

Fredonia Central School District

Financial Management

JUNE 2018



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

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Report Highlights

Fredonia Central School District

Audit Objective

Determine whether the Board and District officials properly managed fund balance.

Key Findings

- The Board overestimated appropriations by more than \$5.7 million over a three-year period (6.75 percent), resulting in annual operating surpluses and a fund balance increase of more than \$2 million (52 percent).
- As of June 30, 2017, unrestricted fund balance totaled more than \$3.3 million and was 11 percent of the 2017-18 budgeted appropriations, exceeding the statutory limit by more than \$2.1 million, or 7 percentage points.
- Despite the significant amount of accumulated fund balance, the Board annually increased the tax levy and did not take steps to reasonably fund reserves.

Key Recommendations

- Adopt budgets using realistic estimates for appropriations and the amount of fund balance to be used to fund operations.
- Reduce unrestricted fund balance to within the statutory limit and use the excess funds in a manner more beneficial to residents.

District officials disagreed with certain aspects of our findings and recommendations, but indicated they planned to initiate some corrective action.

Background

The Fredonia Central School District (District) serves the Towns of Arkwright, Dunkirk, Pomfret, Portland and Sheridan in Chautauqua County.

The District is governed by its elected seven-member Board of Education (Board). The Superintendent of Schools (Superintendent) is the chief executive officer and is responsible for day-to-day management under the Board's direction. The Board, Superintendent and Business Administrator (Administrator) are responsible for developing the annual budget. The Administrator is also responsible for the administration and supervision of its financial activities.

Quick Facts

| | |
|-------------------|--------------|
| Enrollment | 1,455 |
| Employment | 280 |
| Number of Schools | 3 |
| 2017-18 Budget | \$32 million |

Audit Period

July 1, 2014 – November 28, 2017

Financial Management

What Is Effective Financial Management?

To effectively manage financial condition, the Board should adopt realistic and structurally balanced operating budgets based on historical or known trends, in which recurring revenues finance recurring expenditures. In preparing the budget, the Board must estimate what the District will spend and receive in revenue, how much fund balance will be available for use at fiscal year-end and, to balance the budget, what the required tax levy will be. Accurate estimates help ensure that the real property tax levy is not greater than necessary.

The Board should retain both a reasonable amount of fund balance for cash flow needs or unexpected expenditures and an adequate amount of reserves for other identified or planned needs. Fund balance is the difference between revenues and expenditures accumulated over time. The New York State Real Property Tax Law¹ limits the amount of unrestricted fund balance that a school district can retain to no more than 4 percent of the subsequent year's budgeted appropriations. Any unrestricted fund balance over this percentage must be used to reduce the upcoming fiscal year's tax levy or to fund necessary reserves.

Reserves can be used to legally set aside portions of fund balance to finance future costs for specific purposes. 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. Therefore, it is important that the Board adopt a written policy that states its rationale for establishing reserve funds, objectives for each reserve, maximum targeted funding levels and conditions under which reserves will be used or replenished.

The Board Overestimated Appropriations and Appropriated Fund Balance That Was Not Needed

The Board and District officials should improve budgeting practices to ensure that budgets are realistic and take action to address the reasonableness of fund balance. We compared budgeted appropriations and estimated revenues with actual operating results for fiscal years 2014-15 through 2016-17 and found that, while revenue variances were generally reasonable (underestimated by less than 1 percent), appropriations were overestimated by more than \$5.7 million, or an annual average of \$1.9 million (6.75 percent).

The most significant budget variances were for utilities, transportation, special education and debt service (Figure 1 shows the cumulative three-year totals).

¹ New York State Real Property Tax Law §1318

Figure 1: Significantly Overestimated Appropriations

| Appropriation | Total Budgeted Appropriations | Total Actual Expenditures | Total Variance | Percentage |
|--------------------------|-------------------------------|---------------------------|--------------------|------------|
| Utilities | \$2,304,980 | \$1,656,192 | \$648,788 | 39% |
| Special Education | \$9,862,750 | \$8,770,775 | \$1,091,975 | 12% |
| Transportation | \$3,856,318 | \$3,324,466 | \$531,852 | 16% |
| Debt Service | \$9,480,110 | \$8,614,852 | \$865,258 | 10% |
| Totals | \$25,504,158 | \$22,366,285 | \$3,137,873 | 14% |

The Administrator stated that he annually overestimates utility and debt service costs for fund balance purposes, and that he budgets for one to two extra special education students and an extra out-of-district bus route due to the highly variable nature of these costs. However, budgetary practices that overestimate appropriations can result in tax levies that are higher than necessary.

Because the Board overestimated appropriations, it appeared the District needed to use appropriated fund balance to close projected budget gaps. The Board annually appropriated an average of \$1 million of fund balance as a financing source in the 2014-15² through 2016-17 budgets, which should have resulted in planned operating deficits equal to the amount appropriated and decreased fund balance. However, due to overestimated appropriations, the District realized annual operating surpluses, and fund balance increased by more than \$2.1 million (52 percent). As of June 30, 2017, unrestricted fund balance totaled more than \$3.3 million and was 11 percent of the 2017-18 budgeted appropriations, exceeding the statutory limit by more than \$2.1 million, or 7 percentage points (Figure 2).

² The Board appropriated \$1,250,000 of fund balance for the 2014-15 budget.

Figure 2: Unrestricted Fund Balance at Year-End

| | 2014-15 | 2015-16 | 2016-17 |
|--|--------------|--------------|--------------|
| Beginning Fund Balance | \$3,718,654 | \$4,113,184 | \$4,474,101 |
| Operating Results | \$494,530 | \$509,108 | \$1,303,208 |
| Transfers Out (Unbudgeted) | \$100,000 | \$148,191 | \$(99,419) |
| Ending Fund Balance | \$4,113,184 | \$4,474,101 | \$5,876,728 |
| Reserve Funds | \$1,216,762 | \$1,216,775 | \$1,216,789 |
| Restricted Debt Proceeds^a | \$0 | \$47,841 | \$342,841 |
| Appropriated Fund Balance | \$1,250,000 | \$1,000,000 | \$950,000 |
| Unrestricted Fund Balance | \$1,646,422 | \$2,209,485 | \$3,367,098 |
| Subsequent Year's Budget | \$30,677,815 | \$30,904,671 | \$31,818,588 |
| Unrestricted Fund Balance as a Percentage of Subsequent Year's Budget | 5% | 7% | 11% |

a In 2015-16, \$47,841 interest earned on a bond anticipation note was incorrectly recorded and left unrestricted in the general fund. In 2016-17, a \$295,000 premium earned on a bond issue was also incorrectly recorded and left unrestricted in the general fund. These funds should have been restricted and/or recorded in the debt service fund, to be used to pay off the related debt. We discussed these findings with District officials. We included these amounts in the restricted debt proceeds figures in this table.

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.

Because the District did not use the appropriated fund balance, it actually exceeded the statutory limit by higher amounts than reported. When unused appropriated fund balance is added back, unrestricted fund balance exceeded the limit each year by 5 to 10 percentage points (Figure 3).

Figure 3: Recalculated Unrestricted Fund Balance at Year-End

| | 2014-15 | 2015-16 | 2016-17 |
|---|--------------|--------------|--------------|
| Unrestricted Fund Balance | \$1,646,422 | \$2,209,485 | \$3,367,098 |
| Unused Appropriated Fund Balance | \$1,250,000 | \$1,000,000 | \$950,000 |
| Recalculated Unrestricted Fund Balance | \$2,896,422 | \$3,209,485 | \$4,317,098 |
| Subsequent Year's Budget | \$30,677,815 | \$30,904,671 | \$31,818,588 |
| Recalculated Unrestricted Fund Balance as a Percentage of Subsequent Year's Budget | 9% | 10% | 14% |

Based on our analysis of the 2017-18 adopted budget and year-to-date operations, the District will likely experience an operating surplus and not use appropriated fund balance. Therefore, fund balance will continue to increase and exceed the limit.

Despite its budgetary surpluses and excess fund balance, the Board continued to increase the tax levy by approximately 1 percent each year. The Board increased the tax levy by a total of \$611,000 (4 percent) from 2014-15 through 2017-18.

Given these practices and fund balance levels, the Board levied more taxes than necessary to sustain operations and may have missed opportunities to better use fund balance and reduce taxes.

The Board had not adopted a fund balance or reserve policy to establish how much fund balance should be retained or what reserves should be funded, how they would be funded and when they would be used. A fund balance and reserve policy would clarify the Board's intent with respect to fund balance and reserves.

What Do We Recommend?

The Board and District officials should:

1. Develop and adopt budgets that include realistic estimates for appropriations and the amount of fund balance that will be used to fund operations.

-
2. Develop a plan to reduce unrestricted fund balance to within the statutory limit and use the excess funds in a manner that benefits District residents. Such uses include, but are not limited to:
 - Funding one-time expenditures;
 - Reducing property taxes and
 - Funding necessary reserves.
 3. Adopt a comprehensive fund balance and reserve policy to include targeted funding levels and conditions under which reserves will be used and replenished.

Appendix A: Response From District Officials

Mr. Jeffrey A. Sortisio
Superintendent

Mr. John A. Forbes
Business Administrator

Mr. Joseph P. Reyda
Director of Instruction/CIO

Fredonia Central School District
425 East Main Street • Fredonia, New York 14063 • Phone (716) 679-1581



Ms. Amy S. Piper
Elementary Principal

Ms. Rachel A. Badger
Interim Middle School Principal

Mr. Darrin B. Paschke
High School Principal

Mrs. Kristen L. Ferro
Director of Special Education

May 9, 2018

State of New York
Office of the State Comptroller
Attn: Mr. Jeffrey Mazula, Chief Examiner
110 State Street
Albany, NY 12236

Dear Mr. Mazula:

The Fredonia Central School District (CSD) is in receipt of the draft Report of Examination by the Office of the State Comptroller for the period July 1, 2014 to November 28, 2017. The District would like to take this opportunity to thank the State Comptroller's auditors for their professionalism while completing their work in the District.

The Board of Education, Administration and Employees of Fredonia CSD work very hard to provide the best possible learning environment and educational opportunities for all students attending the district, while also financially protecting the District through times of funding uncertainties. Like all levels of audit reports the District receives, we welcome the opportunity to apply the recommendations and findings of the audit team to help improve upon our current operational practices.

The Report of Examination indicates that Fredonia CSD should develop and adopt budgets that include realistic estimates for appropriations and the amount of fund balance that will be used to fund operations. Further, the report states that overestimating utility costs, and programs and transportation for high cost special education students results in tax levies that are higher than necessary.

Fredonia CSD has routinely adopted budgets that are conservative in nature, particularly in the areas of special education and utilities. This is based upon historical review, current actual costs, and projections of future student enrollments. The Fredonia CSD has had several high costs students move into the district that were not anticipated, as well as had some leave the district that were not anticipated. Both situations can have significant impact on projected versus final appropriations. The budgeting for these areas is based on a prudent plan for worst case scenarios as one high cost student alone can generate over \$100,000 of expense. During the budget process, the District is also asked to project utility costs that go as far as 14 months into the future, without knowing what global impacts there may be to oil/fuel prices, or the type of winter weather we may need to endure.

It should be noted that since the implementation of the tax levy limit requirements in 2012-13, the District has appropriated between \$950,000 and \$1,300,000 towards the tax levy in each year, and has been at or below the NYS Tax Levy Limit in each year including the proposed 2018-19 budget. The District also recognizes that a review of past budgets versus past actual final expenditures may result in the belief that the original appropriations were more than needed. However, the District is comfortable that the original appropriations were in line with expectations in the year in which the budgets were adopted.

The audit report has also recommended the District develop a plan to reduce unrestricted fund balance to within the statutory limit and to use the excess funds in a manner that benefits District residents. This would include one-time expenditures, reducing property taxes or funding necessary reserves.

Prior to receipt of the auditors draft report and recommendations, the District had already begun to take steps to reduce the total unappropriated fund balance. In May, 2017, the District taxpayers approved the creation of a Capital Reserve Fund of up to \$500,000 to be used towards the District's forthcoming \$8,500,000 capital project. The District has already funded that reserve with \$300,000, and anticipates funding the balance of \$200,000 at the end of the 2017-18 school year. As part of the planning process

"The Fredonia Central School District and community will maintain a continuing partnership to provide an educational environment for the children of the community which will insure that all children are valued, all children learn and all children possess the knowledge and attitudes needed to reach their full potential intellectually, personally, socially and productively".

| | | | | |
|---------------------------------------|---|-------------------------------------|-----------------------------------|---------------------------------------|
| Business Office Fax (716) 673-9449 | Elementary School Fax (716) 679-9043 | Middle School Fax (716) 672-2686 | High School Fax (716) 672-8687 | District Office Fax (716) 679-1555 |
|---------------------------------------|---|-------------------------------------|-----------------------------------|---------------------------------------|

for the forthcoming capital project, the District is looking at items that are not in the final scope of the project to see if there is the possibility of a one-time purchase. The District also will be using funds as a one-time expenditure to cover a separation settlement with a District employee.

When the Board of Education adopted the proposed 2018-19 budget, the District applied additional unappropriated fund balance to reduce the proposed tax levy from 1.91% to 1.50%. The District has been and will continue to discuss the funding of other appropriate reserves at the end of the 2017-18 school year with the District's External Auditor.

The final audit recommendation was to have the District adopt a comprehensive fund balance and reserve policy to include targeting funding levels and conditions under which reserves will be used and replenished. As mentioned above, Fredonia CSD already has begun this process with the creation of the Capital Reserve Fund last year, and the on-going discussion with the External Audit firm about additional reserve options. Fredonia CSD, over the last few years, has used a service provided by Erie 1 BOCES to assist the Board of Education's Policy Committee with a review of all District policies. It is the intention of the District to have the Policy Committee review the suggested policy language with guidance from the State and Erie 1 BOCES, for final Board of Education approval.

Fredonia CSD acknowledges that it is the duty of the Office of the Comptroller to audit school districts in the state, and to make recommendations to improve accountability and financial practices. Having said that, it is also the duty of school districts in NYS to maintain solvency through careful financial planning. When NYS reduced state aid through the Gap Elimination Adjustment, Fredonia CSD was able to sustain all academic, extracurricular and athletic activities through available budgetary funds. In the absence of these funds, the district would have been faced with catastrophic cuts to staffing and elimination of numerous programs. The District needs to budget conservatively to maintain and improve current programming.

Please be advised that this letter does not represent the formal Corrective Action Plan for Fredonia CSD. The District will be submitting the plan to the Office of the Comptroller after receipt and review of the final published audit report.

Cordially,

Jeffrey A. Sortino,
Fredonia CSD Superintendent

Appendix B: 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 and reviewed policies, procedures and Board minutes to gain an understanding of the District's financial management practices.
- We analyzed appropriations and estimated revenues and compared them to actual results for the last three completed fiscal years.
- We reviewed the 2017-18 budget and used trend analysis to project operating results through year-end.
- We analyzed fund balance and assessed whether appropriated fund balance was used as budgeted. We calculated unrestricted fund balance as a percentage of the subsequent year's budget, including both appropriated fund balance and unrestricted fund balance in our calculation.
- We reviewed the District's tax levy for the last four fiscal years.
- We reviewed the reserve fund policy and reserve fund activity and evaluated each reserve for reasonableness.

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 C: 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

Office of the New York State Comptroller
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110 State Street, 12th Floor, Albany, New York 12236

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