OFFICE OF THE NEW YORK STATE COMPTROLLER

DIVISION OF LOCAL GOVERNMENT
& SCHOOL ACCOUNTABILITY

Hancock Central School District

Financial Condition

Report of Examination

Period Covered:

July 1, 2011 — June 30, 2013

2013M-187

Thomas P. DiNapoli

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State of New York
Office of the State Comptroller

Division of Local Government
and School Accountability

September 2013

Dear School District Officials:

A top priority of the Office of the State Comptroller is to help school district officials manage their district 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 district's 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 Hancock 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 Hancock Central School District (District) is located in the Towns of Deposit, Hancock, and Tompkins in Delaware County. The District is governed by the Board of Education (Board), which comprises five elected members. The Board President is the chief financial officer. The Board is responsible for the general management and control of the District's financial and educational affairs. The Board is also responsible for monitoring and controlling the budget throughout the year. 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. Responsibilities relating to the District's finances, accounting records, and reports are largely delegated to the Business Manager.

The District has two educational buildings and a bus garage with total enrollment of 360 students and 140 employees. For the 2013-14 fiscal year, the District's operating budget is approximately $10 million, funded primarily with State aid and real property taxes.

Objective

The objective of our audit was to evaluate the District's financial operations. Our audit addressed the following related question:

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

Scope and Methodology

We reviewed the District's financial condition for the period July 1, 2011, to June 30, 2013. To analyze the District's fund balance, budgeting, and financial trends, we extended the audit period back to the 2007-08 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 are 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. Except as indicated in Appendix A, District officials generally agreed with our findings and indicated they planned to initiate corrective action. Appendix B includes our comments on issues District officials raised in their response.

The Board has the responsibility to initiate corrective action. A written corrective action plan (CAP) that addresses the findings and recommendations in this report should be prepared and forwarded to our office within 90 days, 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. 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 this plan available for public review in the District Clerk's office.

Financial Condition

The responsibility for accurate and effective financial planning rests with the Board, the Superintendent, and the Business Manager. District officials must ensure that budgets are prepared, adopted, and modified in a prudent manner, accurately depict the District's financial activity, and use available resources to benefit District taxpayers. Prudent fiscal management also includes maintaining sufficient balances in reserves to address long-term obligations or planned expenditures.

Although the Board and District management believed they were effectively managing the District's financial condition, the adopted budgets continually included over-estimated appropriations. For fiscal years 2007-08 through 2010-11, these budgeting practices generated $2.76 million in operating surpluses, which caused the accumulated fund balance to exceed the statutory maximum of 4 percent of the ensuing year's budget for those same fiscal years. To reduce the unexpended surplus fund balance[1] and bring it closer to the 4 percent limit, District officials made unplanned transfers to the District's reserves. We found those reserves to be over-funded by approximately $699,000 at June 30, 2013. The Board was more conservative in its budgeting practices for fiscal years 2011-12 and 2012-13 and reduced its unexpended surplus funds to a more reasonable level. However, we found that the Board did not include in its 2013-14 budget more than $790,000 in insurance revenues it expects to receive during this fiscal year ending 2013-14. This, combined with the over-funded reserves, will bring total available fund balance to more than $1.9 million in fiscal year ending 2013-14.

Budgeting

The Board is responsible for preparing and presenting the District's budget to the public for vote. In preparing the budget, the Board must estimate what the District will receive in revenue, how much fund balance will be available at fiscal year-end (some or all of which may be used to fund the ensuing year's appropriations and to balance the

[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, committed, assigned, and unassigned. 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).

budget), and what the expected tax levy will be. Accurate estimates help ensure that the levy of real property taxes is not greater than necessary.

The Board did not develop reasonable budget estimates. From fiscal years 2007-08 through 2011-12, the Board adopted budgets that over-estimated expenditures by $2.6 million; over-estimated employee benefits comprised more than 91 percent of that variance. Given that these benefits are driven by contractual agreements, estimating these expenditures should be straightforward. District officials' revenue estimates were under-estimated by nearly $1.2 million for fiscal years 2007-08 through 2009-10. This variance was mainly due to under-estimating Federal and State aid as well as refunds of prior year expenditures. However, since fiscal year ended 2010-11, revenue estimates were much closer to what was actually received.

The District's annual budgets also included the use of fund balance to finance operations. For a four-year period (2007-08 through 2010-11), the Board adopted budgets that included aggregate appropriated unexpended surplus of more than $1.3 million, an average of more than $330,000 annually, which should have decreased the amount of fund balance that was available to appropriate. However, because of the significant variances in expenditures to the adopted budget, actual operations generated surpluses totaling more than $2.7 million, as indicated in Table 1. Therefore, very little of the planned amount was used during this time. However, starting in fiscal year 2011-12, the District's operating results were more consistent with the amounts budgeted, as some of the planned deficits were realized. District officials told us they were aware that their budgeting practices would generate surpluses in some years – in fact, they planned these surpluses to fund any unforeseen expenditures during the year.

Table 1: Analysis of Operating Results						
	FY 2007-08	FY 2008-09	FY 2009-10	FY 2010-11	FY 2011-12	FY 2012-13
Beginning Fund Balance	$2,433,590	$3,523,183	$4,301,055	$5,039,374	$5,409,166	$5,078,376
Actual Revenues	$9,737,538	$10,181,048	$10,674,130	$10,077,006	$9,751,275	$9,247,319
Actual Expenditures	$8,818,341	$9,421,472	$9,949,123	$9,719,269	$10,092,489	$9,683,259
Operating Surplus/(Deficit)	$919,197	$759,576	$725,007	$357,737	($341,214)	($435,940)
Add: Prior Period Adjustments	$170,396	$18,296	$13,312	$12,055	$10,424	$6,366
Ending Fund Balance	$3,523,183	$4,301,055	$5,039,374	$5,409,166	$5,078,376	$4,648,802
Less: Appropriated Unexpended Surplus Fund Balance and Encumbrances	$403,194	$550,986	$532,496	$749,576	$926,904	$550,432
Less: Restricted Fund Balance	$2,160,471	$3,178,766	$3,852,079	$4,050,133	$3,804,490	$3,634,953
Total Unexpended Surplus Fund Balance	$959,518	$571,303	$654,799	$609,457	$346,982	$463,417

The District's property tax increases, while fairly modest (averaging 1.9 percent from fiscal years 2007-08 through 2012-13), were not needed to cover actual expenditures as operating surpluses were greater than the increases in the tax levy during this time. In addition, the District's unexpended surplus fund balance was over the 4 percent limit for fiscal years ending 2007-08 through 2010-11, but fell below the legal limit in 2011-12 after peaking in 2008-09 at 9.5 percent.[2]

Further, the Board was not fully transparent in developing the 2013-14 budget. The District has an insurance rebate coming during this fiscal year that totals approximately $1.2 million. However, District officials did not include $790,000 of this amount as a revenue source in the budget even though they anticipate putting this money into the District's retirement reserve. After considering the unbudgeted portion of the insurance refund ($790,000) and the over-funded reserves ($699,000) discussed below, the District's fund balance, once this rebate is received, could be upwards of $1.9 million, or 19 percent of the 2013-14 budgeted appropriations, which is over the 4 percent legal limit.

Reserves

Reserves may be established by the Board in accordance with applicable laws. Moneys set aside in reserves must be used only

[2] For fiscal year 2012-13, the unexpended surplus fund balance also exceeds the 4 percent limit by .47 percent.

in compliance with statutory provisions which determine how reserves are established and how they may be funded, expended, and discontinued. Generally, school districts are not limited as to how much money can be held in reserves. However, 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 operations. The Board is responsible for developing a formal plan for the use of its reserves. This plan should include guidelines on how and when disbursements should be made, optimal or targeted funding levels and why these levels are justified, and ensuring that appropriate documentation is maintained to account for and monitor reserve activity and balances.

As of June 30, 2013, the District had general fund reserves totaling approximately $3.6 million, an increase from $1.5 million as of the fiscal year ended 2007-08. We analyzed these reserves for adherence to statutory requirements for establishing the reserves[3] and reasonableness of funding, and found the funding of three reserves – capital, retirement, and repairs – to be reasonable. However, three reserves – employee benefit accrued liabilities, tax certiorari, and property loss – totaling approximately $699,000,[4] were questionable as to the amounts required for their stated purposes and the amounts actually retained, as follows:

Employee Benefit Accrued Liability Reserve — This reserve was established 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 compensated absences was approximately $469,000 as of June 30, 2013; however, the actual reserve balance was $783,000, an over-funding of approximately $314,000.

Tax Certiorari Reserve — This reserve is for the payment of judgments and claims for tax certiorari proceedings for the tax roll in the specific year in which the money was deposited in the reserve. This reserve fund may not exceed the amount which might reasonably be deemed necessary to meet anticipated judgments. Based upon our review of claims received by the District arising out of tax certiorari proceedings, we estimate that the amount needed to settle claims is significantly less than the $330,822 balance as of June 30, 2013; the reserve is over-funded by approximately $300,000.

[3] For more information on the legal requirements for these reserves, see http://joomlaprod.ent.nysret.osc.state.ny.us/index.php/divisions/state-and-local-government/local-govt-accountability.html

[4] While on-site, we found the District had a reserve for workers' compensation totaling $121,000. Subsequent to our audit, it eliminated this reserve.

Property Loss Reserve — School districts are authorized to establish and maintain reserves, not to exceed 3 percent of the annual budget, to cover property loss and liability claims to reduce insurance costs. The District has not expended moneys from this reserve since it was established in 2003. The reserve had a balance of $85,000 as of June 30, 2013.

By maintaining excessive and/or unnecessary reserves, combined with ongoing budgeting practices that generate repeated operating surpluses, the Board and District officials have withheld significant funds from productive use, raised taxes unnecessarily, and compromised the transparency of District finances to the taxpayers.

Recommendations

1. The Board and District officials should develop expenditure and revenue estimates that are realistic and based upon all information available at the time the budget is developed. District officials should provide appropriate transparency through the budget process with public disclosure.

2. The Board should review all reserve balances and determine if the amounts reserved are necessary, reasonable, and in compliance with statutory requirements. To the extent that they are not, transfers should be made to unrestricted fund balance, where allowed by law, or other reserves established and maintained in compliance with statutory directives.

APPENDIX A

RESPONSE FROM DISTRICT OFFICIALS

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

HANCOCK CENTRAL SCHOOL

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Terrance P. Dougherty, Superintendent
Brenton Taylor, PK-12 Principal
Michael A. MacDonald, Director of Pupil/ Personnel Services
Scott R. MacDowall, Business Manager

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September 12, 2013
Hancock Central School District Response to New York State Comptroller's Office Audit
Period: July 1, 2011–June 30, 2013
"Financial Conditions"

The Hancock Central School District recently completed a comprehensive audit of "Financial Conditions" with the New York State Comptroller's Office. Throughout the audit process, Hancock Central School District officials fully cooperated with the field auditor, believing the audit process could only serve to improve District internal controls and financial operations. Superintendent Dr. Terrance P. Dougherty commented, "We take the audit process seriously and fully intend to utilize its recommendations to assist our efforts to strengthen policies, procedures and internal controls."

The audit reported two findings, one pertaining to the development of reasonable budget expenditure and revenue estimates and overall budget transparency, and a second pertaining to the establishment and subsequent management of reasonable and appropriate reserve accounts. With respect to the District's budget development process, given the unpredictable and tumultuous economic climate in New York State and Delaware County, the Board of Education, Superintendent, and Business Manager will remain vigilant in their efforts to ensure transparency, prudence, and wise fiscal management and appropriation of all taxpayer funds. In recent years, the District has been budgeting state and local revenues at actual funding levels. On the expense side, per the recommendation of the Comptroller, moving forward the District will work diligently to budget expenses much closer to actual levels. We remain grateful to our constituents for the continued support, confidence, and trust they have demonstrated to us over the years.

Following closely the expert advice of legal counsel and our external auditors, the District has strategically and purposefully worked over the years to establish a host of legal budget reserve accounts at no additional expense to our taxpayers. In turn, these reserve accounts have provided the District with an added sense of financial security and stability, especially in the face of a highly uncertain and volatile economic climate. Contrary to the opinions expressed in the Comptroller's Audit report, we feel it worth noting that, according to the expert opinions of our legal counsel and external auditors, it is our strongly held belief that all of our reserve accounts have been legally established and appropriately funded as per statutes prescribed by New York State Municipal Law, the Commissioner's Regulations, and New York State Education Law. That said, per the recommendations of the Comptroller, the District will diligently work toward creating financial systems and analysis tools in an attempt to more accurately predict and project anticipated liability expenses that could potentially be offset by funds originating from budget reserve accounts. Furthermore, also consistent with recommendations of the Comptroller, the District will undertake a comprehensive review of all of our existing budget reserves for the purpose of determining the fiscal and structural efficacy of each account. Those found to be defective, if any, will be dissolved and the remaining funds transferred to unrestricted fund balance.

See Note 1 Page 12

See Note 2 Page 12

Terry L. Whitt
President
Hancock Central School District Board of Education

Terrance P. Dougherty
Superintendent
Hancock Central School District

APPENDIX B

OSC COMMENTS ON THE DISTRICT'S RESPONSE

Note 1

The District's budgeting practices have resulted in surpluses which District officials used to finance District reserve funds. These surpluses were a result of tax levies that were greater than necessary to sustain District operations.

Note 2

Our audit findings relate to the reasonableness of the amounts held in specific reserve accounts, not to the legality of the establishment and funding of those reserves.

APPENDIX C

AUDIT METHODOLOGY AND STANDARDS

To accomplish our objective, we interviewed appropriate District officials and employees, tested selected records, and examined pertinent documents for the period July 1, 2011, through June 30, 2013. To analyze the District's historical appropriation of fund balance and establishment of reserves, we extended the audit period back to the fiscal year ended 2007-08.

Our examination included the following:

- We interviewed District officials and employees and reviewed District policies and procedures to gain an understanding of District operations.
- We analyzed revenue and expenditure trends and budget-to-actual figures for the operating funds for fiscal years 2007-08 through 2012-13.
- We reviewed and analyzed reported fund balance levels in comparison to amounts appropriated in adopted budgets for fiscal years 2007-08 through 2012-13.
- We calculated the increase in the tax levy for fiscal years 2007-08 through 2012-13 by reviewing the tax warrants.
- We analyzed reserves to determine if they were properly established, supported, and reasonably funded as of June 30, 2013.
- We obtained the fiscal year 2013-14 general fund trial balance and tested it for accuracy by comparing the balances to original source documents such as bank reconciliations and subsidiary ledgers.
- We obtained health insurance consortium invoices, contracts, and other related documents to verify the amount of potential refund and confirmed the planned use of the refund with District officials. We identified the amount of the refund included in the 2013-14 fiscal year budget through inquiry of District officials and review of the adopted budget for fiscal year ending June 30, 2014.

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.

APPENDIX D

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