

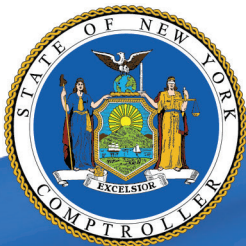
# North Warren Central School District

## Financial Condition Management

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JANUARY 2018

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

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# Report Highlights

## North Warren Central School District

### Audit Objective

Determine whether District officials effectively managed general fund balance.

### Key Findings

- The District's budgets included appropriated fund balance that was not used as planned to fund operations. The budgets overestimated appropriations by approximately \$2.9 million or 6 percent from 2013-14 through 2016-17.
- Unrestricted fund balance increased to almost \$2.26 million or 17 percent of the ensuing year's budgeted appropriations, exceeding the statutory limit by 13 percentage points.
- Tax certiorari and unemployment insurance reserves are overfunded.

### Key Recommendations

- Adopt realistic annual budgets based on historical or other known trends and use appropriated fund balance to fund operations.
- Use surplus funds as a financing source to fund one-time expenditures and needed reserves or reduce District property taxes.
- Review all reserves to determine whether the amounts retained are necessary and reasonable.

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

### Background

The North Warren Central School District (District) is located in the counties of Warren and Essex.

The District is governed by a 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 (Superintendent) is responsible for the day-to-day management of the District. The Superintendent is also responsible for budget development and administration, and is assisted by the Business Manager with these responsibilities.

#### Quick Facts

Employees	130
Enrollment	519
2017-18 Appropriations	\$13.3 million

### Audit Period

July 1, 2013 – May 31, 2017

# Financial Condition Management

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## **What is Effective Financial Condition Management?**

To effectively manage a district's financial condition, a board must adopt realistic and structurally balanced budgets based on historical data or known trends, in which recurring revenues finance recurring expenditures and reasonable levels of fund balance are maintained. A district may retain a portion of fund balance, referred to as unrestricted fund balance to provide cash flow and a cushion against unforeseen events.

Districts should ensure that unrestricted fund balance does not exceed the amount allowed by New York State Real Property Tax Law, which currently limits unrestricted fund balance to no more than 4 percent of the following year's appropriations. Any unrestricted fund balance over this percentage must be used to reduce the real property tax levy by appropriating fund balance to lower the unrestricted fund balance. When fund balance is appropriated to finance operations, the District is budgeting for a 'planned operating deficit' equal to the amount of fund balance appropriated.

Districts are legally allowed to reserve portions of fund balance to finance future costs (e.g., capital projects or retirement expenditures). District officials should ensure that reserve balances do not exceed the amount necessary to address long-term obligations or planned expenditures. The Board should adopt a reserve policy, which is a formal written plan that indicates how the reserves will be funded, how much should be accumulated in the reserves and when the money will be used to finance related costs.

While school districts are generally not limited as to how much money can be held in reserves, the balances should be reasonable. The Board should balance the intent for accumulating money for future identified needs with the obligation to ensure that the District's real property tax levy is not greater than necessary.

## **Unrestricted Fund Balance Exceeded the Statutory Limit**

District officials need to improve their budgeting practices and more effectively manage the District's fund balance. While District officials appropriated fund balance annually to finance operations, none of the appropriated fund balance was actually used to finance operations in 2014-15, 2015-16, and 2016-17. The District did incur an operating deficit in 2013-14, however it only used \$154,793 of the \$500,000 appropriated fund balance. The District realized an operating surplus of \$904,663 in 2016-17, which will result in an unrestricted fund balance of approximately \$2.26 million, or 17 percent of the 2017-18 budgeted appropriations and exceed the statutory limit by about 13 percentage points.

When fund balance is appropriated as a funding source, it reduces the fund balance subject to the statutory limit. Although District officials appropriated fund balance each year, the fund balance was not always used because the officials overestimated appropriations. We compared the District’s budgeted revenues and appropriations with actual results of operations from 2013-14 through 2016-17 to determine whether the estimates were reasonable. While revenue estimates were reasonable, District officials presented, and the Board approved, budgets that overestimated appropriations by a total of approximately \$2.9 million or 6 percent over the four-year period.

**Figure 1: Overestimated Appropriations**

	2013-14	2014-15	2015-16	Unaudited 2016-17	Total
<b>Appropriations</b>	\$12,593,675	\$12,823,613	\$12,923,694	\$13,006,285	\$51,347,267
<b>Actual Expenditures</b>	\$12,073,281	\$12,276,206	\$12,081,434	\$12,006,832	\$48,437,753
<b>Overestimated Appropriations</b>	\$520,394	\$547,407	\$842,260	\$999,453	\$2,909,514
<b>Percentage Overestimated</b>	4.3%	4.5%	7.0%	8.3%	6.0%

While overestimated appropriations are not significant in any particular year, there is a trend of increasing total overestimation, with certain individual accounts being materially overestimated.

We analyzed all expenditure accounts to determine whether the budget estimates were reasonable based on prior years’ actual expenditures and the District’s current needs. Overestimated appropriations were spread among numerous accounts throughout the budgets. The most significant overestimations in fiscal year 2015-16 appropriations were:

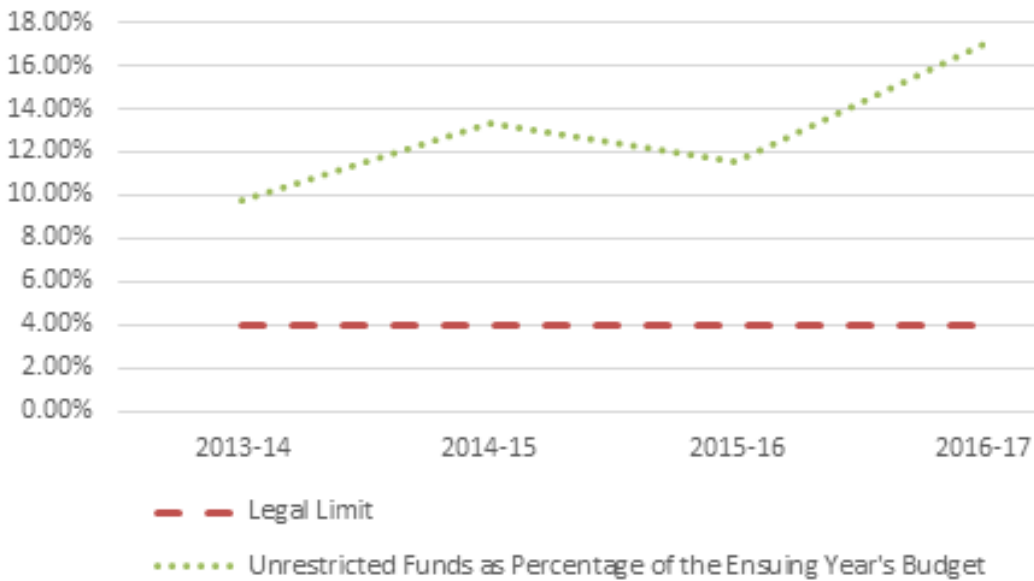
- Operation of plant – \$247,695 (32 percent), this included overestimations of fuel oil cost by \$128,030 (75 percent) and electricity by \$88,215 (53 percent).
- Transportation services – \$123,528 (15 percent), this included overestimations of gasoline cost by \$39,005 (46 percent) and repair parts by \$16,329 (25 percent).

In the 2016-17 fiscal year these items were again overestimated. Fuel oil cost were overestimated by approximately \$90,000 (58 percent); electricity cost by approximately \$80,000 (50 percent); and repair parts by approximately \$26,000 (38 percent). Because appropriations were overestimated, the District realized operating surpluses from 2014-15 through 2016-17. As a result, total fund balance increased and the District’s unrestricted fund balance exceeded the 4 percent statutory limit by 5.8 to 13.0 percentage points.<sup>1</sup>

<sup>1</sup> Detail behind Figure 2 is found in Figure 4 in Appendix A.

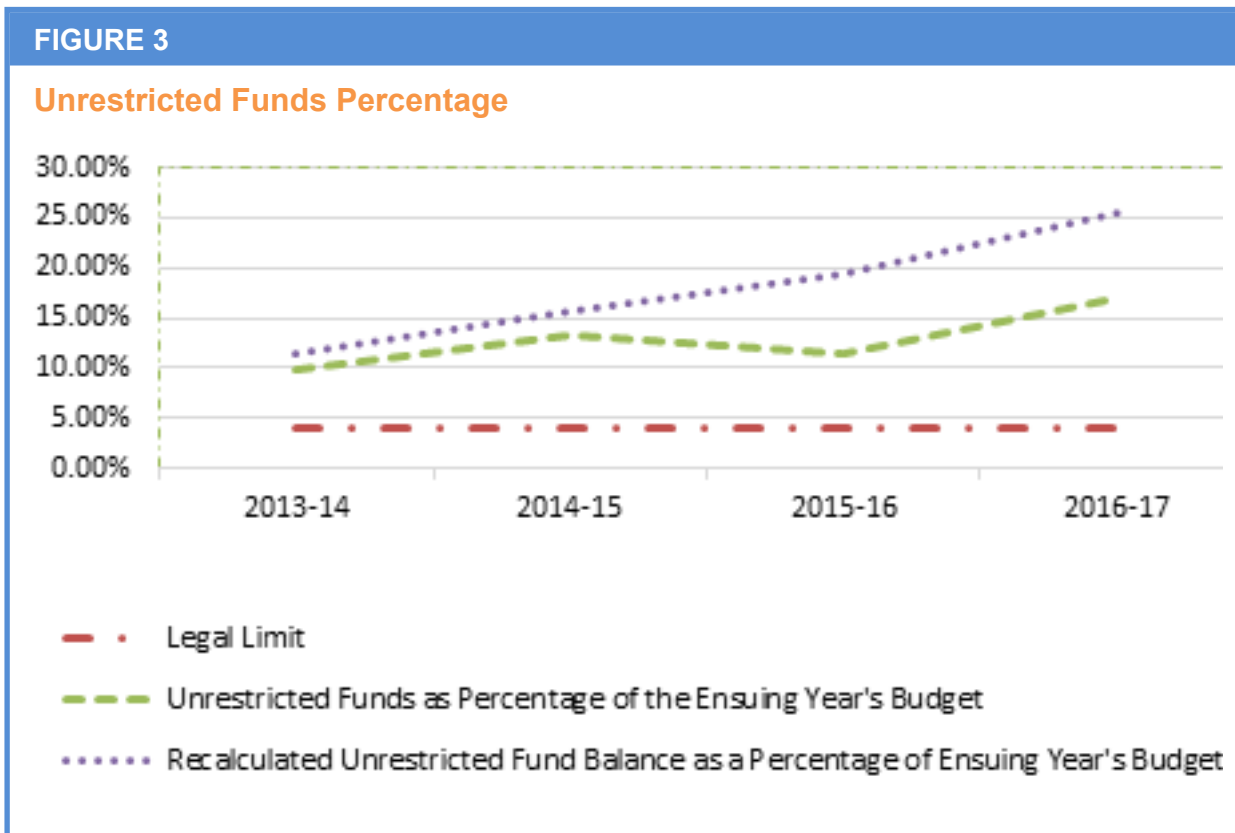
FIGURE 2

Unrestricted Funds Percentage



The District's practice of appropriating fund balance each year that was not needed to finance operations is, in effect, a reservation of fund balance that is not provided for by statute and is a circumvention of the statutory limit. District officials also misclassified a portion of fund balance as non-spendable rather than additional unrestricted fund balance. Non-spendable fund balance typically consists of assets considered non-spendable in the current period because of their form or because they must be maintained intact. Items in non-spendable fund balance typically include inventories, long-term portions of loans, financial assets held for resale and principal of endowments. We determined the District incorrectly classified \$786,939 and \$839,421 as non-spendable fund balance respectively as of June 30, 2016 and 2017. The amounts represented cash in the general fund that had been temporarily advanced to the capital project fund. However, this is not an appropriate classification because the advances will be repaid once State Aid is received and used to satisfy current liabilities. As such, the advance is an interfund receivable and should be considered a current asset and classified as unrestricted fund balance.

As shown in Figure 3, when unused appropriated fund balance and misclassified non-spendable fund balance is added back, the unrestricted fund balance actually exceeded the 4 percent statutory limit by amounts ranging from 7.4 to 21.4 percentage points.<sup>2</sup>



We also reviewed the District's adopted 2017-18 budget totaling approximately \$13.3 million and found while estimated revenues are reasonable, appropriations continue to be overestimated. For example, appropriations for fuel oil and electricity expenditures were consistent with prior year estimates and the appropriation for repair parts also increased. In addition, the Board again appropriated \$275,000 in fund balance to help finance operations in the 2017-18 budget even though it will likely not be needed. As a result, fund balance will likely increase by approximately the same amount, rather than decrease as budgeted by District officials.

<sup>2</sup> Detail behind Figure 3 is found in Figure 4 in Appendix A.

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The Board was aware of the excess amount of unrestricted fund balance the District accumulated but has not adopted a written plan to reduce this excess. However, the Superintendent indicated the District is currently in the process of reviewing the school building for future capital projects to repair and update the aging infrastructure that will likely require the future use of fund balance.

## Two Reserves Are Overfunded

As of June 30, 2017, the District reported four general fund reserves (unemployment insurance, tax certiorari, capital and repair) with balances totaling approximately \$2.8 million. We examined the District's plans for funding and using these reserves. We did not find any significant concerns with the capital and repair reserves since the District has pending projects to use those funds. However, we had the following concerns with the tax certiorari and unemployment reserves:

- The Board established a tax certiorari reserve<sup>3</sup> in 2004 to pay judgments and claims in tax certiorari proceedings. The balance as of June 30, 2017 was \$190,416. The District has maintained this reserve even though there have not been any recent judgments or claims against the District. The District last used funds from this reserve eight years ago.
- The Board established an unemployment reserve to fund reimbursement to the New York State Unemployment Insurance Fund for claims filed. The balance as of June 30, 2017 was \$21,337, sufficient to cover almost 6 years of unemployment costs which average \$2,656 over the past three years. The District has not used any reserve funds to pay for these expenditures and instead paid them from annual budgeted appropriations.

Had the District developed a written reserve fund policy that describes a maximum funding level and the planned use of the reserves, they might have ensured that reserve balances did not exceed the amount necessary to address long-term obligations or planned expenditures.

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<sup>3</sup> A tax certiorari reserve can be established to pay judgments and claims in tax certiorari proceedings in accordance with the RPTL. The total amount in this reserve fund may not exceed the amount that might reasonably be deemed necessary to meet anticipated tax certiorari judgments and claims. Balances in tax certiorari reserves must be supported by actual certiorari challenges lodged in the year the money is deposited in the reserve.



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## What Do We Recommend?

The Board and District officials should:

1. Adopt annual budgets which are realistic based on historical trends or other known factors and use appropriated fund balance to fund operations.
2. Ensure that interfund loans are properly reported in the accounting records.
3. Adopt a written plan to reduce the excess amount of unrestricted fund balance. Surplus funds can be used as a financing source for:
  - Funding one-time expenditures.
  - Funding needed reserves.
  - Reducing District property taxes.
4. Review all reserves at least annually to determine whether the amounts reserved are necessary and reasonable, and use excess amounts in accordance with applicable statutes in a manner that benefits residents.
5. Adopt a written reserve fund policy that includes how the reserves will be funded, the optimal funding levels for each reserve and the conditions under which reserves will be used to finance related costs.

# Appendix A: Fund Balance Charts

**Figure 4: Unrestricted Fund Balance at Year End**

	2013-14	2014-15	2015-16	Unaudited 2016-17
<b>Total Beginning Fund Balance</b>	\$5,026,624	\$4,871,831	\$5,001,035	\$5,507,618
<b>Prior Period Adjustment</b>		(\$32,993) <sup>a</sup>		
<b>Add: Operating Surplus/(Deficit)</b>	(\$154,793)	\$162,197	\$506,583	\$904,663
<b>Total Year-End Fund Balance</b>	\$4,871,831	\$5,001,035	\$5,507,618	\$6,412,281
<b>Less: Non-Spendable Fund Balance</b>	\$178,749	\$209,380	\$996,318	\$1,048,801
<b>Less: Restricted and Assigned Funds</b>	\$3,107,673	\$2,789,570	\$2,770,797	\$2,824,146
<b>Less: Appropriated Fund Balance for the Ensuing Year</b>	\$350,000	\$300,000	\$250,000	\$275,000
<b>Total Unrestricted Funds at Year-End</b>	\$1,235,409	\$1,702,085	\$1,490,503	\$2,264,334
<b>Ensuing Year's Budgeted Appropriations</b>	\$12,550,000	\$12,758,293	\$13,006,285	\$13,300,785
<b>Unrestricted Funds as Percentage of the Ensuing Year's Budget</b>	9.8%	13.3%	11.5%	17.0%

a Adjustment for error identified in the annual independent audit.

**Figure 5: Unused Fund Balance**

	2013-14	2014-15	2015-16	Unaudited 2016-17
<b>Unrestricted Fund Balance at Year-End</b>	\$1,235,409	\$1,702,085	\$1,490,503	\$2,264,334
<b>Add: Misclassified Non-Spendable Fund Balance</b>	\$0	\$0	\$786,939	\$839,421
<b>Add: Appropriated Fund Balance Not Used to Fund Ensuing Year's Budget</b>	\$195,207	\$300,000	\$250,000	\$275,000
<b>Recalculated Unrestricted Fund Balance at Year-End</b>	\$1,430,616	\$2,002,085	\$2,527,442	\$3,378,755
<b>Recalculated Unrestricted Fund Balance as a Percentage of Ensuing Year's Budget</b>	11.4%	15.7%	19.4%	25.4%

## Appendix B: Response From District Officials

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January 9, 2018

NYS Office of the State Comptroller  
Division of Local Government and School Accountability  
[REDACTED]  
One Broad Street Plaza  
Glens Falls, New York 12801

Re: North Warren Central School Audit  
2017M-197

Dear [REDACTED]

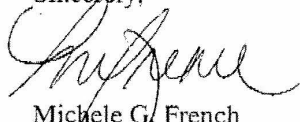
In response to audit on Financial Condition Management, the district would like to address the key findings and how we will respond to the recommendations stated in the audit.

The Board of Education is currently preparing the 2018-2019 budget, paying particular attention to the reduction of the over estimations mentioned in the audit. We will be working to adopt a more realistic annual budget for this upcoming year based on historical data of expenditures while addressing the current needs of the district.

The Board of Education is prioritizing upcoming capital projects and expenditures and will utilize surplus funds as well as existing reserve funds in order to support these priorities. The BOE will also continue to appropriate surplus funds to reduce property taxes.

The Board of Education will review all district reserves to determine their necessity and future use and will review policies related to reserves in order to establish proper funding levels.

Sincerely,

  
Michele G. French  
Superintendent

## Appendix C: Audit Methodology and Standards

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We conducted this audit pursuant to Article V, Section 1 of the State Constitution and the State Comptroller's authority as set forth in Article 3 of the New York State General Municipal Law. To achieve the audit objective and obtain valid audit evidence, we performed the following audit procedures:

- We interviewed the Superintendent and other District officials to gain an understanding of the District's financial management policies and procedures and the District's budgeting practices.
- We analyzed the District's general fund financial records from 2013-14 through 2016-17 to determine whether unrestricted fund balance increased or declined. We also evaluated any factors contributing to the increase or decline identified.
- We reviewed the Board adopted general fund budgets to determine whether they were realistic and structurally balanced by comparing the adopted budgets from 2013-14 through 2016-17 with actual results of operations.
- We reviewed the adopted general fund budget for 2017-18 to determine whether budgeted revenues and appropriations were reasonable based on historical data and supporting source documentation.
- We analyzed the general fund's financial condition to determine whether during the audit period fund balance increased or was in excess of statutory limit and whether operating deficits were incurred.

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

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### **Regional Office Directory**

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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