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Thomas Douglas, Superintendent
Members of the Board of Education
Horseheads Central School District
143 Hibbard Road
Horseheads, NY 14845

Report Number: 2016M-138-F

Dear Superintendent Douglas and Members of the Board of Education:

One of the Office of the State Comptroller's primary objectives is to identify areas where school district officials can improve their operations and provide guidance and services that will assist them in making those improvements. The Office also works to develop and promote short-term and long-term strategies to enable and encourage school district officials to reduce costs, improve service delivery and to account for and protect their school district's assets. In accordance with these objectives, we conducted an audit of the Horseheads Central School District (District) to assess financial condition. As a result of our audit, we issued a report, dated August 2016, identifying certain conditions and opportunities for the District management's review and consideration.

To further our policy of providing assistance to school districts, we revisited the District in June 2021 to review the progress in implementing our recommendations. Our follow-up review was limited to interviews with District personnel and inspection of certain documents related to the issues identified in our report. Based on our limited procedures, it appears that the District has made progress implementing corrective action. Of the eight audit recommendations, two recommendations were implemented, five recommendations were partially implemented and one recommendation was not implemented.

Recommendation 1 – Budgeting

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

Status of Corrective Action: Partially Implemented

Observations/Findings: Although the Board adopted more realistic budgets in recent years, there is still room for improvement. We reviewed the budget-to-actual status reports for revenues and expenditures from July 1, 2016 through June 30, 2020 and found the four-year average budget

variance was \$3.3 million per year. We recognize this is an improvement from the three-year \$5 million average budget variance discussed in our previous audit report.

Recommendation 2 – Appropriated Fund Balance and Reserves

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

Status of Corrective Action: Partially Implemented

Observations/Findings: The Board adopted budgets that gave taxpayers the impression that the District needed to both increase real property taxes and use appropriated fund balance and reserves to close projected budget gaps. By adopting more realistic budgets, the Board reduced the amount of appropriated fund balance and reserves used to balance the budgets from the previous average of \$5.4 million to approximately \$2.8 million. Although an improvement, the fund balance and reserves appropriated were not needed to fund operations as a result of operating surpluses each year.

Recommendation 3 – Compensated Absence Liability

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.

Status of Corrective Action: Fully Implemented

Observations/Findings: We reviewed the calculation of the compensated absence liability and determined the amount was reasonable.

Recommendation 4 – Unused Flex Spending Money

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

Status of Corrective Action: Fully Implemented

Observations/Findings: We reviewed the District’s balance for flex spending from the administrator and general ledger account balance as of June 30, 2020. We determined that funds were transferred to the general fund for unused flex spending amounts after the period for reimbursement had passed.

Recommendation 5 – Unrestricted Fund Balance

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.

Status of Corrective Action: Partially Implemented

Observations/Findings: While the District reduced how much appropriated fund balance and reserves was used to balance the budgets, it continues to not use the appropriated fund balance and reserves. The District also used excess fund balance to fund one-time expenditures and transferred it into reserves. However, recent amounts were less than reported in our previous audit. Unrestricted fund balance decreased from \$10.4 million to \$3.3 million from June 30, 2015 through June 30, 2020. This decrease was largely due to net interfund transfers of \$4 million to the capital reserve fund, which were subsequently used to fund a capital project. These transfers were in conformance with our recommendation for funding one-time expenditures. However, other actions, such as using excess funds to increase already overfunded reserves (unemployment insurance reserve increased by \$406,000; retirement contribution reserve increased by \$1.3 million), rather than reducing District property taxes, shows additional implementation is warranted. Lastly, the District's recalculated unrestricted fund balance ranged from 6.4 percent to 7.3 percent of the next year's appropriations, which is a significant improvement since the prior audit's 20 percent.

Recommendation 6 – Reserve Policy

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.

Status of Corrective Action: Partially Implemented

Observations/Findings: The Board adopted a reserve plan that states the purpose and intent for establishing each reserve fund and the conditions under which each reserve will be used. However, the plan does not address the way the Board will fund all the reserves or, with the exception of the retirement contribution reserve, the optimal or targeted funding levels for the reserves.

Recommendation 7 – Excess Reserves

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.

Status of Corrective Action: Not Implemented

Observations/Findings: We reviewed the reserves' activity through June 30, 2020 and found the District's total reserve balances increased by \$5.6 million to \$11.8 million since July 1, 2016. Reserve balances increased even though officials transferred \$10 million from the capital reserve to the capital projects fund to finance the local portion of improvement, and used \$604,000 from the employee benefit accrued liability reserve to pay employees leaving District service for unused

vacation, sick or other leave time. Excess general fund money, fueled by continued operating surpluses, allowed for \$4 million to be added to the capital reserve, \$1.3 million to the retirement contribution reserve and \$406,000 to the unemployment insurance (UI) reserve. The retirement contribution and UI reserves were reported as excessive in our previous report. Specifically, the retirement contribution reserve is sufficient to pay four years of the average annual expenditures and the UI reserve is sufficient to fund 150 years of the average annual expenditures. In addition the District started a Teachers Retirement Reserve with \$200,000 and increased the Tax Certiorari Reserve about \$309,000.

District officials stated it was necessary to have three to five years of annual employee retirement system payments in the retirement contribution reserve and they increased the UI reserve in June 2020 by over \$700,000 because they were concerned about fraudulent unemployment insurance claims during the COVID-19 pandemic. However, the District's average annual costs were less than \$5,000.

Recommendation 8 – Debt Service Fund Reserve

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

Status of Corrective Action: Partially Implemented

The District began using the debt service fund resources to make debt service payments totaling approximately \$695,000 during the two-year period of July 1, 2017 through June 30, 2019. However, this action was offset over the four-year period of July 1, 2016 through June 30, 2020 by interest, premiums, the sale of property and appropriate interfund transfers totaling \$1.4 million. As a result, the debt service fund reserve had a net increase of \$733,000. District officials plan to continue implementing this recommendation by using \$630,000 during the 2020-21 fiscal year.

During our review, we discussed the basis for our recommendations and the operational considerations relating to these issues. We encourage District officials to continue their efforts to fully implement our recommended improvements.

Thank you for the courtesies and cooperation extended to our auditors during this review. If you have any further questions, please contact Edward V. Grant, Chief Examiner of our Rochester Regional Office, at 585-454-2460.

Sincerely,

Elliott Auerbach
Deputy Comptroller