



Kenmore-Town of Tonawanda Union Free School District Financial Management

Report of Examination

Period Covered:

July 1, 2013 — May 12, 2015

2015M-155



Thomas P. DiNapoli

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State of New York Office of the State Comptroller

Division of Local Government and School Accountability

November 2015

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 Kenmore-Town of Tonawanda Union Free 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 Kenmore-Town of Tonawanda Union Free School District (District) is located in the Town of Tonawanda in Erie County. The District is governed by the Board of Education (Board) which is composed of five 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 day-to-day management of the District under the Board's direction. The Assistant Superintendent for Finance is responsible for the District's finances and accounting records.

There are 12 schools in operation within the District, with approximately 7,180 students and 2,140 employees. The District's budgeted appropriations for the 2014-15 fiscal year totaled \$151.8 million and were funded primarily with State aid, real property taxes, sales tax and grants.

Objective

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

- Did the District maintain reserves at appropriate levels and properly recognize liabilities?

Scope and Methodology

We examined the District's financial management practices for the period July 1, 2013 through May 12, 2015. We extended our analysis of the use of fund balance back to fiscal year 2011-12 and our analysis of the Debt Reserve back to June 30, 2008.

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 findings and recommendations and indicated 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

The Board and Superintendent are responsible for adopting budgets that contain estimates of actual and necessary expenditures that are funded by planned, realistic revenues. Sound budgeting provides sufficient funding for necessary operations. Prudent fiscal management includes establishing reserves needed to address long-term obligations or planned future expenditures. Once the Board has addressed those issues, any remaining fund balance, exclusive of the 4 percent of the ensuing fiscal year's budget currently allowed by law to be retained to address cash flow and unexpected occurrences,¹ should be used to reduce the tax levy.

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. Amounts reported as accrued liabilities at fiscal year-end also directly impact the amount of fund balance available for appropriation in the ensuing year's budget.

During fiscal years 2011-12 through 2014-15, the District annually appropriated an average of \$9.1 million (65 percent) more in fund balance than what was actually needed to fund operations. This practice allowed the District to circumvent the 4 percent statutory limit imposed on the level of unrestricted fund balance by a range of 4.9 percent to 6.9 percent. For example, in 2013-14, the District appropriated \$9.4 million more in fund balance than was needed to fund operations. Furthermore, the District overfunded three reserves² by approximately \$5.6 million (66 percent), incorrectly recognized certain liabilities by \$1.2 million (92 percent) and accumulated \$905,606 in the Debt Reserve as of June 30, 2014 from interest earnings on capital projects. Consequently, the District accumulated approximately \$17 million in excess funds as of June 30, 2014. This amount is 11 percent of the 2014-15 budget.

Appropriation of Fund Balance

The District reported year-end unrestricted fund balance at levels that essentially complied with the 4 percent limit for fiscal years 2011-12 through 2014-15. This was accomplished, in part, by appropriating fund balance that was not actually used. In the last four fiscal years,

¹ See New York State Real Property Tax Law.

² The District maintains seven reserves totaling \$17.4 million as of June 30, 2014.

the District appropriated an average of \$13.9 million³ of fund balance annually to help finance budgeted appropriations. However, due to positive variances between amounts budgeted and actual operating results, the amounts appropriated averaged \$9.1 million (65 percent) more than what was actually needed to fund operations (an average of \$4.9 million of fund balance was used annually). For 2013-14, the District appropriated \$10.7 million in fund balance but only used \$1.3 million (12 percent) to help finance operations. Similarly, for 2014-15, the District appropriated \$15.9 million in fund balance but only used \$8.5 million (53 percent) to help finance operations. 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.

Figure 1: Unrestricted Fund Balance at Year End and Unused Appropriated Fund Balance

| | 2011-12 | 2012-13 | 2013-14 | 2014-15 ^a | Four-Year Average |
|---|---------------|---------------|---------------|----------------------|-------------------|
| Prior Fiscal Year End Unrestricted Fund Balance | \$5,888,308 | \$5,784,649 | \$5,964,897 | \$5,967,378 | \$5,901,308 |
| Budgeted Appropriations | \$147,231,858 | \$147,776,616 | \$149,015,111 | \$151,811,842 | \$148,958,857 |
| Unrestricted Fund Balance as a Percentage of Budgeted Appropriations | 4.00% | 3.91% | 4.00% | 3.93% | 3.96% |
| Appropriated Fund Balance | \$15,903,171 | \$13,383,471 | \$10,727,571 | \$15,875,000 | \$13,972,303 |
| Operating Surplus (Deficit) | (\$5,709,475) | (\$3,920,789) | (\$1,325,607) | (\$8,451,766) | (\$4,851,909) |
| Unused Appropriated Fund Balance | \$10,193,696 | \$9,462,682 | \$9,401,964 | \$7,423,234 | \$9,120,394 |
| Unused Appropriated Fund Balance as a Percentage of Budgeted Appropriations | 6.92% | 6.40% | 6.31% | 4.89% | 6.12% |

^a Data has not been audited

The Assistant Superintendent for Finance prepared a multiyear financial plan which shows that, over the next three fiscal years,⁴ the District will continue to appropriate fund balance and reserve funds in the annual budget. The Board appropriated \$7.5 million of fund balance in the District's 2015-16 general fund budget. However, the multiyear financial plan also indicates that most of the appropriated fund balance will not be needed to finance operations, thereby continuing the practice of circumventing the statutory limit imposed on the level of unrestricted fund balance allowed.

³ This amount includes appropriated fund balance and appropriated reserves.

⁴ 2015-16, 2016-17 and 2017-18

Employee Benefit Accrued Liability Reserve

An Employee Benefit Accrued Liability Reserve (EBALR) is authorized to be used for the cash payment of accrued and unused sick, vacation and certain other leave to employees upon separation from service and expenditures related to the administration of the reserve. The District had \$4.1 million in this reserve as of June 30, 2014.

We reviewed the District's calculated liability associated with this reserve and determined that only \$1.2 million (11 percent) of the \$10.8 million liability represents the monetary value of accrued and unused sick, vacation and certain other leave due to employees upon separation from service. The remaining \$9.6 million relates to estimated costs for retirement incentives that are not permitted by law to be paid from an EBALR. Since there is no authority to establish a reserve for retirement benefits that are not based on accrued leave, the District has set aside \$2.9 million more than needed to fund costs that can be paid from the EBALR.

We also noted that the District reported a current liability totaling \$1.3 million as of June 30, 2014⁵ representing the monetary value of employees' accrued but unused vacation days.⁶ However, the actual liability appears to be minimal, as only \$81,000 in unused leave recorded in this account was paid out in 2014-15. Thus, the liability is overstated by approximately \$1.2 million (92 percent).

Tax Certiorari Reserve

A tax certiorari is a legal proceeding whereby a taxpayer who has been denied a reduction in property tax assessment by a local assessment review board or small claims procedure challenges the assessment on the grounds of excessiveness, inequality, illegality or misclassification. Education Law authorizes school districts to establish a reserve for the payment of judgments and claims resulting from tax certiorari proceedings. Any money not expended after four years must be returned to the general fund.

The District established a Tax Certiorari Reserve. As of June 30, 2014, the balance of this reserve was \$2.7 million. The District's current schedule of pending tax certiorari proceedings and estimated costs totaled only \$537,000. Most of the reserve fund balance was not related to any specific tax certiorari proceedings that would result in future payments, as required by law. Therefore, this reserve is overfunded by \$2.2 million (81 percent). This money should be returned to unrestricted fund balance in the general fund.

⁵ Total liabilities reported as of June 30, 2014 were \$11.3 million, including the \$1.3 million mentioned here.

⁶ This annual leave is not payable at separation from service.

Workers' Compensation Reserve

The District established a Workers' Compensation Reserve. The balance of the reserve was \$852,000 as of June 30, 2014. The District is authorized to establish this reserve to pay for workers' compensation benefits; medical, hospital or other expenses; and the expenses to administer a self-insurance program. According to General Municipal Law (GML), within 60 days of the close of the fiscal year, the District should transfer any excess in the reserve to another authorized reserve or use the excess to fund the workers' compensation appropriation in the succeeding fiscal year's budget.

The District contracts with a third-party vendor to administer its self-insurance plan. According to the plan administrator, the District's estimated liability for all open workers' compensation claims was \$1.17 million as of June 30, 2014. However, considering the \$852,000 in the Workers' Compensation Reserve and an \$840,000 accrued liability for workers' compensation costs reported as of June 30, 2014, the District has set aside \$520,000 (31 percent) more than needed to fund the estimated liability for workers' compensation costs.⁷

Debt Reserve

GML and New York State Local Finance Law require that a debt reserve be established and money restricted based on certain circumstances. For example, unexpended debt proceeds must be restricted and used to pay debt service on that debt issue or for related capital expenditures.

The District maintains a Debt Reserve. In our prior report of examination, dated June 2009,⁸ we indicated that District officials did not provide us with evidence to indicate the source of most of the cash in this reserve. Since that time, District officials identified the sources of the cash in this reserve, one of which was interest earnings on capital projects fund cash. District records show that cash in the Debt Reserve from this source increased by \$206,444, from \$699,162 as of June 30, 2008 to \$905,606 as of June 30, 2014 (45 percent of the Debt Reserve balance).⁹ The District did not use any of the cash from interest earnings to help fund annual debt service costs until 2012-13. If the interest income was earned on cash from a capital project that was funded with the proceeds of debt, the District would be required to use the cash to repay the associated outstanding debt. Accumulating interest earnings in the Debt Reserve and not using the

⁷ The District paid workers' compensation claims totaling \$789,400 in 2012-13 and \$630,000 in 2013-14.

⁸ 2009M-21: *Kenmore-Town of Tonawanda UFSD, Financial Condition and Internal Controls Over Procurement*

⁹ District records show that from June 30, 2008 through June 30, 2014, interest earnings of \$509,219 were credited to the Debt Reserve and \$302,775 of the interest earnings in the Debt Reserve was used to help finance debt service costs. The balance of the Debt Reserve was almost \$2 million as of June 30, 2014.

cash to help fund debt service costs results in real property tax levies being higher than necessary.

It is the Board's responsibility to monitor the District's finances and take appropriate action to ensure that the excess funds identified in this report are properly used to benefit District residents.

Recommendations

The Board and District officials should:

1. Ensure that budgeted appropriations are reasonable so that only taxes actually needed to fund operations will be levied.
2. Ensure that estimates in the annual budget for the planned use of fund balance are accurate and reasonable.
3. Ensure that reserve fund balances are maintained at reasonable levels and take appropriate action, in accordance with statute, to remedy reserves with excess funds.
4. Ensure that accrued liabilities are properly recognized.
5. Continue to use Debt Reserve funds to pay related debt service.

APPENDIX A

RESPONSE FROM DISTRICT OFFICIALS

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



**Kenmore-Town of Tonawanda
Union Free School District**

1500 Colvin Blvd.
Buffalo, New York 14223
(716) 874-8400
ktufsd.org

October 29, 2015

NYS Office of the State Comptroller
Buffalo Regional Office
Attn.: Jeffrey D. Mazula, Chief Examiner
295 Main St., Suite 1032
Buffalo, NY 14203-2510

Dear Mr. Mazula:

Re: Kenmore-Town of Tonawanda Union Free School District

We are writing on behalf of the Kenmore-Town of Tonawanda Union Free School District with respect to the *Financial Management – Report of Examination* issued by your office (the “Audit Report”). The Audit Report covers certain aspects of the District’s fiscal operations during the period July 1, 2013 through May 12, 2015.

The District would like to acknowledge the professional and courteous manner in which the Office of the State Comptroller conducted the audit.

The District’s Board of Education and Administration are committed to conducting all financial matters in a responsible manner for student and community benefit. This Audit Report will assist the District in accomplishing this goal. The findings and recommendations presented in the Audit Report will guide preparation of the corrective action plan.

The District will take this opportunity to respond to aspects of the Audit Report as follows:

Appropriation of Fund Balance: “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.” (Audit Report, p. 6)

The District’s goal is to develop future budgets that are less conservative when estimating General Fund expenses and revenues. The District has a long range financial plan that will reduced the appropriated fund balance to \$6,000,000 in the near term.

However, given these strides to budget in a less conservative manner, the District must also consider potential losses of revenue due to the likely closure of the Huntley Power LLC power plant. Such a closure will have a significant impact on future revenue to the District and possible implications on instructional programming and overall operations.

We educate, prepare and inspire all students to achieve their highest potential.

Employee Benefit Accrued Liability Reserve: “We reviewed the District’s calculated liability associated with this reserve and determined that only \$1.2 million (11 percent) of the \$10.8 million liability represents the monetary value of accrued and unused sick, vacation and certain other leave due to employees upon separation from service.” (Audit Report, p. 7)

As of June 30, 2015, the balance of the District’s Employee Benefit Accrued Liability Reserve (EBALR) was \$4,000,000. Moving forward, the District’s goal is to gradually make adjustments in a fiscally responsible manner as to not introduce any fiscal stress to the District.

Tax Certiorari Reserve: “Most of the reserve fund balance was not related to any specific tax certiorari proceedings that would result in future payments, as required by law.” (Audit Report, p. 8)

Between June 30, 2011 and June 30, 2015, the District reduced the Tax Certiorari Reserve balance by 83% and further adjustments reflecting Tax Certiorari changes will continue as needed.

The District’s goal is to gradually adjust the balance of the reserve in a manner that avoids introducing financial stress to the District.

Workers’ Compensation Reserve: “According to General Municipal Law (GML), within 60 days of the close of the fiscal year, the District should transfer any excess in the reserve to another authorized reserve or use the excess to fund the workers’ compensation appropriation in the succeeding fiscal year’s budget.” (Audit Report, p. 8)

As of June 30, 2015, the Workers’ Compensation plan administrator estimated the liability for claims to be \$1.66 million. This is an increase of almost \$500,000 over the previous year, as cited in the Audit Report.

On June 30, 2015, the liability was reduced to \$590,000 and the reserve was increased to \$1.07 million. These changes and adjustments addressed concerns that the Office of the State Comptroller had regarding the District’s Workers’ Compensation Reserve. Because claims in each year account for an estimated \$600,000, the liability of \$590,000 is within reason. Coupled with the reserve, the liability is within the range of the plan administrator’s estimated liability of \$1.66 million as of June 30, 2015, which was not reviewed in the audit. It should be noted that the District is self-insured for Workers Comp and as such, a reserve is a prudent, fiscally responsible tool.

Debt Service Reserve: “Continue to use Debt Reserve funds to pay related debt service.” (Audit Report, p. 9)

The Audit Report has acknowledged the District’s improvements in identifying the source of funds in the Debt Service Reserve. As part of the District’s long range financial plan, the Debt Service Reserve will continue to be utilized and be compliant with the General Municipal Law and New York State Local Finance Law. Adjustments will be made to avoid any possible fiscal stress to the District.

Conclusion

Ensuring fiscal stability is a major priority of the Board of Education and District Administration. The District has advance knowledge of the possible shuttering of the Huntley Power LLC power plant which generates significant PILOT revenue. With the fiscal uncertainty surrounding Huntley Power LLC, the partial intention of the District’s reserves plan is to avoid large increases in future tax levies. Reserve funding reflects the desire to protect the taxpayer from sudden increases in tax bills as a result of the pending closure of the power plant.

The District’s Board of Education and Administration thank the Office of the State Comptroller’s assistance during this audit. The recommendations made to the District are of immense value and will assist in shaping the future fiscal landscape. We encourage your office to contact the District if there are any questions regarding the District’s response to the Report of Examination. The District looks forward to having future opportunities to work with the Office of the State Comptroller.

Sincerely,

Jill O’Malley
President, Board of Education

Dawn F. Mirand
Superintendent of Schools

APPENDIX B

AUDIT METHODOLOGY AND STANDARDS

Our objective was to determine whether the District maintained reserves at appropriate levels and properly recognized certain liabilities. To accomplish our objective, we performed the following procedures:

- We interviewed District officials to obtain an understanding of the District's financial management practices, including liability recognition and funding and using reserve funds.
- We obtained and reviewed pertinent Board meeting minutes, certain financial transactions and schedules to document the establishment and use of the District's reserve funds.
- We reviewed selected current liabilities reported as of June 30, 2014 to determine whether they were properly recognized.
- We analyzed certain aspects of the District's budgetary practices for the 2011-12 through 2014-15 fiscal years.
- We compared unrestricted fund balance at fiscal year-end to ensuing years' budgeted appropriations.
- We reviewed the District's multiyear financial plan.

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.

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