



Elba Central School District Financial Condition

Report of Examination

Period Covered:

July 1, 2011 — July 30, 2013

2013M-240



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
Budgeting and Fund Balance	6
Reserves	7
Recommendations	9
APPENDIX A Response From District Officials	10
APPENDIX B Audit Methodology and Standards	13
APPENDIX C How to Obtain Additional Copies of the Report	14
APPENDIX D Local Regional Office Listing	15

State of New York Office of the State Comptroller

Division of Local Government and School Accountability

October 2013

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 district's 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 Elba 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 Elba Central School District (District) is located in the Towns of Batavia, Byron, Elba, Oakfield, and Stafford. The District is governed by a Board of Education (Board), which comprises seven elected members. The Board is responsible for the general management and control of the District's financial and educational affairs. The Superintendent of Schools (Superintendent) is the chief executive officer of the District and is responsible, along with other administrative staff, for the day-to-day management of the District under the direction of the Board. The Superintendent and Treasurer are responsible for the District's finances, accounting records, and financial reports.

The District has one school in operation with 460 students and 86 full-time and nine part-time employees. The District's budgeted appropriations for the 2013-14 fiscal year totaled \$9.7 million and were funded primarily with real property taxes and State aid. As of June 30, 2013, the District had more than \$2.1 million in Board authorized reserves.

Objective

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

- Have District officials provided for effective financial planning and management by ensuring budget estimates and reserve balances are reasonable and by maintaining unassigned fund balance levels in accordance with statutory requirements?

Scope and Methodology

We examined the District's financial activities for the period July 1, 2011, to July 30, 2013. We extended our scope back to the 2008-09 fiscal year to analyze budgeting, fund balance trends, and reserve account balances.

We conducted our audit in accordance with generally accepted government auditing standards (GAGAS). More information on such standards and the methodology used in performing this audit are included in Appendix B of this report.

Comments of District Officials and Corrective Action

The results of our audit and recommendations have been discussed with District officials and their comments, which appear in Appendix A, have been considered in preparing this report. District officials generally agreed with our finding and planned to initiate corrective action.

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 the CAP 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 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 also can legally 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.

From the 2008-09 to 2012-13 fiscal years, District officials consistently over-estimated expenditures by a total of \$5.5 million. These budgeting practices generated approximately \$2.2 million in operating surpluses, which caused unexpended surplus funds to exceed statutory limits in each of the past five years. For example, as of June 30, 2013, unexpended surplus funds exceeded statutory limits by \$949,184. Although District officials appropriated on average \$413,000 in each of the last five fiscal years to reduce the tax levy, the Board over-estimated expenditures by an average of \$1.1 million annually, thus negating any benefit the appropriation of fund balance would have in reducing fund balance or the property tax levy. District officials also used some of the annual operating surpluses to fund six reserves that, as of June 30, 2013, totaled \$2.1 million. Four of the six reserves appear to be over-funded.

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

Budgeting and Fund Balance

The Board and Superintendent are responsible for accurately estimating expenditures, revenues, and fund balance that will be available at fiscal year-end to reduce the ensuing year's tax levy. Accurate estimates help ensure that the levy of real property taxes is not greater than necessary. The estimation of fund balance is an integral part of the budget process. Unexpended fund balance represents uncommitted funds. The portion of the unexpended fund balance that is used to help finance the next fiscal year's budget is referred to as appropriated, unexpended surplus fund balance and the remaining portion, which can be used for cash flow purposes and unanticipated expenditures, is unexpended surplus fund balance. Real Property Tax Law currently limits unexpended surplus fund balance to no more than 4 percent of the ensuing fiscal year's budget. Any surplus fund balance over this percentage should be used for non-recurring expenditures or to reduce the upcoming fiscal year's tax levy.

We compared the District's budgeted appropriations with actual results of operations for fiscal years 2008-09 to 2012-13 and found that the District consistently over-estimated budgeted appropriations, by a total of approximately \$5.5 million (Table 1). The majority of the over-estimations for the five-year period were in the categories of employee benefits² (\$1.3 million), teaching³ (\$1.6 million), special apportionment programs⁴ (\$1 million), and central services⁵ (\$792,000).

Fiscal Year	Budgeted Appropriations	Actual Expenditures	Difference
2008-09	\$9,975,559	\$9,023,298	\$952,261
2009-10	\$9,995,010	\$8,751,108	\$1,243,902
2010-11	\$9,668,087	\$8,460,091	\$1,207,996
2011-12	\$9,511,835	\$8,312,995	\$1,198,840
2012-13 ^a	\$9,540,820	\$8,632,815	\$908,005
Totals	\$48,691,311	\$43,180,307	\$5,511,004

^a The 2012-13 amounts have not been audited.

Due to the District's practice of significantly over-estimating appropriations, it has experienced operating surpluses totaling approximately \$2.2 million during this time (Table 2).

² Includes retirement contributions, Social Security, workers' compensation, unemployment, and health insurance

³ Includes salaries, equipment, conferences, supplies, and textbooks

⁴ Includes programs for students with special needs (handicapped, learning disabilities, and other special needs)

⁵ Includes expenditures for the operation and maintenance of the school

Table 2: Results of Operations					
Fiscal Year	2008-09	2009-10	2010-11	2011-12	2012-13^a
Beginning Fund Balance	\$1,851,450	\$2,526,444	\$3,244,169	\$3,651,710	\$3,940,945
Revenues	\$9,698,292	\$9,468,833	\$8,867,632	\$8,602,230	\$8,785,360
Expenditures	\$9,023,298	\$8,751,108	\$8,460,091	\$8,312,995	\$8,632,815
Operating Surplus	\$674,994	\$717,725	\$407,541	\$289,235	\$152,545
Year-End Fund Balance	\$2,526,444	\$3,244,169	\$3,651,710	\$3,940,945	\$4,093,490
Less: Amount Appropriated for the Next Fiscal Year	\$400,000	\$400,000	\$400,000	\$400,000	\$465,000
Less: Restricted Fund Balance ^b	\$866,507	\$1,379,338	\$1,855,783	\$1,771,796	\$2,288,696
Unexpended Surplus Fund Balance	\$1,259,937	\$1,464,831	\$1,395,927	\$1,769,149	\$1,339,794
Fund Balance in Excess of 4% Limit	\$860,137	\$1,078,108	\$1,015,454	\$1,387,516	\$949,184
^a The 2012-13 amounts have not been audited.					
^b The restricted fund balance includes a reserve for encumbrances, which totaled \$187,060 as of June 30, 2013.					

Although an average of \$413,000 was appropriated to fund the next year's expenditures in each of the last five fiscal years, the operating surpluses offset any actual benefit of appropriating fund balance in the budget. Budgeting practices which produce operating surpluses, and maintain fund balances that exceed the amount allowed by law, result in real property tax levies that are greater than necessary to fund operations.

Reserves

Reserves may be established by the Board in accordance with applicable laws. Moneys set aside in reserves must be used only 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 must be reasonable. Funding reserves at greater-than-reasonable levels contributes to real property tax levies that are higher than necessary, because the excessive reserve balances are not being used to fund operations. The Board is responsible for developing a formal plan for the use of its reserves, including how and when disbursements should be made, and for ensuring that appropriate documentation is maintained to account for and monitor reserve activity and balances.

As of June 30, 2013, the District had six reserve funds with balances totaling \$2.1 million. The balances of four of the six reserves – including the retirement contribution reserve, the unemployment insurance reserve, the worker's compensation reserve, and the

property loss insurance reserve – appeared higher than necessary to fund current obligations.

Retirement Contribution Reserve – General Municipal Law (GML) authorizes the establishment of this type of reserve to pay benefits for employees covered by the New York State and Local Retirement System. The District cannot include the cost of financing contributions for employees covered by the New York State Teachers’ Retirement System. No moneys have been expended from this reserve since it was created in 2009. The balance of the reserve was \$518,667 as of June 30, 2013. This balance was five times the District’s average contribution of \$95,966 over five years. It is unclear why the Board funded this reserve while continuing to budget for retirement costs in the general fund and levy taxes to fund them.

Unemployment Insurance Reserve – GML authorizes the establishment of this type of reserve to reimburse the State Unemployment Insurance Fund for payments made to claimants. This reserve had a reported balance of \$297,349 as of June 30, 2013. While the District incurred unemployment costs totaling \$92,668 from 2008-09 to 2012-13, these expenditures were budgeted for and paid out of the general fund as routine operating costs. No money has been spent from the reserve. If unemployment costs continue to average \$18,534 per year, the reserve would last for nearly 16 years, assuming no taxes were levied for this purpose. We question the need to reserve funds for this purpose for this length of time.

Worker’s Compensation Reserve – GML authorizes the establishment of this type of reserve for payments of compensation and benefits, medical, and hospital costs based on workers’ compensation claims, rather than paying annual premiums. This reserve had a reported balance of \$201,983 as of June 30, 2013. No cash has been spent from this reserve since it was created by the Board in 2009. The balance is seven times the District’s five year average annual worker’s compensation cost of \$28,331, which has been budgeted for and paid out of the general fund. Therefore, we question the reasonableness of the amount in this reserve.

Property Loss Reserve – Education Law authorizes school districts to establish and maintain this type of reserve to cover property loss and liability claims. However, according to law, its balance should not exceed 3 percent of the annual budget. The primary purpose of a property loss reserve is to provide the ability to “self-insure” for all or portions of claims that would typically be covered by insurance, to result in a reduction in insurance costs. Since the establishment of the reserve during the 2008-09 school year, the District has maintained it at a level above 3 percent of the annual budget. As of June 30, 2013,

the amount in this reserve was \$303,532, which is \$17,307 above the limitation of 3 percent of the 2012-13 fiscal year budget. The Board authorized this reserve in May 2009 for \$300,000. District officials stated that these funds were to be used for unforeseen costs relative to a capital project. No property loss claims have been paid from this reserve; therefore, we question its reasonableness.

By maintaining excessive and/or unnecessary reserves – combined with ongoing budgeting practices that routinely generate operating surpluses – the Board and District officials have withheld significant funds from productive use, levied taxes that were higher than necessary, and compromised the transparency of District finances to the taxpayers.

Recommendations

1. The Board and District officials should develop realistic expenditure and fund balance estimates for the annual budget.
2. The Board and District officials should review reserves and determine if the amounts reserved are necessary, reasonable, and in compliance with statutory requirements.
3. District officials should include both the funding and use of all reserves in their adopted budget plan each year to provide increased transparency to District voters.
4. District officials should develop a plan for the use of the general fund's excess unexpended surplus fund balance and the excess amounts in reserve funds in a manner that benefits District taxpayers. Such uses could include, but are not limited to, paying off debt, financing one-time expenditures, and reducing District property taxes.

APPENDIX A

RESPONSE FROM DISTRICT OFFICIALS

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

Elba Central School

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Jerome J. Piwko, Jr.

Superintendent of Schools

October 17, 2013

Office of the State Comptroller
295 Main St.
Buffalo, NY 14203-2510

To Whom It May Concern:

The Board of Education and the Administration would like to thank the Comptroller's Office for working with the District so that we can strive to provide accountability for tax dollars being spent to support district operations which are being used to maintain effective educational programs for our students. We believe the Comptroller's report to be a fair and accurate account of our current financial condition.

The District has taken a very conservative approach in regards to the General Fund budget, the establishment of several reserve accounts, and maintaining a low and consistent tax rate over the past few years. This conservative approach is the result of having a negative fund balance several years ago and having to raise taxes significantly over a two-year period to eliminate the negative fund balance. This conservative approach has also allowed the District to considerably reduce the amount of borrowing compared to several years ago. For example, with the establishment of the Capital Bus Reserve, the District was able to pay for bus purchases without having to borrow. Not having to borrow for these types of purchases has decreased other costs such as interest expense, bond counsel and financial advisement.

Often times during the budgeting process, expenditures are being budgeted based on estimates not actual figures. When using estimates, the District has tried to be very conservative. When budgeting for expenditures such as gas, electricity, and snowplowing those expenditures are significantly affected when we have mild winter seasons. Some of the budget years referenced in this audit report had events occur after the budget vote that the District had neither anticipation of nor any control over. For example, when the 2010-11 budget was presented for vote in May to the taxpayers, the District had no anticipation that the State would be offering a retirement incentive in June nor did the District have any idea that six staff members would take the retirement incentive. This retirement incentive resulted in a significant budget surplus for the 2010-11 school year. Table 2 on page 7 of the Comptroller's Report demonstrates the District's cognizant effort to reduce the operating surpluses. Table 2 shows that the operating surplus has decreased significantly in the last two years. In developing the 2013-14 budget, the District looked at five-year trends to determine the amount to budget for various expenditure items. The District anticipates the operating surplus for the 2013-14 school year to be reduced even more.

In any given budget year, unanticipated revenues can improve the District's financial outlook while unanticipated expenditures can quickly damage the District's financial condition. For example, unanticipated expenditures such as programs for new special education students can range from a few thousand dollars to over \$100,000 a year. Since a District cannot over-expend the voter approved budget, the District tries to build a conservative budget to accommodate for unanticipated expenditures such as special education costs.

The District will work collaboratively on a five-year financial plan with our financial advisor in order to do due diligence to the taxpayers of Elba Central School. The Board of Education and the Administration will take the Comptroller's Report under advisement in order to assure that the District is operating in an efficient and effective manner to best serve the students of the District by maintaining quality educational programs and at the same time be fiscally responsible to the taxpayers of our community.

Sincerely,

Mark Torrey
Board of Education President

APPENDIX B

AUDIT METHODOLOGY AND STANDARDS

Our overall goal was to assess the adequacy of the internal controls put in place by officials to safeguard District assets. To accomplish this, we performed an initial assessment of the 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 condition, 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 procedures 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, and/or professional misconduct. We then decided on the reported objective and scope by selecting for audit those areas most at risk. We selected financial condition for further audit testing. To accomplish our objective, we performed the following procedures:

- We interviewed District officials to obtain an understanding of the District's financial condition, budgeting, and use of reserve funds.
- We reviewed the last five years of financial information submitted to the Office of the State Comptroller.
- We compared budgets with actual results for the 2008-09 to 2012-13 fiscal years to assess whether the budgets were realistic and supported.
- We reviewed the minutes of the Board's proceedings, accounting records, audited financial statements, applicable statutes, and activity within the reserves to determine if the reserves were properly established, 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 to determine whether the District complied with applicable statutory provisions.

We conducted this performance audit in accordance with generally accepted government auditing standards (GAGAS). Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

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