

Iroquois Central School District

Financial Management

AUGUST 2018



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

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Report Highlights

Iroquois Central School District

Audit Objective

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

Key Findings

- Appropriations were overestimated by an annual average of \$2.3 million. As a result, appropriated fund balance, which annually averaged \$1.8 million, was not needed to finance operations.
- The Board and District officials did not transparently budget to fund a capital reserve.
- The Board did not review all reserves and District officials did not prepare an annual report of reserves, as required by the District's policy.
- The unemployment insurance reserve is overfunded (\$604,000) and the debt reserve is improperly restricting \$245,000.

Key Recommendations

- Adopt budgets with realistic, transparent estimates of appropriations and appropriated fund balance.
- Review all reserves to determine whether balances are necessary and reasonable, and use excess amounts in accordance with applicable statutes in a manner that benefits taxpayers.

District officials generally disagreed with our recommendations. Appendix B includes our comments on issues raised in the District's response.

Background

The Iroquois Central School District (District) serves the Towns of Aurora, Elma, Lancaster, Marilla and Wales in Erie County and the Town of Bennington in Wyoming County.

An elected seven-member Board of Education (Board) is responsible for the general management and control of District financial and educational affairs. 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 under the Board's direction. The Business Administrator oversees the District's business operations.

Quick Facts

| | |
|--------------------------------------|----------------|
| 2017-18 Enrollment | 2,200 |
| 2017-18 Appropriations | \$49 million |
| 2017-18 Total Beginning Fund Balance | \$11.9 million |

Audit Period

July 1, 2014 – April 3, 2018

For certain tests, we expanded our audit scope period back to July 1, 2012.

Financial Management

What Is Effective Financial Management?

The Board and District officials are responsible for developing realistic estimates of revenues, appropriations and fund balance in the annual budget and ensuring that the amount of unrestricted fund balance is in compliance with New York State Real Property Tax Law (RPTL).¹ Accurate budget estimates help ensure that the levy of real property taxes is not greater than necessary. Excess funds should be used in a manner that benefits taxpayers.

The Board and District officials should ensure that unrestricted fund balance does not exceed the amount allowed by RPTL, which currently limits unrestricted fund balance to no more than 4 percent of the next year's 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.

The Board may establish reserves to restrict a portion of fund balance that can be used for specific purposes (e.g., capital projects or retirement expenditures) 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 usage. Combining a reasonable level of unrestricted fund balance with specific legally established reserve funds provides resources for both unanticipated events and other identified or planned needs.

The Board and District Officials Did Not Adopt Realistic Budgets

We compared budgeted revenues and appropriations with actual operating results from July 1, 2014 through June 30, 2017. While revenue estimates were generally reasonable, appropriations were annually overestimated by an average of \$2.3 million, or a total of \$6.9 million. This included approximately 30 appropriation account codes that totaled from \$925,000 to \$1.1 million annually but were never used for any expenditures. These accounts included items such as: salaries, custodial and benefits.² District officials told us that they intentionally overestimated these appropriations to fund a capital reserve; however, these budgeted account codes did not contain any indication they were related to a capital reserve and, therefore, District officials did not transparently communicate their intention to taxpayers.

1 RPTL Section 1318

2 The majority of the account codes with unused appropriations include "District Wide" in the appropriation title.

Figure 1: Overestimated Appropriations

| | 2014-15 | 2015-16 | 2016-17 |
|--|--------------|--------------|--------------|
| Appropriations | \$45,021,322 | \$46,648,435 | \$47,980,609 |
| Actual Expenditures | \$43,102,566 | \$44,123,323 | \$45,530,457 |
| Overestimated Appropriations | \$1,918,756 | \$2,525,112 | \$2,450,152 |
| Percent Overestimated^a | 4.5% | 5.7% | 5.4% |

a Overestimated appropriations divided by actual expenditures

We also analyzed 2017-18 appropriations in comparison with the last three completed fiscal years of actual results and project a similar trend to continue, which District officials agreed with. As a result, we project that appropriations are overestimated by approximately \$2.4 million (4.9 percent) and the District will realize an operating surplus as of June 30, 2018. Subsequent to our onsite audit fieldwork, we obtained the District's 2018-19 budget which totaled \$51.4 million. Despite incurring an annual operating surplus in each year of our audit scope period, the 2018-19 budgeted appropriations increased by approximately 5 percent and the property tax levy increased approximately 3 percent from the 2017-18 budget. As a result, we project that a similar trend of overestimating appropriations will continue driving additional amounts of operating surplus.

Because the Board routinely overestimated appropriations, the District realized operating surpluses and as a result, appropriated fund balance amounts were not used as presented to the taxpayers in the annual budgets. Appropriating fund balance each year that is not needed to finance operations is, in effect, a reservation of fund balance that is not provided for by statute, which circumvents the statutory limit because it indicates that fund balance is lower than it actually is. As a consequence, the Board may levy more real property taxes than needed.

The overestimated appropriations contributed to annual operating surpluses totaling approximately \$3.2 million during the last three fiscal years. Additionally, although the budgets for 2014-15 through 2017-18 included appropriated fund balance that averaged approximately \$1.8 million annually, none of the appropriated fund balance was needed.³ District officials told us their goal is to use the appropriated fund balance to avoid the need for issuing short-term debt over the summer months when cash flow is lower. However, they did not prepare a cash flow analysis to demonstrate there were cash flow deficits; the District in fact had year-end unrestricted cash balances annually averaging \$4.2 million and restricted cash balances annually averaging \$10.6 million over the three fiscal years.

³ When fund balance is appropriated by the Board for the next year's budget, the expectation is that there will be a planned operating deficit equal to the amount of fund balance that was appropriated. This allows school districts to return excess fund balance that has accumulated in prior years back to the taxpayers.

The District reported unrestricted fund balance at the 4 percent limit during our audit period.

Figure 2: Reported Unrestricted Fund Balance at Fiscal Year-End

| | 2014-15 | 2015-16 | 2016-17 |
|--|---------------------|---------------------|---------------------|
| Total Beginning Fund Balance | \$15,519,024 | \$15,787,034 | \$16,473,464 |
| Operating Surplus | \$474,191 | \$1,606,211 | \$1,099,273 |
| Less: Non-Budgeted Transfers Out | \$206,181 | \$919,781 | \$8,094 |
| Less: Capital Reserve Reclassified to the Capital Projects Fund | | | \$5,700,000 |
| Total Ending Fund Balance | \$15,787,034 | \$16,473,464 | \$11,864,643 |
| Less: Reserve Funds | \$11,958,358 | \$12,171,636 | \$7,725,223 |
| Less: Nonspendable Fund Balance | \$24,010 | \$25,229 | \$28,940 |
| Less: Encumbrances | \$155,416 | \$575,277 | \$371,021 |
| Less: Appropriated Fund Balance | \$1,773,612 | \$1,773,612 | \$1,773,612 |
| Unrestricted Fund Balance | \$1,875,638 | \$1,927,710 | \$1,965,847 |
| Next Year's Budget | \$46,648,435 | \$47,980,609 | \$49,026,895 |
| Unrestricted Fund Balance as a Percentage of the Next Year's Budget | 4.0% | 4.0% | 4.0% |

However, once appropriated fund balance not needed to finance operations is added back to unrestricted fund balance, the recalculated unrestricted fund balance ranged from \$3.6 million to \$3.7 million, exceeding the 4 percent limit in each year by nearly 4 percentage points (Figure 3).

Figure 3: Recalculated Unrestricted Fund Balance

| | 2014-15 | 2015-16 | 2016-17 |
|---|-------------|-------------|-------------|
| Unrestricted Fund Balance | \$1,875,638 | \$1,927,710 | \$1,965,847 |
| Add: Appropriated Fund Balance Not Used for the Next Year | \$1,773,612 | \$1,773,612 | \$1,773,612 |
| Recalculated Unrestricted Fund Balance | \$3,649,250 | \$3,701,322 | \$3,739,459 |
| Recalculated Unrestricted Fund Balance as a Percentage of the Next Year's Budget | 7.8% | 7.7% | 7.6% |

During this same period, the Board continued to increase taxes by a total of approximately \$2.7 million (10 percent) despite recurring operating surpluses.

The Board and District Officials Did Not Properly Manage Reserves

The Board adopted a reserve fund policy that requires the Board to annually perform an analysis of the projected needs for all reserve funds for the upcoming fiscal year and funding these projected needs. The policy further requires the Board to periodically review all reserve funds and District officials to submit an annual report of all reserves to the Board.

As of June 30, 2017, the District reported 11 general fund reserves with cumulative balances totaling approximately \$7.7 million and one debt reserve⁴ totaling \$332,000. While the Board reviewed certain reserves during budget workshop meetings, it did not review all the reserves and District officials did not prepare an annual report of reserves, as required by policy, for the Board's review.

The unemployment insurance reserve,⁵ which totaled \$604,000 as of June 30, 2017, was overfunded. While the Board and District officials appropriated money from this reserve for these annual costs, this reserve had a sufficient balance to pay over 16 years of related expenditures, based on average annual expenditures of \$36,700 over the last five years. We found no significant exceptions with the remaining 10 general fund reserves⁶ totaling \$7.1 million.

Further, our previous audit⁷ identified issues with the debt reserve, which is statutorily required when there are unexpended bond proceeds. The funds must be restricted and used for related debt principal and interest payments. As of June 30, 2017, the debt reserve totaled \$332,000. As reported in our previous audit, District officials were unable to document the source or reason for restricting approximately \$130,000 in the debt reserve when there was no evidence it derived from unexpended bond proceeds. We evaluated the reserve since our last audit and found that the Board and District officials did not remove the \$130,000 from the reserve and, additionally, have since increased the balance to \$332,000, which includes approximately \$87,000 in unexpended bond proceeds that was added to the debt reserve as statutorily required. However, District officials had no explanation or documentation of why \$115,000 was added to the \$130,000 already retained in the debt reserve. As a result, the District has improperly restricted \$245,000 in this reserve which should be returned to the general fund as unrestricted fund balance.

4 Recorded in the debt service fund

5 New York State General Municipal Law (GML- Section 6m) authorizes the establishment of this reserve for payment of contributions to the New York State Unemployment Insurance Fund.

6 Two capital reserves (\$2.2 million), an employee benefit accrued liability reserve (\$1.6 million), three repair reserves (\$953,000), and reserves for retirement contribution (\$916,000), tax certiorari (\$669,000), workers' compensation (\$528,000) and insurance (\$210,000)

7 Iroquois Central School District: Financial Condition (2014M-22)

What Do We Recommend?

The Board should:

1. Adopt budgets with realistic and transparent estimates of appropriations and appropriated fund balance.
2. Review all reserves, in compliance with the policy, to determine whether balances are necessary and reasonable, and use excess amounts in accordance with applicable statutes in a manner that benefits taxpayers.

District officials should:

3. Provide the Board with an annual report as prescribed by the District's reserve policy, including descriptions of each reserve fund, dates established, funds used and an analysis of projected needs and recommendations for funding.
4. Determine the composition of the debt reserve, use any statutorily restricted money to pay related debt service and return any other money to general fund unrestricted fund balance.

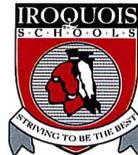
Appendix A: Response From District Officials

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August 8, 2018

Office of the New York State Comptroller
Attn: Mr. Jeffrey D. Mazula
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The Iroquois Central School District has received, and reviewed, the New York State Comptroller's Office Audit and our response and corrective actions are found below. The District appreciated the audit process and will give consideration to the guidance that the Office of the State Comptroller provided to the District.

1) Budgeting and Fund Balance

In the current fiscal climate, and the ability of New York State to withhold aid based on State financial conditions by way of the Gap Elimination Adjustment, the Iroquois Central School District must take a conservative approach to budgeting, fund balance and reserves to protect its community. While the tax cap does allow exclusions for particular expense items, it does not consider or adjust for changes in utilities, transportation contracts, health insurance, and special education. The District does budget conservatively to consider possible variations in operational expenses. Our conservative approach is discussed openly and transparently including any use of funds to support appropriated fund balance and reserves.

Through our budgeting and fund balance practices, the District has achieved a score of 3.33 on the Fiscal Stress Monitoring System Report. Our status of "No Designation" identifies Iroquois as a district with minimal fiscal stress. This low score reflects a strong financial position and allows our District to provide outstanding programs and opportunities for our students and community.

Our budgeting and financial practices have also resulted in a positive impact on our bond rating. The Iroquois Central School District recently issued a bond to support a capital project. As part of that process, the District was required to update our credit rating information with Moody's Investors Service.

The Iroquois District notes the differing opinions of the State Comptroller's office and the analysis completed by Moody's. The most recent Credit Opinion by Moody's (April 18, 2018) cited Iroquois strengths as "strong reserve levels" and "manageable debt and pension burden." They also caution the District on factors that could lead to a downgrade; specifically, a "material decline in reserve levels." The

report goes on to state, “Conservative budgetary management will continue to support the healthy financial operations of the district.” The Moody’s rating is critical in that it determines how much of our funding (taxes and state aid) will go towards interest payments in the future.

Our use of appropriated fund balance to fund the next year’s finances (typically 3.5% of budget) is a common and best practice for school districts. The Iroquois Central School District receives minimal state aid payments in July and August and tax revenues begin in September. Use of appropriated fund balance allows schools to maintain cash flow in difficult years without the need for short-term borrowing at the start of a school year. It has not been, nor is it required to be, reported as unrestricted fund balance in our annual report which is completed by an independent auditor.

See
Note 1
Page 10

2) The Board should review all reserves, in compliance with the policy, determine reasonableness.

This item is addressed in 3) District Officials should provide the Board with an annual report on reserves.

3) District Officials should provide the Board with an annual report on reserves.

The District respectfully disagrees with the audit report’s opinion on review of reserves by the Board of Education. The Board of Education is informed of reserve levels and use of reserves at various times during the year in open public session. At the Board planning sessions in July, reserves are fully reviewed and discussed by the Board and administrative staff. The District conducts multiple public Budget Work Sessions each year between January and April. At two of these sessions, reserves are presented to the Board and the public for open discussion. Reserve funding use and the impact to long-range planning is discussed. All budget presentations are available to the public and posted on the District website.

See
Note 2
Page 10

We believe the information we share on reserve levels, at planning meetings and at budget meetings, exceeds our policy guidelines in that more than one “annual report” is provided to the Board of Education and public. The District will continue to keep the Board of Education informed of reserve levels and add specific data points, including interest earned, to further comply with our policy.

The Board of Education and district administration will discuss reserve reporting and determine if any changes in procedures are needed and, if so, amend our policy to reflect the changes.

4) District Officials should provide the Board with an annual report on reserves.

We agree with the audit’s recommendation to identify debt reserve funding and develop a plan to pay related debt service or return money to the general fund. The District has begun this process by appropriating \$30,000 from the debt reserve to fund debt service payments in the 2018-19 budget. This appropriation was shared with community members in our budget presentations for 2018-19. We will continue to appropriate debt reserve funds for statutorily approved uses, in a manner consistent with our long-term planning.

In summary, The Iroquois Central School District was able to maintain consistent programs and staffing through periods of inconsistent state aid funding by maintaining conservative budgets and strong reserves.

We agree on many points in Thomas P. DiNapoli’s Report on the State Fiscal Year 2018-19, Enacted Budget Financial Plan and Capital Program and Financing Plan (July 2018). It is not a question of *if* the State will go through an economic downturn, it is a question of *when*. New York State successfully created a tool to quickly and uniformly cut education spending in response to an economic downturn when the Gap

Elimination Adjustment was created. When considering long-term financial plans, we believe that the State will again implement a Gap Elimination Adjustment when an economic downturn or catastrophic event hits New York State. We share the concern about New York's fiscal outlook presented in the Comptroller's report.

We will continue our belief that saving for capital projects and planning for the unexpected will provide consistent programs in our schools, increase the value of our educational programs and minimize the long-term tax impact on our residents.

Sincerely,

Douglas R. Scofield
Superintendent
Iroquois Central School District

Appendix B: OSC Comments on the District's Response

Note 1

Because the Board and District officials routinely overestimated appropriations, the District realized operating surpluses. As a result, appropriated fund balance amounts were, in fact, not used to fund the next year's finances as presented to the taxpayers in the annual budgets.

Note 2

The Board's meeting minutes did not reflect that the Board performed an annual analysis of the projected needs and funding methods for all reserve funds, in accordance with the adopted reserve policy.

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 the Board and District officials and reviewed budgeting and reserve policies and procedures to gain an understanding of the budgeting process and financial management processes and procedures; including the rationale for determining the levels to maintain for unrestricted fund balance and reserves.
- We calculated unrestricted fund balance as a percentage of the next year's appropriations to determine whether the District was within the statutory limit during 2014-15 through 2016-17.
- We added unused appropriated fund balance to unrestricted fund balance to determine whether the recalculated unrestricted fund balance exceeded the statutory limit during the last three years.
- We analyzed the District's budget over the last three years by comparing budgeted revenues and appropriations to actual revenues and expenditures to determine whether estimates were reasonable. We also obtained the District's 2018-19 budget subsequent to the completion of our onsite audit fieldwork and compared the budgeted revenues and appropriations to the budgets over the last three years to determine whether the budget was similarly estimated.
- We analyzed the trend in fund balance over the last three years by comparing appropriated fund balance to the operating results to determine whether appropriated amounts were actually used.
- We interviewed District officials to determine whether they performed a cash flow analysis.
- We analyzed the District's use of, and balances maintained in, reserves during the last five years to determine whether balances were excessive by reviewing related reserve expenditures and liabilities.
- We reviewed the real property tax levy to determine whether it changed over the past four years.

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 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#lgmg

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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