



Pavilion Central School District Financial Management

Report of Examination

Period Covered:

July 1, 2013 – February 21, 2017

2017M-62



Thomas P. DiNapoli

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State of New York Office of the State Comptroller

Division of Local Government and School Accountability

June 2017

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 Pavilion Central School District, entitled Financial Management. 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 Pavilion Central School District (District) is located in Genesee, Livingston and Wyoming Counties. The District is governed by an elected seven-member Board of Education (Board), which is responsible for the general management and control of the District's financial and educational affairs. The Superintendent of Schools (Superintendent) is the District's chief executive officer and is responsible, along with other administrative staff, for the District's day-to-day management under the Board's direction. The Business Administrator is responsible for accounting for the District's finances, maintaining accounting records and preparing financial reports.

The District operates two schools with approximately 740 students and 170 employees. Budgeted appropriations for the 2016-17 fiscal year are approximately \$18 million, and are funded primarily with State aid, real property taxes and grants.

Objective

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

- Did the Board adopt accurate budgets and take appropriate action to address the reasonableness of fund balance, including reserves?

Scope and Methodology

We examined the District's financial management practices for the period July 1, 2013 through February 21, 2017.

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 planned to initiate 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 Management

In preparing the budget, the Board and District officials should accurately estimate how much the District will likely spend, what it will receive in revenue (e.g., State aid) and how much fund balance will be available at the fiscal year-end to help fund the budget. Accurate budget estimates help ensure the tax levy is not greater than necessary. The Board and District officials should ensure that unrestricted fund balance does not exceed the amount allowed by New York State Real Property Tax Law, which currently limits unrestricted fund balance to no more than 4 percent of the subsequent year's budget. Any unrestricted fund balance over this percentage must be used to reduce the upcoming fiscal year's tax levy or fund necessary reserves. School districts are legally allowed to establish reserves and accumulate funds for certain future purposes (e.g., capital projects, retirement expenditures). District officials should plan for the funding and use of these reserves.

The Board needs to improve its budgeting practices to ensure the adopted budgets are accurate and take action to address the reasonableness of fund balance, including reserves. The Board and District officials prepared budgets for the 2013-14 through the 2015-16 fiscal years that overestimated appropriations. District officials appropriated \$2.4 million of fund balance that was not needed to finance operations because the District's budgeting practices produced operating surpluses totaling \$2.1 million during these years. When unused appropriated fund balance was added back, the District's recalculated unrestricted fund balance exceeded the statutory limit by up to 4 percentage points.

The District's reserves, totaling approximately \$6.6 million as of June 30, 2016, were properly established and used in compliance with statutory provisions. However, the Board and District officials did not take appropriate action to address the reasonableness of reserves. Although the Board adopted a reserve fund policy, the policy did not stipulate the maximum funding levels for each reserve, the conditions necessary for using reserves to finance related costs or the circumstances under which reserve funds will be replenished. We found that three of the District's six reserves appear overfunded.

Budgeting

The annual operating budget represents the District's financial plan for a fiscal year and is an important tool for managing finances. A good budget begins with sound estimates and well supported budgetary assumptions to ensure that planned services are properly funded. The Board, Superintendent and Business Administrator are responsible for accurate and effective budgeting.

We compared budgeted appropriations and estimated revenues with actual operating results from 2013-14 through 2015-16. We found that the Board overestimated appropriations by a total of \$5.6 million and underestimated revenues by a total of \$1.7 million. While revenue estimates were generally reasonable (underestimated by 4 percent each year), appropriations were overestimated by approximately \$1.9 million, or 11 percent each year.

The most significant budget variance overestimates were appropriations for utilities (annually averaged \$221,000 or 57 percent), special education teaching (annually averaged \$231,000 or 47 percent), retirement and health insurance benefits (annually averaged \$352,000 or 12 percent) and teaching salaries (annually averaged \$380,000 or 10 percent). Because many of these costs are determined by contractual agreements, District officials should be able to reasonably estimate these amounts in the annual budgets. Budgeting practices that overestimate appropriations each year result in tax levies that are higher than necessary.

Fund Balance

A school district may retain a portion of fund balance at the end of the fiscal year for cash flow needs or unexpected expenditures. School districts may also establish reserve funds to restrict reasonable portions of fund balance for specified purposes in compliance with applicable statutes. When fund balance is appropriated to finance operations, the District should incur a planned operating deficit. However, the Board and District officials overestimated appropriations each year and realized operating surpluses.

Figure 1: General Fund Unrestricted Fund Balance at Year End			
	2013-14	2014-15	2015-16
Beginning Fund Balance	\$9,575,863	\$8,943,366	\$8,976,044
Add: Operating Surplus	\$408,023	\$957,178	\$763,310
Less: Transfers to Capital Projects Fund ^a	\$892,184	\$576,000	\$940,000
Less: Use of Reserves ^b	\$148,336	\$348,500	\$226,371
Ending Fund Balance	\$8,943,366	\$8,976,044	\$8,572,983
Less: Restricted Fund Balance (Reserves)	\$7,157,788	\$6,813,912	\$6,586,909
Less: Encumbrances	\$298,667	\$657,090	\$463,861
Less: Appropriated Fund Balance	\$800,000	\$800,000	\$800,000
Unrestricted Fund Balance at Year End	\$686,911	\$705,042	\$722,213
Subsequent Year's Budgeted Appropriations	\$17,334,648	\$17,628,232	\$18,190,577
Unrestricted Fund Balance as a Percentage of Subsequent Year's Budget	4%	4%	4%

^a Except for \$100,000 in 2015-16, the transfers to the capital projects fund were not included in the adopted budget and were recorded as interfund transfers after the close of the fiscal year.

^b According to the Business Administrator, reserve fund activity occurred after the end of the fiscal year when operating results had been determined.

From 2013-14¹ through 2015-16, the Board appropriated fund balance of \$2.4 million (\$800,000 each year) to finance operations. The District realized operating surpluses during the same period and did not need to use any of the appropriated fund balance to finance operations. When unused appropriated fund balance was added back, recalculated unrestricted fund balance exceeded the statutory limit each year by more than 4 percentage points (Figure 2).

Figure 2: Recalculated Unrestricted Fund Balance at Year End

	2013-14	2014-15	2015-16
Unrestricted Fund Balance at Year End	\$686,911	\$705,042	\$722,213
Add: Appropriated Fund Balance Not Used to Fund Subsequent Year's Budget	\$800,000	\$800,000	\$800,000
Recalculated Unrestricted Fund Balance at Year End	\$1,486,911	\$1,505,042	\$1,522,213
Subsequent Year's Budgeted Appropriations	\$17,334,648	\$17,628,232	\$18,190,577
Unrestricted Fund Balance as a Percentage of Subsequent Year's Budget	8.6%	8.5%	8.4%

The 2016-17 adopted budget continues the trend of appropriating \$800,000 of fund balance and overestimating appropriations. Therefore, we estimate that the District will likely generate an operating surplus. The 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.

Reserve Funds

Generally, school districts are not limited in the amounts they can maintain in reserves. However, funding reserves at greater than reasonable levels contributes to higher than necessary tax levies because excessive reserve balances are not used to fund operations. Therefore, it is important that the Board adopt a written policy that states its rationale for establishing reserve funds, objectives for each reserve, maximum targeted funding levels and conditions under which reserves will be used or replenished.

A reserve fund policy should require the Board to periodically assess the amounts accumulated in each reserve and determine whether the amounts retained are reasonable. If the Board determines that the reserve balances are excessive, the policy should address reducing reserve balances to reasonable levels and discontinuing reserves that are no longer needed or whose purpose has been achieved.

¹ As of June 30, 2013, \$800,000 was appropriated as a financing source for the 2013-14 budget.

Although the Board adopted a reserve fund policy, the policy did not address the maximum funding levels for each reserve, the conditions necessary for using reserve funds to finance the related costs or the circumstances under which reserve funds would be replenished. The policy indicated that the Business Administrator will determine reserve funding levels and report them to the Board.

As of June 30, 2016, the District reported approximately \$6.6 million in six reserve funds. We analyzed the reserves for reasonableness and adherence to statutory requirements and Board policy. We found that the employee benefit accrued liability reserve (\$3 million) and capital reserve (\$508,000) were reasonably funded and the debt reserve (\$344,000) was properly used to pay related debt. However, the retirement contribution, unemployment insurance and workers' compensation reserves may be overfunded.

Retirement Contribution Reserve – General Municipal Law (GML) authorizes the Board to establish this type of reserve to pay contributions for employees covered by the New York State and Local Retirement System. As of June 30, 2016, this reserve had a balance of approximately \$1.3 million.

While the District incurred annual costs averaging \$287,000 from 2013-14 through 2015-16, the Board and District officials budgeted \$334,000 annually to pay for these expenditures from the general fund as routine operating costs. The reserve balance was reduced by \$100,000 at the end of 2014-15 and 2015-16 to help fund annual retirement expenditures. We question the reasonableness of the amount held in this reserve because the balance is nearly five times the annual average costs.

Unemployment Insurance Reserve – GML authorizes establishing this type of reserve to reimburse the New York State Unemployment Insurance Fund for payments made to claimants on the District's behalf. As of June 30, 2016, this reserve had a balance of \$918,000.

While the District incurred unemployment costs averaging \$3,500 annually from 2013-14 through 2015-16, the Board and District officials budgeted \$50,000 annually to pay for these expenditures from the general fund as routine operating costs. The reserve balance was reduced at the end of 2015-16 by \$4,750 to fund related expenditures. The amount held in this reserve is excessive because the balance is more than 250 times the annual average costs and recent budgets included appropriations of almost 15 times the average annual cost.

Workers' Compensation Reserve – GML authorizes establishing this type of reserve to pay for workers' compensation costs and to pay the

expenses of administering a self-insurance program. As of June 30, 2016, this reserve had a balance of \$429,000.

While the District incurred expenditures averaging \$45,000 annually, from 2013-14 through 2015-16 the Board and District officials budgeted \$38,000 annually to pay for these expenditures from the general fund as routine operating costs. The reserve balance was reduced at the end of 2015-16 by \$25,000 to help fund related expenditures. We question the reasonableness of the amount held in this reserve because the balance is nearly 10 times the annual average costs.

The Board should balance the intent for accumulating funds for future identified needs with the obligation to ensure that the tax levy is not higher than necessary.

Recommendations

The Board and District officials should:

1. Adopt budgets that realistically reflect the District's operating needs based on historical trends or other identified analysis.
2. Revise the reserve fund policy to ensure that it identifies optimal or targeted funding levels for each reserve and the conditions under which each reserve fund will be used or replenished.
3. Use surplus funds as a financing source for:
 - Funding one-time expenditures
 - Funding needed reserves
 - Reducing District property taxes
4. Review all reserves to determine if the amounts reserved are necessary and reasonable.

APPENDIX A

RESPONSE FROM DISTRICT OFFICIALS

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



Pavilion Central School District

Pavilion Middle School / High School / Administration

7014 Big Tree Road; Pavilion, NY 14525 Phone 585-584-3115 Fax 585-584-3421

Dorothy B. Bunce Elementary School

7071 York Road; Pavilion, NY 14525 Phone 585-584-3011 Fax 585-584-1050

June 12, 2017

Office of the State Comptroller
Buffalo Regional Office
295 Main Street, Room 1032
Buffalo, New York 14203-2510

To Whom It May Concern:

This letter is the initial response from the Pavilion Central School District (the "District") to the draft Financial Management Report of Examination (the "report") for the period of July 1, 2013 through February 21, 2017, which was released to the District with a letter dated May 18, 2017.

We have reviewed the report and it is our impression that the report of our financial condition along with the recommendations within the report appear to be accurate and appropriate. Once the final audit report is issued, the District will follow-up with a Corrective Action Plan (CAP) within 90 days. The CAP will be filed with the Office of the State Comptroller and New York State Education Department. In addition, the CAP will be made available for public inspection.

The Board of Education and Administration are always eager to consider suggestions and ideas to improve the financial operations of our District, especially in light of our strong commitment to protect both the short-term and long-term fiscal health of the District and, at the same time, ensure that our residents continue to receive the same high level of efficiency and predictability from the District that they have enjoyed and benefited from in the past and, justifiably, expect to receive in the future. It has been and will continue to be a top priority of this District to maintain and improve upon our record of providing a strong education for our students in the most cost effective manner possible. The Board of Education and Administration are committed to ensuring that the District's financial operations are conducted with the highest level of integrity and that the interests of the District's taxpayers are properly protected

As an additional comment, the District wishes to acknowledge and express our appreciation for the professional and courteous interaction we experienced with your staff throughout the audit process.

Sincerely,

Kenneth J. Ellison
Superintendent of Schools

APPENDIX B

AUDIT METHODOLOGY AND STANDARDS

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

- We interviewed District officials to gain an understanding of the District's financial management practices.
- We analyzed budgeted appropriations and estimated revenues and compared them to actual results for three fiscal years (2013-14, 2014-15 and 2015-16). We calculated whether there was an operating surplus or deficit for each of these years.
- We reviewed the 2016-17 budget and compared it to the three previous fiscal years' budgets and actual results. We documented significant trends and analyzed projected future trends.
- We analyzed fund balance and assessed whether appropriated fund balance was used as budgeted.
- We evaluated selected appropriation and revenue codes and compared them to actual results. We identified those with significant variances from budgeted amounts.
- We calculated unrestricted fund balance as a percentage of the next year's budget. We included both appropriated fund balance and unrestricted fund balance in our calculations.
- We documented the flow of funds in and out of the reserves and determined whether reserve funds were used to pay reserve related expenditures
- We reviewed the reserve fund policy and evaluated each reserve for reasonableness.

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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