

Letchworth Central School District

Reserves

JANUARY 2019



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

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Report Highlights

Letchworth Central School District

Audit Objective

Determine whether the Board properly established reserve funds and maintained them at reasonable levels.

Key Findings

- The written reserve fund policy does not adequately address funding levels resulting in overfunded reserves that are not used.
- Five reserve funds totaling \$3.5 million are overfunded.

Key Recommendations

- Adopt a more comprehensive written policy and review reserves to determine whether they are necessary and balances are reasonable.
- Use excess amounts in accordance with statutory requirements and in a manner that benefits taxpayers.

District officials disagreed with certain aspects of our findings and recommendations. Appendix B includes our comments on issues raised in the District's response letter.

Background

The Letchworth Central School District (District) serves the Towns of Centerville and Hume in Allegany County and the Towns of Castile, Eagle, Gainesville, Genesee Falls, Pike, Warsaw and Wethersfield in Wyoming County.

An elected nine-member Board is responsible for the general management and control of operations. The Superintendent of Schools (Superintendent) is the chief executive officer and is responsible, along with other administrative staff, for the District's day-to-day management. The Business Administrator oversees the business office, maintains financial records and prepares financial reports.

The Board, Superintendent and Business Administrator are responsible for properly establishing and funding reserves.

Quick Facts

Enrollment	940
Employees	192
2018-19 Budget	\$19.6 million
2017-18 Year-End Reserve Balances	\$7.9 million

Audit Period

July 1, 2014 – July 30, 2018

Reserves

How Should a Board Ensure Reserves Are Properly Established and Reasonably Funded?

A board may establish reserves to restrict a portion of fund balance that it can use for specific purposes (e.g., capital projects or retirement contributions) in compliance with statutory requirements. However, reserve balances must be reasonable and should be routinely monitored by the board and district officials, which can be accomplished in part by adopting a comprehensive reserve policy addressing funding methods, optimal levels and use.

A debt reserve is statutorily required¹ if unexpended bond proceeds remain on a capital improvement or when a capital improvement has outstanding debt remaining at the time of sale. These funds must be restricted and used for related debt principal and interest payments.

The Board Did Not Adopt an Adequate Reserve Fund Policy

The Board adopted an updated written reserve fund policy in July 2017. The policy requires an annual report to the Board, which includes a description of the reserves, the date of establishment, interest earned, withdrawal details, ending balances and an analysis of projected needs for the reserves in the upcoming fiscal year with a recommendation regarding funding those needs. However, the policy does not address funding methods, optimal funding levels or use. The Business Administrator prepares the annual reserve plan and typically presents it to the Board in October each year. However, the annual reserve plans submitted did not include an analysis of the projected needs for the reserve funds in the upcoming fiscal year as required.

Reserves Were Unreasonably Funded

As of June 30, 2018, the District reported 11 general fund reserves totaling approximately \$7.3 million and a debt reserve of approximately \$594,000 in the debt service fund. We found that District officials properly established all reserves with the exception of the debt reserve, and that the retirement contribution, debt, repair, property loss and liability, and insurance reserves with balances totaling \$3.5 million are overfunded and may be unnecessary:

- Retirement Contribution Reserve – This reserve had a balance of \$2.1 million as of June 30, 2018. According to New York State General Municipal Law (GML),² the Board may transfer a portion of money in this reserve to certain other reserves including capital reserves.

¹ New York State Local Finance Law (LFL), Section 165.00 and General Municipal Law (GML), Section 6-I. Refer to our publication Reserve Funds available at www.osc.state.ny.us/localgov/pubs/lgm/reservefunds.pdf

² GML, Section 6-r

During our audit period, District officials made several transfers resulting in a net decrease of \$585,000³ or 22 percent. In addition, officials paid retirement contribution expenditures, which averaged \$309,000 during our audit period, directly from general fund appropriations. The annual reserve plan includes a targeted funding level of five years of related expenditures, which we calculated as approximately \$1.5 million. The District has exceeded its optimal funding level by approximately \$600,000. Furthermore, because the policy does not describe how officials should use these funds, we question if the reserve is necessary.

- Debt Reserve – This reserve had a balance of \$594,000 as of June 30, 2018. District officials were unable to relate these funds to any current outstanding debt. Therefore, they were not legally required to restrict these funds in a debt reserve.⁴ During our audit period, District officials made three transfers totaling \$633,000 to general fund unrestricted fund balance.
- Repair Reserve – This reserve had a balance of \$295,000 as of June 30, 2018. During the audit period, District officials reduced the reserve by \$609,000 or 67 percent. This reduction included a transfer of \$500,000 to a capital reserve. While District officials used a portion of these funds for the reserve’s intended purpose, the remaining balance could fund related expenditures for more than 10 years based on average annual repair expenditures of \$28,500.
- Property Loss and Liability Reserve – This reserve had a balance of \$245,000 as of June 30, 2018. During the audit period, District officials properly⁵ transferred approximately \$21,500 of excess funds to unrestricted fund balance reducing the balance by 8 percent. While the reserve’s balance is within the legal limit,⁶ we question its need, as there is no formal plan detailing the anticipated use of these funds.
- Insurance Reserve – This reserve had a balance of \$240,000 as of June 30, 2018. During the audit period, District officials improperly transferred approximately \$30,000 of excess funds to unrestricted fund balance reducing the balance by 11 percent. Because GML requires that expenditures from this reserve must be used to pay for uninsured losses, this transfer was improper.⁷ We question the reserve’s need, as there is no formal plan⁸ detailing the need and expected use of these funds.

3 Depositing a total of \$365,000 from unrestricted fund balance and transferring \$950,000 to capital reserves.

4 LFL, Section 165.00 and GML, Section 6-l

5 Pursuant to a public vote

6 Not to exceed 3 percent of the annual budget

7 GML, Section 6-n

8 Officials may use an insurance reserve only to fund uninsured losses, claims, actions or judgments, for which the District is authorized or required to purchase or maintain insurance, with exceptions, such as for life, health and workers’ compensation insurance. An insurance reserve may also be used to pay for related professional services.

District officials told us that they reduced the balance in these reserves to comply with our previous audit's recommendations.⁹ However, the District should reduce reserves in accordance with statutory requirements. From 2014-15 through 2017-18, officials increased the tax levy by approximately \$230,000 while continuing to maintain overfunded reserves. Therefore, the tax levy increase may not have been necessary. The balances in District reserves are excessive and based on officials' lack of effective planning and using reserves, we question if they are all necessary.

What Do We Recommend?

The Board and District officials should:

1. Adopt a more comprehensive written reserve fund policy and ensure compliance with it.
2. Ensure the annual reserve plan includes all elements required by the policy.
3. Review all reserve balances to determine whether the amounts reserved are necessary and reasonable.
4. Consult with legal counsel as to the appropriate remedy for addressing improperly used reserves and develop a plan to reduce the balances to reasonable levels in accordance with applicable statutes in a manner that benefits taxpayers.
5. Identify the source of the funds in the debt reserve and return any money improperly restricted to general fund unrestricted fund balance.

⁹ Refer to our prior audit report, Letchworth Central School District – Financial Management (2013M-332), issued in 2014. www.osc.state.ny.us/localgov/audits/schools/2014/letchworth.pdf

Appendix A: Response From District Officials



Letchworth Central School District

5550 School Road - Gainesville, NY 14066

Todd Campbell Superintendent [585] 493-5450	John Novak Business Admin [585] 493-5150	Rae Lynn Helman Pupil Personnel Dir [585] 493-3512	Julie Pernesky Curriculum & Inst Dir [585] 493-3513	
William Bean IV PK-4 Principal [585] 493-2581	Amy Leone 5-8 Principal [585] 493-2592	Paul Rogers 9-12 Principal [585] 493-2571	Kevin Murray Asst Principal 5-12 [585] 493-2571	Directory Auto Attendant [585] 493-5999

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

RE: Letchworth Central School District
Reserve Funds - Report of Examination 2018M-176
Date: December 28, 2018

Dear Mr. Mazula:

Please accept this letter as the Letchworth Central School District's response to the Draft Report of Examination of the Reserve Funds dated November 2, 2018 and the exit discussion of November 9th. On behalf of the District, I want to thank the representatives of the Office of the State Comptroller for their work throughout this process. In general, we were pleased with the ability to discuss our reserve protocols and have candid discussions about issues as they arose. However, as we do not believe that the draft report accurately characterizes the District's actions with respect to its budget and reserve funds over the past four years we felt it was important to put these efforts in context.

See
Note 1
Page 8

The audit objective was to "determine whether the Board properly established reserve funds and maintained them at reasonable levels." The Board feels that to properly assess the District's general reserve funds, one needs to examine the progress the district has made since the last audit in 2014. As identified in the 2014 report, as of June 30, 2013, the District had eight general fund reserves and one debt reserve fund totaling \$10.5 million and \$1.4 million, respectively. The OSC opined that five of these reserves were identified as over-funded. In the District's response letter, we commented that we would be establishing a plan to reduce these reserves over the next five years while continuing a conservative and wise reserve plan to protect our tax payers. The District has, and will continue, to do so.

The continued strong financial health of the Letchworth Central School District is due to conservative budgeting, years of solid financial planning and strategic use of our reserves. This planning and the ways we use reserves has led to the region's lowest tax rates, long term fiscal health, many extra-curricular choices for students, and a competitive educational program. We were able to maintain all of this despite state aid revenues that are only slightly higher now than they were in 2009, after significant reductions in the intermediate years.

Small, rural districts such as Letchworth continue to deal with financial stress due to the heavy reliance of our annual budget on New York State aid. Letchworth receives approximately 68% of its operating revenues from New York State. The low tax rates, when combined with the

Property Tax Cap, limit the District's ability to raise additional revenues year to year. Strategic use of reserves make it possible to offer our students an equitable and competitive education without overburdening our tax payers. Currently, a 1% increase in taxes generates \$44,932. This is less than an increase of 1% in our total employee benefits budget. (Our total benefit budget in 2017-18 was \$4,609,779; our total levy equated to \$4,493,158.)

Each year we try to offer tax-levy stability (0% increase in 2018) to our taxpayers and maintain the lowest tax rate in the Genesee Valley BOCES region at \$13.69 on true value for Letchworth taxpayers (vs. the highest rate in the region at \$26.90 and the average of \$19.91 for the region in 2017-18.) The wise and conservative use of our reserves is a vehicle to maintain this approach for years to come.

Our plan has addressed our reserves in a responsible and strategic manner. Per the directive in the 2014 audit, the District has decreased these reserves by approximately \$4 million over the last five years.¹ The Board of Education reviews the appropriate level of funding for each reserve annually during public session. We have been diligent in these efforts and compliant and transparent with our taxpayers by listing these reserves in our annual budget newsletter, District website and yearly plan. The Board will continue to do so in a conservative and fiscally responsible way that protects the District from unforeseen expenditures and/or decreases in revenue which cannot be predicted.

As noted, the Board recently adopted an updated written reserve policy in July 2017. The Board will take into consideration whether to revise the policy to include the additional items suggested such as funding methods, optimal funding levels, and projected needs.

With regard to the specific comments about the reserves:

Retirement Contribution Reserve: This is a reserve established to mitigate the impact of unpredictable employers' contribution rates. The Board of Education feels it is fiscally prudent to reserve funds to offset future increases in the employer contribution rate which are completely beyond the District's control. The Board will continue to evaluate the appropriate funding level and plan for use.

See Note 2 Page 8

Debt Reserve: As stated in our 2014 Corrective Action Plan, the District has continued to appropriate funds from the Debt Reserve on an annual basis to support principal and interest payments on the debt from past capital projects. The current Reserve Plan will continue this process over the next five year period. The plan continues to have a positive impact on District taxpayers by lowering the amount of the levy needed to support the debt payments.

Repair Reserve: During the audit period the District has used funds from this reserve for their intended purpose to provide for necessary repairs. The balance of this reserve has decreased by 67% over the audit period demonstrating the District's effort to manage these funds responsibly. These funds continue to be utilized to complete unexpected repairs less than

¹Our general reserve funds have decreased, currently totaling approximately \$7.3 million, down from \$10.5 million in June of 2013. The debt reserve has decreased from \$1.4 million in 2013 to \$529,000.

\$100,000. These repairs do not impact the budget, the levy or the rate affecting the taxpayers. It will continue to be monitored closely by the Board of Education.

Property Loss and Liability Reserve: The balance of this reserve has decreased by 8% demonstrating the District's effort to manage these funds responsibly. The Board established this reserve for the possibility of any future liability claims, for which the expense cannot be realistically estimated. These claims can arise unexpectedly and the Board feels it fiscally prudent to have funds set aside to mitigate the possible negative impact of these claims on the District budget and tax levy.

Insurance Reserve: The Board established this reserve for the possibility of any future insurance claims, for which the expense cannot be realistically estimated. The District reduced the balance of this reserve by 11 percent during the audit period. Funds were used to help lower the tax burden of the general fund budget during the 2015-16 fiscal school year. The Board of Education will continue to evaluate the appropriate funding level for this reserve and use the funds to benefit students and taxpayers.

The Board of Education and Administration will continue to work with the residents of our district to develop, maintain and protect an educational program that we can all be proud of. Fiscal health, high quality programs and student success will continue to be at the forefront as we move forward with enthusiasm and optimism.

Respectfully,

Todd Campbell, Superintendent of Schools

Appendix B: OSC Comments on the District's Response

Note 1

As indicated in the report, District officials have reduced the balances of reserves since our prior audit. However, some reserve balances are excessive and District officials should continue to improve their plans to maintain and use reserves.

Note 2

The New York State and Local Retirement System announces pension contribution rates approximately one year before the start of the District's fiscal year. The District's budget vote is in May, less than two months before the start of the fiscal year. Furthermore, contributions are based on the District's payroll. Consequently, officials have sufficient information to reasonably estimate these appropriations.

Appendix C: Audit Methodology and Standards

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 to gain an understanding of reserve fund management practices.
- We reviewed the Board minutes and District policies and procedures to identify and examine any information that related to the Board's oversight and responsibilities for establishing, funding and maintaining reserves.
- We reviewed financial records and reports to determine the reserve fund balances and review the activities of each reserve.
- We analyzed the use of and balances maintained in reserves during the audit period to determine whether balances were excessive by reviewing related reserve expenditures and the reserve fund policy.
- We reviewed the real property tax levy to determine whether it changed during the audit period.

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.

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 District Clerk's office.

Appendix D: Resources and Services

Regional Office Directory

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

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

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

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

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/lgli/pdf/cybersecurityguide.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

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

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

www.osc.state.ny.us/localgov/academy/index.htm

Contact

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