



North Collins Central School District Financial Management

Report of Examination

Period Covered:

July 1, 2012 – February 9, 2016

2016M-189



Thomas P. DiNapoli

Table of Contents

	Page
AUTHORITY LETTER	1
INTRODUCTION	2
Background	2
Objective	2
Scope and Methodology	2
Comments of District Officials and Corrective Action	3
FINANCIAL MANAGEMENT	4
Budgeting and Fund Balance	4
Reserves	6
Recommendations	9
APPENDIX A Response From District Officials	11
APPENDIX B Audit Methodology and Standards	13
APPENDIX C How to Obtain Additional Copies of the Report	14
APPENDIX D Local Regional Office Listing	15

State of New York Office of the State Comptroller

Division of Local Government and School Accountability

August 2016

Dear School District Officials:

A top priority of the Office of the State Comptroller is to help school district officials manage their districts efficiently and effectively and, by so doing, provide accountability for tax dollars spent to support district operations. The Comptroller oversees the fiscal affairs of districts statewide, as well as districts' compliance with relevant statutes and observance of good business practices. This fiscal oversight is accomplished, in part, through our audits, which identify opportunities for improving district operations and Board of Education governance. Audits also can identify strategies to reduce district costs and to strengthen controls intended to safeguard district assets.

Following is a report of our audit of the North Collins Central School District, entitled Financial Management. This audit was conducted pursuant to Article V, Section 1 of the State Constitution and the State Comptroller's authority as set forth in Article 3 of the New York State General Municipal Law.

This audit's results and recommendations are resources for district officials to use in effectively managing operations and in meeting the expectations of their constituents. If you have questions about this report, please feel free to contact the local regional office for your county, as listed at the end of this report.

Respectfully submitted,

*Office of the State Comptroller
Division of Local Government
and School Accountability*

Introduction

Background

The North Collins Central School District (District) is located in the Towns of North Collins, Collins, Concord, Brant, Eden and Evans in Erie County. The District is governed by the Board of Education (Board), which is composed of seven elected members. The Board is responsible for the general management and control of the District's financial and educational affairs. The Superintendent of Schools is the District's chief executive officer and is responsible, along with other administrative staff, for the day-to-day management of the District under the Board's direction. The Superintendent began his current role with the District in January 2016.

The District operates two schools with approximately 590 students and 95 employees. The District's budgeted appropriations for the 2015-16 fiscal year were \$15.5 million, which were funded primarily with State aid, real property taxes and sales tax.

The Board and District officials did not correct all the deficiencies that were identified in our previous audit (issued in January 2009), which included findings of the Board's monitoring of its budget process and the Board's establishment and maintenance of reserve funds.¹ Many of the findings discussed in this prior audit were not addressed and corrected by the Board and District officials and, as a result, are reported again in this audit.

Objective

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

- Did the Board and District officials adopt reasonable budgets and ensure fund balance and reserves were managed in accordance with statutes?

Scope and Methodology

We examined the District's management of financial activities for the period July 1, 2012 through February 9, 2016. We also examined certain reserve documentation back to March 2004.

We conducted our audit in accordance with generally accepted government auditing standards (GAGAS). More information on such standards and the methodology used in performing this audit are included in Appendix B of this report.

¹ *North Collins Central School District – Internal Controls Over Selected Financial Operations (2008M-127)*

**Comments of
District Officials and
Corrective Action**

The results of our audit and recommendations have been discussed with District officials, and their comments, which appear in Appendix A, have been considered in preparing this report. District officials generally agreed with our recommendations and indicated they plan to initiate corrective action.

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

Financial Management

The Board and Superintendent are responsible for adopting budgets that contain estimates of actual and necessary expenditures that are funded by realistic revenues. Sound budgeting provides sufficient funding for necessary operations. Once the Board has addressed those issues, any remaining fund balance, exclusive of the amount allowed by law to be retained to address cash flow and unexpected occurrences, should be used to reduce the property tax levy. A school district may retain a portion of fund balance, referred to as unrestricted fund balance, but must do so within the legal limits established by New York State Real Property Tax Law (RPTL). RPTL limits the amount of unrestricted fund balance to no more than 4 percent of the subsequent year's budget.

Prudent fiscal management includes establishing reserves needed to address long-term obligations or planned future expenditures. A school district can legally set aside and reserve portions of fund balance to finance future costs for a variety of specified objects or purposes. The Board should fund reserves appropriately, monitor reserve amounts and use them as intended for the related expenditures.

The Board and District officials did not adopt reasonable budgets or ensure that fund balance and reserves were managed in accordance with statutes. From fiscal years 2012-13 through 2014-15, the District overestimated appropriations in the adopted budget by approximately 12 percent each year. The District has also appropriated approximately \$1.5 million of fund balance and reserves annually as a financing source in the annual budget, which was not fully used. This practice allowed the District to circumvent the 4 percent statutory limit imposed on the level of unrestricted fund balance.

However, when adding back the unused appropriated fund balance, recalculated unrestricted fund balance for each year ranged from \$1.4 million (9 percent of the ensuing year's appropriations) to \$1.6 million (10 percent of the ensuing year's appropriations), exceeding the allowable limit. Although recalculated fund balance levels consistently exceeded the limit through June 30, 2015 and are projected to continue to do so through June 30, 2016, District officials continued to raise the tax levy every year, totaling more than \$360,000 or 8 percent over the last four years.

Budgeting and Fund Balance

The Board and District management are responsible for developing realistic estimates of revenues, appropriations and the use of fund balance and reserves in the annual budget, as well as ensuring that the amount of unrestricted fund balance is in compliance with RPTL.

Accurate budget estimates help ensure that the levy of real property taxes is not greater than necessary.

We compared budgeted revenues and appropriations with actual results of operations from July 1, 2012 through June 30, 2015 and found that the Board and District officials did not consistently ensure that budget estimates for appropriations were reasonable. While the District generally estimated revenues accurately, certain budgeted appropriations were consistently overestimated. As a result, during this period, District officials overestimated appropriations by an average of approximately \$1.7 million, or 12 percent annually. The majority related to an improper use of a contingency account within the budget annually averaging \$700,000. School districts are not permitted to include contingency accounts in the annual budgets. The District also overestimated appropriations for custodial operations (\$300,000 or 15 percent) and employee benefits (\$245,000, or 10 percent).

We also analyzed the 2015-16 budgeted revenues and appropriations in comparison with the last three completed fiscal years of actual results and project a similar trend to continue. As a result, the District is projected to end 2015-16 with revenues reasonably estimated and appropriations overestimated by approximately \$1.7 million, or 11 percent of total budgeted appropriations.

The District has reported unrestricted fund balance at or near the 4 percent limit in all three years of our audit period, as indicated in Figure 1.

Figure 1: Unrestricted Fund Balance at Year-End			
	2012-13	2013-14	2014-15
Beginning Fund Balance	\$5,890,000	\$6,040,000	\$5,940,000
Add: Operating Surplus/(Deficit)	\$150,000	(\$280,000)	(\$30,000)
Ending Fund Balance	\$6,040,000	\$5,760,000	\$5,910,000
Less: Appropriated Fund Balance	\$1,020,000	\$1,020,000	\$1,020,000
Less: Reserved Fund Balance	\$4,400,000	\$4,260,000	\$4,310,000
Unrestricted Fund Balance at Year-End	\$620,000	\$480,000	\$580,000
Ensuing Year's Budget	\$14,860,000	\$15,210,000	\$15,510,000
Reported Unrestricted Fund Balance as a Percentage of Ensuing Year's Budget	4%	3%	4%

The District appropriated an average of \$1 million in fund balance and \$676,000 in reserves as a financing source for the annual budgets in fiscal years 2012-13 through 2015-16. This made it appear that unrestricted fund balance was within the statutory limit. However, due to the overestimated appropriations, the District did not use all of the fund balance and reserves that were appropriated. Instead, the District used fund balance totaling \$310,000 (10 percent). When

unused appropriated fund balance was added to unrestricted fund balance, recalculated unrestricted fund balance exceeded the limit in all three years. Recalculated fund balance totals ranged from approximately \$1.4 million (9 percent) to \$1.6 million (10 percent), as indicated in Figure 2.

During 2014-15, the District appropriated fund balance totaling approximately \$1 million and \$600,000 in reserves for the 2015-16 budget. However, we project that the District will end the year with an operating surplus and, as a result, the appropriated amounts will not be needed. As such, we expect the recalculated unrestricted fund balance will continue to exceed the statutory limit.

Figure 2: Unused Fund Balance			
	2012-13	2013-14	2014-15
Unrestricted Fund Balance at Year-End	\$620,000	\$480,000	\$580,000
Add: Appropriated Fund Balance Not Used to Fund Ensuing Year's Budget	\$740,000	\$990,000	\$1,020,000
Recalculated Unrestricted Fund Balance	\$1,360,000	\$1,470,000	\$1,600,000
Recalculated Unrestricted Fund Balance as a Percentage of Ensuing Year's Budget	9%	10%	10%

The Board and District officials continued to increase taxes by approximately \$360,000 despite apparently having sufficient resources to fund ongoing operations. To illustrate, if the tax levy had not been increased during the last three years, but remained at the same level as in 2012-13 (approximately \$4.9 million), residents could have realized approximately \$800,000 in cumulative savings.

We also reviewed the District's 2016-17 adopted budget, which is similar to previous years' budgets. District officials increased revenues and appropriations by 5 percent and appropriated approximately \$1 million in fund balance to finance operations. While the District did not increase the 2016-17 tax levy from 2015-16, we still anticipate the District will have another operating surplus and will not need the entire amount appropriated.

Reserves

School districts may establish reserve funds to finance a variety of objects or purposes but must do so in compliance with statutory requirements. When school districts establish reserves for specific purposes, it is important that they develop a formal written plan or policy for how to fund the reserves, how much should be accumulated in the reserves and when the money will be used to finance related costs. Such a plan serves to guide a school district in the accumulation and use of reserves and to inform residents about the use of their tax money, increasing transparency. Funding reserves at greater than reasonable levels contributes to real property tax levies that are higher than necessary because the excessive reserve balances are not being used to fund related expenditures.

As of June 30, 2015, the District reported eight reserves in the general fund totaling \$4.3 million and one reserve in the debt service fund totaling approximately \$1.3 million. We analyzed the reserves to ensure they were properly established, reasonably funded and adhered to statutory requirements. We found that the District does not have established plans regarding the future purpose, use and replenishment of funds for any of the reserves. Based on correlating expenditures, the employee benefit accrued liability (\$442,000), retirement contribution (\$350,000), property loss (\$93,000) and liability (\$31,000) reserves appear reasonably funded. However, without an established plan, it is unclear what the Board's intention is for the amounts restricted in these reserves.

The remaining four general fund reserves totaling approximately \$3.4 million and the debt reserve totaling approximately \$1.3 million were either not properly funded or established, appeared overfunded or were not being used for related expenditures. In our prior audit, we also reported similar findings that certain reserves were not properly established or were overfunded and that the debt reserve was not being used.

Capital Reserves – Education Law authorizes the establishment of these reserves to pay the cost of any object or purpose for which bonds may be issued. Establishment of these reserves requires voter approval. The proposition that is voted upon must specify the purpose of the reserve, the maximum amount to be funded, the probable term and the source from which the funds are to be obtained. Voter approval is also required for the use of these reserves. The District maintains two capital reserves. As of June 30, 2015, the District reported a balance of \$1 million in the roof repair/replacement and other capital improvements reserve and approximately \$971,000 in the bus and vehicle replacement reserve.

The District properly established the roof repair/replacement and other capital improvements reserve in 2004 at a maximum funding of \$1.25 million and a probable term of 10 years. Beginning with the establishment of the reserve, through 2011-12, the District transferred a total of \$2.15 million to this reserve, overfunding it by \$900,000. Since establishing this reserve, the District has made certain expenditures that were properly approved by the voters. As a result, the remaining balance as of June 30, 2015 is approximately \$1 million, of which the majority (\$900,000) is overfunded. If voters determine that the original purpose for which the capital reserve was established is no longer needed, the reserve may be liquidated by first applying its proceeds to any related outstanding indebtedness and then applying the balance, if any, to the annual tax levy.²

² The District should consult with legal counsel prior to liquidating or removing funds from the reserve.

The District could not provide support that the bus and vehicle replacement reserve was properly approved by the voters. As such, the District could not demonstrate what the reserve's maximum funding or probable term are. District officials improperly used this reserve as a rolling capital reserve and indicated that funds from this reserve are regularly used for the purchase of new buses to maintain the fleet on a rotating schedule. The District properly obtains voter approval prior to spending from this reserve.

On average, the District spends approximately \$160,000 annually on vehicles. The District continues to replenish the reserve after purchases are made and has deposited \$2.1 million into this reserve since fiscal year 2007-08 and used \$1.26 million for the purchase of vehicles. While District officials indicate they replenish the reserve to continue the replacement schedule, the Board minutes to approve transfers to the reserve indicate that they are made to reduce the unassigned fund balance (i.e., unrestricted fund balance) to comply with the established RPTL limitation. As a result, the remaining \$970,000 in this reserve has been improperly restricted without voter approval.³

Debt Reserve – Unexpended bond proceeds from completed capital projects and related interest income earned on this money must be used to help finance related debt service costs.⁴ Resources restricted for the payment of debt service should be reported in the debt service fund. The District reported a debt reserve of approximately \$1.3 million as of June 30, 2015, funded primarily by leftover debt proceeds from a capital project in 2001. The District began appropriating funds from the reserve to the general fund for debt payments. However, while the District budgeted to appropriate a total of \$1.2 million from this reserve during our audit period, it actually transferred approximately \$380,000 (32 percent). The District does not have a documented plan to use the debt reserve to pay off related debt other than continuing its previous practice of appropriating reserves, which historically have not been entirely used.

Repair Reserve – General Municipal Law (GML) authorizes the establishment of a repair reserve for certain repairs to capital improvements or equipment that must not occur annually or at shorter intervals. Voter authorization is required to fund this reserve. The District maintains a repair reserve that was established in 2009. However, the Board has not indicated a level of funding or plan for the use of the reserve. The resolution establishing the reserve

³ The reported balance in this reserve as of June 30, 2007 was approximately \$113,000. Interest totaling approximately \$13,000 was also added to the reserve from July 1, 2007 through June 30, 2015.

⁴ See New York State Local Finance Law.

indicates that the funding shall be determined as part of the District's overall plan to comply with the RPTL limitation for unrestricted fund balance. As a result, the Board has not properly funded the reserve in accordance with statute. The District maintained the reserve at approximately \$1.2 million with no activity other than interest earned during our audit period. With no plan for funding the reserve or using the funds, it is also unclear if the level of funding is appropriate.

Unemployment Insurance Reserve – GML authorizes the establishment of this reserve to reimburse the New York State Unemployment Insurance Fund for payments made to claimants on the District's behalf. If there are excess amounts after claims are paid and pending claims are considered, the Board can transfer all or part of the excess amounts to certain other reserve funds or apply all or part of the excess to the next year's budget appropriation.

The balance of this reserve as of June 30, 2015 was approximately \$223,000. While the District incurred unemployment costs totaling \$36,000 from 2012-13 through 2014-15, these expenditures were paid from the general fund as routine operating costs. If unemployment costs continue to average \$12,000 per year, the reserve would last for more than 18 years. Therefore, we question the reasonableness of the amount in this reserve.

Recommendations

The Board and District officials should:

1. Develop realistic estimates of appropriations and the use of fund balance and reserves in the annual budgets to avoid raising more real property taxes than necessary.
2. Discontinue the use of a contingency account within the annual budget.
3. Develop a written policy indicating how much money will be reserved, how each reserve will be funded and when the balances will be used to finance related costs.
4. Review all reserves at least annually to determine if the amounts reserved are necessary and reasonably funded and use the excess amounts in reserve funds, in accordance with applicable statutory provisions, in a manner that benefits the District's residents. Such use could be a financing source for:
 - Funding one-time expenditures;
 - Funding needed reserves; and
 - Reducing District property taxes.

5. Ensure that capital reserves are properly used in accordance with statute.
6. Consult with legal counsel and take appropriate remedial action to properly ratify the capital reserve for bus and vehicle replacement.
7. Use debt reserve funds to pay related debt service as required.
8. Submit a proposition to District residents to obtain voter approval on the funds in the repair reserve.

APPENDIX A

RESPONSE FROM DISTRICT OFFICIALS

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



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Chief Information Officer

DEBRA L. RANDALL
Director of Special Education

July 22, 2016

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

Dear Mr. Mazula,

The North Collins Central School District is in receipt of the Draft Financial Management Condition Report (period covered: July 1, 2012 - February 9, 2016). On behalf of the North Collins Central School District, I would like to thank your office staff for the time, effort, insight and expertise provided through the process. The District does not dispute the findings of the report. We are in the process of preparing a Corrective Action Plan, which will take into consideration the audit recommendations.

The North Collins Central School District prides itself on providing an education that allows our students to reach their full potential in a supportive community. We thank you for the recommendations provided, which will help to strengthen our financial operations, resulting in the continuous support of student learning.

Sincerely,

Scott J. Taylor
Superintendent

APPENDIX B

AUDIT METHODOLOGY AND STANDARDS

To achieve our audit objective and obtain valid evidence, we performed the following procedures:

- We interviewed District officials to gain an understanding of the District's financial management practices.
- We reviewed the Board's meeting minutes and the District's policies and procedures regarding financial management, including annual budgets, Board oversight and responsibilities, and establishing, funding and maintaining reserves.
- We analyzed 2012-13, 2013-14 and 2014-15 budgeted appropriations and revenues and compared them to actual results. We calculated operating surpluses or deficits and identified significant variances.
- We reviewed the 2015-16 budget and compared it to the 2012-13, 2013-14 and 2014-15 budgets. We documented significant trends and analyzed for projected future trends.
- We analyzed fund balance for 2012-13, 2013-14 and 2014-15 and compared it with ensuing years' budgets to calculate unrestricted fund balance as a percentage in comparison with the statutory limit. We also recalculated unrestricted fund balance by including appropriated fund balance not needed as a financing source.
- We identified all reserves in place during the last three years and requested substantiation from District officials to determine if each reserve was established and maintained properly and if the reserve balances were reasonable. We extended our review of the roof repair/replacement and other capital improvements reserve back to March 24, 2004 and the bus and vehicle replacement reserve back to July 1, 2007.
- We projected the amount of unrestricted fund balance that would be available if the District did not increase the tax levy during 2013-14, 2014-15 and 2015-16 but maintained the same amount as the levy in 2012-13.

We conducted this performance audit in accordance with GAGAS. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

APPENDIX C

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