

Little Falls City School District

Financial Condition Management

JUNE 2019



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

Contents

- Report Highlights 1**

- Financial Condition Management 2**
 - What Is Effective Financial Condition Management? 2
 - Surplus Fund Balance Exceeded the Statutory Limit 3
 - What Do We Recommend? 5

- Appendix A – Response From District Officials 7**

- Appendix B – OSC Comment on the District’s Response. 9**

- Appendix C – Audit Methodology and Standards 10**

- Appendix D – Resources and Services. 11**

Report Highlights

Little Falls City School District

Audit Objective

Determine whether the Board and District officials effectively managed financial condition.

Key Findings

- For the last three completed fiscal years (2015-16 through 2017-18) surplus fund balance exceeded the statutory limit by \$1.15 to \$1.83 million or 5.3 to 8.5 percentage points.
- The District has generated operating surpluses totaling approximately \$1.5 million over the last three fiscal years. Although total budget variances were generally reasonable, District officials failed to use surplus funds in a manner that benefits the taxpayers and reduces the surplus fund balance.
- District officials have not developed a comprehensive multiyear financial plan.

Key Recommendations

- Reduce the surplus fund balance to within the statutory limit and use the surplus funds to finance one-time expenditures or needed reserves, pay off debt or reduce property taxes.
- Develop a comprehensive multiyear financial plan.

District officials agreed with our recommendations and have initiated or indicated they planned to initiate corrective action.

Background

The Little Falls City School District (District) serves the City of Little Falls and the Towns of Danube, Fairfield, Herkimer, Little Falls, Manheim and Stark in Herkimer County. The District is governed by an elected seven-member Board of Education (Board) responsible for general management and control of financial affairs.

The Superintendent of Schools (Superintendent) is the chief executive officer and responsible, along with other administrative staff, for day-to-day management, budget development and administration. The Director of Business Operations is responsible for District business activities.

Quick Facts

Enrollment	1,098
2017-18 Appropriations	\$21.4 million

Audit Period

July 1, 2017 – October 31, 2018. We extended our audit period back to July 1, 2015 to review fund balance and budgeting trends, for the last three completed fiscal years.

Financial Condition Management

What Is Effective Financial Condition Management?

To effectively manage a school district's financial condition, a board must adopt realistic and structurally balanced budgets, based on historical or known trends, in which recurring revenues finance recurring expenditures. The board must estimate the district's spending, revenue, available fund balance at fiscal year-end, and the expected tax levy. Accurate budget estimates help ensure the real property tax levy is not greater than necessary.

The board must maintain a reasonable level of fund balance, which is the difference between revenues and expenditures accumulated over time. Boards may retain a portion of fund balance for unexpected events and cash flow but must do so within statutory limits. New York State Real Property Tax Law¹ limits the amount of surplus fund balance that a school district can retain to no more than 4 percent of the subsequent year's budget.²

Additionally, school districts are allowed to legally set aside, or reserve, portions of fund balance to finance future costs for specific purposes (e.g., capital projects or retirement expenditures) and may appropriate a portion of fund balance to help finance the next year's budget. When fund balance is appropriated in the budget, there is an expectation of an operating deficit (expenditures exceeding revenues) to be financed by the appropriated fund balance. This allows a school district to use excess fund balance accumulated in prior years to fund current operations.

A board that is planning to establish and maintain reserve funds should develop a written policy that states its rationale for establishing the reserve funds, objectives for each reserve, maximum targeted funding levels and conditions under which reserves will be used or replenished. When using reserve funds, district officials should balance the desire to accumulate funds for future needs with the obligation to make sure real property taxes are not higher than necessary.

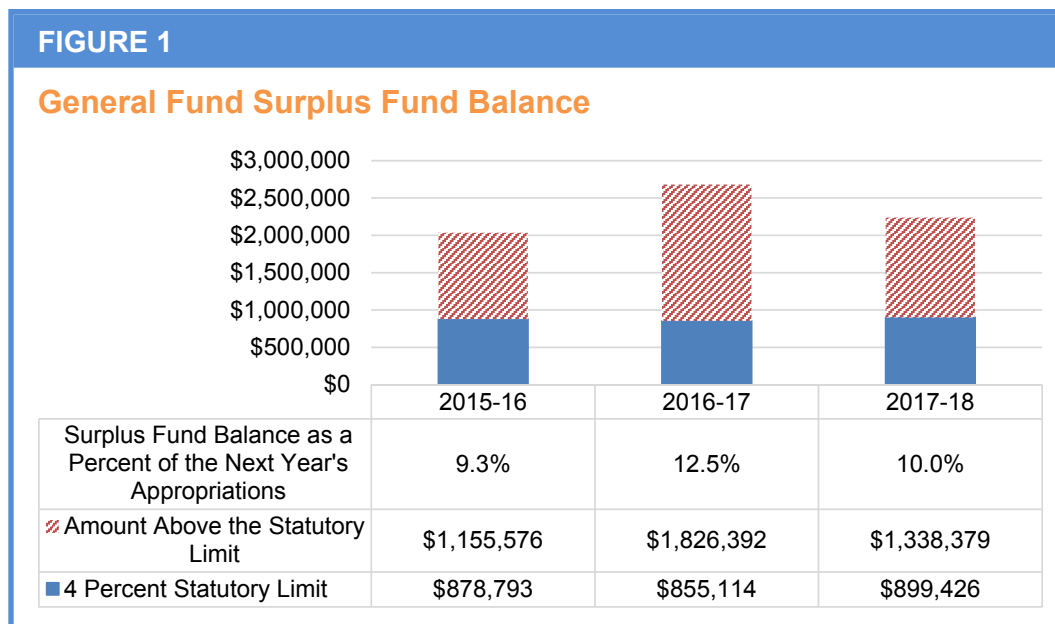
Multiyear financial planning is a valuable tool school districts can use to improve the budget development process. It enables district officials to identify revenue and expenditure trends, establish long-term priorities and goals, consider the impact of near-term budgeting decisions on future fiscal years, and assess the merits of alternative approaches (such as using surplus funds or establishing and using reserves) to finance operations. Any long-term financial plan should be continually monitored and updated to provide a reliable framework for preparing budgets and ensure that information used to guide decisions is current and accurate.

1 New York State Real Property Tax Law, Section 1318

2 Surplus fund balance is defined as unrestricted fund balance minus appropriated fund balance and encumbrances included in committed and assigned fund balance. See our accounting bulletin at <https://www.osc.state.ny.us/localgov/pubs/releases/gasb54.pdf>

Surplus Fund Balance Exceeded the Statutory Limit

For the last three completed fiscal years (2015-16 through 2017-18) the District has reported surplus fund balance in the general fund that exceeded the statutory limit by \$1.15 to \$1.83 million or 5.3 to 8.5 percentage points. Officials need to improve budgeting practices and establish long term financial plans to effectively manage fund balance and maintain it within the legal limit.



District officials did not appropriate any fund balance to finance the 2015-16 budget and appropriated \$105,000 of fund balance (about \$52,500 each year) to finance the 2016-17 and 2017-18 budgets. However, these amounts were not used to finance operations because the District generated operating surpluses of approximately \$710,000 for 2015-16, \$781,000 for 2016-17 and \$11,000 for 2017-18.

We compared estimated revenues and budget appropriations with actual results of operations from 2015-16 through 2017-18 and found that total budget variances were 2 percent or less each of the last three years (Figure 2).

Figure 2: General Fund Budget-to-Actual Comparison

	2015-16	2016-17	2017-18 ^a	Total
Estimated Revenues	\$21,421,133	\$21,916,688	\$21,326,082	\$64,663,903
Actual Revenues	\$21,708,960	\$22,316,803	\$21,711,975	\$65,737,738
Amount Over Budget	\$287,827	\$400,115	\$385,893	\$1,073,835
Percentage Over Budget	1.3%	1.8%	1.8%	1.7%
Budgeted Appropriations	\$21,421,133	\$21,969,830	\$21,377,838	\$64,768,801
Actual Expenditures	\$20,998,417	\$21,535,667	\$21,701,168	\$64,235,252
Amount Over (Under) Budget	\$422,716	\$434,163	(\$323,330)	\$533,549
Percentage Over (Under) Budget	2.0%	2.0%	(1.5%)	0.8%
Operating Surplus	\$710,543	\$781,136	\$10,807	\$1,502,486

^a While total expenditures exceeded the original budget in 2017-18, the District kept expenditures under total appropriations in the modified budget. The District modified the budget to increase appropriations by \$346,445 for prior year encumbrances and unbudgeted revenues from gifts and donations.

While revenue variances in total were generally reasonable, the District underestimated revenues from refunds of prior year expenditures each year. These revenues primarily consisted of payments from the Herkimer-Fulton-Hamilton-Otsego Board of Cooperative Educational Services for surplus funds returned to the District (as a component unit) from the prior fiscal year. The District annually budgeted \$25,000 for this revenue, but actually received \$200,000 to \$220,000 in revenue each year.

Over the three-year period, the District received about \$550,000 more than budgeted, which represents about half of the District's total revenue budget variance. In the 2018-19 budget, the District increased the revenue estimate to \$100,000, which may still be low based on prior year historical results.

Although the total budget variances were not significant in terms of their percentage, they led to the District generating operating surpluses totaling \$1.5 million over the three-year period, which doubled the total fund balance from about \$1.5 million at the beginning of 2015-16 to nearly \$3 million at the end of 2017-18.

The Board and District officials have taken limited actions to reduce the unassigned fund balance to the legal limit and to use the surplus funds in a manner that benefits taxpayers, such as reducing the District property taxes, funding needed reserves or one-time expenditures or paying off debt. For example, when surplus fund balance was 5.3 percentage points over the statutory limit at the end of 2015-16, officials increased the tax levy by an additional \$187,844 (2 percent) in the 2016-17 budget rather than apply the excess funds to maintain or decrease the tax levy. Since that time, the District has maintained a flat tax levy.

Figure 3: Real Property Tax Levies

	2015-16	2016-17	2017-18	2018-19
Real Property Tax Levy	\$8,449,553	\$8,637,397	\$8,637,397	\$8,637,397
Dollar Increase From Prior Year	\$71,780	\$187,844	\$0	\$0
Percentage Increase From Prior Year	1%	2%	0%	0%

The Board established and funded a retirement contribution reserve³ in the amount of \$225,000 during 2017-18, which helped reduce surplus fund balance to 10 percent of the next year's appropriations. However, if the Board intends to establish and finance other reserves using the surplus funds, it should adopt a formal reserve fund policy that includes the financial objectives for establishing each reserve, optimal or targeted funding levels and the conditions under which the reserves will be used to finance the related costs.

Prudent fiscal management also requires the Board to establish multiyear long-term financial plans which include plans for reducing the surplus fund balance to the legal limit and for maintaining and using any reserves funds established. District officials told us they currently do not have a written long-term financial plan.

What Do We Recommend?

The Board and District officials should:

1. Ensure that the amount of surplus fund balance complies with the statutory limit and use the surplus funds as a financing source for:
 - Funding one-time expenditures;
 - Funding needed reserves;
 - Paying off debt; and
 - Reducing District property taxes.
2. Develop a comprehensive written multiyear financial plan to provide a framework for future budgets and guide the District's management of financial condition. The plan should be periodically reviewed and updated as appropriate.

³ The District reported no other reserve funds during our audit period.

The Board should:

3. Adopt annual budgets that contain realistic estimates for revenues and appropriations based on historical or other known factors.
4. Adopt a written reserve fund policy if it chooses to establish and fund reserves.

-
- Developing a long-term plan to outline the funding of established reserve funds, set board-adopted parameters for the use of reserve funds, and setting targets for maintenance of a reasonable fund balance.

Audit Recommendation: The Board should adopt annual budgets that contain realistic estimates for revenues and appropriations based on historical or other known factors.

The anticipated revenues from BOCES aid and Medicaid Reimbursement, among others, have been better aligned with historical trends in the 2019-2020 budget. As noted in the review, total budget variances have not been significant in past budgets, although those budgets have contributed to an increase in the fund balance to differing degrees. In order to better address this issue, the District and School Board will, as of the 2020-2021 School Year:

- Adopt budgets that better reflect anticipated revenues and projected appropriations based on historical trends.
- Clearly indicate the funds in the budget that will be allocated to funding the established reserves on adopted budgets.
- Attach a schedule of reserve funds to future budgets.
- Adopt a clear reserve policy that delineates reserve fund limits, annual funding levels and the purposes and conditions under which the funds may be accessed.

The Little Falls City School District has always prioritized the needs of students while remaining cognizant of our fiscal responsibility to our community. Not too many years ago, the district was urged to increase fund balance levels to provide a firewall against upheaval to students and teachers during adverse fiscal climates. We have maintained our programs, staffing levels and class sizes while districts around us had to make difficult choices. Moving forward, we will continue to remain fiscally prudent, while also adopting the recommendations and findings of this audit to improve our current practices.

Sincerely,

Keith T. Levatino
Superintendent of Schools

Appendix B: OSC Comment on the District's Response

Note 1

The Board must follow the provisions of Education Law, Section 3651(1) when establishing and expending funds from a capital reserve and therefore may not be able to use a capital reserve fund for *unexpected* one-time expenditures.

The law allows the District to establish a capital reserve, with voter approval, to finance all or part of the cost of any object or purpose for which bonds may be issued. The proposition submitted to voters for approval must specify: (1) the purpose for which the fund would be established, (2) the ultimate amount, and (3) the probable term and the source from which the funds are to be obtained. Expenditures from the reserve can only be made by authorization of the voters and for the specific purpose specified in the proposition. For more information, District officials should refer to our publication entitled *Local Government Management Guide - Reserve Funds*: <http://www.osc.state.ny.us/localgov/pubs/lgmng/reservefunds.pdf>.

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 interviewed District officials and reviewed the Board minutes, resolutions and budget policies to gain an understanding of the budget process and whether the District had developed multiyear financial or capital plans.
- We reviewed and analyzed the District's financial records and reports for the general fund including annual general fund budgets, audited financial statements, budget status reports and general ledgers.
- We analyzed the trend in total fund balance in the general fund for the 2015-16 through 2017-18 fiscal years. We assessed fund balance levels and compared surplus fund balance with the next years' budget appropriations to determine whether the District was within the statutory limit.
- We compared the general fund's total estimated revenues and budget appropriations with actual revenues and expenditures for the 2015-16 through 2017-18 fiscal years to determine whether District budgets were reasonable. We followed up with District officials on significant budget variances.

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

Regional Office Directory

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

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

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

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

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/pubs/cyber-security-guide.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

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

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

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