

Clarence Central School District

Financial Condition Management

JULY 2022



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

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Report Highlights

Clarence Central School District

Audit Objective

Determine whether the Clarence Central School District's (District) Board of Education (Board) and District officials effectively managed the District's financial condition.

Key Findings

The Board and District officials did not effectively manage the District's financial condition. As a result, the District levied more taxes than needed to fund operations. The Board and District officials:

- Consistently overestimated general fund appropriations from 2018-19 through 2020-21 by a total of \$16 million and appropriated \$6.4 million that was not needed or used.
- Recorded fiscal year-end commitments related to unperformed contracts for goods and services totaling \$3.3 million during the audit period. However, \$3.2 million was unsupported or for unbudgeted purchases. In effect, officials improperly sheltered a portion of surplus fund balance from the statutory limit and made surplus fund balance appear less than it actually was.
- Adopted annual budgets which gave the impression the District would have operating deficits totaling \$6.4 million when it had operating surpluses totaling \$7.3 million, or a swing in operational results of \$13.7 million.
- As of June 30, 2021, surplus fund balance totaled \$9.2 million, or more than 6 percentage points above the 4 percent legal limit.

Key Recommendations

- Develop budgets that include reasonable appropriation estimates, only appropriate fund balance when needed and ensure encumbrances are appropriate.
- Develop a plan to reduce surplus fund balance to comply with the statutory limit.

District officials generally agreed with our findings and indicated they plan to initiate corrective action. Appendix B includes our comments on certain issues District officials raised in their response.

Background

The District serves the Towns of Clarence, Amherst, Lancaster and Newstead in Erie County.

The elected seven-member Board is responsible for managing the District's financial and educational affairs.

The Superintendent of Schools (Superintendent), along with other administrative staff, is responsible for the District's day-to-day management under the Board's direction.

The Board, Superintendent and Business Administrator are responsible for developing and monitoring the District's annual budget. The Business Administrator is responsible for the District's financial records.

2020-21 Fiscal Year Quick Facts

General Fund

| | |
|--------------|----------------|
| Expenditures | \$82.7 million |
| Balance | \$18.6 million |

Audit Period

July 1, 2018 – February 16, 2022

We extended our audit period back to review historical expenditure trends and forward to March 3, 2022 to project results of operations for the current fiscal year.

Financial Condition Management

Our Office issued an audit report¹ that identified similar deficiencies in 2016 and the Board, in its corrective action plan, indicated that it planned to take corrective action to:

- Adopt realistic budgets and comply with the fund balance statutory limit.
- Develop a long-range plan to ensure compliance with the statutory requirement.
- Consider using surplus funds as a financing source, funding one-time expenditures, funding necessary reserves and reducing District property taxes.

However, the Board and District officials did not effectively implement corrective actions.

How Should Financial Condition Be Effectively Managed?

To effectively manage financial condition, a board should adopt reasonably estimated and structurally balanced budgets based on historical data or known trends, in which recurring revenues finance recurring expenditures. In preparing the budget, a board and school district officials must estimate the amount the school district will spend and receive and the amount of fund balance that may be available at fiscal year-end to determine the expected tax levy. Accurate budget estimates help ensure that the real property tax levy is enough to fund operations but not greater than necessary.

School districts may encumber (carryover) appropriations from one budget year to the next when there are outstanding commitments related to unfulfilled contracts for goods or services at the end of the fiscal year. Encumbrances are intended to help prevent a school district from exceeding appropriations and allow officials to set aside a portion of fund balance for these commitments into the next fiscal year. Encumbrances are added to and increase the following year's adopted budget. Generally, encumbrances should be liquidated within the first few months of the following year when the related contractual obligations have been satisfied and the vendors are paid. Sufficient documentation should be maintained to support that such transactions were initiated in the fiscal year when the funds were encumbered.

Fund balance represents the cumulative residual resources from prior fiscal years. School districts are currently limited by New York State Real Property Tax Law Section 1318 to retaining surplus fund balance² totaling no more than 4

... [A] board should adopt reasonably estimated and structurally balanced budgets. ...

1 Refer to *Clarence Central School District – Financial Condition (2016M—128)* issued in February 2016

2 Surplus fund balance is defined as unrestricted fund balance minus appropriated fund balance and encumbrances included in committed and assigned fund balance. For further information, refer to our accounting bulletin at <https://www.osc.state.ny.us/files/local-government/publications/pdf/gasb54.pdf>

percent of the next year’s budget. Any surplus fund balance over this percentage must be used to reduce the upcoming fiscal year’s real property tax levy or to fund needed reserves. When fund balance is appropriated 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 is appropriated.

The Board and District Officials Overestimated Appropriations and Improperly Encumbered Funds

We compared budgeted appropriations and estimated revenues with actual operating results for 2018-19 through 2020-21 to determine whether budget estimates were reasonable. While estimated revenues were reasonable, expenditures were overestimated by an average of \$5.3 million (7 percent) each year, or a total of approximately \$16 million (Figure 1).

Figure 1: General Fund Budget-to-Actual Comparison^a

| Expenditures | 2018-19 | 2019-20 | 2020-21 | Total |
|---------------------------------|--------------|--------------|--------------|----------------------|
| Budgeted | \$83,143,000 | \$85,668,000 | \$88,202,000 | \$257,013,000 |
| Less Actual | 78,728,000 | 79,523,000 | 82,746,000 | 240,997,000 |
| Overestimated | \$4,415,000 | \$6,145,000 | \$5,456,000 | \$16,016,000 |
| Percentage Overestimated | 6% | 8% | 7% | 7% |
| a) Rounded to thousands. | | | | |

The most significant overestimated appropriations were for:

- Hospital insurance program (self-funded health insurance),
- Teachers’ retirement system contributions and
- Tuition to other school districts for students with disabilities.

These appropriations were overestimated between 28 and 43 percent, or a total of approximately \$10.6 million from 2018-19 through 2020-21.

The Business Administrator told us the Board and District officials overestimated appropriations due to the unpredictability of these budget items, specifically health insurance expenditures which the District self-insures. However, while actual expenditures for these budget items fluctuated, the year-to-year actual expenditure variances for the self-funded health insurance program – the District’s most overestimated budget item – was at most 4 percent over the past five years. Furthermore, the District has a stop-loss policy that is meant to protect it against catastrophic or unpredictable claims. Therefore, officials can and should use realistic estimates.

In addition, the Business Administrator told us that officials use excess appropriations as a way to finance unbudgeted technology equipment purchases. The Business Administrator stated every June, he determines the amount of unexpended appropriations remaining in the budget, meets with the Information Technology Director to identify technology equipment needing to be replaced and makes budget adjustments to accommodate technology equipment purchases. This budgeting practice is not driven by operational needs; instead, equipment purchases appear to be driven by the amount of excess funds.

During our audit period, the District budgeted approximately \$183,000 for technology equipment purchases but spent more than \$3.9 million. The Business Administrator also recorded fiscal year-end encumbrances totaling \$5.1 million for technology equipment, but \$2.6 million were not valid commitments at fiscal year-end (Figure 2). Therefore, they were used to improperly set aside a portion of fund balance and to reduce the amount of surplus fund balance subject to the statutory limit.

Figure 2: Technology Equipment

| Fiscal Year | Budgeted | Actual | Fiscal Year-End Encumbrances | Inappropriate Encumbrances |
|----------------|------------------|--------------------|------------------------------|----------------------------|
| 2018-19 | \$61,000 | \$1,509,000 | \$1,228,000 | \$233,000 |
| 2019-20 | 61,000 | 1,193,000 | 1,215,000 | 716,000 |
| 2020-21 | 61,000 | 1,239,000 | 2,701,000 | 1,696,000 |
| Total | \$183,000 | \$3,941,000 | \$5,144,000 | \$2,645,000 |

District officials also overstated other encumbrances, which reduced the amount of surplus fund balance subject to the statutory limit. We reviewed 39 encumbrances totaling \$3.3 million,³ and found 37 totaling \$3.2 million (97 percent) were not valid encumbrances, including the technology equipment previously discussed. This included 10 encumbrances totaling \$1.8 million at the end of the 2020-21 fiscal year. By improperly encumbering funds for purchases that the District did not yet initiate, the District misstated its surplus fund balance and diminished the transparency of its overall budget process.

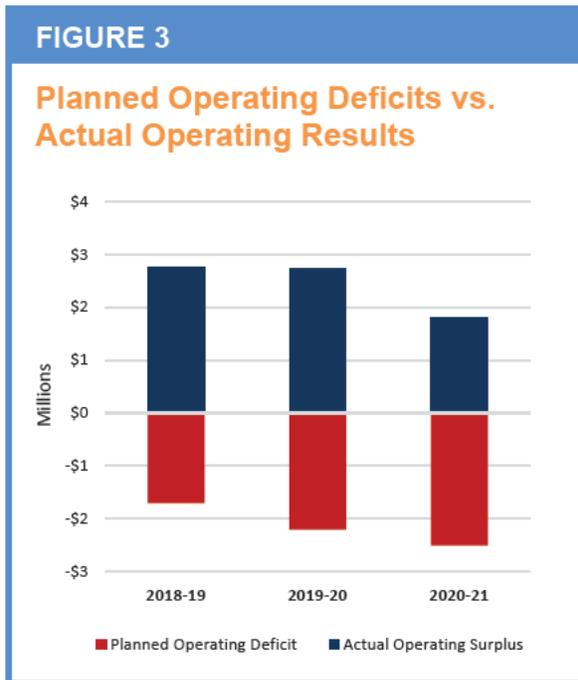
The Board and District Officials Appropriated Fund Balance That Was Not Needed

A pattern of over-budgeting resulted in the District generating operating surpluses from 2018-19 through 2020-21 totaling \$7.3 million (averaging \$2.4 million per year), instead of the operating deficits that were budgeted (Figure 3).

By improperly encumbering funds for purchases that the District did not yet initiate, the District misstated its surplus fund balance and diminished the transparency of its overall budget process.

³ See Appendix C for sampling methodology.

In the 2018-19 through 2020-21 budgets, the Board annually appropriated between \$1.7 million and \$2.5 million of fund balance, but the District did not use the fund balance that was appropriated for those fiscal years, totaling \$6.4 million. Over this period, the Board gave the appearance the District would have operating deficits totaling \$6.4 million, when it had operating surpluses totaling \$7.3 million, or a swing in operational results of \$13.7 million.



Based on our review of the 2021-22 budget and year-to-date operating results as of

March 3, 2022, we project that the District will generate another operating surplus in 2021-22 and will not need to use the \$2 million in fund balance appropriated in the budget. The Business Administrator agreed that the District will likely generate an operating surplus in 2021-22 and will not use any appropriated fund balance.

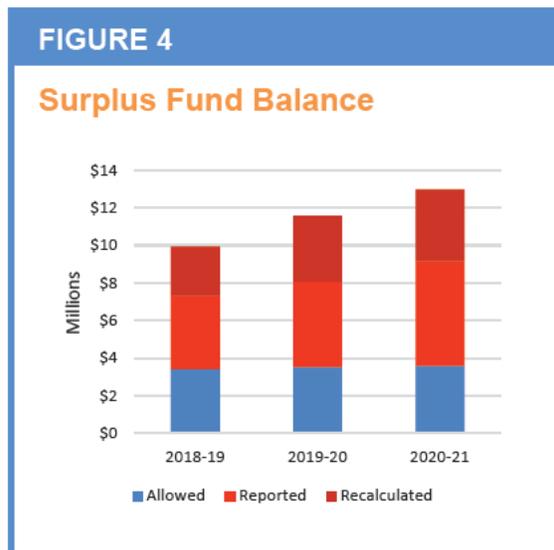
Annually appropriating fund balance that is not needed to fund operations is, in effect, a reservation of fund balance that is not provided for by statute and circumvents the statutory limit imposed on the level of surplus fund balance. By continually appropriating fund balance that is not needed, overestimating budgeted appropriations and inappropriately encumbering funds, the District is not presenting its surplus fund balance or budget in a transparent manner.

Surplus Fund Balance Exceeded the Statutory Limit

The District's reported surplus fund balance in the general fund exceeded the 4 percent statutory limit from 2018-19 through 2020-21. As of June 30, 2021, surplus fund balance totaled \$9.2 million and was 10 percent of the 2021-22 budgeted appropriations, which exceeded the statutory limit by approximately \$5.6 million, or 6 percentage points.

When unused appropriated fund balance of \$2 million and unsupported encumbrances of \$1.8 million are added back, the recalculated surplus fund balance of approximately \$13 million exceeds the 4 percent statutory limit by as much as 10.5 percentage points, or \$9.4 million (Figure 4).

By maintaining surplus fund balance in excess of the statutory limit, District officials are withholding funds from productive use, which results in real property taxes that are higher than necessary. While surplus fund balance continued to increase, the District also continued to increase the tax levy by an average of 4 percent each year. Had the Board and District officials developed and adopted more reasonable budgets, they could have considered using these excess funds to fund one-time expenditures and/or needed reserves, pay off debt or reduce the tax levy.



The Business Administrator told us that the Board and District officials intentionally overestimated appropriations and maintained surplus fund balance in excess of the statutory limit. They did so because there was not another way to save funds in case of a significant increase in the health insurance costs, and the statutory limit on surplus fund balance was not sufficient. The Business Administrator and two Board members told us that they believed budgeting in this manner would protect taxpayers from sudden and significant tax increases. However, by using budgeting practices that are not based on historical data, known trends and anticipated needs, the Board and District officials are not presenting the District's spending plan in a transparent and meaningful manner to taxpayers. Furthermore, if the District maintained its surplus fund balance at the allowable level, it would have approximately \$3.6 million in surplus fund balance to cover unanticipated expenditures, and District officials could make certain budget transfers from other unused appropriations when necessary.

What Do We Recommend?

The Board and District officials should:

1. Develop and adopt budgets that include reasonable estimates for appropriations, including technology equipment purchases, and the amount of fund balance that will be used to fund operations.
2. Discontinue the practice of appropriating fund balance that is not needed or used to fund operations.

...[M]aintaining surplus fund balance in excess of the statutory limit... results in real property taxes that are higher than necessary.

...[T]he Board and District officials intentionally overestimated appropriations and maintained surplus fund balance in excess of the statutory limit.

-
3. Analyze fiscal year-end encumbrances to ensure that they represent actual unfulfilled obligations for the current fiscal year.
 4. Develop a plan to reduce surplus fund balance to comply with the statutory limit. Surplus funds can be used for:
 - Reducing District property taxes
 - Funding one-time expenditures,
 - Funding needed reserves, and
 - Paying off debt.

Appendix A: Response From District Officials

CLARENCE CENTRAL SCHOOL DISTRICT

Administration

Matthew T. Frahm, Ed.D.
Superintendent of Schools
Patricia Grupka, Ed.D.
Assistant Superintendent for Finance & Operations
James Maloney
Interim Director of Special Education
Robert O. Michel
Assistant Superintendent for Human Resources
Kristin Overholt, Ed.D.
Assistant Superintendent for Curriculum & Instruction



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June 1, 2022

Melissa A. Myers, Chief Examiner
Office of the New York State Comptroller
295 Main Street, Suite 1032
Buffalo, NY 14203-2510

RE: Clarence Central School District Response to the Financial Condition Management Report of Examination for the time period from July 1, 2018 through June 30, 2021

Dear Ms. Myers,

The Clarence Central School District is in receipt of the State Comptroller's Office Draft Report of Examination for Financial Condition for the period of July 1, 2018 through June 30, 2021. On behalf of the District, I would like to thank the Comptroller's Office, who we found to be professional and courteous throughout the audit process. As always, the District welcomes feedback, and appreciates the opportunity to improve its practices based on reflection of your observations.

The District is pleased that the report does not suggest any malfeasance or legal impropriety with respect to general business operations. To the extent the Comptroller's audit represents a review of the operations, practices, and policies for compliance, the District generally agrees with the findings. However, the District would like to offer three observations related to its conservative financial management during the period of the audit.

See
Note 1
Page 10

First, because public schools are susceptible to financial constraints imposed by a 2% property tax cap, New York State's failure to fully fund education aid, as well as external market pressures, the District has committed itself to conservative budgeting practices. Toward the end of the audit period, the need for this approach became more pronounced as the Governor announced a series of planned "measurements periods" resulting from the COVID-19 pandemic. This information caused the District to limit expenditures wherever possible in order to meet its fiduciary responsibility to taxpayers.

Second, the audit listed Special Education as an area of surplus. As all school officials know, Special Education expenditure estimates are based on student needs at the time of budget adoption. However, as placements change and students move in and out of the District during the summer months, actual costs can change significantly. For example, a single high-cost placement can cost in excess of \$100,000, and the District has a legal—as well as a moral—obligation to provide needed services for all students. To ensure the District is prepared to meet these commitments, it has employed a conservative budgeting approach, as well as advocated for legislation giving schools the ability to create Special Education Reserves.

See
Note 2
Page 10

Finally, the audit also indicated that Health Insurance was an area of surplus. Because the health and well-being of faculty and staff is a priority, the District provides a self-insured medical plan for all employees. While the District does carry stop loss insurance, it cannot know with certainty the number of high cost claims that will occur within a year—especially in the midst of the COVID-19 pandemic. To show the volatility of this area of the budget, I would highlight health care needs during this current school year. While the District included a modest increase to Health Insurance—approximately 7% less than the local trend—it overspent its budget because of three unanticipated high-cost claims.

Again, the District would like to thank the representatives of the Office of the State Comptroller for their insight and assistance. We are fortunate that the Clarence Central School District has established itself as one of the highest achieving schools in Upstate New York, while at the same time maintaining the lowest tax rate in Erie County.

Sincerely,

Matthew Frahm, Ed.D.
Superintendent of Schools

Appendix B: OSC Comments On the District's Response

Note 1

By maintaining surplus fund balance in excess of the statutory limit, the District is in violation of New York State Real Property Tax Law Section 1318.

Note 2

While our audit report does not discuss special education costs specifically, we amended the report to clarify that tuition to other school districts referred to in the report is for tuition paid to other school districts for students with disabilities. The District overestimated these expenditures by a total of \$2.4 million during the three completed fiscal years in our audit period. According to District-reported expenditures for this budget item, the total net increase in costs over the past five completed fiscal years, 2015-16 through 2020-21, was approximately \$708,000, which was significantly less than the \$2.4 million overbudgeted for three years.

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 reviewed the adopted general fund budgets from 2018-19 through 2020-21 to determine whether they were reasonable and structurally balanced by comparing adopted budgets with actual results of operations, excluding transfers.
- We extended our audit scope period to review historical reported results of operations for fiscal years 2015-16 through 2020-21 to determine year-to-year variances in the District's self-funded health insurance expenditures.
- We reviewed the adopted 2021-22 general fund budget to assess whether similar budgeting patterns existed in comparison with the 2017-18 through 2020-21 adopted budgets.
- We calculated surplus fund balance as a percentage of the next year's appropriations for 2018-19 through 2020-21 to assess District compliance with statute.
- We recalculated surplus fund balance as a percentage of the next year's appropriations after adding back the unused appropriated fund balance and inappropriate encumbrances. We extended our audit scope period to estimate the amount of fund balance that will not be used to finance the 2021-22 fiscal year based on the previous total of unused appropriated fund balance as a percentage of total budgeted appropriated fund balance.
- We compiled the fiscal year-end encumbrances from the three account codes for 2018-19 through 2020-21 that accounted for the majority of reported encumbrances. We determined 92 totaling \$3.4 million had not been liquidated or expensed by September 30 of the next fiscal year. We selected the 39 (totaling \$3.3 million) encumbrances exceeding \$5,000. We reviewed the purchase orders and supporting documentation to determine the date of purchase and whether encumbrances were appropriate and represented valid fiscal year-end commitments.
- We reviewed the corrective action plan the District submitted in response to our 2016 audit report to determine whether the District took appropriate corrective action.

We conducted this performance audit in accordance with generally accepted government auditing standards (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.

Unless otherwise indicated in this report, samples for testing were selected based on professional judgment, as it was not the intent to project the results onto the entire population. Where applicable, information is presented concerning the value and/or size of the relevant population and the sample selected for examination.

The Board has the responsibility to initiate corrective action. 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-a (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 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 CAP should be posted on the District's website for public review.

Appendix D: Resources and Services

Regional Office Directory

www.osc.state.ny.us/files/local-government/pdf/regional-directory.pdf

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

www.osc.state.ny.us/local-government/publications

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www.osc.state.ny.us/local-government/fiscal-monitoring

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

www.osc.state.ny.us/local-government/publications

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www.osc.state.ny.us/local-government/resources/planning-resources

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

www.osc.state.ny.us/files/local-government/publications/pdf/cyber-security-guide.pdf

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