

# Hornell City School District

## Financial Management

JUNE 2019



OFFICE OF THE NEW YORK STATE COMPTROLLER  
Thomas P. DiNapoli, State Comptroller

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# Report Highlights

## Hornell City School District

### Audit Objective

Determine whether the Board adequately managed the District's financial condition.

### Key Findings

- Conservative budgeting has produced operating surpluses negating the use of appropriated fund balance.
- Certain reserve balances were excessive.
- District officials did not develop comprehensive written multiyear financial or capital plans.

### Key Recommendations

- Discontinue the practice of appropriating fund balance that is not needed or used to fund operations.
- Review reserve balances and develop a plan to reduce balances to reasonable levels in accordance with applicable statutes.
- Develop comprehensive multiyear financial and capital plans that set long-term objectives and goals.

District officials generally agreed with our recommendations and indicated they plan to initiate corrective action.

### Background

The Hornell City School District (District) serves the City of Hornell as well the Towns of Fremont, Hornellsville and Howard in Steuben County.

The District is governed by a seven-member Board. The Superintendent of Schools (Superintendent) is responsible, along with other administrative staff, for managing day-to-day operations under the Board's direction. The Business Administrator is responsible for the administration and supervision of financial activities, including working with the Superintendent as budget officer to develop and administer the budget.

#### Quick Facts

Employees	430
Enrollment	2,000
2018-19 Appropriations	\$39.5 million

### Audit Period

July 1, 2015 – December 3, 2018

# Financial Management

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## What is Effective Financial Management?

To effectively manage a school district's financial condition, a board must adopt reasonably estimated and structurally balanced budgets based on historical data or known trends, in which recurring revenues finance recurring expenditures. In preparing the budget, a board and district officials must estimate the district's spending, revenue, available fund balance at fiscal year-end, and the expected tax levy. Accurate estimates help ensure that the real property tax levy is not greater than necessary.

Fund balance represents the cumulative residual resources from prior fiscal years. New York State Real Property Tax Law<sup>1</sup> currently limits surplus<sup>2</sup> fund balance to no more than 4 percent of the next year's budget. Any surplus fund balance over this percentage must be used to fund needed reserves or reduce the upcoming year's real property tax levy. When fund balance is appropriated for the ensuing year's budget, the expectation is that there will be a planned operating deficit equal to the amount of fund balance that was appropriated. Additionally, a board should adopt a fund balance policy to ensure sufficient funding for necessary operations is available and that the real property tax levy is not greater than necessary.

Districts are legally allowed to establish reserves and accumulate reasonable funds for certain future purposes (e.g., capital project, retirement expenditures). District officials should plan for the funding and use of reserves by balancing the desire to accumulate funds for future needs with the obligation to make sure real property taxes are not higher than necessary. Ideally, amounts to be placed in reserves should be included in the annual budget to ensure taxpayers are aware of the board's intent to fund reserves in the upcoming year.<sup>3</sup> The 2015 board-adopted reserve policy establishes reporting requirements to assist the board in providing adequate oversight and maintenance of reserve funds.

Finally, prudent fiscal management also requires the board to establish long-term financial plans, which include plans for maintenance and use of both unexpended surplus funds and reserve funds. Planning on a multiyear basis allows district officials to identify developing revenue and expenditure trends, set long-term priorities and goals and consider the impact of current budget decisions on future fiscal years. Effective multiyear plans project operating and capital needs and financing sources over a three- to five-year period. These plans should be monitored and updated on an ongoing basis to provide a reliable framework

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1 New York State Real Property Tax Law, Section 1318

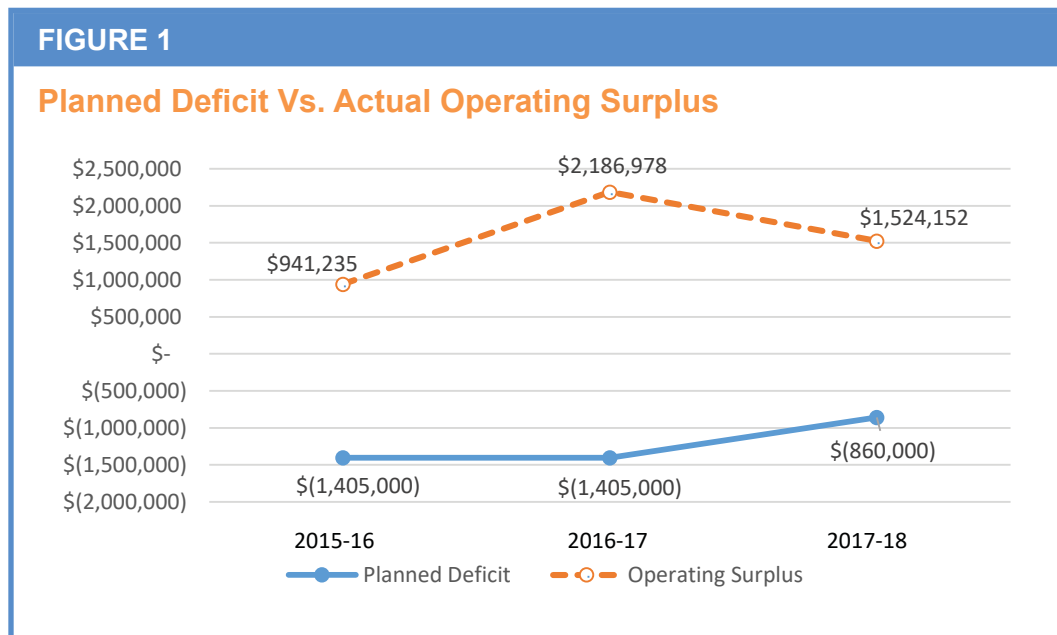
2 Surplus fund balance is defined as unrestricted fund balance minus appropriated fund balance and encumbrances included in committed and assigned fund balance. See our accounting bulletin at <https://www.osc.state.ny.us/localgov/pubs/releases/gasb54.pdf>

3 Refer to our publication *Reserve Funds* available at [www.osc.state.ny.us/localgov/pubs/lgmg/reservefunds.pdf](http://www.osc.state.ny.us/localgov/pubs/lgmg/reservefunds.pdf)

for preparing budgets and to ensure that information used to guide decisions is current and accurate.<sup>4</sup>

### The Board’s Actions to Manage Fund Balance Were Not Transparent

The Board adopted budgets that conservatively estimated revenues and appropriations the last three fiscal years, which resulted in unplanned operating surpluses totaling \$4,652,365 instead of planned deficits.



Due to the unplanned operating surpluses, appropriated fund balance totaling \$3,670,000 was not used. 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 surplus fund balance.

Over the past three completed fiscal years, the District reported surplus fund balance that ranged from 3.4 percent to 4 percent of the ensuing year’s appropriations, which is within the 4 percent limit allowed by RPTL. However, when unused appropriated fund balance is added back, surplus fund balance exceeded the statutory limit by as much as seven percentage points.

When unused appropriated fund balance is added back, surplus fund balance exceeded the statutory limit by as much as 7 percentage points.

<sup>4</sup> Refer to our multiyear financial planning resources available at [www.osc.state.ny/localgov/planbudget/index.htm](http://www.osc.state.ny/localgov/planbudget/index.htm)

**Figure 2: Recalculated Fund Balance**

	2015-16	2016-17	2017-18
Total Surplus Fund Balance at Year-End	\$2,882,884	\$2,170,532	\$1,978,020
Add: Appropriated Fund Balance Not Used to Fund Ensuing Year's Budget	\$1,405,000	\$1,405,000	\$860,000
Total Recalculated Surplus Funds	\$4,287,884	\$3,575,532	\$2,838,020
Ensuing Year's Budget	\$37,223,952	\$38,114,393	\$39,510,674
Recalculated Fund Balance as a Percentage of Ensuing Year's Budget	11.5%	9.4%	7.2%

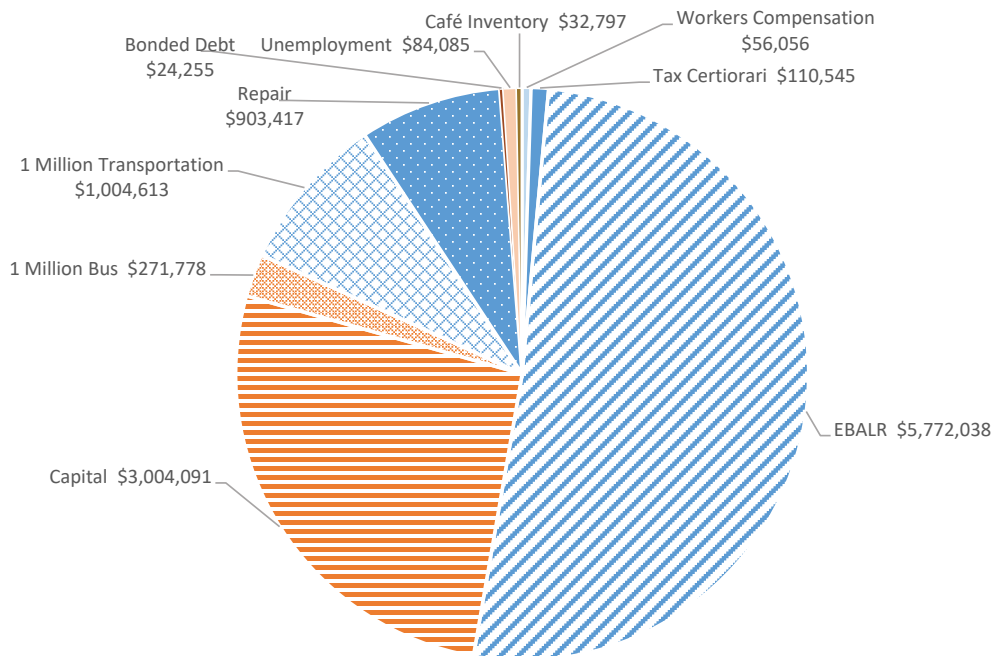
Because the Board did not enforce the 2015 reserve policy, District officials transferred money to reserves from operating surpluses at the end of each fiscal year to stay within the 4 percent limit. For example:

- \$795,558 was transferred to the employee benefit accrued liability reserve (EBALR) reserve on June 30, 2016
- \$1,500,000 was transferred to a capital reserve and \$175,000 to the repair reserve on June 30, 2017
- \$1,600,000 was transferred to two capital reserves and \$400,000 to the repair reserve on June 30, 2018

Ideally, reserve financing should be included in the annual budget so voters and residents are given an opportunity to know the Board's plan for funding its reserves. The current method of funding reserves is not transparent and occurred without formal Board approval. As of June 30, 2018, the District reported \$11,263,676 in 10 reserves.

**FIGURE 3**

**Reserve Funds Balances as of 6/30/2018**



Our review of the reserves' activities determined the EBALR reserve was overfunded by \$3.1 million because District officials incorrectly calculated the liability for various leave accruals and incorrectly included amounts held by the District on behalf of retirees for the payment of health insurance premiums after retirement.

In addition, the workers compensation,<sup>5</sup> unemployment<sup>6</sup> and repair reserves may not be needed because District officials have not used the reserves to fund related expenditures during the three-year period July 1, 2015 through June 30, 2018. Instead, expenditures were paid out of the operating budget. The Board can discontinue these reserves if it determines they are unnecessary. However, money from the discontinued reserves has to be transferred per statute.

Lastly, the capital reserves are not being used properly. New York State Education Law<sup>7</sup> authorizes the Board to establish capital reserves to fund the cost of any object or purpose for which bonds may be issued. Voter authorization is required

<sup>5</sup> The District belongs to a self-funded workers' compensation plan negating the need to use this reserve; however, District officials have not taken action to dissolve the reserve.

<sup>6</sup> District officials stated they will start using this reserve for unemployment expenditures as intended.

<sup>7</sup> New York State Education Law Section 3651

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for creation as well as use of capital reserves, and the stated expenditures must be specific. District officials were tracking amounts in the District's four capital reserves that remained unexpended from prior authorizations and inappropriately using these remaining accumulated balances as justification for similar expenditures from the capital reserve in subsequent years without obtaining voter and Board approval. For example, District officials inappropriately expended \$115,065 from such funds to purchase a bus from the capital reserve on August 31, 2015.

By maintaining overfunded and/or unnecessary reserves, the Board and District officials levied more taxes than necessary, and may have compromised the transparency of District finances.

### **District Officials Did Not Develop Formal Multiyear Financial and Capital Plans**

District officials did not develop comprehensive written multiyear financial or capital plans. However, we noted that some departments did some planning. Information technology (IT) staff have recently updated the Technology Plan, which partially addresses replacement schedules and proposed future expenditures for IT. The Athletic Coordinator has a replacement schedule (rotation) for sports uniforms and equipment and the Transportation Department has a 10-year<sup>8</sup> replacement cycle for buses and other student transportation vehicles. However, the Board and District officials have not formally adopted any written multiyear plans combining all these various elements into one cohesive and comprehensive document. The Board is currently in the process of hiring a consultant to assist it in developing long-range facilities plans.

Well-designed multiyear plans, which include specific estimates for revenues, expenditures, reserves, fund balance and long-term capital needs can assist the Board and District officials' in effectively managing the District's finances, addressing the use of excess fund balance and planning for the reasonable and proper use of reserve funds.

### **What Do We Recommend?**

The Board should:

1. Discontinue the practice of appropriating fund balance that is not needed or used to fund operations.

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<sup>8</sup> The District has also started leasing buses on a five-year cycle.



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2. Develop a fund balance policy and formulate a plan to reduce the amount of surplus fund balance in a manner that benefits District residents.

Surplus funds can be used as a financing source for:

- Funding one-time expenditures;
  - Funding needed reserves;
  - Paying off debt; and
  - Reducing District property taxes.
3. Assure that District officials comply with the annual reporting on reserves in accordance with Board policy.
  4. Review reserve balances and develop a plan to reduce balances to reasonable levels in accordance with applicable statutes.
  5. Develop comprehensive multiyear financial and capital plans that set long-term objectives and goals. These plans should be monitored and updated on an ongoing basis.

District officials should:

6. Prepare an estimate of year-end fund balance to assist in developing and adopting budgets that include reasonable estimates for appropriations and the amount of fund balance that will be used to fund operations.
7. Prepare and submit to the Board an annual report on reserve funds in compliance with the District's policy.
8. Use capital reserve funding for voter and Board authorized expenditures in the fiscal year in which it was approved.

# Appendix A: Response From District Officials



**HORNELL**  
**CITY SCHOOL DISTRICT**

25 Pearl Street • Hornell • New York • 14843

Jeremy P. Palotti, Superintendent  
Phone 607.324.1302  
FAX 607.324.1345  
Business Office  
607.324.1302

<u>Schools</u>	
Senior High	324-1303
Intermediate	324-1304
Bryant	324-2171
N. Hornell	324-0014

April 8, 2019

Mr. Edward V. Grant Jr.,  
Chief Examiner  
Rochester Regional Office  
Office of State Comptroller  
Powers Building  
16 West Main St. Suite 522  
Rochester, New York 14614-1608

Dear Mr. Edward V. Grant Jr.,

The Hornell City School District has acknowledged receipt of the draft audit report of our financial condition of July 2015 through December 2018 prepared by the Office of the State Comptroller (OSC).

During the audit we found the OSC representatives to be extremely professional, collaborative, and knowledgeable and we appreciate the dedication and many hours they spent in our District. We value the perspectives and recommendations of the OSC, and our intent is to review their report and adjust our operating practices where appropriate based on the advisement of our internal and external auditors, financial advisors, and audit committee.

As discussed in the exit meeting attended by Board of Education President Kerry Davis, Business Administrator Patrick Flaitz, School Treasurer Sue Brown and Superintendent Jeremy Palotti, we appreciate the opportunity to evaluate the district's conservative management of finances as we seek to maintain long term stability for our taxpayers while providing high quality educational programming for our students allowing them to be successful in college and the workplace. Our conservative approach to our finances has helped us maintain strong academic programs while staying off massive layoffs and massive tax increases during a time when state aid funding was unpredictable as was the rising cost of employee benefits and other operational costs.

See  
Note 1  
Page 11

#### *Budgeting and Fund Balance*

The Hornell Business Administrator, Superintendent, Administration, and Board of Education work collaboratively to evaluate expenses from prior years, forecast future expenditures, and identify the needs of the district to create a budget based on believed actual costs that maximizes efficiencies while staying focused on our goal of providing the highest quality education at a reasonable expense to the local tax paying community member.

The Hornell City School District is highly dependent on state aid revenue to fund its programs. In fact, this year the district utilized approximately 77% revenue from the state government in order to fund educational programs. From 2008-2016, the Hornell City School District faced revenue shortcomings as a result of a nationwide recession. The recession coupled with a NYS imposed Gap Elimination deduction from our aid along with the creation of the 2% Tax Cap

See  
Note 2  
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together with our dependence on state aid left the district in a position where the revenue budget became dependent on using fund balance as an additional revenue source to attempt to stave off massive tax increases and employee layoffs. During this same time, the district did reduce some positions through retirements as a means to balance the budget. As the finances in the district became more stable the district began the process of reducing excess fund balance to balance the budget. As recent as the 2015-16 school year, the District appropriated an extra \$1,235,000 beyond our 4% in fund balance as appropriated fund balance to offset tax increases. By 2018-19 that number was reduced to \$310,000 and in the 2019-20 budget this number will be reduced further to \$190,000. Our goal and plan will be to reduce the fund balance excess of our 4% to \$0 by the 2020-21 school year. The Hornell City School District does indeed understand and appreciate this guidance. Prior to this audit, our financial plan was to do just as advised, however we stand by our practices in prior years due to the aforementioned reasons relating to the uncertainty of NYS aid as it relates to funding our school.

See  
Note 3  
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See  
Note 1  
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When building a budget, the district must balance predicted revenues with predicted expenditures. We naturally never want to overspend our budget. With that in mind we conservatively estimate slightly higher on expenses and estimate slightly lower on revenue with the goal to end the year with just enough fund balance such that we can meet our obligations and potentially save some for the future. The district has used excess fund balances in years past to pay down debt, to fund reserves and has reduced property taxes. The district has also used these excess for one time purchases of items that do not require ongoing expenses. The district plans on continuing these aforementioned practices and as of the 2019-20 school year, has tasked departments with generating list of items that could be purchased as one time expenses. The annual fund balance is reviewed annually and communication to and with the board is routine practice when determining the intended use of the fund balance.

#### *Reserve Funds*

The other focus of the audit was on the district's reserve funds. The OSC recommended several practices to regularly monitor and review these funds including the creation of a reserve fund plan. The district spent the fall of the 2018-19 creating a reserve plan and procedures for regular review of these reserve funds as well as their intended use. This plan has been approved by the Board of Education and will be followed and monitored by the Business Administrator, Superintendent, and Board of Education annually. While the Board is routinely made aware of reserve balances through regular reporting, the District will more formally discuss the balance, use, and funding of those reserves and will document those discussions.

#### *Long Range Planning*

The District very much understands the value of long range planning. Beginning in 2017, the District embarked on creating long range plans. The District began this process with evaluating our current needs via a comprehensive needs assessment involving stakeholders from all aspects of our community. From this, district priorities were established followed by goals and objectives. With this focus and plan, the District has a clear road map for program to build its budget based on. For a district that is currently dependent on NYS Aid for 77% of it is revenue,

it is tough to make long range forecast as it relates to revenue when more than three quarters of our revenue varies significantly, with very little predictability. Despite this, the District through it's reserve plan and ongoing budgeting practices along with contract negotiations has done so being mindful of future financing challenges. The District is in the process of completing a multi year financial plan knowing that it will have to be modified and adapted annually based on the state of NYS finances. Starting last June, the District began the process of creating a long range capital plan as it relates to capital improvements within the district. The District hired an outside consultant during the 2018-19 school year to evaluate program, facilities, and finances to create a long range capital and facilities plan that spans the next five to ten years. By June of 2019 the Board of Education will have this plan for its consideration. With these three plans in place, the District will have a clear road map and plan to follow for the foreseeable future.

See  
Note 1  
Page 11

*Capital Reserve use*

The District has Capital Reserves set aside for the purchase of vehicles that transport students as well as for capital improvements. In the past, the community has authorized the use of such funds through a proposition that is voted on during our annual budget vote. Once approved, the District has used these funds for the specified purchases. The OSC has suggested that these approved funds be spent during the fiscal year when they were approved. In communicating with our own auditors, we have not been provided indication that this is a requirement under law. However, in an effort to be fully transparent with the community, we will establish a timeframe on the referendum indicating the time in which we intend to use such funds that are approved through public vote.

See  
Note 4  
Page 11

In conclusion, we respect the OSC for their efforts and acknowledge their findings. The review and examination of our financial condition only serves to validate our lawful procedures and strengthen our budgeting practices, governance, and policy. We intend to comply with the recommendations provided by the OSC, and continue to engage the community on our progress.

Respectfully,

Kelley Davis  
Board of Education President  
Hornell City School District

Jeremy P. Palotti  
Superintendent of Schools  
Hornell City School District

## Appendix B: OSC Comments on the District's Response

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### Note 1

The District's State aid funding has remained consistent for the last five fiscal years, at 74 or 75 percent. In addition, over the last three completed fiscal years, the net increases in employee benefits and operational costs were 4 percent and 2 percent, respectively.

### Note 2

Over the last three fiscal years, the District has recognized additional revenues and State aid remained consistent at 75 percent.

### Note 3

Over the last three fiscal years, the tax levy and related items have remained consistent and appropriated fund balance was not needed to finance operations.

### Note 4

New York State Education Law, Section 3651

## Appendix C: Audit Methodology and Standards

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We conducted this audit 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. To achieve the audit objective and obtain valid audit evidence, our audit procedures included the following:

- We interviewed District officials and reviewed policies and procedures to gain an understanding of the budgeting and financial management processes and procedures, including the rationale for determining the levels to maintain for surplus fund balance and reserves.
- We compared budgeted appropriations and estimated revenues to actual results for three fiscal years and identified significant variances.
- We calculated operating results for the past three years and assessed if appropriated fund balance was used as budgeted.
- We calculated surplus fund balance as a percentage of the next year's appropriations to assess District compliance with statute.
- We recalculated surplus fund balance as a percentage of the next year's appropriations after adding back unused appropriated fund balance.
- We analyzed reserve fund balances to determine whether balances were reasonable and/or being used as intended.

We conducted this performance audit in accordance with GAGAS (generally accepted government auditing standards). 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.

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.

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, pursuant to Section 35 of General Municipal Law, Section 2116-1(3) (c) of New York State Education Law and Section 170.12 of the Regulations of the Commissioner of Education. To the extent practicable, implementation of the CAP must begin by the end of the 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. We encourage the Board to make the CAP available for public review in the Clerk's office.

## Appendix D: Resources and Services

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### **Regional Office Directory**

[www.osc.state.ny.us/localgov/regional\\_directory.pdf](http://www.osc.state.ny.us/localgov/regional_directory.pdf)

### **Cost-Saving Ideas** – Resources, advice and assistance on cost-saving ideas

[www.osc.state.ny.us/localgov/costsavings/index.htm](http://www.osc.state.ny.us/localgov/costsavings/index.htm)

### **Fiscal Stress Monitoring** – Resources for local government officials experiencing fiscal problems

[www.osc.state.ny.us/localgov/fiscalmonitoring/index.htm](http://www.osc.state.ny.us/localgov/fiscalmonitoring/index.htm)

### **Local Government Management Guides** – Series of publications that include technical information and suggested practices for local government management

[www.osc.state.ny.us/localgov/pubs/listacctg.htm#lmgm](http://www.osc.state.ny.us/localgov/pubs/listacctg.htm#lmgm)

### **Planning and Budgeting Guides** – Resources for developing multiyear financial, capital, strategic and other plans

[www.osc.state.ny.us/localgov/planbudget/index.htm](http://www.osc.state.ny.us/localgov/planbudget/index.htm)

### **Protecting Sensitive Data and Other Local Government Assets** – A non-technical cybersecurity guide for local government leaders

[www.osc.state.ny.us/localgov/pubs/cyber-security-guide.pdf](http://www.osc.state.ny.us/localgov/pubs/cyber-security-guide.pdf)

### **Required Reporting** – Information and resources for reports and forms that are filed with the Office of the State Comptroller

[www.osc.state.ny.us/localgov/finreporting/index.htm](http://www.osc.state.ny.us/localgov/finreporting/index.htm)

### **Research Reports/Publications** – Reports on major policy issues facing local governments and State policy-makers

[www.osc.state.ny.us/localgov/researchpubs/index.htm](http://www.osc.state.ny.us/localgov/researchpubs/index.htm)

### **Training** – Resources for local government officials on in-person and online training opportunities on a wide range of topics

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## Contact

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Division of Local Government and School Accountability  
110 State Street, 12th Floor, Albany, New York 12236

Tel: (518) 474-4037 • Fax: (518) 486-6479 • Email: [localgov@osc.ny.gov](mailto:localgov@osc.ny.gov)

[www.osc.state.ny.us/localgov/index.htm](http://www.osc.state.ny.us/localgov/index.htm)

Local Government and School Accountability Help Line: (866) 321-8503

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**ROCHESTER REGIONAL OFFICE** – Edward V. Grant Jr., Chief Examiner

The Powers Building • 16 West Main Street – Suite 522 • Rochester, New York 14614-1608

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