



Whitesville Central School District Financial Management

Report of Examination

Period Covered:

July 1, 2012 – April 8, 2016

2016M-313



Thomas P. DiNapoli

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State of New York Office of the State Comptroller

Division of Local Government and School Accountability

December 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 Whitesville 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 Whitesville Central School District (District) is located in the Towns of Independence and Willing in Allegany County and the Town of West Union in Steuben County. The District is governed by an elected five-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 Junior Accountant (Accountant) is responsible for accounting for the District's finances, maintaining accounting records and preparing financial reports. The Accountant also assists the Board and Superintendent with developing and monitoring the budget.

The District operates one school with 259 students and 52 employees. The District's general fund budgeted appropriations for the 2015-16 fiscal year totaled approximately \$6.7 million, which were funded primarily with State aid and real property taxes.

Objective

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

- Did the Board properly manage District finances by ensuring that budgets were realistic and fund balance levels were reasonable?

Scope and Methodology

We examined the District's management of financial activities for the period July 1, 2012 through April 8, 2016. On November 30, 2016, District officials provided us with updated financial information. We subsequently updated certain financial information in the report and extended the scope period to June 30, 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 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 they have taken, or plan to take, corrective action.

The Board has the responsibility to initiate corrective action. Pursuant to Section 35 of General Municipal Law, Section 2116-a (3) (c) of New York State Education Law and Section 170.12 of the Regulations of the Commissioner of Education, a written corrective action plan (CAP) that addresses the findings and recommendations in this report must be prepared and provided to our office within 90 days, with a copy forwarded to the Commissioner of Education. To the extent practicable, implementation of the CAP must begin by the end of the next fiscal year. For more information on preparing and filing your CAP, please refer to our brochure, *Responding to an OSC Audit Report*, which you received with the draft audit report. The Board should make the CAP available for public review in the District Clerk's office.

Financial Management

The Board, Superintendent and Accountant are responsible for properly managing the District's finances. This includes adopting realistic budgets and ensuring that fund balance does not exceed the amount allowed by law. Fund balance represents the cumulative residual resources from prior fiscal years that can, and in some cases must, be used to lower property taxes for the ensuing year. A school district may retain a portion of fund balance, referred to as unrestricted fund balance, but must do so within the legal limit established by New York State Real Property Tax Law (RPTL). RPTL limits the amount of unrestricted fund balance for school districts to 4 percent of the subsequent year's budget. A school district can also legally set aside and reserve portions of fund balance to finance future costs for a variety of specified objects or purposes.

District officials have not effectively managed fund balance and have allowed unrestricted fund balance to exceed the statutory limit for three fiscal years by 12 to 17 percentage points. As of June 30, 2015, the District's unrestricted fund balance totaled more than \$1.3 million and was 20 percent of the 2015-16 budgeted appropriations, exceeding the statutory limit by more than \$1 million. Although District officials have appropriated approximately \$420,000 of fund balance each year, these funds were not needed because District officials consistently overestimated appropriations by an average of \$710,000, or 11 percent. When unused appropriated fund balance is added back, unrestricted fund balance exceeded the statutory limit by 18 to 23 percentage points. Furthermore, District officials overfunded one reserve by approximately \$250,000. Based on the 2015-16 and 2016-17 adopted budgets, these budgeting practices have continued. However, District officials have taken steps to reduce unrestricted fund balance. As of June 30, 2016, unrestricted fund balance was approximately \$527,000, or 8 percent of the subsequent year's budget.

Budgeting and Fund Balance

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

During 2012-13 through 2014-15, the District's unrestricted fund balance averaged approximately \$1.2 million and exceeded the statutory limit by an average of \$980,000. As of June 30, 2015, the unrestricted fund balance totaled more than \$1.3 million and was 20 percent of 2015-16 appropriations. District officials appropriated an

average of \$420,000 of fund balance annually to help finance budgeted appropriations. However, because District officials significantly overestimated appropriations, appropriated fund balance was not actually used to finance operations.

When fund balance is appropriated as a funding source, it reduces the fund balance subject to the statutory limit, and the expectation is that there will be a planned operating deficit in the subsequent fiscal year equal to the amount of fund balance appropriated. Although District officials appropriated fund balance each year, none of it was used because District officials overestimated appropriations each year by an average of \$710,000, or 11 percent.¹ The most significant variances were in instructional salaries (cumulative variance of \$410,000, or 12 percent of the amount budgeted), special education (\$510,000, or 19 percent) and employee benefits (\$690,000, or 19 percent). Because appropriations were overestimated, the District realized operating surpluses of approximately \$260,000 in 2012-13, \$110,000 in 2013-14 and \$220,000 in 2014-15. As a result, appropriated fund balance was not used to finance operations and unrestricted fund balance exceeded the statutory limit by 12 to 17 percentage points.

Figure 1: Unrestricted Fund Balance at Fiscal Year-End

	2012-13	2013-14	2014-15
Beginning Fund Balance	\$2,590,000	\$2,800,000	\$2,740,000
Add: Operating Surplus	\$260,000	\$110,000	\$220,000
Less: Transfers Out	\$50,000	\$170,000	\$410,000
Ending Fund Balance	\$2,800,000	\$2,740,000	\$2,550,000
Less: Restricted Fund Balance (Reserves)	\$1,030,000	\$1,280,000	\$900,000
Less: Appropriated Fund Balance	\$420,000	\$420,000	\$320,000
Unrestricted Fund Balance at Year-End	\$1,350,000	\$1,040,000	\$1,330,000
Subsequent Year's Budgeted Appropriations	\$6,470,000	\$6,530,000	\$6,700,000
Unrestricted Fund Balance as a Percentage of the Subsequent Year's Budget	21%	16%	20%

Routinely adopting budgets that appropriate fund balance that will not be used can be misleading to residents because they are under the impression that surplus funds will be used to reduce taxes. In addition, the District's 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 and a circumvention of the statutory limit imposed on the level of unrestricted fund balance.

As shown in Figure 2, because the District did not actually use the appropriated fund balance to finance operations, when unused appropriated fund balance is added back, it actually exceeded the 4

¹ District officials also overestimated revenues by approximately \$80,000, or 1.25 percent each year.

percent statutory limit by higher amounts than reported in all three years by approximately \$1.3 million or an average of 21 percentage points above the 4 percent allowed.

Figure 2: Unused Fund Balance			
	2012-13	2013-14	2014-15
Unrestricted Fund Balance at Year-End	\$1,350,000	\$1,040,000	\$1,330,000
Add: Appropriated Fund Balance Not Used to Fund the Subsequent Year's Budget	\$420,000	\$420,000	\$320,000
Recalculated Unrestricted Fund Balance at Year-End	\$1,770,000	\$1,460,000	\$1,650,000
Recalculated Unrestricted Fund Balance as a Percentage of the Subsequent Year's Budget	27%	22%	25%

Based on the 2015-16 adopted budget and actual operating results, the District budgeted similarly to previous years and did not need to use the \$320,000 it appropriated in fund balance. However, District officials reduced unrestricted fund balance by transferring approximately \$1 million to capital reserves. As a result, as of June 30, 2016, unrestricted fund balance was approximately \$527,000, or 8 percent of the subsequent year's budget.

We also reviewed the District's 2016-17 adopted budget and determined that appropriations decreased by about \$60,000, or 1 percent, but estimated State aid revenues also increased by approximately \$100,000, or 2 percent. However, in November 2016, District officials used \$465,000 of fund balance to pay off outstanding bonds; therefore, unrestricted fund balance will likely be closer to the statutory limit at the end of 2016-17.

Budgeting practices that produce operating surpluses and maintain fund balance in excess of the amount allowed by law often result in real property tax levies that are greater than necessary to fund operations.

Reserve Funds

School districts may establish reserve funds to retain a portion of fund balance to finance a variety of objects or purposes but must do so in compliance with statutory requirements. While school districts are generally not limited as to how much money can be held in reserves, balances should be reasonable. Funding reserves at greater than reasonable levels contributes to property tax levies that are higher than necessary because the excessive reserve balances are not being used to fund operations.

As of June 30, 2015, the District reported six reserves in the general fund totaling approximately \$900,000. We analyzed the reserves for reasonableness and found the balance in one reserve was excessive when compared to the potential costs which could be paid from the reserve.

General Municipal Law authorizes school districts to create an employee benefit accrued liability reserve (EBALR) to fund the cash payment of accrued and unused sick, vacation and certain other leave time due employees when they leave District employment. The District's long-term liability for compensated absences payable from the reserve was approximately \$60,000 as of June 30, 2015. However, the reserve balance was \$310,000, resulting in an overfunding of approximately \$250,000 (417 percent). The District would need New York State Legislative approval to remove funds from the reserve to use them for other purposes. Prior to 2014, District officials had not been using the reserve to pay for separation payments but had, instead, levied taxes for this purpose. However, the District used approximately \$7,800 in 2014 and \$35,000 in 2015 from the reserve to pay for separation payments.

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

Recommendations

The Board and District officials should:

1. Ensure budgets include realistic estimates of appropriations based on actual needs and that estimates for the planned use of fund balance are accurate and reasonable.
2. Maintain unrestricted fund balance within the statutory limit.
3. Develop a plan to reduce unrestricted fund balance in a manner that benefits District residents. Such uses could include, but are not limited to:
 - Funding one-time expenditures;
 - Reducing District property taxes; and
 - Funding needed reserves.
4. Ensure that the EBALR is used in accordance with statute and take appropriate action to better align funding levels with the District's long-term liability.

APPENDIX A

RESPONSE FROM DISTRICT OFFICIALS

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

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November 17, 2016

Jeffrey D. Mazula, Chief Examiner
Office of the State Comptroller
295 Main Street, Suite 1032
Buffalo, New York 14203-2510

Dear Mr. Jeffrey Mazula,

The Whitesville Central School District acknowledges receipt of the draft audit report of our financial condition for the period of July 1, 2012 through April 8, 2016, prepared by the Office of the State Comptroller. On behalf of the Whitesville CSD Board of Education and administration, we would like to thank you for the collaborative and professional way in which the audit was directed. The recommendations were fair and we have made some adjustments to our budgeting and reserve practices that will better reflect our financial condition and take into account our long term planning.

The Whitesville Central School District has always budgeted conservatively to ensure that we remain financially secure into the future. It has been very important, as a small community with a limited tax base, to plan for unanticipated expenses or decreased revenues that could suddenly impact our ability to give our students the quality education that they need and deserve. The uncertainty of New York State's final budget each year coupled with the tax cap program make it impossible to quickly recoup revenue if needed. To ensure the long term stability of the district, our board and community have supported this conservative philosophy.

The district has already taken steps to more realistically budget for anticipated needs for the 2016-2017 school year and beyond. We will continue to monitor unrestricted fund balance and establish reserves or make necessary one time expenditures. Recently, the District paid off the final two years of debt from a past capital project. Reserve funds are transparently being reviewed by the board and other financial experts and auditors. Necessary decisions will be made by the board to adequately manage the District's reserve fund balances while being mindful of its role and responsibility to the public.

The Whitesville Central School would like to thank the Office of the New York State Comptroller for leading a comprehensive, professional audit of our financial condition. We seek to continuously improve as a district, therefore, recommendations within the report will help us strengthen our policies, procedures and oversight.

Respectfully,

Laurie M. Sanders
Superintendent
Whitesville Central School

Jeffrey Erdmann
Board of Education President
Whitesville Central School

W. C. S.
We Choose Success

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 and reviewed written policies and procedures to gain an understanding of the District's budgeting and financial management practices.
- We analyzed the last three years of financial data and budgets to evaluate fund balance and reserve fund levels, assess operating results and evaluate if budget estimates were reasonable.
- We analyzed the 2015-16 and 2016-17 adopted budgets for reasonableness and to assess if budgeting practices were similar to prior years.
- We calculated unrestricted fund balance as a percentage of the next year's budget to determine if the District was in compliance with RPTL.
- We reviewed Board minutes and other records to verify that reserves were properly established, funded and used.

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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