenski, President
Gates Chili Board of Education

Appendix B: OSC Comments on the District's Response

Note 1

Any known expenditures or plans to transfer fund balance to reserves or capital projects should be clearly stated in budget documents for voter approval.

Note 2

While the use of the \$5 million capital reserve toward the \$68 million project was included in the project planning documents and the proposition approved by voters, we found no project documentation that disclosed or authorized contributions to capital reserves for the project.

Note 3

This citation is from a July 2001 OSC accounting bulletin which was sent to county, city, town, village and fire district officials and did not apply to school districts. Furthermore, the cited bullet described a factor to consider when determining a reasonable amount of unappropriated unreserved fund balance - for those units which do not have the statutory fund balance limit that school districts have - not for determining the amount of appropriated fund balance. The applicable guidance for school districts is included on page 4 (including Footnote 3) of an April 2011 accounting bulletin which uses updated GASB language and is available at the following link: <https://www.osc.state.ny.us/localgov/pubs/releases/gasb54.pdf>

Note 4

The District could continue to accumulate funds for these purposes by transparently budgeting for them, for voter knowledge and approval, instead of inflating estimates in other unrelated budget lines and consistently appropriating fund balance that would not actually be used.

Note 5

The District did not, in fact, apply all excess fund balance from 2015 to 2017 to finance the \$68 million capital project. As shown in Figure 5 below, only \$4.2 million, or 35 percent, of the \$12 million in year-end surplus fund balance was transferred to the capital reserve. Further, all transfers of surplus fund balance to the capital projects fund in those years were for the BOCES capital project.

Figure 5: Year-End Transfers of Surplus Fund Balance

Year-end Transfers	2015-16	2016-17	2017-18	Total
To Capital Reserve	\$1,711,990		\$2,500,000	\$4,211,990
To Retirement Contribution Reserve		\$1,000,000	\$1,100,000	\$2,100,000
To Unemployment Insurance Reserve	\$1,558,000	\$1,374,192		\$2,932,192
To Capital Fund for BOCES Project	\$805,497	\$2,028,096		\$2,833,593
Total Surplus Fund Balance Transfers	\$4,075,487	\$4,402,288	\$3,600,000	\$12,077,775

Note 6

The District reported \$248,567 in the capital reserve as of June 30, 2014. The amount in the graph corresponds with another reserve.

Note 7

It is not appropriate to encumber funds against the prior year's budget for program expenditures of the following school year.

Note 8

This finding addresses the unbudgeted funding of multiple reserves and the BOCES capital project. There was no discussion of funding or use of capital reserves in the BOCES capital project documentation. While financing plans for the BOCES project included the use of unappropriated (and unreserved) fund balance, these provisions were not included in the budget, which was misleading to taxpayers.

Note 9

As stated in the report, the misleading 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 is a circumvention of the statutory limit imposed on the level of surplus fund balance.

Note 10

If District officials do not intend to use or reduce fund balance and reserves, they should not give taxpayers the impression that they will be using and reducing fund balance and reserves, by appropriating fund balance and reserves in their adopted budgets.

Note 11

Reserves that have been reduced to amounts needed, or smaller unused balances, do not represent fiscal stress.

Note 12

Eliminating capital reserves from this analysis of "Total Reserves" is a misrepresentation of available funds. Furthermore, most of the reduced reserves were reallocated to the capital reserves. Reserves are generally not lower than necessary, and not used as budgeted. Thus, the District's projected decline to financial stress is an unsupported representation.

Note 13

Other than plans for the current capital project, District officials did not provide a written multiyear financial plan or a current and sufficiently detailed plan for the funding or use of all reserves. The lack of a formal documented plan decreases the ability of all Board members and District officials to be familiar with and monitor progress of approved plans.

Note 14

The District did not move funds from the unemployment reserve to other reserves over several years. Furthermore, the reserve plan presented to the Board made no mention of moving money from the unemployment reserve to other reserves. The Board budgeted annually to use portions of the unemployment reserve toward the general fund budget. However, the reserve was instead replenished and further funded in 2015-16 and 2016-17. The 2017-18 fiscal year was the first year the District did not replenish the unemployment reserve, but instead allocated the surplus fund balance to the retirement contributions and capital reserves.

Note 15

Any such long-range plan should have been formalized, approved by the Board and shared with taxpayers. The District provided no documentation of prior discussions or plans for use of the long-standing unaccounted for debt service fund balance toward future debt service on the current capital project. Project information shared at public meetings and in the proposition approved by voters did not include the use of debt service funds as a financing source, but included only bond proceeds, applicable state aid, and \$5 million from the capital reserve. As stated in the report, debt service funds should be used to pay off specific outstanding debt, not held for payments on future bond issues.

Note 16

The limited reserve analysis provided to the Board in February 2018 showed projected reserve balances that were reduced by the amounts appropriated or projected to be used (from the unemployment and retirement contribution reserves) each year, despite the fact that the District replenished & further funded those reserves at year-end. Thus, the analysis showed declining reserve

balances, when they were in fact increasing annually, significantly misleading the Board and taxpayers. Further, the District's reserve plan does not include a financial plan for the capital project or ongoing operations.

Appendix C: 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 employees, reviewed Board and finance committee meeting minutes, resolutions, policies and reserve plan to gain an understanding of the budget process, financial management policies and procedures and the monitoring of fund balance and reserves.
- We analyzed fund balance for the general fund and calculated surplus fund balance as a percentage of the next year's appropriations to assess compliance with statute.
- We recalculated surplus fund balance as a percentage of the next year's appropriations after adding back unused appropriated fund balance, overstated encumbrances and overfunded reserves.
- We reviewed operating results and compared the results to the appropriated fund balance to determine whether appropriated fund balance was used as budgeted.
- To assess budget reasonableness, we compared budget estimates to actual results for 2015-16 through 2017-18. We also compared the 2018-19 adopted budget to determine whether any significant changes had been made to the District's budgeting practices.
- We reviewed the listing of purchase orders comprising encumbrances. We reviewed all 87 2016-17 and 2017-18 purchase orders totaling \$1.75 million to determine whether they were valid encumbrances.
- We analyzed the debt service fund balance and activity to determine amounts that accounted for the balance and whether the fund was used to make debt payments.
- We analyzed the fund balance for the capital projects fund to determine whether the funds were for ongoing/open capital projects.
- We analyzed reserves and related expenditures to determine whether they were properly established, used and funded and whether balances were reasonable.

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.

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.

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 D: Resources and Services

Regional Office Directory

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

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

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

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

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/pubs/cyber-security-guide.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

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

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

Contact

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Division of Local Government and School Accountability
110 State Street, 12th Floor, Albany, New York 12236

Tel: (518) 474-4037 • Fax: (518) 486-6479 • Email: localgov@osc.ny.gov

www.osc.state.ny.us/localgov/index.htm

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