



Honeoye Falls-Lima Central School District

Financial Management and Competitive Procurement

Report of Examination

Period Covered:

July 1, 2012 – February 11, 2016

2016M-124



Thomas P. DiNapoli

Table of Contents

	Page
AUTHORITY LETTER	1
EXECUTIVE SUMMARY	2
INTRODUCTION	4
Background	4
Objectives	4
Scope and Methodology	4
Comments of District Officials and Corrective Action	5
FINANCIAL MANAGEMENT	6
Budgeting and Fund Balance	6
Reserves	9
Recommendations	12
COMPETITIVE PROCUREMENT	14
Recommendations	16
APPENDIX A Response From District Officials	17
APPENDIX B OSC Comments on the District's Response	22
APPENDIX C Audit Methodology and Standards	24
APPENDIX D How to Obtain Additional Copies of the Report	25
APPENDIX E Local Regional Office Listing	26

State of New York Office of the State Comptroller

Division of Local Government and School Accountability

August 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 Honeoye Falls-Lima Central School District, entitled Financial Management and Competitive Procurement. 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*



State of New York Office of the State Comptroller

EXECUTIVE SUMMARY

The Honeoye Falls-Lima Central School District (District) is governed by the Board of Education (Board), which is composed of nine elected members. The Board is responsible for the general management and control of the District's financial and educational affairs. The Superintendent of Schools 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.

Scope and Objectives

The objectives of our audit were to evaluate the District's financial management for the period July 1, 2012 through February 11, 2016 and evaluate the District's competitive procurement of goods and services for the period July 1, 2014 through February 11, 2016. Our audit addressed the following related questions:

- Did the Board and District officials effectively manage the District's finances by ensuring that budget estimates and fund balances were reasonable?
- Did the Board ensure that goods and services were procured in a manner to assure the prudent and economical use of public moneys in the best interest of District residents?

Audit Results

The Board did not adopt budgets based on historical or known trends but instead overestimated expenditures by approximately 5 percent from fiscal years 2012-13 through 2014-15, which generated more than \$3.5 million in operating surpluses. The Board also budgeted for operating deficits by appropriating fund balance totaling approximately \$1.7 million over that period, but did not need to use these funds due to the operating surpluses. To reduce the year-end fund balance to within the 4 percent limit established by New York State Real Property Tax Law, District officials made unbudgeted transfers to the capital projects fund and to reserves. When adding back unused appropriated fund balance, the District's unrestricted fund balance was more than 5 percent of the ensuing year's budget, exceeding the statutory limit each year. Furthermore, two of the District's six general fund reserves, which had balances totaling \$4 million as of June 30, 2015, are overfunded or potentially unnecessary. These practices diminish the transparency of District finances to the residents.

Additionally, the Board did not adopt an adequate procurement policy, in compliance with General Municipal Law, to require and enforce competitive procedures for procuring goods and services that fell below the competitive bidding thresholds or for professional services. We found that, of 35 purchases reviewed totaling approximately \$1.4 million, the District did not properly seek competition

or adequately document the reasons for selecting particular service providers for 15 purchases (43 percent) totaling more than \$780,000. Therefore, the District may not be receiving services of the desired quality at the lowest possible price.

Comments of District Officials

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 disagreed with our findings and recommendations regarding financial management, generally agreed with those regarding competitive procurement, and indicated they will take corrective action in certain areas. Appendix B includes our comments on the issues raised in the District's response letter.

Introduction

Background

The Honeoye Falls-Lima Central School District (District) is located in the Towns of Mendon, Henrietta and Rush in Monroe County; the Towns of Avon, Lima and Livonia in Livingston County; and the Towns of Victor, West Bloomfield and Richmond in Ontario County. The District is governed by the Board of Education (Board), which is composed of nine 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 Business and Operations (Assistant Superintendent) is responsible for managing the finance-related operations under the direction of the Superintendent and the Board. The Assistant Superintendent also acts as the District's purchasing agent.

The District operates four schools with approximately 2,300 students and 410 employees. The District's budgeted appropriations for the 2015-16 fiscal year were \$47.4 million, which were funded primarily with State aid, sales tax and real property taxes.

Objectives

The objectives of our audit were to evaluate the District's financial management and the District's procurement of goods and services. Our audit addressed the following related questions:

- Did the Board and District officials effectively manage the District's finances by ensuring that budget estimates and fund balances were reasonable?
- Did the Board ensure that goods and services were procured in a manner to assure the prudent and economical use of public moneys in the best interest of District residents?

Scope and Methodology

We examined the District's financial management for the period July 1, 2012 through February 11, 2016. We examined the District's procurement of goods and services for the period July 1, 2014 through February 11, 2016.

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 C of this report. 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.

**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 disagreed with our findings and recommendations regarding financial management, generally agreed with those regarding competitive procurement, and indicated they will take corrective action in certain areas. Appendix B includes our comments on the issues raised in the District's response letter.

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, Superintendent and Assistant Superintendent are accountable to District residents for the use of District resources and are responsible for effectively planning and managing the District's operations. One of the most important tools for managing the District's finances is the budget process. District officials must ensure that budgets are prepared, adopted and modified in a prudent manner, accurately depict the District's financial activity, and use available resources to benefit District residents. Prudent fiscal management includes maintaining sufficient and appropriate balances in reserves that are needed to address long-term obligations or planned future expenditures. 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. Budget transparency is important for public participation and accountability and allows residents to provide feedback on services and on decisions that affect the District's long-term financial stability. Complete and accurate budget information helps residents make informed decisions when voting on the budget.

The Board did not adopt budgets based on historical or known trends. The Board overestimated expenditures by approximately 5 percent from fiscal years 2012-13 through 2014-15, which generated more than \$3.5 million in operating surpluses. As a result, approximately \$1.7 million of appropriated fund balance was not used. To reduce the year-end fund balance to within the statutory limit, District officials made unbudgeted transfers to the capital projects fund and to the District's reserves. These practices compromised the transparency of the District's finances and in effect increased the District's unrestricted fund balance to more than the statutory limit in each year. Further, two of the District's six general fund reserves, with balances totaling \$4 million as of June 30, 2015, are overfunded or potentially unnecessary.

Budgeting and Fund Balance

In preparing the general fund budget, the Board is responsible for estimating what the District will spend and what it will receive in revenue (e.g., State aid), estimating how much fund balance will be available at the fiscal year-end to help fund the budget and balancing the budget by determining the required tax levy. Accurate estimates help ensure that the tax levy is not greater than necessary. New York State Real Property Tax Law allows the District to retain up to 4 percent of the ensuing year's budget in fund balance for unexpected events and cash flow. Additionally, districts are legally allowed to establish reserves and accumulate funds for certain future purposes

(for example, capital projects or retirement expenditures). Fund balance in excess of the statutory limit must be used to fund a portion of the next year's appropriations, thereby reducing the tax levy, or to fund legally established and necessary reserves, pay down debt or pay for non-recurring expenditures.

The Board and District officials adopted budgets that overestimated expenditures by approximately 5 percent from fiscal years 2012-13 through 2014-15, totaling more than \$6.8 million (Figure 1). These significant budget variances resulted in operating surpluses that increased available surplus fund balance each year. The District reported operating surpluses in 2012-13 and 2014-15. While the District reported a small operating deficit of \$100,393 in 2013-14, this resulted from unbudgeted interfund transfers¹ totaling nearly \$1.5 million to the capital projects fund. Because these unbudgeted transfers were not general fund operating expenditures, we excluded them from our analysis of the operating results to determine the reasonableness of the budget estimates. As shown in Figure 1, the District generated operating surpluses each year totaling more than \$3.5 million (an average of nearly \$1.2 million a year). The Board should include any planned transfers for known capital purchases or projects in its adopted budgets to increase transparency.

Figure 1: Overestimated Appropriations				
	2012-13	2013-14	2014-15	Totals
Appropriations	\$42,466,327	\$44,417,354	\$45,848,400	\$132,732,081
Actual Expenditures ^a	\$40,362,807	\$41,956,727	\$43,604,941	\$125,924,475
Variance	\$2,103,520	\$2,460,627	\$2,243,459	\$6,807,606
Percentage Variance	5.0%	5.5%	4.9%	5.1%
Operating Surplus (Revenues Minus Expenditures ^a)	\$1,172,255	\$1,345,032	\$998,037	\$3,515,324
Unbudgeted Transfers to Capital Projects Fund	\$448,000	\$1,445,425	\$515,086	\$2,408,511
District-Reported Operating Surplus/(Deficit)	\$724,255	(\$100,393)	\$482,951	\$1,106,813

^a Actual Expenditures do not include unbudgeted interfund transfers to the capital projects fund because they are not operating expenditures.

Specifically, two expenditure categories (salaries and health insurance) were overestimated by a total of more than \$6 million (8 percent) between fiscal years 2012-13 and 2014-15. Estimates for salaries should be readily obtainable because they are based on employment contracts, with the exception of contract negotiation years.² District

¹ These transfers were not budgeted, but were for Board- and voter-approved capital projects and bus purchases.

² During the course of the audit, District officials were in negotiations for contracts that will begin in fiscal year 2015-16. These negotiations should not have impacted the ability of District officials to estimate salaries for fiscal years 2012-13 through 2014-15.

officials said they conservatively budgeted for health insurance due to the open enrollment period occurring halfway through the fiscal year and the potential for unenrolled employees to enroll during that time. Additionally, they stated that the health insurance plan premium increases have been higher than estimated.

The District also appropriated \$1.7 million in fund balance and approximately \$4 million from reserves (see Reserves section) to finance operations from 2012-13 through 2014-15, which should have resulted in operating deficits and reductions in fund balance and reserves. However, the District did not use any of this budgeted amount due to the operating surpluses.

Figure 2: Unrestricted Fund Balance at Year-End			
	2012-13	2013-14	2014-15
Total Beginning Fund Balance	\$12,166,499	\$12,890,754	\$12,790,361
Add: Operating Surplus/(Deficit) ^a	\$724,255	(\$100,393)	\$482,951
Total Ending Fund Balance	\$12,890,754	\$12,790,361	\$13,273,312
Less: Nonspendable Fund Balance	\$260,223	\$758,916	\$755,520
Less: Restricted Funds	\$9,659,189	\$8,888,524	\$9,226,814
Less: Encumbrances	\$249,224	\$249,985	\$290,642
Less: Appropriated Fund Balance for the Ensuing Year	\$500,000	\$610,000	\$610,000
Less: Appropriated Fund Balance for Bus Purchases ^b	\$445,425	\$449,000	\$494,200
Total Unrestricted Fund Balance at Year-End	\$1,776,693	\$1,833,936	\$1,896,136
Ensuing Year's Budgeted Appropriations	\$44,417,354	\$45,848,400	\$47,426,328
Unrestricted Fund Balance as Percentage of Ensuing Year's Budget	4.0%	4.0%	4.0%

^a Operating surplus/(deficit) calculation (revenues less expenditures) includes interfund transfers.
^b The audited financial statements included fund balance appropriated for bus purchases which was not included in the adopted budget but was addressed in a budget amendment and transferred to the capital projects fund each year per voter-approved propositions.

Because the District made unbudgeted transfers to the capital projects fund, funded reserves at year-end and appropriated fund balance for ensuing years' operations, it reported year-end unrestricted fund balance that complied with the statutory restriction from fiscal years 2012-13 through 2014-15. However, after adding back unused appropriated fund balance, the District's recalculated unrestricted fund balance exceeded the statutory limit each year.

Figure 3: Unused Fund Balance			
	2012-13	2013-14	2014-15
Total Unrestricted Funds at Year-End	\$1,776,693	\$1,833,936	\$1,896,136
Add: Appropriated Fund Balance Not Used to Fund Ensuing Year's Budget	\$500,000	\$610,000	\$610,000
Total Recalculated Unrestricted Funds	\$2,276,693	\$2,443,936	\$2,506,136
Recalculated Unrestricted Funds as Percentage of Ensuing Year's Budget	5.1%	5.3%	5.3%

During 2014-15, the District appropriated \$610,000 for the 2015-16 budget; however, similar to the three prior years, it will not be needed, and the District's unrestricted fund balance will continue to exceed the statutory limit. The District's practice of 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 circumvents the statutory limit imposed on unrestricted, unappropriated fund balance.

The Board increased real property tax levies by more than 12 percent from the 2012-13 through 2015-16 fiscal years, with average tax rate increases of approximately 3 percent per year. The Board remained within the tax cap since its inception in 2012-13.³ The 2015-16 adopted budget continues the trend of appropriating fund balance and reserves and includes a 3.4 percent increase in appropriations from 2014-15. Consequently, the general fund will realize another operating surplus, which will continue to increase the fund balance level in 2015-16.

Reserves

Districts may establish reserves, in compliance with applicable laws, to restrict a reasonable portion of fund balance for specific purposes to address long-term obligations or planned future expenditures. District officials should adopt a detailed policy or plan governing the establishment, use and funding levels/goals of reserve funds. While school districts are generally not limited as to how much money can be held in reserves, reserve balances must be reasonable and substantiated. The Board should make clear provisions for using or funding reserves in the proposed budget to inform residents of the Board's plans and increase transparency. When conditions warrant, the Board should reduce reserves to reasonable levels, or discontinue a reserve fund that is no longer needed or whose purpose has been

³ In 2011, the New York State Legislature enacted a law establishing a property tax levy limit, generally referred to as the property tax cap. Under this legislation, the property tax levied annually generally cannot increase more than 2 percent or the rate of inflation, whichever is lower, with some exceptions. School districts may override the tax levy limit by presenting to the voters a budget that requires a tax levy that exceeds the statutory limit. However, the budget must be approved by 60 percent of the votes cast.

achieved by transferring unneeded balances to other existing reserves as authorized by Education Law.

As of June 30, 2015, the District had six general fund reserves totaling approximately \$9.2 million, which represents 70 percent of its total fund balance. The Board and District officials have not included provisions in the annual budgets for funding the reserves. Instead, they used year-end operating surpluses to fund reserves in amounts totaling approximately \$4.8 million over the three years from 2012-13 through 2014-15 (averaging \$1.6 million per year).

In addition, the Superintendent and Board presented to the voters, for budget approval, projected uses of over \$4 million from reserves to finance operations from fiscal years 2012-13 through 2014-15. While total reserve balances should have decreased by approximately \$4 million, these appropriated reserve funds were not necessary and were essentially not used because of the surpluses generated by unrealistic budget estimates. Furthermore, in the 2013-14 and 2014-15 budgets,⁴ the Board did not specify which reserves would be used, but instead appropriated undesignated reserve funds totaling \$3 million for the two years.⁵ While the District did record reserve usage at the end of each fiscal year for certain reserves, it generally replenished those reserves immediately and often further increased them, using annual operating surpluses. This was in effect the same as not using the reserves despite appropriating their use in the budget. Most reserve balances increased and total restricted fund balance decreased by only \$432,000, which resulted from an unbudgeted \$1 million transfer to the capital projects fund from the capital reserve in 2013-14 for a voter-approved capital project.

The Board adopted a reserve fund policy that requires the District to manage reserve funds in accordance with applicable laws and regulations. The policy requires District officials to provide the Board with an annual report, prior to budget adoption, of all reserve funds, which includes a listing of each reserve with its balance, the amounts paid into and expended from each reserve during the prior year and an analysis of the projected needs for the reserves in the upcoming fiscal year with a recommendation for funding those projected needs. We found that the Assistant Superintendent prepared a report entitled “2013 – 2015 Restricted Reserve Use and Forecast” (reserve report) that included reserve balances, 2013-14 use and funding of reserves,

⁴ The Board also failed to specify which reserves it planned to use in the 2015-16 budget.

⁵ The District last allocated appropriated reserves to specific reserves in the 2012-13 budget, which included use of the unemployment insurance, self-insurance (which has since been closed out), retirement contribution and employee benefit accrued liability reserves.

planned uses of reserves in 2014-15 and target funding levels for each reserve. However, the reserve report did not include updated information for 2014-15 or project needs for 2015-16 as required by the District's reserve policy. Further, it appears that the Assistant Superintendent provided the reserve report to the Board's Reserve Committee in February 2015, but not to the full Board. He told us that he updates and provides the reserve report to the Board at the end of the fiscal year when the District is allocating its surplus fund balance to reserves. However, the policy requires that this analysis be completed and reviewed prior to budget adoption. Updating the forecast after the budget has been adopted and without updated current-year information and needs and expectations for the ensuing year defeats the purpose of the analysis.

We analyzed the District's reserves for reasonableness and adherence to statutory requirements and found the balances of the capital, tax certiorari, workers' compensation and employee benefit accrued liability reserves totaling approximately \$5.2 million to be reasonable. However, the reserves for retirement contribution and unemployment insurance totaling approximately \$4 million were overfunded and potentially unnecessary.⁶

Retirement Contribution Reserve – By law, this reserve can be used only to pay benefits for employees covered by the New York State and Local Retirement System. The reserve balance has grown by approximately \$66,000 from July 1, 2012 to \$3.6 million at June 30, 2015, which is approximately four times the amount billed for 2016. The District reported annual retirement contributions that averaged \$883,000 over the last three years. District officials annually recorded reductions of the reserve for expenditures totaling over \$2.63 million for the three-year period, but immediately⁷ replenished and further funded the reserve, by a total of \$2.64 million. While District officials indicated, in the adopted budgets, that they would use the reserve to fund annual expenditures,⁸ the reserve balance instead grew slightly each year, as the Board was able to replenish and further fund the reserve with the District's significant surpluses. The District's reserve report includes a target funding level of \$3 to \$4 million (four years of retirement contributions). We question the need to maintain this

⁶ These reserves can insulate taxpayers from spikes in costs due to fluctuations in retirement system contributions or layoffs rather than financing the total cost of the expenditure. This promotes a stable tax rate.

⁷ District officials replenished the reserves on the same day they recorded the usage (June 30) for 2013-14 and 2014-15 and within one month (on July 31) after 2012-13.

⁸ While the Board did not specify which reserves it was using in the 2013 -14 through 2015-16 budgets, it is assumed that the majority of the undesignated amount was intended to come from the retirement contribution reserve based on retirement expenditures and recorded activity.

balance since the District has been covering the costs with its annual operating funds.

Unemployment Insurance Reserve – This reserve is allowed for reimbursing the New York State Unemployment Insurance Fund (SUIF) for payments made to claimants where the school district has elected to use the “benefit reimbursement” method based on actual unemployment claims.⁹ The District made payments to the SUIF totaling \$59,166 for the three-year period July 1, 2012 through June 30, 2015, which averaged \$19,722 per year. However, the Board appropriated a total of \$200,000 for unemployment insurance claims over the three years, which significantly exceeded actual expenditures and, therefore, contributed to annual operating surpluses. Although the Board did reduce its appropriations for unemployment insurance in the 2015-16 budget to \$25,000, the reserve’s balance as of June 30, 2015 was \$359,901 (more than 18 times the average annual expenditures) and exceeds the target level in the District’s reserve report. The reserve report lists a \$200,000 funding level goal but also describes the target level as three years of unemployment insurance expenditures, which would be approximately \$60,000. District officials annually recorded reductions of the reserve for expenditures totaling \$53,610 for the three year period, but further funded the reserve at the end of the 2012-13 and 2014-15 years by a total of \$80,000.

Because they did not include the funding of reserves in the annual budgets, but instead funded reserves with year-end surpluses, District officials did not provide residents with accurate information and the opportunity to vote on how their taxes were being used. District officials can better support the District’s reserve balances and budgetary choices by developing and updating more accurate budgeting, fund balance and reserve policies or plans.

By maintaining excess fund balance, both restricted and unrestricted, and not using the fund balance appropriated in adopted budgets, District officials are levying more taxes than necessary to sustain District operations. In addition, some current budgeting practices circumvented statutory controls and resulted in fund balance that exceeded the statutory limit.

Recommendations

The Board and District officials should:

1. Adopt budgets that reflect the District’s actual needs and include realistic estimates based on historical trends or other identified analysis.

⁹ The New York State Labor Law’s Benefit Reimbursement option allows employers to reimburse the unemployment insurance fund for benefits paid to their former employees, instead of paying on a contribution basis.

2. To the extent possible, include all planned uses of fund balance and specific reserves and any plans to fund reserves in the adopted budget.
3. Develop a plan to reduce the amount of unrestricted fund balance in a manner that benefits District residents. Such uses could include, but are not limited to:
 - Funding one-time expenditures;
 - Funding needed reserves; and
 - Reducing District property taxes.
4. Review all reserve balances and determine if the amounts reserved are necessary, reasonable and in compliance with statutory requirements. To the extent they are not, transfers should be made in compliance with statutory requirements.

The Board should:

5. Require District officials to present an annual reserve report that complies with the Board's established reserve funds policy.

Competitive Procurement

An effective purchasing process helps the District obtain goods and services of the right quality and quantity from the best qualified and lowest-priced sources, in compliance with Board policy and legal requirements. Such a process also helps guard against favoritism, extravagance and fraud. General Municipal Law (GML) generally requires the Board to advertise for bids on contracts for public works involving expenditures of more than \$35,000 and on purchase contracts involving expenditures of more than \$20,000.

GML also requires the Board to adopt written policies and procedures for the procurement of goods and services that are not legally subject to competitive bidding requirements, such as items that fall below bidding thresholds and professional services, to help ensure the prudent and economical use of public money in the best interests of the taxpayers. These policies and procedures must require that alternate proposals or quotes for goods or services be secured through written requests for proposals (RFPs), written quotes, verbal quotes or any other appropriate method of competitive procurement. These policies and procedures should also outline when District officials must seek competition and how to determine the competitive method that will be used, and should describe the documentation requirements and responsibilities, including required justification and documentation of any contract awarded to other than the lowest responsible dollar offeror.

The Board did not adopt an adequate procurement policy. The Board-adopted procurement policy states that public work contracts and purchase contracts above the specified legal limits are required to be competitively bid, but did not address either purchases that fall below the statutory bidding thresholds or professional services. The District Treasurer (Treasurer) provided us with a chart that contained competitive bidding and verbal and written quote thresholds, but it was not adopted by the Board and contained outdated competitive bidding thresholds that were not consistent with the procurement policy. The Assistant Superintendent and Treasurer acknowledged that the limits in this chart were outdated and were likely not familiar to or used by all District employees when making purchases.¹⁰ Therefore,

¹⁰ At our exit conference on June 16, 2016, District officials provided a purchasing manual that they developed to serve as the District's administrative regulations for purchasing. They implemented this manual in April 2016. The manual established reasonable dollar thresholds for obtaining quotes for purchases under bidding thresholds. It requires that quotes be documented, scanned and attached to the requisition when entered into the computerized financial system. It also includes additional, but vague, language related to selecting professional service providers.

we selected a sample of 35 purchases made during our audit period¹¹ totaling approximately \$1.4 million and found that the District did not properly seek competition for 15 purchases (43 percent) totaling more than \$780,000.

Competitive Bidding – We reviewed five purchases totaling approximately \$560,000 that were subject to competitive bidding and found that four of them were properly bid. The District did not bid its pizza purchases for the school lunch program, which totaled \$39,547 over the period. District officials said they contacted other pizza vendors who were unable to meet their needs but did not retain documentation of these attempts to seek competitive pricing. Furthermore, while the District seemed to pay reasonable prices,¹² the pizza purchases exceeded the legal bidding threshold and must be formally advertised for competitive bids.

Items Under Bidding Thresholds – The District’s procurement policy does not prescribe competitive procurement procedures for items that fall under competitive bidding thresholds, as required by GML. We reviewed 25 purchases totaling \$236,436 that were under competitive bidding thresholds and found that competition was not properly sought and documented for nine purchases totaling \$88,401. While District officials gave us reasonable verbal explanations for some of the purchases (e.g., an emergency freezer purchase), they could not provide adequate documentation of their method or reason for selecting the vendors. Further, although certain vendors had State contracts, District officials did not clearly document contract use or verify that contract discounts were received. For example, the District did not receive over \$700 in discounts due from one State contract vendor on the purchase of fitness equipment.¹³ Without documented price comparisons, District officials lack assurance that goods and services were purchased at the lowest possible cost for the desired quality.

Professional Services – GML does not require competitive bidding for the procurement of professional services that involve specialized skill, training and expertise, use of professional judgment or discretion or a high degree of creativity. However, it does stipulate that professional services must be procured using a documented competitive method in the best interest of the residents, in accordance with Board-adopted procurement policies and procedures. Education Law specifically requires school districts to use an RFP process when contracting

¹¹ Between July 1, 2014 and November 13, 2015

¹² Generally, \$6.50 per large pizza and \$19 per sheet pizza

¹³ At our exit conference on June 16, 2016, District officials provided documentation that they contacted this vendor and received a \$687.96 reimbursement check dated February 29, 2016.

for annual auditing services and to limit the audit engagement to no longer than five consecutive years.

We reviewed the District's procurement of services from five professional service providers totaling \$652,890 and found that District officials did not properly seek competition or adequately document the rationale for the decisions made. District officials could not provide us with any evidence that they sought competition for the District's financial advisors or counseling service provider. Although the District did use RFPs to seek competition for its external auditors, legal service providers and construction manager, District officials did not select the lowest-cost provider for any of these three services and could not provide us with adequate written justification and documentation for selecting the higher-cost vendors. District officials apparently selected the auditors and construction manager primarily due to their longstanding relationship with these vendors. Although not required by law, the periodic rotation of contracted auditors helps to maintain independence and a fresh perspective. District officials told us there was significant discussion regarding the legal services, but mostly in executive session.¹⁴ When selecting and approving a vendor, the Board and District officials should document their rationale for the decisions made.

Recommendations

6. The Board should: Adopt detailed policies and procedures to address the procurement of goods and services that are not required by law to be competitively bid, including the use of RFPs or written and verbal quotes, and requiring supporting documentation of such efforts and the rationale for decisions made.

District officials should:

7. Solicit bids for all purchases exceeding the statutory bid thresholds as required by law.
8. Ensure that the purchasing agent receives and reviews purchasing documentation, such as quotes, bids and proposals, and retains such documentation, in accordance with the District's revised procurement policy and procedures.
9. Monitor and enforce compliance with the revised purchasing policy and procedures.

¹⁴ In which the Board meets privately and minutes are not kept

APPENDIX A

RESPONSE FROM DISTRICT OFFICIALS

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

HONEOYE FALLS-LIMA

Central School District

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Mr. Ed Grant
Office of the State Comptroller
Division of Local Government
And School Accountability
Albany, NY

July 13, 2016

The Honeoye Falls – Lima School District has always welcomed the opportunity to review and strengthen our financial practices and oversight. We have worked diligently over the past several years to update policies, strengthen internal controls, and develop budgets that balance short term financial priorities with the long term financial well-being of the District. To that end, we have developed multi-year financial projections that guide our decision making. We communicate clearly and often with the public about our financial strategies, and our annual budget materials seek to provide a transparent and engaging environment. Each year the district holds six to eight budget development meetings with our public budget committee, which includes staff, administrators, Board of Education members, and community members. These meetings are open to the public and presentations are posted to the district’s website. In addition, regular Board of Education Audit and Reserve committee meetings are open to the public.

The State Comptroller’s office spent 4 months at the Honeoye Falls – Lima School District reviewing our procedures, processes, and policies. As expected, the audit did not uncover any instances of fraud, or malfeasance with the School District Financial Management. The audit did preliminary testing in multiple areas, including online banking, NY employee pensions, severance payments, and disaster recovery. This work stimulated some positive discussions and lead to some helpful improvements. However, there were no major findings in these areas.

Ultimately, the scope of the audit focused on examining the District’s financial management and purchasing practices for the period of July 1, 2012 through February 11, 2016. We work closely with our outside independent auditors to review our financial management practices, oversight procedures and financial condition. The District has reviewed the Comptroller’s findings and recommendations of this audit and will take corrective action in certain areas. These will be outlined in our Corrective Action Plan.

Budgeting and Fund Balance

The first portion of the audit focuses on the District’s budgeting and use of appropriated fund balance, a topic on which the District and the Comptroller’s office have a difference of opinion. The Comptroller is of the opinion that the School District should deplete its appropriated fund balance

See
Note 1
Page 22

annually. However, guidance from the Association of School Business Officials, Government Officers Financial Association, and New York State School Board Association recommend a conservative approach to utilization of fund balance as part of ongoing operations. Even the Office of the New York State Comptroller’s Fiscal Stress Close-Up Fund Balance document indicates “Low fund balance may be a symptom of ongoing fiscal stress for a local government and can also lead to future fiscal stress”. Finally the Office of the New York State Comptroller’s Fiscal Stress Close-up fund Balance Document indicates “The presence of sufficient fund balance reflects good financial performance in prior years, and constitutes some protection against adverse events that may occur in the future. Low fund balance, on the other hand, may be a sign of poor financial practices”. We believe the district’s budget practices are aligned to this guidance with a view to long term sustainability.

The fundamental difference in opinion is based in the district’s use of a forward looking budgeting process with the aim of creating budgets over multiple years that are sustainable. The district has established legal reserves, which in essence are savings accounts. Each year the budget is balanced by including planned expenditures from these savings in the form of appropriated fund balance and restricted reserve expenditures.¹ If the district receives all planned revenue and encounters no unexpected, often legally mandated, expenses, the district budget is structured to refund its reserves back to target levels. In effect, the district carries these contingency funds forward from year to year.

See
Note 2
Page 22

In comparison and as recommended by the Comptroller, school districts that use appropriated fund balance and restricted reserves to supplement their budget without refunding them create a “structural deficit”. They basically spend more than they receive. When their savings run out, they are faced with financial hardship that often requires them to ask the local taxpayers to exceed the tax levy limit (i.e., NY Tax Cap) or make significant cuts to programs. The district considers this an unsustainable and unsound financial practice.

See
Note 3
Page 22

The audit also reviewed the district’s reserves. The report found all reserves were fully compliant with NY State Municipal and Educational Law. Excluding voter authorized reserves for capital projects, the district maintains 4% of its budget in the form of unassigned reserves and approximately 11% of its budget in the form of restricted reserves. To put this in context, the NYS Comptroller considers a district to begin entering fiscal stress if their unassigned reserves fall below 3% and if their total reserves fall below 10%.

See
Note 4
Page 22

See
Note 5
Page 22

Reserve balances are set strategically by the Board of Education based on evaluating future risk rather than relying solely on past data. For example, if the district were required to balance its budget through program reductions, the unemployment reserve balance is aligned to its target value. If the state reduced aid through a Gap Elimination Adjustment as it did from 2008 - 2016, the district’s retirement reserve balance would not even supplement this aid shortfall for even two years.

See
Note 6
Page 23

See
Note 7
Page 23

The report also neglects the importance of reserves and fund balance in securing a favorable credit rating, which is critical in determining the interest rate the school district pays on its bonds. Moody’s rates the Honeoye Falls – Lima School District as Aa3. This is one of the highest credit ratings a district with our tax base can achieve. Should we deplete our reserves, the district will diminish a key metric used in determining its credit rating. If the district’s rating dropped from Aa3 to A, our financial

See
Note 8
Page 23

¹ See HF-L Budget Newsletters for this period at www.hficsd.org/budget

advisors estimate the district would incur an additional \$50,000 per year interest expense over the term of the recently approved capital project.

Competitive Procurement

The district continually strives to receive the best prices and maximum value from its purchases. The Board updated its purchasing policies in 2014 to reflect changes in municipal law related to bid thresholds and best value purchasing. However, the district continued to use its original, more conservative, guidance in specifying the number of quotations needed for below bid purchases. However, the district agrees with the audit report that a better practice is to fully align internal guidance documents with board policy. As a result, the district prepared and issued a new purchasing manual detailing the requirements for obtaining competitive quotations.

The audit confirmed that four of five major bids, comprising 93% of the bid dollars audited, were properly bid. The district agrees with the audit findings that the total district purchases for pizza exceeded \$20,000. Therefore, the district will review our forecast pizza purchases for the coming year and determine whether these purchases should be formally bid.

For purchases under the bidding threshold, the district agrees that more formally documenting the rationale for selecting a particular product or vendor is a good practice. Using our new financial software installed in 2015, scanned attachments can now be attached electronically to all requisitions. The new purchasing manual details the required documentation needed for each level of purchase. The electronic approval process for requisitions now includes a step to verify that the required supporting documentation is attached and complete.

The district used a request for proposal (RFP) process to contract the services of its internal auditors, external auditors, and attorneys. For our external auditors, the district participated in a regional RFP, in which the lead school district prepared a scoring rubric based on the specific requirements outlined in the original RFP completed in 2011. The district chose the Audit firm with the highest scoring on the rubric which is in compliance with General Municipal Law. For other professional services and although not legally required, the district will review expanding its use of the RFP process. However, the timing for seeking new proposals needs to be made strategically. For example, changing architects in the middle of a capital project may make no sense. The district also agrees that documenting and archiving the information used to select a service provider is a good practice.

See
Note 9
Page 23

The Honeoye Falls – Lima School District Board of Education and Administration always seek opportunities to improve our processes and clearly communicate our plans and practices with our community and taxpayers. The District will implement the steps outlined in the attached corrective action plan.

Sincerely;

Sincerely;

Gary Stottler
Board President

Gene Mancuso
Superintendent

Corrective Action Plan

Budgeting and Fund Balance

1. The District always seeks ways to be more transparent regarding its budgeting processes and reserve use. Therefore, by October 15, 2016 and coincident with the adoption of the District's annual financial statements, the District will post a reserve plan on its web site. The reserve plan will detail the current balances, target balances, purpose, planned expenditures, and strategies for refunding each reserve. The plan will be updated as part of the District's annual budgeting process.

Purchasing

2. The district has developed a new purchasing manual detailing the requirements to provide and document competitive information. This updated process leverages new technology to scan and attach needed competitive information with each requisition. The electronic approval process has been modified to include a step to verify that the needed competitive information has been provided. This work was completed and shared with the Board of Education Audit committee on May 10, 2016.
3. The district will develop additional guidance related to procuring professional services. This guidance will review and detail our processes for seeking requests for proposals (RFP's) for other professional service providers.
4. The district will review its planned purchases of pizza for the coming school year and determine if pizza should be purchased through a formal bid process.

APPENDIX B

OSC COMMENTS ON THE DISTRICT'S RESPONSE

Note 1

We did not suggest that the District deplete fund balance. Our findings and recommendations focus on consistent budgeting practices used over the last three years and encourage District officials to adopt more accurate budgets. Budgeting for the use of fund balance while overestimating expenditures (and, therefore, not using the appropriated fund balance) is not a transparent means of communicating the District's financial plans and true financial condition to residents.

Note 2

A budget that was balanced and included reasonable estimates would provide funds needed for operations and a tool to help monitor expenditures. A reasonable level of unappropriated fund balance and reserves would provide a cushion against unforeseen events. Budgets that significantly overestimate expenditures and include appropriations of fund balance and reserves result in accumulations of levy money and tax rates that are unnecessarily high.

Note 3

The Office of the State Comptroller does not recommend that the District budget to deplete its fund balance and reserves, but that it appropriate fund balance and reserves only when it needs and intends to use it. As stated in the audit report, when districts have excess funds on hand, as in this case, we recommend reducing them to a reasonable level.

Note 4

While we found that the reserves were established and used in accordance with applicable laws, the retirement contribution and unemployment insurance reserves were overfunded and potentially unnecessary.

Note 5

The context used in the District's response is incorrect. The Office of the State Comptroller's fiscal stress monitoring system established indicators related to fund balance.¹⁵ For school districts, the threshold for low available fund balance (fund balance that is not reserved, committed, appropriated or otherwise restricted) is defined as less than 3 percent of current year expenditures, and a low total fund balance (all fund balance including all reserves, appropriated fund balance and unassigned fund balance) is defined as less than 10 percent of expenditures. At the conclusion of the 2014-15 fiscal year, the District had available fund balance of 4 percent and total fund balance of 30 percent of gross expenditures.

¹⁵ See the *Fiscal Stress Close-Up – Fund Balance* publication referenced in the District's response at <http://www.osc.state.ny.us/localgov/pubs/fiscalmonitoring/pdf/closeup/fundbalance.pdf>

Note 6

District officials did not indicate or present any documentation to suggest that program reductions were being considered. Further, the District's established target funding level for the unemployment insurance reserve is \$200,000. This reserve is funded to approximately \$360,000. Therefore, the District does not follow its own internally set thresholds.

Note 7

The retirement contribution reserve is authorized only for the payment of retirement contributions to the New York State and Local Retirement System. Given that the District has been covering the costs with its annual operating funds and further funding the reserve each year, it has not justified the need to maintain a balance equal to approximately four times the entire 2016 annual billing (as of June 30, 2015).

Note 8

Moody's scorecard allows school districts to have lower fund balances than cities or counties with the same credit rating because they have a more predictable funding composition and more transparent schedule of cash outflows. School districts should raise enough taxes to fund operations and maintain a reasonable cushion against unforeseen events.

Note 9

GML requires the District to implement policies and procedures to ensure that competition is sought in the procurement of goods and services that are not required to be competitively bid.

APPENDIX C

AUDIT METHODOLOGY AND STANDARDS

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

- We interviewed District officials to gain an understanding of the budget process and reviewed Board meeting minutes and financial information to determine the reports provided to the Board.
- We compared the adopted general fund budgets for fiscal years 2012-13 through 2014-15 with actual results of operations to determine if the budgets were realistic and structurally balanced.
- We analyzed the trend in total fund balance, including the use of reserves, in the general fund for fiscal years 2012-13 through 2014-15. We also compared the unrestricted fund balance to the ensuing year's budget expenditures to determine if the District was within the statutory limit during the same fiscal years.
- We reviewed the general fund budget for 2015-16 to determine whether the budgeted revenues and appropriations were reasonable and if fund balance trends would continue.
- We reviewed real property tax rates and levies for the 2012-13 through 2015-16 fiscal years.
- We reviewed the District's reserve accounts and related expenditures to determine if reserves were properly and legally established, were being funded or used and had reasonable balances. We also determined if transfers were appropriate.
- We reviewed the District's multiyear financial and capital plans for adequacy.
- We interviewed District officials and reviewed purchasing documentation to gain an understanding of the purchasing process.
- We judgmentally selected a representative variety of vendors composed of 25 purchases based on dollar values that were below competitive bidding thresholds, five purchases that were at or above competitive bidding thresholds and five procurements of professional services, and traced them from the accounting records to the invoices and purchase orders.
- We reviewed documentation to determine if the District was seeking competition in procuring goods and services. We used professional judgment to determine if the goods or services procured were appropriate for a school district. For those goods or services where the District did not seek competition, we inquired with District officials for an explanation.

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 objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

APPENDIX D

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