Office of the New York State Comptroller

Division of Local Government
& School Accountability

Homer
Central School District

Financial Condition

Report of Examination

Period Covered:

July 1, 2011 — July 30, 2013

2013M-306

Thomas P. DiNapoli

Table of Contents

State of New York
Office of the State Comptroller

Division of Local Government
and School Accountability

February 2014

Dear School District Officials:

A top priority of the Office of the State Comptroller is to help local government officials manage government resources efficiently and effectively and, by so doing, provide accountability for tax dollars spent to support government operations. The Comptroller oversees the fiscal affairs of local governments statewide, as well as 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 operations and the Board of Education governance. Audits also can identify strategies to reduce costs and to strengthen controls intended to safeguard local government assets.

Following is a report of our audit of the Homer 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 local government 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 Homer Central School District (District) is located in Cayuga, Cortland, Onondaga and Tompkins Counties. The District is governed by the Board of Education (Board) which comprises nine elected members. The Board is responsible for the general management and control of the District's financial and educational affairs, including budget development. The Superintendent of Schools (Superintendent) is the District's chief executive officer and is responsible, along with other administrative staff, for the District's day-to-day management under the direction of the Board. The District's Director of Business and Finance (Director)[1] plays a key role in the budget development process and daily administration of the Business Office.

There are five schools and a transportation facility in operation within the District with approximately 2,150 students. The District's budgeted expenditures for the 2013-14 fiscal year are $39 million, which were funded primarily with State aid and real property taxes.

Objective

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

- Did the Board and District management ensure that budget estimates and reserve balances were reasonable?

Scope and Methodology

We examined the District's budgeting practices and reserves and analyzed the District's financial records for the period of July 1, 2011 through July 30, 2013. To analyze the District's historical financial condition and budgeting and reserves, we extended our audit scope period back to July 1, 2008.

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 B 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 agreed with our recommendations and indicated they planned to initiate corrective action.

[1] The District's Director position experienced significant turnover in the last three fiscal years. A prior Director resigned in May 2011 and was replaced with an interim Director, who only served the District for the summer of 2011. Another Director served the District from August 2011 until April 2013. The current Director was hired in July 2013.

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

The Board and Superintendent are responsible for ensuring that adopted budgets are prepared and amended based on reasonable appropriation and revenue estimates. Sound budgeting provides sufficient funding for necessary operations. Prudent fiscal management includes establishing reserves needed to address long-term obligations or planned future expenditures. Once the Board has addressed those issues, any remaining fund balance, exclusive of the amount allowed by law to be retained to address cash flow and unexpected occurrences, should be used to reduce the local tax levy. Additionally, the Board should fund reserves appropriately, monitor reserve amounts and use them as intended for planned expenditures.

The Board did not ensure budget estimates were reasonable. Over the last five fiscal years, the District appropriated a total of almost $3.6 million[2] of unexpended surplus funds[3] and budgeted for expenditures from its reserves in its budgets. Although unexpended surplus and reserve funds were included in the budgets as financing sources, the District did not actually use the surplus funds or all of the budgeted reserve fund amounts as planned in the 2008-09 to 2009-10 fiscal years, and the 2011-12 to 2012-13 fiscal years. District expenditures were significantly less than what had been estimated for those years. In addition, two of the District's reserve fund balances are excessive. Finally, when we consider the total operating surpluses and planned use of fund balance over the last five fiscal years, the District raised $2.4 million more in taxes than necessary for operations.

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[2] This total is from the adopted budgets. The District's annual financial reports reported different amounts for the 2009-10, 2010-11 and 2012-13 fiscal years for appropriated fund balance for a total of $6.3 million over the past five years.

[3] The Governmental Accounting Standards Board (GASB) issued Statement 54, which replaces the fund balance classifications of reserved and unreserved with new classifications: non-spendable, restricted and unrestricted (comprising 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, less any amounts appropriated for the ensuing year's budget (after Statement 54).

Table 1: Budget vs. Actual Revenues and Expenditures

	2008-09	2009-10	2010-11	2011-12	2012-13	Totals
Estimated Revenues[a]	$36,898,050	$38,199,905	$37,836,495	$37,811,205	$37,400,000	**$188,145,655**
Actual Revenues	$35,467,671	$36,998,971	$34,525,369	$34,179,426	$36,152,488	**$177,323,925**
Variance	($1,430,379)	($1,200,934)	($3,311,126)	($3,631,779)	($1,247,512)	**($10,821,730)**
Appropriations	$37,198,050	$38,649,905	$38,286,495	$39,211,205	$38,400,000	**$191,745,655**
Actual Expenditures	$34,152,505	$35,378,737	$35,070,837	$35,455,251	$36,198,616	**$176,255,946**
Variance	$3,045,545	$3,271,168	$3,215,658	$3,755,954	$2,201,384	**$15,489,709**
Operating Surplus/ (Deficit)	$1,315,166	$1,620,234	($545,468)	($1,275,825)	($46,128)	**$1,067,979**

[a] This amount does not include the amount of appropriated fund balance.

The aggregate expenditures variance of almost $15.5 million was driven primarily by over estimating salaries, employee benefits, debt and building utilities. Most of these expenditures should be predictable because they are based on fixed contracts and debt schedules. The District also fixes their utility rates on an annual basis. Most of the $10.8 million variance in actual revenues was due to the District receiving less Federal aid than estimated. While the Board members told us they reviewed actual expenditures during the budget process, the information included in the Board's public budget presentations only included the prior year's budgets for comparison. Moreover, the Board adopted budgets for the last four fiscal years that were, on average, 10 percent higher than the preceding fiscal years actual expenditures, while each year's actual expenditures were, on average, increasing 1 percent.

The District's annual budgets also included the use of fund balance and various reserves to finance operations in order to keep the real property tax levies at amounts the Board considered to be reasonable. For the five-year period, the Board adopted budgets that included aggregate appropriated unexpended surplus funds of almost $3.6 million. However, very little of the planned amount was used because, for the same period, actual operations generated surpluses totaling nearly $1,067,979 (see Table 1).

Similarly, the Superintendent and Board presented projected uses of reserve money to finance operations that were not necessary because of the significant surpluses generated instead of the deficits that had been planned. For instance, during the development of the 2012-13 fiscal year budget, the Superintendent and Board presented plans to use $2.7 million in reserves to finance operations. However, the District used $1 million because the particular planned expenditures were financed instead by real property taxes. Because this has repeated over the years, the reserve balances have remained high and some specific reserves were higher than necessary.

At the 2012-13 fiscal year end, the District's reserve balances totaled more than $6.8 million. The District had accumulated over $2.5 million in both the workers' compensation reserve and the unemployment reserve. Since 2009, the workers' compensation reserve had a balance that was nearly 32 times the average annual expenditures. Likewise, since 2009, the balance in the unemployment reserve was over 24 times the annual average expenditures. The Board included a provision to use $425,000 from the workers' compensation reserve in the 2012-13 fiscal year budget; however, it was not used. The Board did not include a provision in the 2012-13 fiscal year budget for the use of unemployment reserve funds. Although the District has a five-year plan indicating the amounts it plans to use, the plan has not been followed.

Combined with the poor budget estimates, the increases in tax levies for last three fiscal years may not have been necessary. Additionally, the operating surpluses generated in two of the fiscal years were more than the tax levy increases. If the real property tax levies remained at the level of the fiscal year ended 2009, the total taxes paid by residents would have been over $2.4 million less than actually paid.

Recommendations

1. The Board should adopt budgets that include the District's actual needs based on historical trends or other identified needs.

2. District officials should develop a plan for the use of the unexpended surplus funds identified in this report in a manner that benefits District taxpayers and provides appropriate transparency through the budget process with public disclosure. Such uses could include, but are not limited to, reducing District property taxes, funding one-time expenditures or establishing and funding necessary reserves.

3. 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. If these transfers cause the unrestricted fund balance to exceed the statutory limit, then the Board should develop a plan to reduce the amount of fund balance in a manner that benefits District taxpayers.

APPENDIX A

RESPONSE FROM DISTRICT OFFICIALS

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

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(607) 749-7241
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Nancy S. Ruscio
Superintendent

January 29, 2014

Office of the State Comptroller
Attention: Mr. H. Todd Eames
Binghamton Regional Office
44 Hawley Street
Binghamton, NY 13901-4417

Dear Mr. Eames and Homer Community,

The Homer Central School District is in receipt of the draft audit report, Financial Condition, for the period July 1, 2011-July 30, 2013, prepared by the Office of the State Comptroller. First and foremost, the Board of Education and District Administrators wish to thank [redacted] and [redacted] for their patience and professionalism.

This Audit examined the Financial Condition of the School District. The Comptroller's Local Government Management Guide titled "Financial Condition Analysis," defines financial condition as a local government's ability to finance services on a continuing basis. This ability involves maintaining adequate service levels, while surviving economic disruptions, being able to identify and adjust to long-term changes, and anticipating needs. We believe the financial condition of the Homer Central School District reflects these principles.

Over the past five years, the demands for change in education have been many and the ability to anticipate needs has become extremely challenging. Schools have had to bear non-funded mandates for increased student achievement and new requirements for fiscal accountability measures. At the same time, schools are working diligently to live within the property tax cap during this unprecedented national and state economic recession.

Over the last five years, the district has lost $13 million in state aid and is still receiving less state aid than in 2008. To weather this storm, the district has utilized more reserve funds each year to balance the budget. Over the past ten years, the district indeed saved for a rainy day which came to fruition these past four years in the worst recession in our country's recent history.

In the past three years, the district has worked very hard to be fiscally transparent. To that end, the district went above and beyond the normal auditing requirements by hiring D'Arcangelo & Company, LLP to complete a forensic audit of our reserves. The auditors' recommendation was for the district to develop a budgeting plan to utilize amounts accumulated in the debt service fund and the EBLAR reserve. The district did indeed create such a spend-down plan and continues to update that plan with each budgeting year. In 2012-13, the district has drawn down

"Excellence of Instruction and Opportunity"

the debt reserve by $3 million. It has been the advice of both Internal and External auditors and our Fiscal Advisors to use a conservative approach to this spend-down plan.

It is true that during the last two budget presentations, we informed the public that we would use up to $2.35 million in reserves if necessary. However, the amount of reserve use is always an estimate since our state budget is passed by April 1st, but budget estimates are completed well in advance in order to set our maximum allowable tax levy by March 1st of each year.

While the Audit was being conducted, the District Facilities Committee and the Board of Education were planning for a much needed $20.9 million capital project that was approved by voters on December 12, 2013. Working with our Fiscal Advisors, the district has committed to spending $3.9 million in reserves as a down payment, thus reducing the project's starting principal amount to $17 million. Through our discussions with the Auditors, it was determined that monies from the Workers Compensation and Unemployment Reserves would be utilized. This commitment to use 3.9 million in reserves will aid us in our planning for future budgets by reducing potential taxpayer expenses.

Therefore, let this response be our official corrective action:

1. The district will adopt future budgets based on an analysis of actual as well as historical trends. The budgets figures will be screened by both the BOE Budget/Finance Committee and the BOE Audit Committee.

2. Going forward, the District will work with the BOE Budget/Finance Committee to do a five year projection on Reserves. The use of the $3.9 million in reserves for the capital project will also be paramount in the projections. Utilizing actual, as well as, historical revenue and appropriation trends will allow the BOE to determine the best course of action that will benefit the students and taxpayers alike.

3. The Board of Education, (along with the BOE Budget/Finance Committee and the BOE Audit Committee) will review all reserve balances quarterly and determine if the amounts reserved are necessary, reasonable, and in compliance with statutory requirements. To the extent that they are not, transfers will be made to unrestricted fund balance (where allowed by law) or other reserves established and maintained in compliance with statutory directives. If these transfers cause the unrestricted fund balance to exceed the statutory limit, then the Board of Education will develop a plan to reduce the amount of fund balance in a manner that benefits District taxpayers.

We believe those steps address any concerns raised. We appreciate your report as it helps us in future fiscal responsibility for all of our stakeholders.

Respectfully submitted,

Nancy S. Ruscio

Nancy S. Ruscio
Superintendent of Schools

APPENDIX B

AUDIT METHODOLOGY AND STANDARDS

To accomplish our objective, we interviewed appropriate District officials, tested selected records and examined pertinent documents for the period of July 1, 2011 through July 30, 2013. To analyze the District's historical financial condition and budgeting and reserves, we extended our audit scope period back to July 1, 2008. Our examination included the following:

- We interviewed District officials and reviewed Board meeting minutes and resolutions to gain an understanding of their budgeting process including their determination of fund balance available for appropriation and their procedures for monitoring and controlling the budget.

- We calculated the results of operations over the last five fiscal years by comparing actual revenues to actual expenditures including appropriated fund balance where applicable.

- We compared the budgeted revenues and appropriations to actual revenues and expenditures for the general fund for the fiscal years 2008-09 through 2012-13 to determine if the District's budget estimates were reasonable. We examined the budget line items where actual revenues and expenditures were at least 5 percent of total revenue or expenditures or where the variance was $100,000 over- or under-budget to determine line items that were significantly over- or under-budgeted.

- We reviewed the District's tax levy, taxable assessment and tax rate for the fiscal years 2008-09 through 2012-13 to determine if the tax levy and rates had been increasing.

- We analyzed the reserves to determine if they were properly established, supported and reasonably funded. This included calculating an average expenditure and comparing it to the annual balance to determine how many years each of the reserves could fund.

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 conclusions based on our audit objective.

APPENDIX C

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