



Silver Creek Central School District Financial Condition

Report of Examination

Period Covered:

July 1, 2012 – September 15, 2015

2015M-321



Thomas P. DiNapoli

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State of New York Office of the State Comptroller

Division of Local Government and School Accountability

February 2016

Dear School District Officials:

A top priority of the Office of the State Comptroller is to help school district officials manage their districts efficiently and effectively and, by so doing, provide accountability for tax dollars spent to support district operations. The Comptroller oversees the fiscal affairs of districts statewide, as well as districts' compliance with relevant statutes and observance of good business practices. This fiscal oversight is accomplished, in part, through our audits, which identify opportunities for improving district operations and Board of Education governance. Audits also can identify strategies to reduce district costs and to strengthen controls intended to safeguard district assets.

Following is a report of our audit of the Silver Creek 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 New York State 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 Silver Creek Central School District (District) is located in the Towns of Hanover and Sheridan in Chautauqua County and the Town of Brant in Erie County. The District is governed by the Board of Education (Board), which is composed of 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 District's chief executive officer and is responsible, along with other administrative staff, for the District's day-to-day management under the Board's direction. The Board, Superintendent and Business Administrator are responsible for the District's annual budget. The Business Administrator is responsible for the District's financial records.

The District operates three schools out of one building: an elementary school, a middle school and a high school. The District has approximately 1,030 students and 205 employees. The District's general fund budgeted appropriations for the 2015-16 fiscal year are \$22.8 million, which are funded primarily with State aid and real property taxes.

Objective

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

- Did District officials properly manage District finances by ensuring that budget estimates, unrestricted fund balance and reserve balances were reasonable and properly reported?

Scope and Methodology

We examined the District's financial records for the period July 1, 2012 through September 15, 2015.

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 recommendations and indicated that they plan to take corrective action.

The Board has the responsibility to initiate corrective action. Pursuant to Section 35 of General Municipal Law, Section 2116-a (3)(c) of New York State Education Law and Section 170.12 of the Regulations of the Commissioner of Education, 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 continue funding public educational services. The responsibility for accurate and effective financial management rests with the Board, Superintendent and Business Administrator. District officials are responsible for adopting realistic budgets and for ensuring that fund balance does not exceed the amount allowed by law. Fund balance represents the cumulative residual resources from prior 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 unrestricted fund balance, but must do so within the legal limits established by New York State Real Property Tax Law.¹ A district also can establish reserves to finance future costs for a variety of specified objects or purposes.

District officials have not effectively managed fund balance and have allowed unrestricted fund balance to exceed statutory limits for the past three fiscal years. As of June 30, 2015, the District's unrestricted fund balance totaled \$2.7 million and was 12 percent of the 2015-16 budgeted appropriations, exceeding the statutory limit by more than \$1.7 million. Although District officials annually appropriated fund balance to reduce the tax levy, these funds were not used as budgeted because District officials consistently overestimated appropriations by an average of \$1.5 million, or 7 percent, each year. Furthermore, the District significantly overfunded two reserves² by approximately \$784,000. Despite the significant amount of accumulated fund balance, District officials have continued to increase the tax levy each year.

Budgeting and Fund Balance

The Board and District management are responsible for ensuring that the annual budget includes accurate estimates of expected revenues, expenditures and the use of fund balance. Accurate budget estimates help ensure that the levy of real property taxes is not greater than necessary.

During fiscal years 2012-13 through 2014-15, the District's unrestricted fund balance averaged approximately \$3.3 million and exceeded the statutory limit by an average of \$2.4 million. The District appropriated an average of \$1.2 million of fund balance

¹ New York State Real Property Tax Law limits the amount of unrestricted fund balance for school districts to 4 percent of the ensuing year's budget.

² The District had nine general fund reserves totaling \$6.1 million as of June 30, 2015.

annually to help finance budgeted appropriations. However, due to positive variances between amounts budgeted and actual operating results, only a small portion (less than 4 percent) of appropriated fund balance was actually used to finance operations.

When fund balance is appropriated as a funding source, it reduces the fund balance subject to statutory limits and the expectation is that there will be a planned operating deficit in the ensuing fiscal year. Although the District appropriated fund balance each year, it generally was not needed as the District also consistently overestimated expenditures by an average of \$1.5 million, or 7 percent, each year. The most significant variances were found in instructional salaries (\$967,000) and special education contractual services³ (\$730,000). Because expenditures were overestimated, the District realized operating surpluses of \$420,000 for 2012-13, \$603,000 for 2013-14 and a much smaller operating deficit of \$141,000 than was intended for 2014-15. As a result, only a small portion (\$141,000) of appropriated fund balance was actually used to finance operations and total fund balance generally increased.

Figure 1: Unrestricted Fund Balance at Year-End

	2012-13	2013-14	2014-15
Beginning Fund Balance	\$9,116,414	\$9,535,937	\$10,138,557
Plus: Operating Surplus/(Deficit)	\$419,516	\$602,620	(\$140,987)
Ending Fund Balance	\$9,535,930	\$10,138,557	\$9,997,570
Less: Appropriated Fund Balance	\$1,129,187	\$1,216,812	\$1,129,068
Less: Restricted Fund Balance (Reserves)	\$4,681,725	\$5,209,107	\$6,181,249
Less: Nonspendable Fund Balance	\$141,117	\$0	\$0
Unrestricted Fund Balance at Year-End	\$3,583,901	\$3,712,638	\$2,687,253
Unrestricted Fund Balance as a Percentage of Ensnung Year's Budget	18%	17%	12%

In addition, the District's practice of consistently 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. As shown in Figure 2, because the District did not actually use the appropriated fund balance to finance operations, it actually exceeded the 4 percent statutory limit by higher amounts than reported. At the end of the 2012-13 and 2013-14 fiscal years, the District's unrestricted fund balance was actually more than 20 percent of the ensuing years' budgets. Based on the 2015-16 adopted budget, the District budgeted similarly to previous years and most likely will not use the \$1.1 million

³ Contractual services provided by the Boards of Cooperative Educational Services for special education students.

it appropriated in fund balance. Therefore, the District’s recalculated fund balance will likely continue to exceed the statutory limit.

Figure 2: Unused Fund Balance			
	2012-13	2013-14	2014-15
Unrestricted Fund Balance at Year-End	\$3,583,901	\$3,712,638	\$2,687,253
Add: Appropriated Fund Balance Not Used to Fund Ensuing Year’s Budget	\$1,129,187	\$1,075,825	\$1,129,068
Recalculated Unrestricted Fund Balance at Year-End	\$4,713,088	\$4,788,463	\$3,816,321
Recalculated Unrestricted Fund Balance as a Percentage of Ensuing Year’s Budget	23%	21%	17%

Although the Board was told every year by the District’s independent auditors that unrestricted fund balance was in excess of the statutory limit, the Board continued to maintain unrestricted fund balance in excess of the amount legally allowed. Despite its budgetary surpluses and excess fund balance, the District continued to increase the tax levy by approximately 2 percent each year. Over the last three years, the District has increased its real property tax levy by approximately \$380,000 (7 percent) and its total fund balance by more than \$880,000 (10 percent). Budgeting practices which produce operating surpluses and maintain fund balance in excess of the amount allowed by law result in real property tax levies that are greater than necessary to fund operations and place an unnecessary burden on District taxpayers.

Reserves

Generally, school districts are not limited as to how much money they can maintain in reserves. However, 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. Therefore, the appropriate use of reserve funds is also an important part of the budget process.

As of June 30, 2015, the District had nine general fund reserves with balances totaling more than \$6.1 million. We analyzed the District’s reserves for reasonableness and found two reserves were overfunded by more than \$784,000. We discussed with District officials our concerns with the funding levels of five other reserves. The remaining two were properly established and reasonably funded.

Retirement Contribution Reserve – General Municipal Law authorizes establishing and funding such a reserve for retirement contribution costs. This reserve can only be used to pay employer retirement contributions to the New York State and Local Employees’ Retirement System. As of June 30, 2015, the reserve totaled more than \$2.6 million, which represents over 8 times the District’s five-year annual average cost for retirement contributions. While the Board has appropriated a portion of the reserve, approximately \$120,000 (5 percent), to be applied towards related expenditures during each of the past two fiscal years,

the majority of the retirement contributions have been paid with taxes levied for that purpose. The District's fund equity plan⁴ indicates that expenditures paid from the reserve will increase to \$220,000 (8 percent) per year for the next nine years. However, even if the District uses the reserve as planned, the reserve would still have a balance of more than \$508,000 and be sufficient to cover the District's contribution for another two years. Therefore, it is unclear why the Board has funded the reserve to such a level.

Reserve for Property Loss – Education Law authorizes establishing and funding such a reserve for property loss and liability claims. As of June 30, 2015, the reserve had a balance of approximately \$275,500. The District has had no property loss claims over the past three years. The Business Administrator indicated that currently there are no claims for which the reserve could be used and no plans to use the reserve funds in the future. Therefore, we question why the District continues to maintain this reserve.

Funding reserves at greater than reasonable levels contributes to real property tax levies that are higher than necessary because the excessive balances are not being used to fund operations.

While it is prudent to provide for unforeseen circumstances, maintaining excessive levels of fund balance, using overly conservative budget estimates and overfunding reserves places an unfair burden on the taxpayers.

Recommendations

The Board and District officials should:

1. Ensure budgets include realistic appropriations based on actual needs to avoid levying taxes at a level greater than needed.
2. Ensure that the estimates in the annual budget for the planned use of fund balance are accurate and reasonable.
3. Maintain unrestricted fund balance within the statutory limit.
4. Develop a plan to reduce unrestricted fund balance in a manner that benefits District taxpayers. Such uses could include, but are not limited to, paying off debt, financing one-time expenditures and reducing property taxes.
5. Ensure that reserve fund balances are maintained at reasonable levels and take appropriate action, in accordance with statute, to reduce reserves with excess funds.

⁴ District officials have developed a multiyear financial plan detailing the proposed use of fund balance and reserves and the projected balances over a 10-year period.

APPENDIX A

RESPONSE FROM DISTRICT OFFICIALS

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



SILVER CREEK CENTRAL SCHOOL DISTRICT

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February 12, 2016

Office of the State Comptroller
295 Main Street, Suite 1032
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Chief Examiner, Jeffrey D. Mazula:

The Silver Creek Central School District is in receipt of the Draft Financial Condition Report of Examination for the period of July 1, 2012 to September 15, 2015. Please allow this letter to serve as the Districts' response to the audit findings.

While the District does not dispute the findings of the report, we feel that any report which fails to cite the volatile economic climate in which the District has been forced to operate is incomplete at best. Since the State imposed the "Gap Elimination Adjustment" the resulting cumulative loss in revenue to our District amounted to over \$5.1 million. These cuts in funding led to mid-year corrective actions by the District to better match revenues and expenses.

This district has been faced with many difficult decisions with respect to budget development. We have prepared each budget guided by two fundamental principles. The first is the sustainment of educational programs for our District's children. The second is that a budget must be sustainable over time. The district is aware that the unrestricted fund balance is over the statutory limit. In order to mitigate the tax burden to tax payers the District previously established a 10 year plan for the use of reserves and unassigned fund balance. This plan will be revisited, adjusted and enhanced to accelerate the use of unrestricted fund balance. It should be noted that any plan that is not carefully executed over time could have disastrous consequences in light of the "2%" tax cap limit.

As always we thank the Office of the State Comptroller for their insight and expertise. It is extremely helpful to have this critical lens focused on our work, and it will only serve to enhance the way we do business.

Sincerely,

Matt Bogosian
President, Board of Education
Silver Creek Central School

District Mission:

*Silver Creek Central School District builds bridges with students
linking today's learning to tomorrow's possibilities.*

APPENDIX B

AUDIT METHODOLOGY AND STANDARDS

To achieve our audit objective and obtain valid evidence, we performed the following procedures:

- We interviewed District officials and reviewed Board minutes and policies to gain an understanding of the procedures in place for maintaining financial records, monitoring unrestricted fund balance and reserve funds and developing the annual budget.
- We reviewed the last five years of financial data and budgets to document fund balance and reserve fund levels, determine the operating results of the District and determine if budget estimates were reasonable.
- We reviewed the District's tax levy and budget documents provided by District officials to support the tax levy calculations.
- We calculated the District's unrestricted fund balance as a percentage of the next year's appropriations to determine if the District is in compliance with statute.
- We reviewed Board minutes and other records to verify that reserves were properly established and whether they were properly funded and used.
- We reviewed financial transactions made to District funds other than the general fund to determine that the District's financial activity was properly reported.
- We reviewed significant liability accounts to ensure that the reported liabilities are sufficiently supported and accurate.

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

APPENDIX C

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