Office of the New York State Comptroller

Division of Local Government & School Accountability

Horseheads Central School District

Financial Condition

Report of Examination

Period Covered:

July 1, 2012 – March 10, 2016

2016M-138

Thomas P. DiNapoli

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State of New York
Office of the State Comptroller

Division of Local Government
and School Accountability

August 2016

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 Horseheads 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 New York State 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

State of New York
Office of the State Comptroller

EXECUTIVE SUMMARY

The Horseheads School District (District) is located in the Towns of Baldwin, Big Flats, Catlin, Erin, Horseheads and Veteran in Chemung County and the Town of Cayuta in Schuyler County. The District is governed by a Board of Education (Board), which is composed of nine elected members. The Board is responsible for the general management and control of the District's financial and educational affairs. The Superintendent of Schools 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 Board's direction.

The District operates seven schools with approximately 4,000 students and 643 employees. The District's budgeted appropriations for the 2015-16 fiscal year were $73.6 million, which were funded primarily with State aid and real property taxes.

Scope and Objective

The objective of our audit was to examine the District's financial condition for the period July 1, 2012 through March 10, 2016. Our audit addressed the following related question:

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

Audit Results

The Board and District officials did not adequately manage the District's financial condition. Officials overestimated general fund appropriations for the 2012-13 through 2014-15 fiscal years by $14.9 million (7 percent), which resulted in operating surpluses totaling $2.4 million. During this period, the District levied an additional $1.6 million in real property taxes and appropriated fund balance totaling $16 million and reserves totaling $258,440 that were not needed to finance operations as planned. This resulted in the District's unrestricted fund balance exceeding the 4 percent statutory limit,[1] ranging from 14.1 to 18.9 percent.

We also project that the District will not use any of the appropriated fund balance totaling $4.5 million for 2015-16. Because District officials continued these budgeting practices when adopting the 2016-17 budget, the District will most likely experience another operating surplus.

[1] New York State Real Property Tax Law limits the amount of unrestricted fund balance to no more than 4 percent of the subsequent year's budgeted appropriations.

In addition, as of June 30, 2015, the District had two reserves totaling $2.6 million that were overfunded, overstated a liability totaling $638,885 and did not transfer unused flex spending moneys totaling $250,047 to the general fund, which further increases the excessive amount of unrestricted fund balance. When combining the unused appropriated fund balance for the ensuing year and reserves with the other overstatements and excesses, the District's recalculated unrestricted fund balance was between 25 and 30 percent of the ensuing year's appropriations, further exceeding the statutory limit. As of June 30, 2015, the District also had more than $3.6 million in the debt service fund available for debt payments that had not been used to finance debt payments, and it continues to accumulate money each year.

Comments of District Officials

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 disagreed with certain aspects of our findings and recommendations in our report but indicated that they planned to implement some of our recommendations. Appendix B includes our comments on the issues raised in the District's response letter.

Introduction

Background

The Horseheads School District (District) is located in the Towns of Baldwin, Big Flats, Catlin, Erin, Horseheads and Veteran in Chemung County and the Town of Cayuta in Schuyler County. The District is governed by a Board of Education (Board), which is composed of nine elected members. The Board is responsible for the general management and control of the District's financial and educational affairs. The Superintendent of Schools 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 Board's direction.

The District operates seven schools with approximately 4,000 students and 643 employees. The District's budgeted appropriations for the 2015-16 fiscal year were $73.6 million, which were funded primarily with State aid and real property taxes.

During our audit period, the former Superintendent resigned on June 30, 2015, and the District hired an interim Superintendent until the current Superintendent started in August 2015. Also, the District's business administrator, who is a Greater Southern Tier Board of Cooperative Educational Services (BOCES) employee, was replaced by another BOCES employee in July 2014 and is working part-time for the District.

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 officials adequately manage the District's financial condition?

Scope and Methodology

We examined the District's financial condition for the period July 1, 2012 through March 10, 2016.

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. 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.

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 disagreed with certain aspects of our findings and recommendations in our report but indicated that they planned to implement some of our recommendations. Appendix B includes our comments on the issues raised in the District's response letter.

The Board has the responsibility to initiate corrective action. 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, 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

It is essential that the Board adopt structurally balanced budgets in which recurring revenues finance recurring expenditures and reasonable levels of fund balance are maintained. District officials must ensure that budgets use available resources to benefit taxpayers; are prepared, adopted and modified in a prudent and transparent manner; and accurately depict the District's financial activity. Prudent fiscal management also includes maintaining sufficient balances in reserves to address long-term obligations or planned expenditures. In doing so, District officials should adopt a policy or plan governing the use of reserve funds and ensure that residents are fully informed of all reserve funding and activity.

The Board and District officials did not adequately manage the District's financial condition. They overestimated general fund appropriations for the 2012-13 through 2014-15 fiscal years by $14.9 million (7 percent), which resulted in operating surpluses totaling $2.4 million. During this period, the District levied an additional $1.6 million in real property taxes and appropriated fund balance totaling $16 million and reserves totaling $258,440 that were not needed to finance operations as planned. This resulted in the District's unrestricted fund balance exceeding the 4 percent statutory limit,[2] ranging from 14.1 to 18.8 percent. We also project that the District will not use any of the appropriated fund balance totaling $4.5 million for 2015-16. Because District officials continued these budgeting practices when adopting the 2016-17 budget, the District will most likely experience another operating surplus.

In addition, as of June 30, 2015, the District had two reserves totaling $2.6 million that were overfunded, overstated a liability totaling $638,885 and did not transfer unused flex spending moneys totaling $250,047 to the general fund, which further increases the excessive amount of unrestricted fund balance. When combining the unused appropriated fund balance for the ensuing year and reserves with the other overstatements and excesses, the District's recalculated unrestricted fund balance was between 25 and 30 percent of the ensuing year's appropriations, further exceeding the statutory limit. As of June 30, 2015, the District also had more than $3.6 million in the debt service fund available for debt payments that had not been used to finance debt payments, and it continues to accumulate money each year.

[2] New York State Real Property Tax Law limits the amount of unrestricted fund balance to no more than 4 percent of the subsequent year's budgeted appropriations.

General Fund Budgeting and Fund Balance

Budget transparency is important for public participation and accountability and allows residents to provide feedback on the quality and adequacy of services and decisions that affect the District's long-term financial stability. It is essential that the Board and District officials prepare budgets based on historical or known trends. In addition, they are responsible for estimating expenditures, revenues (e.g., State aid) and the amount of fund balance that will be available at the end of the current fiscal year and balancing the budget by determining the required tax levy. Accurate budget estimates help ensure that the levy of real property taxes is no greater than necessary.

Unrestricted fund balance represents resources remaining from prior fiscal years that can be used to lower property taxes for the ensuing fiscal year. Unrestricted fund balance in excess of the statutory limit must be used to fund a portion of the next year's appropriations, thereby reducing the tax levy, or used to fund legally established reserves. Districts may establish reserves to restrict a reasonable portion of fund balance for a specific purpose, also in compliance with statutory directives.

Budgeting – We compared the District's appropriations with actual expenditures for the 2012-13 through 2014-15 fiscal years and found that the District overestimated appropriations by $14.9 million (7 percent) during this time (Figure 1).

Figure 1: Overestimated Appropriations

	Appropriations	Expenditures	Difference	Percentage
2012-13	$68,647,671	$63,446,119	$5,201,552	8%
2013-14	$70,226,654	$64,760,338	$5,466,316	8%
2014-15	$71,170,877	$66,949,023	$4,221,854	6%
Totals	**$210,045,202**	**$195,155,480**	**$14,889,722**	**7%**

The majority of the difference can be attributed to the overestimation of appropriations for health insurance by $6.6 million (44 percent), salaries by $4.6 million (31 percent) and teachers' retirement costs by $2.3 million (15 percent). Also, actual revenues exceeded budgeted estimates by an average of $175,000 annually during the same period.

The Board continued these budgeting practices when developing the 2015-16 and 2016-17 budgets. District officials project the District will have an operating surplus totaling approximately $2.6 million at the end of the 2015-16 fiscal year.

Fund Balance – Because District officials significantly overestimated appropriations, it appeared that the District needed to both increase its tax levy and use fund balance to close projected budget gaps. However, because the District realized operating surpluses totaling

$2.4 million, it raised more taxes than necessary and appropriated fund balance totaling $16 million that were not needed to fund operations. As a result, the District's fund balance not only remained excessive, but also increased significantly (Figure 2).

Figure 2: Unrestricted Fund Balance at Year-End

	2012-13	2013-14	2014-15
Total Beginning Fund Balance	$26,539,942	$25,226,297	$24,473,509
Add: Operating Surplus	$141,518	$1,433,430	$848,537
Less: Interfund Transfers	$1,455,163	$2,186,218	$4,081,045
Total Ending Fund Balance	$25,226,297	$24,473,509	$21,241,001
Less: Non Spendable	$12,321	$23,149	$24,020
Less: Restricted Funds	$6,647,360	$5,577,118	$6,117,747
Less: Encumbrances	$26,010	$221,885	$169,372
Less: Appropriated Fund Balance for the Ensuing Year	$6,000,000	$5,000,000	$4,535,128
Less: Amounts Reserved for Tax Reduction	$165,903	$91,056	0
Total Unrestricted Funds at Year-End[a]	$12,374,703	$13,560,301	$10,394,734[b]
Ensuing Year's Budgeted Appropriations	$71,640,654	$72,284,877	$73,641,191
Unrestricted Funds as Percentage of Ensuing Year's Budget	17.3%	18.8%	14.1%

[a] During each fiscal year, the District designated a significant amount of unrestricted funds as committed fund balance ($9,494,922 in 2012-13, $10,694,922 in 2013-14, and $7,463,647 in 2014-15) for purposes such as transportation and technical, retirement incentives and State aid gap elimination. Committed fund balance consists of amounts that are subject to a purpose constraint imposed by the Board. As of June 30, 2015, the committed fund balance included $5 million for transportation and technology and $2.5 million for retirement incentives. However, because committed fund balance is not properly retained under General Municipal Law or Education Law, it must be included in the amount used to calculate the percent of unrestricted funds as a percentage of the ensuing year's budget.

[b] Although unrestricted funds decreased at the end of the 2014-15 fiscal year, it was due to interfund transfers rather than an operating deficit.

By not using the appropriated fund balance from the prior year, the District's unrestricted fund balance significantly exceeded the statutory limit for the last three completed fiscal years. The District has continued to retain excessive unrestricted fund balance even though its last three annual independent audit reports[3] contained a finding related to the District's unrestricted fund balance being in excess of the statutory limit. District officials did not take corrective action in response to these audits.

The District's corrective action plan to address the findings of these audits stated that it would appropriate fund balance to bring its unrestricted funds in compliance with the statutory limit. However, because the District realized operating surpluses in each fiscal year, the appropriated fund balance was unneeded, making the District's corrective action plan ineffective.

In addition to excess unrestricted fund balance, as of June 30, 2015, the District had two reserves totaling $2.6 million that were overfunded[4] and inaccurately calculated and reported its liability for compensated absences and accrued liabilities, and it failed to transfer,

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[3] 2012-13 through 2014-15 fiscal years

[4] Refer to the Reserves section for further information.

or record as an asset of the general fund, unused flex spending moneys from the District's trust and agency fund to the general fund. The inaccurately calculated and reported liabilities resulted in the understatement of fund balance by $638,885. The lack of transfer, or recording as an asset, of the unused flex spending moneys resulted in the understatement of fund balance by $250,047.

When unused actual and projected appropriated fund balance, overfunded reserves, overstated liabilities and the unused flex spending moneys are added back, the District's recalculated unrestricted fund balance was between 25 percent and 30 percent of the ensuring year's appropriations, which is about six to eight times the statutory limit (Figure 3).

Figure 3: Unused Fund Balance

	2012-13	2013-14	2014-15
Total Unrestricted Funds at Year-End	$12,374,703	$13,560,301	$10,394,734
Add: Appropriated Fund Balance Not Used To Fund Ensuing Year's Budget	$6,000,000	$5,000,000	$4,535,128[a]
Add: Overstated Liability	$897,164	$655,883	$638,885
Add: Unused Flex Spending Money	$163,834	$208,906	$250,047
Total Recalculated Unrestricted Funds	$19,435,701	$19,425,090	$15,818,794
Add: Excessive Reserves	$849,888	$2,550,996	$2,552,588
Recalculated Unrestricted Funds (Including Excessive Reserves)	$20,285,589	$21,976,086	$18,371,382
Recalculated Unrestricted Funds (Including Excessive Reserves) as a Percentage of Ensuing Year's Budget	28%	30%	25%

[a] We project that the District will not use any of the appropriated fund balance in 2015-16. The District projects it will have a surplus of $2.6 million for 2015-16.

The District's practice of appropriating fund balance totaling $16 million that was not needed to finance operations was, in effect, a reservation of fund balance that is not provided for by statute and a circumvention of the statutory limit imposed on the level of unrestricted fund balance that the District may retain. While the District has realized operating surpluses and retained excessive fund balance, it also increased the real property tax levy by $1.6 million over the last three completed fiscal years.

District officials stated that the $4.5 million appropriated in the 2015-16 budget will not be needed to help finance 2015-16 operations. Therefore, we expect the District's unrestricted fund balance will again exceed the statutory limit and continue the trend of annual increases.

On May 19, 2015, the voters approved a District proposition to establish a capital reserve. As of June 30, 2016, the District's projected excess unrestricted fund balance will be $10 million, which is more than sufficient to fully fund the capital reserve. Also on May 19, the voters approved another District proposition to construct a capital project with a maximum cost of $3 million to be funded by the issuance of bonds and notes. However, in June 2015 the Board adopted a resolution to use $3 million from committed fund balance to fund this project. A more transparent and appropriate method when presenting the proposition to the voters would have been to calculate ending fund balance and include the use of the excess fund balance as a funding source.

Reserves – The Board is responsible for developing a formal plan for the use of its reserves, including determining how and when disbursements should be made and optimal or targeted funding levels and why these levels are appropriate, and for ensuring that District officials maintain appropriate documentation to account for and monitor reserve activity and balances. The District does not have a policy or formal plan for its eight reserves. As of June 30, 2015, two of the District's reserves totaling $2.6 million were overfunded, as follows:

- Unemployment Insurance Reserve – District officials discontinued the use of two unnecessary reserves (a workers' compensation and dental insurance reserve) and moved the funds to the unemployment insurance reserve. This created a balance in the reserve of $341,935, which is more than nine times the District's average annual expenditures for these costs.[5] District officials had no plans to lay off employees and have budgeted for and paid for unemployment insurance expenditures out of the general fund as routine operating costs.

- Retirement Contribution Reserve – A good business practice is to use the retirement contribution reserve to smooth out spikes in the costs of employee retirements by partially financing the related budgeted appropriation during years of financial stress. As of June 30, 2015, this reserve had a balance of $2.2 million. However, District officials have not been using these funds for payments to the New York State Employees Retirement System. Instead, they are budgeting and paying for these expenditures out of the general fund as routine operating costs.

Using the resources accumulated in the unemployment insurance and retirement contribution reserves for their related expenditures would allow for general fund resources to be used to reduce the real property

[5] The District's average annual unemployment expenditures during our audit period were $35,342.

tax burden. By maintaining excessive reserves, combined with ongoing budgeting practices that generated operating surpluses, the Board and District officials have levied higher taxes than necessary.

Debt Service Fund

A debt service fund is used to account for the accumulation of resources for the payment of principal and interest on long-term debt. These resources include proceeds of a sale of a capital improvement with outstanding debt, State or federal aid that is received for a completed capital improvement for which there is outstanding debt and unexpended proceeds of long-term debt. This money should be used for debt service payments on that debt or, in certain cases, other outstanding debt. In addition, if a district has residual bond proceeds, unused interest earned on bond proceeds or both, that money must be used only to pay for debt service and must be accounted for in the debt service fund.

For each of the last three completed fiscal years, the District had a balance of approximately $3.6 million in its debt service fund. However, District officials did not use any of the available money to reduce debt service expenditures of approximately $2.5 million per year. Because the District budgeted for debt payments in the general fund, the debt service fund is not being used and its balance continues to grow due to interest.

District officials were aware of the large fund balance in this fund but could not specify which capital improvements or debt issuances that the money was associated with and have not planned for its use. Rather than remaining idle, using these funds for debt service would allow District officials to use general fund resources to reduce the real property tax levy.

Recommendations

The Board and District officials should:

1. Adopt budgets that represent the District’s actual needs, based on available current information and historical data.

2. Discontinue the practice of adopting general fund budgets that result in the appropriation of fund balance and reserve funds that will not be used.

3. Use guidance provided by the State Comptroller to accurately calculate the District’s compensated absences liability and classify and report short- and long-term portions accordingly.

4. Properly account for unused flex spending money in the general fund.

5. Reduce the amount of unrestricted fund balance and use the excess funds in a manner that benefits District residents. Such uses could include, but are not limited to:

    - Funding one-time expenditures;

    - Funding needed reserves; and

    - Reducing District property taxes.

6. Adopt a comprehensive reserve policy that clearly states the purpose and intent for establishing each reserve fund, the manner in which the Board will fund and maintain each reserve fund and optimal or targeted funding levels and conditions under which each fund's assets will be used or replenished.

7. Review all reserves and determine the extent of excess balances. District officials should transfer excess reserve funds to unrestricted fund balance, where allowed by law, or to other reserves that have been established and maintained in compliance with statutory directives.

8. Use the money in the debt service fund to make debt payments as appropriate.

APPENDIX A

RESPONSE FROM DISTRICT OFFICIALS

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

Horseheads Central School District

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July 14, 2016

Edward V. Grant Jr., Chief Examiner
The Powers Building
16 West Main Street- Suite 522
Rochester, New York 14614-1605

Re: Horseheads Central School Financial Condition Report of Examination 2016M-138

Dear Mr. Grant:

The Horseheads Central School District (District) is in receipt of the draft Financial Management Report of Examination on the District's financial condition for the period of July 1, 2012 - March 10, 2016. On behalf of the Board of Education and District Administration, we appreciate the opportunity to respond to the findings of this report.

First, we would like to thank the auditors for their professionalism and consideration during the course of this very thorough and in-depth audit of the District's past financial positons. Secondly, we are pleased to note that this examination did not identify any areas of fraud within the District.

The Board of Education (Board) and District Administration recognize the importance of proper fiscal management. The District has strived over the years to provide the high level of education and variety of extra-curricular opportunities that our community has come to expect for our students, amid the many issues that we must also account for, such as reductions and uncertainties in state aid, unfunded mandates, pension cost increases, healthcare increases, technology upgrades, and facilities maintenance. It is important to note that, over the course of the gap elimination adjustment, the District lost a total of nearly $23 million, including the amounts returned to the District through the GEA restoration. We have had to navigate through these challenges while operating under the constraints of the recently imposed property tax cap calculation. In addition, due to the fact that the state has not allowed the foundation aid formula to run as it was intended since its inception in the 2007-08 year, the District has been paid $33 million less than what it should have received had the formula been allowed to run, all of which would have directly benefited the taxpayers of the District and reduced their tax burden over the past six years.

Despite these challenges, the Board of Education and current District Administration consistently strive to balance our fiscal responsibilities to our community with the needs of our students and District. We continue to provide the lowest true value tax rate in the county and maintain minimal levels of debt. The District has continually had the support of its community, with an approval rate of 79% for the 2016-17 budget vote. Standard & Poor's recently reaffirmed our bond rating of A+. As of the 2014-15 school year, the Office of the State Comptroller has not designated the District as being in any sort of fiscal stress, despite having reported operating losses for the three consecutive years reviewed for that report. The District has remained within the mandated tax cap calculation since its inception and has reduced its reliance on appropriated fund balance by 50%, from $5 million in our 2012-13 budget to $2.5 million in our 2016-17 budget. These facts demonstrate that the Board of Education and current Administration have been conscientious and careful in the management of District funds and, as such, have prepared the District for ongoing stability and success.

See Note 1 Page 19

See Note 2 Page 19

See Note 3 Page 19

"Quality Education for All"

The Mission of the Horseheads Central School Community is to provide a quality education for all within a nurturing environment which promotes excellence, growth, and a sense of civic responsibility.

In response to the findings of this report:

1. *Adopt budgets that represent the District's actual needs, based on available current information.*

The District experienced a change in the position of the school business administrator in July 2014 and the superintendent in August 2015. In conjunction with the Board of Education, the current superintendent and school business administrator have developed a more accurate and realistic budget for 2016-17 and will continue to refine the budget over future years. The Board of Education and District Administrators recognize the fact that right-sizing the budget will take several years of careful planning to fully implement this report's recommendations. See Note 4 Page 19

It is important to note, however, consistent with comptroller's recommendation #5, when the District identified surplus funds, decisions were made to utilize those funds for one-time purchases. For example, the District used excess funds to avoid issuing $3 million in debt for an upcoming technology infrastructure and security upgrade project. This alone provided a cost avoidance for the District of over $1 million in issuance and interest costs. For seven years, the District has also paid cash for buses in lieu of issuing debt. The District has funded its reserves, and also plans to fully fund its capital reserve, approved by the voters in May 2015, in preparation for an upcoming capital improvement project. This is all to the benefit of the District's taxpayers. See Note 5 Page 19

2. *Discontinue the practice of adopting general fund budgets that result in the appropriation of fund balance and reserves that will not be used.*

The District's response for the prior finding can also be applied to this finding, as these two findings are similar in nature. In addition to what has been previously stated, District Administration presented, and the Board of Education approved, a budget for the 2016-17 school year that reduced appropriated fund balance by nearly 45% from the prior year. As the District appropriates less fund balance, it will analyze its reserves and fund them appropriately in accordance with the District's approved reserve plan. See Note 3 Page 19

The District intends to continue to reduce its reliance on fund balance in its budget in a careful and controlled manner, as it makes sense, depending on the state's funding of school aid. The District's philosophy is to be proactive, as opposed to reactive, when it comes to future anticipated costs of items such as fuel, energy, and the costs and risks involved with providing self-insured health insurance coverage to the District's employees.

The District does not have the luxury of overspending its budget, nor do we have the luxury of looking backwards. See Note 6 Page 19

The District must be forward-looking when developing the budget and cannot always anticipate when key elements of the budget will increase or decrease. With the constant volatility in today's economy and the unrest in the Middle East, fuel costs could rise dramatically at any moment. The unpredictability of the weather in our region could impact the cost of energy as this area has been known to sink into a deep freeze during any given winter. As any district that is self-insured can relate, the rising costs of healthcare and the unpredictability of employees' and dependents' future health cause a significant strain on the budget. The District can only budget based on trends but must be prepared to cover any and all claims that come to the District for payment, whether they were planned for or not.

The District recognizes the fact that the Office of the State Comptroller will disagree with this stance and will say that flexibility to meet any unanticipated expenditures and revenue shortfalls is provided by unassigned fund balance and reserves. However, the District firmly believes that following this recommended practice could result in financial stress to the Horseheads community down the road. Planning for contingencies in the budget will prevent the erosion of fund balance, reserves, and educational programs.

Despite the fact that this report has noted that the District has overestimated appropriations and "the Board and District officials did not adequately manage the District's financial condition," it is our opinion that the District did the opposite.

The District has maneuvered and survived a very difficult financial period due to the budget crisis caused at the state level - ***a budget crisis in which the state and governors took money away from school districts and taxpayers to close their own fiscal deficit***. With prudent planning and careful spending on the District's part, the District came out on the other side and is ready to move forward. While this report states that we overestimated appropriations, the District actually spent a significant amount of its budget. During the 2014-15 year, the District spent a significant 94% of its total budget; in 2013-14 and 2012-13, 92% of its total budget. Had key elements such as fuel and utility costs increased instead of decreased, the outcome of our budget would have been much different and dire for our community.

See Note 7 Page 20

3. *Use guidance provided by the State Comptroller to accurately calculate the District's compensated absences liability and classify and report short- and long-term portions accordingly.*

The District's current methodology is based on its interpretation of the Comptroller's 2008 bulletin on accounting for compensated absences. The District currently accrues for 100% of the vacation days that are earned and due to its employees. Vacation days earned by the employees have been viewed as a current liability as this is a cost that is actually due and payable to the employees. The District recognizes that our employees have earned this vacation time and its subsequent payout and accrues this expense accordingly. The District also has to consider the cost implications of those who are able to convert sick days to cash to pay for future health insurance costs. The calculation for this liability is not as black and white as the bulletin implies; however, the District will review the bulletin and evaluate the need to modify the calculation going forward.

See Note 8 Page 20

4. *Properly account for unused flex spending moneys in the general fund.*

The District acknowledges this finding as it was previously identified by the District. On April 18, 2016, this item was resolved; the District transferred the unused portion of the flex spending money in the amount of $248,086.30 into unrestricted fund balance. This represents 0.34% of the District's total 2015-16 budget. At the end of the fiscal year, this money will be allocated to other statutorily recognized reserves.

5. *Reduce the amount of unrestricted fund balance and use the excess funds in a manner that benefits District residents. Such uses could include, but are not limited to:*
    a. *Funding one-time expenditures*
    b. *Funding needed reserves*
    c. *Reducing District property taxes*

As previously mentioned, the District has used its excess funds in a manner that benefits District residents. Looking forward, the District plans on fully funding its $10 million capital reserve with its excess funds via a board resolution passed on June 23, 2016. The District is in the early planning phases of a comprehensive capital improvement plan that will impact all facets and buildings of the District. By fully funding this capital reserve, the District will have the ability to reduce the tax burden on its residents with the passage of any future capital project. This transfer to the capital reserve will be funded through this year's unanticipated surplus as well as a careful review of the District's cash resources in order to reduce the future tax burden on our community.

In order to maintain fiscal stability, the utilization of the District's unrestricted fund balance and excess funds has to be planned in a long term manner. For example, as previously mentioned, the District funded a $3 million technology capital project with the use of excess funds. The funds for the project came from the Board-approved Gap Elimination Adjustment Committed Fund Balance account. This account was initially funded when the state was withholding money from the District through the state-imposed gap elimination adjustment. The District and the Board recognized the fact that this account was no longer necessary due to the eventual elimination of the GEA by state officials and transferred these funds to fully fund this capital project, again, with no tax impact to our community.

6. *Adopt a comprehensive reserve policy that clearly states the purpose and intent for establishing each reserve fund, manner in which the Board will fund and maintain each reserve fund, and optimal or targeted funding levels and conditions under which each fund's assets will be used or replenished.*

The District was in the process of developing a formal reserve plan prior to the start of this audit. Prior to the adoption of the formal plan, the Board would annually review in open session a multi-year balance history for each of the reserves as well as review the purpose of the reserves. The District's reserve plan was finalized and approved by the Board of Education in May 2016. This plan is more comprehensive than what has been presented to the Board in the past in that it now includes how the reserve is to be established and funded, as well as targeted funding levels. This plan will be reviewed, updated, and approved accordingly by the Board of Education annually and will be used as the District develops its plan for any excess funds in the future. The District will post this plan to its District website annually.

See Note 9 Page 20

7. *Review all reserves and determine the extent of excess balances. District officials should transfer excess reserve funds to unrestricted fund balance, where allowed by law, or to other reserves that have been established and maintained in compliance with statutory directives.*

The District will review all reserves and current balances to determine the extent of their excess, if any. The balance maintained in the District's reserves is a local decision, and the Board has been consistently made aware of the status of our fund balance and reserves. The District's external auditor has also had detailed discussions with the Audit Committee regarding these balances as well. As mentioned above, the District adopted a comprehensive reserve plan in May 2016.

The District respectfully disagrees with the statement in this audit that our retirement contribution reserve is overfunded. The District is following a statewide trend, based upon the recommendation of our external auditor, of maintaining a balance in this account of three to five years of our ERS payment. Based on our current balance of $2.2 million, we have approximately 2.5 years of payments in this reserve. The District will fund this reserve in accordance with our reserve plan and use this reserve going forward in the budget development process, as we have demonstrated in the 2016-17 budget.

See Note 10 Page 20

8. *Use the moneys in the debt service fund to make debt payments as appropriate.*

The District will develop a long term plan that will utilize the debt service funds to the best benefit of our taxpayers as part of our long term development process. As building aid related to this debt begins to decline, the District will utilize the debt service fund to soften the impact to the budget. The District is in receipt of a plan from our financial advisors to support this.

The Board of Education, Superintendent, and Business Administrator appreciate the findings of this report and will consider the Comptroller's recommendations as we continue to move forward with our long term financial and educational plans on behalf of the Horseheads Central School District Community.

Very Truly Yours,

Pamela F. Strollo

Pamela Strollo
President, Board of Education

Thomas Douglas

Dr. Thomas J. Douglas
Superintendent of Schools

APPENDIX B

OSC COMMENTS ON THE DISTRICT'S RESPONSE

Note 1

The purpose of a bond rating service is to analyze the risk posed to investors by an entity's indebtedness. Standard and Poor's does not consider whether excess funds of District residents are being accumulated. Our audit analyzed the District's finances on behalf of residents.

Note 2

A transfer to another fund is not an operating expenditure. Consequently, the District's claim of operating losses is inaccurate. Instead, the District had a cumulative operating surplus of $2.4 million from the 2012-13 through 2014-15 fiscal years.

Note 3

Appropriated fund balance is intended to finance the gap between estimated revenues and appropriations. The District's budgeting practices do not accurately estimate operating results. Therefore, instead of a planned operating deficit occurring, an operating surplus occurred because revenues exceeded expenditures each year. As a result, the District did not use or rely on appropriated fund balance.

Note 4

The Board continued the same budgeting practices, which produced operating surpluses instead of deficits during the last three completed fiscal years, when developing the 2016-17 budget. For example, 2016-17 budgeted health insurance appropriations, which were overestimated for fiscal years 2012-13 through 2014-15, exceed the previous year's actual expenditures by more the $2 million.

Note 5

Our concern is the lack of transparency to residents for the manner in which excess funds were being used. By maintaining excessive fund balance and reserves, combined with ongoing budgeting practices that generate repeated operating surpluses, the Board and District officials have withheld significant funds from productive use, levied unnecessary taxes and diminished the transparency of District finances to residents.

Note 6

Historical perspective is an important and appropriate tool in developing accurate budgets. Effective multiyear plans project operating and capital needs and financing sources over a three- to five-year period and allow school district officials to identify developing revenue and expenditure trends, set long-term priorities and goals and avoid large fluctuations in tax rates.

Note 7

Despite the crisis described, State aid and the District's real property tax levy increased annually between 2012-13 and 2013-14 while expenditures were less than budgeted. While a conservative approach to budgeting has its merits, it must be re-evaluated in light of the surpluses experienced over the last three fiscal years totaling $2.4 million. Though the percentage variance may not seem significant to District management, over the last three completed fiscal years appropriations have exceeded actual expenditures by $14.9 million. Furthermore, the District's excessive fund balance is more than sufficient to cover unanticipated expenditures.

Note 8

The District's interpretation of a current liability is incorrect. The current portion of the liability only includes payments for unused compensated absences for those employees who have obligated themselves to separate from District employment by the end of the fiscal year. District officials told us that only one person had obligated himself to separate from District employment. As District officials review their interpretation of the bulletin, we are available to provide them with technical assistance.

Note 9

District officials told us that they were developing a reserve plan. However, they did not provide us with a copy of the plan for review during fieldwork.

Note 10

Over the last four completed fiscal years, the District has used current taxpayer funds to pay for retirement costs. Only in the 2016-17 budget did the District appropriate $300,000 as a financing source from the retirement contribution reserve. At $300,000 per year, the $2.2 million reserve could pay 7.3 years of expenditures.

APPENDIX C

AUDIT METHODOLOGY AND STANDARDS

To accomplish the objective of our audit, we performed the following procedures:

- We interviewed District officials to gain an understanding of the District's budgeting process.

- We reviewed the District's results of operations and analyzed changes in fund balance for the general fund for the period July 1, 2012 through June 30, 2015. To gain additional background information and for perspective, we also reviewed financial data for reserves.

- We reviewed the District's fund balance in the debt service fund for the period July 1, 2008 through June 30, 2015 to determine whether the debt service was used to pay down debt and from where the debt service funds were derived. In addition, we interviewed District officials to determine if District officials were aware of the debt service fund balance and from where the balance was derived.

- We compared budgeted appropriations to actual expenditures for the period July 1, 2012 through June 30, 2015 to determine where the District's appropriations were overestimated. We also reviewed the 2015-16 and 2016-17 general fund budgets to determine whether the District continued to overestimate appropriations and the District's projected operating surplus and ending unrestricted fund balance.

- We reviewed management letters and external auditors' reports from the last three completed financial audits and reviewed any corrective action the District may have taken and support for any corrective action that the District planned to take during the corresponding fiscal years.

- We reviewed the appropriation of the District's reserves and fund balance for the period July 1, 2012 through June 30, 2015.

- We reviewed Board minutes, resolutions and other documentation to determine whether reserve funds were created, funded and expended properly, liabilities were properly recorded and transfers were appropriate.

- We tested the reliability of the accounting records by reviewing bank statement reconciliations and Board resolutions and compared them to the annual update document (AUD) data and certified financial statements.

- We reviewed general fund "other" assets and liabilities as of June 30, 2015 to determine whether they were properly accrued.

- We reviewed the trust and agency fund's other funds liability and the District's calculation for compensated absences as of June 30, 2013, June 30, 2014 and June 30, 2015 to determine whether they were properly accrued.

- We reviewed the District's budget newsletters for our audit period, propositions it presented to the voters and voting results for the propositions.

- We reviewed the District's long term plan to determine the District's projected operating surplus for the 2015-16 fiscal year.

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 D

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