



Iroquois Central School District Financial Condition

Report of Examination

Period Covered:

July 1, 2009 — November 22, 2013

2014M-22



Thomas P. DiNapoli

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State of New York Office of the State Comptroller

Division of Local Government and School Accountability

June 2014

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 Iroquois Central School District, entitled Financial Condition. 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 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 Iroquois Central School District (District) is located in the Towns of Aurora, Elma, Lancaster, Marilla and Wales in Erie County and the Town of Bennington in Wyoming County. The District is governed by an elected seven-member Board of Education (Board) responsible for the general management and control of the District's financial and educational affairs. The Superintendent of Schools (Superintendent) is the chief executive officer of the District and is responsible, along with other administrative staff, for the day-to-day management of the District under the direction of the Board. The Business Administrator is responsible for maintaining the District's accounting records and preparing financial reports.

The District has six schools in operation with an enrollment of approximately 2,900 students. The District's budgeted appropriations for the 2013-14 fiscal year total \$44 million, funded primarily with real property taxes, sales tax and State aid. As of June 30, 2013, the District had approximately \$15.3 million in fund balance.

Objective

The objective of our audit was to examine the District's financial management practices and address the following related question:

- Did the Board and District officials effectively manage the District's financial condition?

Scope and Methodology

We examined the District's financial management practices for the period July 1, 2009 through November 22, 2013. We also reviewed certain information relating to the establishment, use and funding of certain reserves back to the 2004-05 fiscal year.

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 is included in Appendix C of this report.

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 disagreed with the findings but indicated they would take corrective action. Appendix B includes our comment on issues raised in the District's response.

The Board has the responsibility to initiate corrective action. Pursuant to Section 35 of the General Municipal Law, Section 2116-a (3)(c)

of the 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 Condition

A school district's financial condition is a factor in determining its ability to continue funding public educational services. The responsibility for accurate and effective financial planning rests with the Board, the Superintendent and the Business Administrator. The Board and District officials are responsible for adopting budgets that contain realistic estimates of expenditures and the resources available to fund them, and for ensuring that fund balance does not exceed the amount allowed by law. Fund balance represents the cumulative residual resources from prior fiscal years that can, and in some cases must, be used to lower property taxes for the ensuing fiscal year. A district may retain a portion of fund balance, referred to as unexpended surplus funds,¹ but must do so within the legal limits established by the Real Property Tax Law. A district also can establish reserves for a variety of specified objects or purposes.

The Board and District officials overestimated expenditures by a total of \$21.3 million and underestimated revenues by a total of \$2.3 million during the last four completed fiscal years. Although District officials appropriated fund balance in each year to reduce the tax levy, most of these funds were not needed because of the poor budget estimates. Consequently the District generated a total operating surplus of approximately \$9 million, which was used to increase the District's reserve funds. We found that the District has approximately \$2 million in excess reserve fund moneys.

Budgeting and Fund Balance

The Board and District officials are responsible for accurately estimating expenditures, revenues and fund balance that will be available to reduce the tax levy. Accurate estimates help ensure that the levy of real property taxes is not greater than necessary. Real Property Tax Law currently limits unexpended surplus funds to no more than 4 percent of the ensuing fiscal year's budget or approximately \$1.8 million for this District. Any surplus fund balance over this percentage

¹ The Governmental Accounting Standards Board (GASB) issued Statement 54, which replaces the fund balance classifications of reserved and unreserved with new classifications: nonspendable, restricted and unrestricted (composed of committed, assigned and unassigned funds). The requirements of Statement 54 are effective for fiscal years ending June 30, 2011 and beyond. To ease comparability between fiscal years ending before and after the implementation of Statement 54, we will use the term "unexpended surplus funds" to refer to that portion of fund balance that was classified as unreserved, unappropriated (prior to Statement 54) and is now classified as unrestricted, minus appropriated fund balance, amounts reserved for insurance recovery and tax reduction, and encumbrances included in committed and assigned fund balance (post-Statement 54).

should be used for non-recurring expenditures, to fund prudently established and maintained reserves or to reduce the tax levy.

We compared the District's budgeted expenditures and revenues for the last four fiscal years and found that the Board and District officials overestimated expenditures by approximately \$21.3 million and underestimated revenues by more than \$2.3 million resulting in a total budget variance of \$23.6 million. The most significant expenditure variances were found in central services² (\$5.8 million), employee benefits³ (\$6 million), teaching⁴ (\$2.9 million) and pupil transportation⁵ (\$2.6 million) during the period. Although fund balance was appropriated by a total of more than \$14.6 million to fund these budgets, due to poor budget estimates, most of these funds were not needed. As a result, the District generated a total operating surplus of approximately \$9 million. Table 1 illustrates the results of operations during the period.

Table 1: Fund Balance – Fiscal Years 2009-10 Through 2012-13					
	2009-10	2010-11	2011-12	2012-13	Total
Beginning Fund Balance	\$12,437,412	\$10,819,084	\$13,303,851	\$15,769,094	
Revenues	\$40,161,387	\$38,847,128	\$40,165,943	\$41,039,781	
Expenditures	\$34,535,104	\$34,898,892	\$35,599,536	\$38,530,095	
Operating Surplus	\$5,626,283	\$3,948,236	\$4,566,407	\$2,509,686	\$16,650,612
Budgeted Transfers In	\$0	\$214,885	\$0	\$0	
Budgeted Transfers Out ^a	\$1,744,611	\$1,710,851	\$1,651,164	\$2,813,786	\$7,920,412
Operating Surplus/ (Deficit) Including Budgeted Transfers	\$3,881,672	\$2,452,270	\$2,915,243	(\$304,100)	\$8,945,085
Non-Budgeted Transfers Out ^b	\$5,500,000	\$0	\$450,000	\$174,000	\$6,124,000
Net Effect on the Operating Surplus/(Deficit)	(\$1,618,328)	\$2,452,270	\$2,465,243	(\$478,100)	\$2,821,085
Fund Balance Adjustment	\$0	\$32,497	\$0	\$0	
Year-End Fund Balance	\$10,819,084	\$13,303,851	\$15,769,094	\$15,290,994	
^a Transfers for debt service and expenditures in connection with Federally supported programs and State funded grants ^b Transfers to fund capital reserves and capital projects					

² Includes expenditures for the operation and maintenance of the schools

³ Includes retirement contributions, social security, workers' compensation, unemployment and health insurance

⁴ Includes salaries, equipment, conferences, supplies and textbooks

⁵ Includes salaries and all costs associated with bus operation and maintenance

Reserves

Reserve funds are mechanisms for accumulating moneys for future capital outlays and other allowable purposes. The Board adopted a reserve policy in 2011 to ensure that District reserves are properly established and maintained and that relevant information is provided to the Board annually. Furthermore, the District is developing a plan to use some of the reserves beginning in the current (2013-14) fiscal year.

During the four-year period 2009-10 through 2012-13, the District's reserves increased by \$5.2 million and as of June 30, 2013 totaled more than \$10.7 million, which is approximately 25 percent of the total budget. The District has accumulated approximately \$2 million more than its documented needs.

Capital Reserves – The District has two capital reserves that were established to fund building and technology projects. The General Capital Reserve was properly established with voter approval in 2011 and has a 10-year term with a maximum limit of \$10 million plus interest earned to fund building and grounds projects. This reserve reported a balance of \$3.1 million as of June 30, 2013. The Capital Technology Reserve was properly established with voter approval in 2005 and has a 10-year term with a maximum limit of \$1 million plus interest earned to fund the purchase of computer hardware, software and network-related costs in support of the District's technology program. Although this reserve had a balance of approximately \$900,000 as of June 30, 2013, the District also used approximately \$400,000 to fund certain technology costs, yet continued to fund the reserve. In effect the District has paid into the reserve more than its' ultimate amount. Therefore, this reserve, exclusive of interest earnings, is overfunded by approximately \$270,000

Employee Benefit Accrued Liability Reserve – This reserve is authorized for the cash payment of accrued and unused sick, vacation and certain other leave time owed to employees when they leave District employment. The District's calculated liability for such compensated absences was approximately \$1.8 million as of June 30, 2013. However, the reserve balance was \$2.1 million, resulting in an overfunding of approximately \$300,000. According to the five-year financial plan, the District plans on using between \$130,296 and \$216,932 of this reserve over the five fiscal years beginning in 2013-14.

Retirement Contribution Reserve – This reserve is authorized for the payment of contributions to the New York State and Local Retirement System for covered employees and cannot be used for contributions to the New York State Teachers' Retirement System. No moneys have been expended from this reserve since it was created in 2011. Rather,

the Board has budgeted for the annual contribution as a general fund cost and, therefore, levied taxes for this purpose. The balance of the reserve was approximately \$1.5 million as of June 30, 2013 which represents over one and one half times the District's two-year annual average cost of approximately \$886,000. However, the District included \$420,000 from this reserve as a funding source in the 2013-14 budget. According to the five-year financial plan, the District also plans to use an amount ranging from \$20,000 to \$75,000 as a funding source in future budgets.

Repair Reserves – The Board established three repair reserves in 2008, 2009 and 2012 totaling \$1.2 million. All three reserves were approved by the voters as required with maximum funding amounts of \$450,000 each. These reserves are to be used for non-recurring repairs to capital improvements or equipment subject to a public hearing.⁶ For the fiscal year period 2009-10 through 2012-13, only \$7,570⁷ was used from the 2008 reserve and the other two reserves have not been used. Because the repair reserves have been used so infrequently, we question whether establishing and funding these reserves has been in the best interest of District taxpayers. The Board could transfer unneeded funds from existing repair reserves to other reserve funds in accordance with statute. The balances of the 2009 and 2012 reserves totaled approximately \$883,000 as of June 30, 2013.

Unemployment Insurance Reserve – This reserve is authorized to reimburse the State Unemployment Insurance Fund for payments made to claimants. This reserve was established in 1997 and reported a balance of \$717,152 as of June 30, 2013. The Board has included an appropriation for unemployment costs in the general fund budget and, therefore, levied taxes for this purpose rather than using this reserve. During the recent poor economy, the District's three-year average unemployment cost of \$90,000 indicates that this reserve is significantly overfunded. If unemployment costs continue to average \$90,000 per year, the reserve would last for nearly seven years, assuming that the Board does not levy taxes to fund these costs. However, the District included \$85,000 from this reserve as a funding source in the 2013-14 budget and, therefore, did not levy any taxes for the total costs estimated to be \$85,000 in the current fiscal year. We estimate the reserve is overfunded by approximately \$300,000.

Workers' Compensation Reserve – This reserve was created in 2005 to fund payments of compensation and benefits, medical and hospital

⁶ If funds are used in emergency situations without a public hearing, the District is required to reimburse the repair reserve for the emergency expenditures.

⁷ October 2011 for a bus garage repair

costs for workers' compensation claims. This reserve reported a balance of \$640,668 as of June 30, 2013. No funds have been spent from this reserve over the past four completed fiscal years. Instead, the Board levied taxes for this purpose. The balance in the reserve could fund over two years of average annual workers' compensation costs of \$270,000, assuming that the Board does not levy taxes to fund these costs. The District included \$45,283 from this reserve in the 2013-14 budget to help fund a portion of the \$260,000 appropriation for workers' compensation costs in the current fiscal year.

Tax Certiorari Reserve – This reserve is authorized to pay judgments and claims arising from tax certiorari proceedings for the year in which the money was deposited. This reserve may not exceed the amount which might reasonably be deemed necessary to meet anticipated judgments. This reserve was created in 1994 and has a balance of \$167,779 as of June 30, 2013. District officials were unable to document what claims this reserve was intended to fund beyond the open claims which totaled \$83,187. As such, the reserve balance exceeds open claims by more than \$84,000, which should be transferred to unexpended surplus funds.

Debt Reserve – The District had a debt service fund with a balance of \$129,833 as of June 30, 2013. This amount has remained relatively constant over the last four completed fiscal years. District officials were unable to document the source of these funds or why these moneys should be restricted. If these moneys are not required to be restricted for debt service, they should be transferred to the general fund; if they are restricted to debt service, they should be used for that purpose.

We conservatively estimate that the District had approximately \$2 million in excess reserve funds⁸ as of June 30, 2013.

Recommendations

1. The Board and District officials should develop realistic revenue, expenditure and fund balance estimates for the annual budget.
2. The Board should ensure that all reserves are established and maintained in compliance with the District's reserve fund policy and applicable statutory requirements and are reasonably funded.
3. District officials should determine the composition of the debt reserve, use any statutorily restricted moneys to pay related debt service and return any other moneys to general fund unexpended surplus.

⁸ Includes overfunded capital, employee benefit accrued liability, tax certiorari and debt reserves by at least \$796,000, unused 2009 and 2012 repair reserves totaling \$883,000 and the unemployment insurance reserve totaling \$300,000.

APPENDIX A

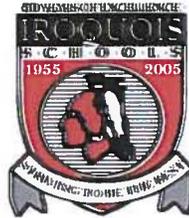
RESPONSE FROM DISTRICT OFFICIALS

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

IROQUOIS CENTRAL SCHOOL DISTRICT
P.O. BOX 32
ELMA, NY 14059-0032
(716) 652-3000
(FAX) 652-9305

DOUGLAS R. SCOFIELD
Superintendent of Schools
(716) 995-2324

KRISTIN KENDALL-JAKUS
*Dir. of Instruction, Student Services
& Assessment*
(716) 995-2313



MARY JO DUDEK, Ed. D.
Assistant Superintendent for Curriculum
(716) 995-2311

JOANNE M. GEORGE
Business Administrator
(716) 995-2315

June 9, 2014

Office of the State Comptroller
Attn: Mr. Jeffrey D. Mazula
Chief Examiner of Local Government and School Accountability
110 State Street
Albany, NY 12236

The Iroquois Central School District received and reviewed the New York State Comptroller's Office Audit. Upon its review, it became obvious that the Comptroller's Office and the District have differing opinions regarding budgeting practices. The District continues to believe in long range fiscal planning that is transparent to the public. What the Comptroller's Office refers to it as "poor budgeting" the District confidently refers to as "purposeful and transparent" budgeting that will ensure the fiscal stability for educational programming. The Iroquois Central School District is currently designated as a District of "No Designation" by the Office of the State Comptroller. This designation signifies that Iroquois is currently fiscally sound with a score of 6.7%. According to the Office of the State Comptroller's publication dated January 2013 entitled Fiscal Stress Monitoring System, a score of 0%-24.9% is classified as "Not in Fiscal Stress."

The Comptroller's report states an overestimation of expenditures by approximately \$21.3 million and underestimation of revenues by more than \$2.3 million resulting in a total budget variance of \$23.6 million in total over a four year period. These variances are the beginning of the total picture that is Iroquois that allows for its long range planning and protection of educational programming. In order to understand the entire balanced budget, one must review the use of the variances. Over the audited time period, the District had \$6.4 million worth of encumbrances to fund expenditures that crossed fiscal years. Transferred \$7.8 million to fund reserves to prepare for future capital projects, protect for emergency health and safety concerns, and mitigate increases in the New York State mandated pension system. The remaining \$9.4 million dollars, of the \$23.6 million, was returned to the tax payers over the four year period to mitigate school taxes.

See
Note 1
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June 13, 2014

The District will implement a corrective action plan by following the audit's recommendation to reduce the total variances but will continue to have open and transparent budget development with public input as a significant aspect. These meetings will continue to focus on long range fiscal stability and the protection of educational programming.

Sincerely in Education,

Douglas R. Scofield
Superintendent of Schools

APPENDIX B

OSC COMMENT ON THE DISTRICT'S RESPONSE

Note 1

While the District annually appropriates fund balance, it is not typically needed due to the District's consistent practice of overestimating expenditures. Table 1 illustrates the results of the District's financial operations, as disclosed in the audited financial statements.

APPENDIX C

AUDIT METHODOLOGY AND STANDARDS

Our objective was to assess the District's financial management practices. To accomplish our objective, we performed the following procedures:

- We interviewed Board members and District officials to obtain an understanding of the District's financial management practices including budgeting, accounting and use of reserve funds.
- We compared budgets with actual results for the 2009-10 through 2012-13 fiscal years to assess whether the budgets were realistic and supported.
- We reviewed the last four fiscal years' audited financial statements and analyzed certain balance sheet items, interfund activity and the debt service fund.
- We reviewed all available reserve approvals by the Board and voters and a draft version of the District's five-year financial plan, which includes the intended use of reserves.
- We reviewed supporting documents for the period 2009-10 through 2013-14, which included account activity and support for reserve balances.

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 conclusion based on our audit objective.

APPENDIX D

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