



Batavia City School District

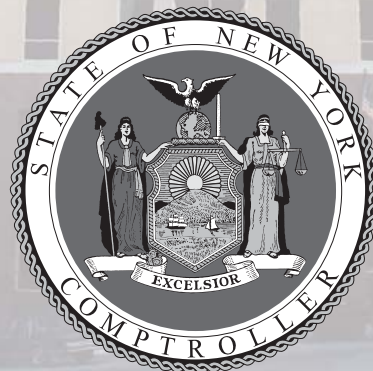
Internal Controls Over Selected Financial Operations

Report of Examination

Period Covered:

July 1, 2007 — May 20, 2009

2009M-143



Thomas P. DiNapoli

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State of New York Office of the State Comptroller

Division of Local Government and School Accountability

November 2009

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 Batavia City School District, entitled Internal Controls Over Selected Financial Operations. This audit was conducted pursuant to Article V, Section 1 of the State Constitution and the State Comptroller's authority as set forth in Article 3 of the General Municipal Law.

This audit's results and recommendations are resources for district officials to use in effectively managing operations and in meeting the expectations of their constituents. If you have questions about this report, please feel free to contact the local regional office for your county, as listed at the end of this report.

Respectfully submitted,

*Office of the State Comptroller
Division of Local Government
and School Accountability*



State of New York Office of the State Comptroller

EXECUTIVE SUMMARY

The Batavia City School District (District) is governed by the Board of Education (Board) which comprises seven elected members. The Board is responsible for the general management and control of the District's financial and educational affairs. The Superintendent of Schools (Superintendent) is the chief executive officer of the District and is responsible, along with other administrative staff, for the day-to-day management of the District under the direction of the Board.

The Business Administrator plays a key role in the daily administration of the Business Office and has several employees to assist with these functions.

Scope and Objectives

The objectives of our audit were to examine the District's financial condition and internal controls over payroll for the period July 1, 2007 to May 20, 2009. We examined certain financial information prior to the scope of our audit for financial analysis purposes.¹ In some instances, we reported on transactions and activities outside of our audit period because we considered it necessary and relevant to this audit. Our audit addressed the following related questions:

- Are internal controls over employee compensation and separation payments appropriately designed and operating effectively?
- Have District officials provided for effective financial planning and management by ensuring budget estimates and reserve balances are reasonable and by establishing and maintaining reserves in accordance with statutory requirements?

Audit Results

The Board failed to establish adequate internal controls over payroll to ensure that employees only receive the compensation and separation payments to which they are entitled. We reviewed the annual compensation of 17 employees. Ten employees, or 59 percent, were overpaid or received compensation which was not provided for in the applicable contracts or supported by sufficient documentation. We also reviewed payments to six employees for the monetary value of their unused leave time and found that three of them were overpaid. In total we identified more than \$50,000 in improper or unsupported payments.

District officials have not ensured that budget estimates and reserve balances are reasonable and they have not established and maintained reserves in accordance with statutory requirements. We found

¹ Financial reports for the 2003-04, 2004-05, 2005-06 and 2006-07 fiscal years

that District officials routinely overestimated appropriations and underestimated revenues, which has consistently resulted in operating surpluses of approximately \$6 million, in total, over the last five fiscal years.

District officials were unable to provide adequate justification for the establishment and funding levels for various reserves. As a result, we identified \$7.3 million which has been inappropriately placed in reserves but rather should be used to benefit taxpayers. For example, the District's reported reserve for encumbrances at June 30, 2008 was \$1.4 million. We reviewed the supporting documentation for 33 encumbrances totaling \$569,849, all of which remained open or not used as of April 1, 2009, and determined that 18 of the 33, totaling \$488,701 were inappropriately accounted for as encumbrances.

Had these practices not occurred, and had District officials complied with statutory limitations for retained fund balance, the excess could have been used for District operations, or to fund necessary reserves or to reduce the tax levy.

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. Except as specified in Appendix A, District officials generally agreed with our recommendations and indicated they planned to take corrective action. Appendix B includes our comments on issues raised in the District's response letter.

Introduction

Background

The Batavia City School District (District) is located in Genesee County in the City of Batavia and the Towns of Batavia and Stafford. The District is governed by the Board of Education (Board) which comprises seven elected members. The Board is responsible for the general management and control of the District's financial and educational affairs. The Superintendent of Schools (Superintendent) is the chief executive officer of the District and is responsible, along with other administrative staff, for the day-to-day management of the District under the direction of the Board.

There are five schools in operation within the District, with approximately 2,400 students and 500 employees. The District's budgeted general fund expenditures for the 2008-09 fiscal year are \$39.4 million, which are funded primarily with State aid and real property taxes. Salaries and compensation represented approximately 52 percent of the District's total 2007-08 budget.

The Business Administrator is responsible for the District's finances, accounting records and financial reports. The Board has designated the Business Administrator as the official authorized to certify the payroll. In this role, the Business Administrator is responsible for verifying the accuracy and completeness of the District's payroll records. The Business Administrator also supervises the Business Office staff, including the clerks responsible for processing payroll and carrying out various personnel functions. The District uses a computerized financial system to maintain its accounting records.

Currently, the Board recognizes five associations for the purposes of collective bargaining: Teachers; Administrators; Clerical; Custodial; and Nutritional Services. The Board has approved six² collective bargaining agreements (CBA) as well as nine separate employment contracts for individuals not represented by the bargaining units, including the Business Administrator, Superintendent, and the Superintendent's secretary.

Objectives

The objectives of our audit were to examine the District's financial condition and internal controls over payroll. Our audit addressed the following related questions:

- Are internal controls over employee compensation and separation payments appropriately designed and operating effectively?

² Substitute teachers are also represented by the Teachers' association but have a separate Collective Bargaining Agreement.

- Have District officials provided for effective financial planning and management by ensuring budget estimates and reserve balances are reasonable and by establishing and maintaining reserves in accordance with statutory requirements?

Scope and Methodology

We examined the District’s internal controls over selected financial operations for the period July 1, 2007 to May 20, 2009. We examined certain financial information prior to the scope of our audit for financial analysis purposes.³ In some instances, we reported on transactions and activities outside of our audit period because we considered it necessary and relevant to this audit.

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 is included in Appendix C of this report.

Comments of District Officials and Corrective Action

The results of our audit and recommendations have been discussed with District officials and their comments, which appear in Appendix A, have been considered in preparing this report. Except as specified in Appendix A, District officials generally agreed with our recommendations and indicated they planned to take corrective action. Appendix B includes our comments on issues raised in the District’s response letter.

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.

³ Financial reports for the 2003-04, 2004-05, 2005-06 and 2006-07 fiscal years

Payroll

The primary objective of internal controls over payroll is to ensure that employees only receive the compensation to which they are entitled. Therefore, it is essential that the Board establish appropriate controls over payroll to prevent and detect errors, abuse and waste. Board-authorized individual employment contracts, collective bargaining agreements (CBA), and written procedures should provide unambiguous guidance regarding employee compensation. The terms of the agreements should be written with clear and precise language so that the intentions of the parties can be easily determined. Compensation for services rendered and separation payments, such as payments for unused leave time, should be clearly defined and authorized by the Board. Written procedures should establish specific responsibilities for the preparation and disbursement of payroll and provide for a proper segregation of duties. In addition, adequate monitoring procedures should be implemented to verify that the payments are made in accordance with written collective bargaining agreements or individual employment contracts.

Internal controls over employee compensation and separation payments are not properly designed and operating effectively. District officials have not established written procedures for the processing and disbursement of payroll and have not provided for the proper segregation of duties over separation payments. Further, District officials did not provide sufficient oversight and review of payments for employee compensation or separation payments to ensure that the payments were accurate. Finally, employment contracts included provisions that were not sufficiently clear to prevent varying or selective interpretations by District officials.

We reviewed the annual compensation of 17 employees. Ten of the 17⁴ employees, or 59 percent, were overpaid or received compensation which was not provided for in the applicable contracts or supported by sufficient documentation. We also reviewed payments to six employees for the monetary value of their unused leave time and found that three of them were overpaid. In total we identified more than \$50,000 in improper or unsupported payments.

Employee Compensation

The District Board and officials did not provide written policies and procedures for staff to follow when calculating and processing employee compensation. Also, District officials have not adequately monitored the payroll process to ensure negotiated salary increases

⁴ Six of the 17 employees tested received more than one overpayment or received more than one improper or unsupported payment.

and longevity increments were calculated correctly and provided in compliance with applicable employment agreements.

We reviewed collective bargaining agreements and individual employment contracts. While the individual employment contracts clearly established the employee's annual compensation (including base salary and longevity payments), only two of the six collective bargaining agreements included provisions that clearly defined compensation. The Administrator, Teacher, Clerical, and Custodial bargaining agreements contained no salary schedules, salary steps, or any other written provision establishing base salaries for members of these units. The agreements only establish starting salary rates for new members or newly hired employees.

In order to ensure payroll payments and related benefits are accurate and in compliance with applicable employment agreements, an appropriate District official, independent of the payroll function, should review salary calculations, non-routine salary adjustments, and separation payments to confirm they are accurate and justified under applicable agreements before the payments are processed and distributed. However, the calculations for determining the compensation (including base salaries, longevity, and stipends) for each District employee were performed by individual staff members (i.e. the former Superintendent's secretary, the personnel clerk, and the Business Administrator). We found that no one reviewed or verified the calculations after they were originally done.

Further, District officials do not provide annual salary notices⁵ or assignment letters to employees stating their salary for the upcoming fiscal year. Without clear, defined compensation terms or sufficient oversight in the calculation of compensation for employees, the Board cannot ensure employees are being paid as authorized.

Base Salary – We tested the calculation of the base salary for 17 District employees and noted the following exceptions:

- Overpayment – One administrator was overpaid by more than \$24,000 over a nine-year period. This individual was to begin employment at a specified step level in July 2000. However, she was inappropriately compensated at the next higher step than the one agreed upon. As a result, the administrator received an overpayment of \$2,359 in her first year of employment (2000-01) and a cumulative overpayment of

⁵ The District began providing annual salary notices to teachers in the 2008-09 fiscal year. Salary notices are not provided to non-instructional staff members. All 10 employees who received an improper or unsupported payment were non-instructional staff members.

over \$24,200 during the past nine years, since she continued to receive compensation at a rate one step higher than she should have received.

- Questionable Salary Increases – Five administrators received increases to their base salaries that were questionable in light of the Administrators’ collective bargaining agreements. When calculating the administrators’ 2008-09 salaries for purposes of a 4 percent increase provided for in the CBA effective on July 1, 2008, the Business Administrator added the “responsibility factors”⁶ and longevity increments paid during the 2007-08 fiscal year to the administrators’ 2007-08 base salary, and applied the negotiated increase of 4 percent to arrive at the new 2008-09 base salaries.⁷ According to both District personnel and payroll records, the “responsibility factors” and longevity increments were not considered part of the administrators’ base salary under the CBA in effect prior to the 2008-09 fiscal year. Assuming that the parties intended that the base salary on which the 4 percent was calculated was not to include “responsibility factors” and longevity increments, consistent with what was indicated for the prior CBA, then these administrators were overpaid.

These increases totaled more than \$11,721 to the administrators’ base salaries in the 2008-09 fiscal year.⁸

Unsupported Compensation – In our review of the 17 District employees, we also identified over \$6,400 in unsupported payments made to eight individuals over the course of the two fiscal years. The payments were made to these employees in addition to their regular contractual pay. District personnel were unable to provide sufficient supporting documentation or evidence of Board authorization for this additional compensation.

⁶ According to contract provisions in effect during the 2007-08 fiscal year, District administrators were entitled to additional compensation beyond base salary for what was identified in the agreement as “responsibility factors” and “longevity.” Responsibility factors were paid to administrators employed in certain titles. The amount was an established percentage of the administrator’s base salary and varied by title. For example, a Principal received an additional 3 percent above her base salary while another Principal received an additional 2 percent.

⁷ Responsibility factors were not included in the 2008-09 CBA.

⁸ For example, an administrator was paid a base salary of \$96,907 plus a “responsibility factor” equal to 2 percent of her base salary (\$1,938) making her total compensation for the 2007-08 fiscal year \$98,845. When calculating her base salary for the 2008-09 fiscal year, the Business Administrator applied the negotiated 4 percent increase to the total compensation of \$98,845 to arrive at a new base salary of \$102,799. However, if the 2008-09 base salary were calculated by applying the 4 percent increase to the previous year’s base salary without the “responsibility factor” and longevity increment (\$96,907) the increased salary would have been only \$100,783.

The payroll clerk and Business Administrator told us that District employees receive extra paychecks or additional pay for a variety of activities including coaching, tutoring, and chaperoning. However, to be paid for these activities, a supervisor-approved payroll voucher should be submitted to the payroll clerk. The payroll clerk was unable to provide such supporting documentation or evidence of supervisory approval for the extra payments made to these eight employees.

We determined that three of these payments were improper:

- On June 30, 2008, a ten-month clerical employee received an extra paycheck in the amount of \$982. The employee had worked beyond her normally scheduled work year and was being paid for this, in addition to two days of unused vacation leave. However, we found that in the following fiscal year, the employee was paid again for the same hours and unused vacation days but at her higher 2008-09 salary resulting in an overpayment of \$1,011. When we brought this overpayment to the attention of District personnel, they confirmed that it was an error.
- We also found that two employees received longevity payments in excess of the amounts authorized by their Board approved contracts resulting in an overpayment of \$1,695 during our audit period. We found that although longevity increments and payments were clearly defined and stated in their individual contracts approved by the Board, these employees were receiving longevity payments which exceeded the amounts authorized by their Board approved contracts.

Administrators' Longevity – According to a provision in the Administrators' CBA in effect during the 2007-08 fiscal year, administrators were entitled to a longevity payment of \$1,500/year after 10 years of continuous service as an administrator in the City School District. The new CBA in effect for the 2008-09 fiscal year provides for longevity to be paid at increasing amounts depending on the employee's length of service as an administrator.⁹ Of the six administrators we tested in our review of the 17 District employees, the amounts paid to three administrators could not be supported by documentation to verify if the amounts paid were appropriate.

The three administrators were being paid longevity increments based on years of service provided to other school districts prior to their employment with the District. The provisions of the CBA in

⁹ \$1,500 per year after eight years; \$1,625 per year after 11 years; \$1,750 per year after 14 years; \$1,875 per year after 16 years; and \$2,000 per year after 18 years

effect during the 2008-09 fiscal year provided payment for longevity increments after a set number of years of “administration” had been completed. The Business Administrator explained that the change in this provision from the previous contract was meant to compensate them for years worked as administrators in other school districts.

The three administrators had been credited with additional years of service for the purposes of the longevity increment based on prior work experience in “administration” and as a result had been paid additional longevity payments totaling \$6,500 during the 2008-09 fiscal year. However, District personnel could not provide documentation to support the additional years of administration credited to these individuals. Further, the Business Administrator could not explain how the prior work experience and years of administration were verified. The District had not yet established procedures or requirements for verifying years of administration for the purposes of the longevity payments. For example, an administrator was paid a total of \$3,125¹⁰ for longevity during the 2008-09 fiscal year. However, according to personnel and payroll records, she had only worked for the District since December of 2002 or just less than six years as of July 1, 2008. District personnel were unable to provide supporting documentation for the additional five years of “administration” credited to her. Depending upon her actual years of creditable service, she may have been overpaid the entire \$3,125, if she did not have the eight years minimum. Otherwise, she may have been overpaid by \$1,625 if she had over eight but not 11 years experience.

Separation Payments

When employees terminate employment with the District by retirement or resignation, they are paid the monetary value of their unused vacation time. There is an inadequate segregation of duties over the calculation and payment of this separation benefit. The payroll clerk is responsible for maintaining the leave and attendance records which support the payouts for unused vacation time. She is also the individual responsible for calculating and issuing payment for unused vacation time. In addition, these calculations were not always reviewed or approved by an appropriate official. Of the six individuals who received payments for unused vacation during our audit period, we could find evidence of supervisory review and approval for only one of the payments.

We reviewed the supporting documentation for the payments made to these six individuals for unused vacation and found that three were overpaid, by \$1,972 in total, due to inaccurate leave records.

¹⁰ The longevity payment was the total of two increments; \$1,500 for the 8 year increment and \$1,625 for the 11 year increment.

Our comparison of timesheets¹¹ to leave records found that while employees charged vacation on their timesheets, the deductions were not always recorded on their leave records by the payroll clerk.

Recommendations

1. The Board should take the necessary action to recover any salary and separation payments determined to have been improperly made or credited to current and former District employees.
2. District officials should establish comprehensive payroll procedures to ensure that employee compensation is properly calculated and all salary payments, including any longevity and separation payments, are paid in accordance with applicable contracts.
3. As the official designated by the Board to certify payroll, the Business Administrator should review bi-weekly payrolls for accuracy and completeness in a timely manner.
4. District officials should establish procedures to provide for an independent review of leave records to ensure they are supported by timesheet entries by employees.
5. The Board should designate an appropriate District official, independent of the payroll process, to review salary calculations, non-routine salary adjustments, and separation payments to confirm they are accurate and in compliance with applicable employment agreements before the payments are processed and distributed.

¹¹ Timesheets are prepared by each employee, reviewed and signed by his/her supervisor, and submitted to the payroll clerk to enter into the computerized financial system.

Financial Condition

A school district's financial condition is a factor in determining its ability to provide public educational services for students within the district. The Board, Superintendent, and Business Administrator are accountable to district taxpayers for the use of district resources, and are responsible for effective financial planning and management of district operations. The Board and Superintendent are also responsible for ensuring that budgets are prepared, adopted and amended based on reasonable estimates of appropriations and revenues. Sound budgeting provides sufficient funding for needed operations, and 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 that allowed by law to be retained to address cash flow and unexpected occurrences, should be used to reduce the local tax levy.

District officials did not provide for effective financial planning and management of budget estimates and reserves. District officials consistently overestimated appropriations and underestimated revenues even though data was often available to help them develop more accurate budget estimates. As a result of these practices, the District generated over \$6 million in operating surpluses over a five year period. District officials used the majority of the \$1.2 million average annual surplus to fund reserves without evidence of adequate public disclosure,¹² Board involvement, or Board policy for the accumulation and use of monies in reserve funds. As of June 30, 2008, the District has accumulated a total of approximately \$7.3 million¹³ that should be used to benefit taxpayers by paying one-time expenditures, funding necessary reserves, reducing debt and/or reducing the tax levy, in accordance with applicable statutory requirements and Board policy.

Budgeting and Use of Fund Balance

The Board is responsible for preparing and presenting the district's budget, or spending plan, to the public for vote. In preparing the budget, the Board is also responsible for estimating what the district will receive in revenue (e.g., State aid), how much fund balance will

¹² Unbudgeted transfers totaling approximately \$4 million were made to reserves during the five-year period reviewed. For the majority of these transfers, totaling more than \$3.4 million, we found no evidence of Board or voter approval. The Board approved approximately \$645,000 transferred to reserves at the end of the 2007-08 fiscal year.

¹³ Includes appropriated fund balance of \$1.2 million, debt reserve of \$4.3 million, unemployment insurance reserve of \$0.7 million, capital reserve of \$0.8 million, and tax certiorari reserve of \$0.3 million

be available at fiscal year end (some or all of which may be used to fund the ensuing year's appropriations) and, to balance the budget, what the expected tax levy will be. Accurate estimates are essential to ensure that the levy of real property taxes is not greater than necessary. During the period from when the budget is adopted by the voters until the tax levy is established, certain information becomes available, such as more accurate State aid estimates and fund balance data that can be used to more accurately budget for revenues and appropriated fund balance.

The estimation of fund balance is an integral part of the budget process. Fund balance represents resources remaining from prior fiscal years that can, and in some cases must, be used to lower property taxes for the ensuing fiscal year. A district may retain a portion of fund balance, referred to as unreserved, unappropriated fund balance, but must do so within the limits established by Real Property Tax Law.¹⁴ Districts may also establish reserves to retain a portion of fund balance for a specific purpose, but must do so in compliance with statutory directives. It is the Board's responsibility to continually monitor the need for all reserves that have been established to ensure the best interests of the taxpayers are being met.

District officials overestimated appropriations and underestimated revenues in the annual budgets and then used the surplus to fund reserves instead of using it to reduce taxes or letting it stay in fund balance and appropriating the transfer to reserves as part of the ensuing year's budget. For the five fiscal years ending prior to and on June 30, 2008, District officials overestimated appropriations by a total of \$8.4 million, an average of \$1.6 million per year, primarily in the categories of salaries and employee benefits. In addition, during all five years we reviewed, the District's budget included an appropriation for uncollected taxes in the amount of \$255,000 per year even though unpaid school taxes are guaranteed by the County and City. The Business Administrator admitted there was no need for this appropriation, and no actual expenditures for uncollected taxes were charged to this appropriation over the five year period we reviewed.

Similarly, District officials routinely underestimated revenues by a total of approximately \$8 million for the five year period ended June 30, 2008. For example, District officials underestimated State aid by over \$1.7 million in total for the past two fiscal years.

¹⁴ Previously, unreserved, unappropriated fund balance could not exceed 2 percent of the ensuing year's appropriations. At June 30, 2007, the limit was 3 percent of 2007-08 appropriations, increasing to 4 percent at June 30, 2008 and continuing at 4 percent for years thereafter.

These budgeting practices made it appear that the District needed to both raise taxes and use accumulated fund balance to close projected budget gaps. In reality the District's budget resulted in an operating surplus each year, so the amount appropriated from fund balance was never actually used. As noted in the following table, inaccurate budget estimates resulted in actual revenues exceeding expenditures by more than \$6 million, in total, over the last five fiscal years. During this same period, the tax levy has increased¹⁵ from approximately \$14.8 million in 2003-04 to approximately \$17.3 million in 2007-08.

Based on an assessment of the District's adopted budget for the 2008-09 fiscal year, (appropriations of \$39.4 million funded by estimated revenues of approximately \$38.3 million and \$1.1 million in appropriated fund balance) we found that this pattern has continued into the current year. Therefore, the District will generate an operating surplus similar to those of the previous five fiscal years.

Year-End Fund Balance Analysis						
Fiscal Year	2003-04	2004-05	2005-06	2006-07	2007-08	Total
Actual Revenue	\$33,856,096	\$33,760,039	\$35,157,909	\$38,304,913	\$39,028,605	\$180,107,562
Actual Expenditures	\$32,186,471	\$32,752,566	\$34,781,279	\$36,967,706	\$37,374,466	\$174,062,488
Operating Surplus	\$1,669,625	\$1,007,473	\$376,630	\$1,337,207	\$1,654,139	\$6,045,074
Appropriated Fund Balance	\$955,000	\$500,000	\$500,000	\$700,000	\$1,180,000	
Unreserved, Unappropriated Fund Balance at June 30	\$640,949	\$610,513	\$724,034	\$1,117,410	\$1,576,240	

Reserves

Reserve funds may be established in accordance with applicable laws. The statutes pursuant to which reserves are established determine how they may be funded, expended or discontinued. Generally, school districts are not limited as to how much money they can maintain in reserves. However, school districts should maintain reserve balances that are reasonable. To do otherwise results in real property tax levies that are higher than necessary.

At June 30, 2008, the District reported five reserves in the general fund with a cumulative balance of \$6.4 million including an Employee Benefit Accrued Liability Reserve (\$4.5 million), an Unemployment Insurance Reserve (\$753,000), Tax Certiorari Reserve (\$283,000), Capital Reserve (\$831,000) and a Repair Reserve (\$100,000). Over the last four fiscal years, reserve balances have more than doubled, increasing by \$3.7 million. We analyzed

¹⁵ The tax levy increased each year except for the 2007-08 fiscal year when it was decreased by approximately \$39,000.

these reserve funds for reasonableness and adherence to statutory requirements.

The Board had not adopted a policy regarding accumulating and using monies in reserve funds. District officials were unable to provide us with a Board resolution establishing the Unemployment Insurance Reserve. Furthermore, the lack of activity in three reserves suggests that the District is using the reserves as a vehicle to retain fund balance beyond the statutory limit, instead of using these monies for the benefit of taxpayers.

- Unemployment Insurance Reserve – The reported balance in this reserve at June 30, 2008 was \$753,032. Districts are authorized to establish such a reserve, by board resolution, when the school district opts to reimburse the State Unemployment Insurance Fund based on actual unemployment claims. District officials were unable to provide us with evidence that this reserve was created by Board resolution. In addition, no monies are expended from the reserve on an annual basis. Instead, the Board budgets for unemployment costs in the general fund and levies taxes to fund them. Therefore, it is unclear why the District has funded such a reserve. Further, general fund expenditures for this purpose averaged only \$17,000 per year over the last five fiscal years leading us to question the reasonableness of the amount reserved for this purpose. If the Board determines that this reserve is no longer needed for this purpose, the unneeded amount must be used in compliance with statutory restrictions.
- Tax Certiorari Reserve – A district can establish this type of reserve fund for the payment of judgments and claims in tax certiorari proceedings. Any monies not expended for the payment of costs related to tax certiorari proceedings must be returned to the general fund by the fourth fiscal year following their deposit.

District officials could not support this reserve's balance with a current schedule of pending tax certiorari proceedings and estimated costs, or any evidence that such proceedings have or will likely result in significant claims. The balance of this reserve at June 30, 2008 was \$283,285. According to the Business Administrator, the Board re-establishes the reserve every four years, but he admitted that there were no pending tax certiorari proceedings at the time the Board re-established the reserve in July 2007. He further represented that there were no current proceedings to support the amount reserved. Thus, the monies deposited to this reserve fund are not related

to any specific tax certiorari proceedings that may result in future payments, as required by law. These monies should be returned to unreserved, unappropriated fund balance.

- Capital Reserve – Education Law authorizes the establishment of a reserve by Board action, subject to approval by district voters, to accumulate resources for capital projects. The Board established a capital reserve in March 1997 and approved funding up to a maximum amount of \$750,000 for unspecified improvements and repairs to District facilities. The life of the reserve was established at 15 years. Further, the balance at June 30, 2008 of \$830,645 exceeded the maximum authorized by the Board by more than \$80,000. District officials indicated that at least part of this reserve would be used to pay expenditures for its forthcoming capital project which was approved by District voters in May 2008. Since the reserve's establishment, the District has financed several capital projects through the issuance of bonds. District officials were unable to provide us with complete records of activity and therefore it is not clear whether this reserve was ever used to finance any capital expenditures.

Debt Service Fund

A debt reserve must be established if property is sold that has outstanding debt or if the district has residual bond proceeds and/or interest earned on the bond proceeds. This money must be used to pay debt service on the related obligations or, for capital expenditures associated with the project for which the debt was issued. The debt reserve should be reported in the debt service fund, which is separate from the general fund.

The District has a debt service fund with a reported cash balance of \$4.3 million at June 30, 2008. District officials have commingled unexpended bond proceeds and interest earned on these bond proceeds with building aid revenue and annual general fund transfers, which have averaged over \$3.5 million per year. As such, District officials were unable to identify how much of the balance, if any, must be reserved in the debt service fund to comply with statutory requirements.

According to the Business Administrator, the debt service fund was originally created more than 10 years ago when the District received previously unpaid building aid from the State. The aid was received many years after it should have been received, because the District had failed to file proper reports with the State Education Department. At the time, debt remained outstanding for these projects; therefore, the payments were deposited into a debt reserve. Since that time, District officials have continued to record building aid in the debt

service fund. In addition, the District also budgets an annual transfer of \$315,000 from the general fund to the debt service fund to finance debt payments.

District officials also recorded \$85,000 in the debt service fund from the sale of property in the 2006-07 fiscal year. The Business Administrator represented that the District sold land and recorded the proceeds from the sale of real property in the debt service fund. However, he confirmed that there was no debt associated with the land at the time of sale. Thus, the District officials should not have set aside these moneys in the reserve.

The District makes all debt service payments from the debt service fund (about \$3.5 million annually over the past five years), using the annual building aid revenue and the transfer from the general fund, which have been sufficient to pay both principal and interest. As such, the accumulated balance in the debt service fund, which has been reported at \$4 million over the past five years, has not been used. The Business Administrator admitted that the District intends to maintain this balance as a “perpetual” reserve to pay for future capital projects and related debt. In fact, he provided us with a schedule indicating that the District intends to increase the amount in this fund. There is no statutory authority for accumulating funds in this manner.

District officials must identify the composition of the balance in this reserve. Any monies that can be identified as required by statute to be reserved for debt service should be restricted for the purpose of making payment on the outstanding debt. And a plan should be in place demonstrating how the monies will be used for that purpose. Monies that the Board intends to set aside for capital purposes must be reserved in compliance with Education Law, subject to the approval of District voters.

Reserve for Encumbrances

Encumbrances are commitments related to unperformed contracts for goods or services and are intended to help prevent a district from exceeding appropriations. In order for school district officials to maintain budgetary control and to arrive at an accurate estimate of its uncommitted appropriations, it is necessary to establish an encumbrance when contracts are approved or purchases are authorized. At the end of the fiscal year, a portion of fund balance is set aside to carry forward appropriations for these commitments into the next fiscal year so that the following year’s budget may be increased by these amounts. This restricted amount of fund balance is known as the reserve for encumbrances.

The District's reported reserve for encumbrances at June 30, 2008 was \$1.4 million. We reviewed the supporting documentation for 33 encumbrances totaling \$569,849, all of which remained open as of April 1, 2009, and determined that 18, totaling \$488,701 were inappropriately accounted for as encumbrances. Ten of the 18, totaling \$393,000, represented commitments in the ensuing fiscal year (2008-09). The Business Administrator confirmed that these encumbrances represented a large purchase of technology services and equipment from BOCES¹⁶ that the District had intended to purchase from the following year's (2008-09) budget. District officials explained that there had been appropriations available in the technology budget at the conclusion of the 2007-08 fiscal year; therefore, they decided to encumber these appropriations to fund the purchase rather than using appropriations already included in the 2008-09 fiscal year budget for this purpose. By incorrectly encumbering funds, the District has sheltered unreserved fund balance that would have been subject to the statutory limit. Had District officials correctly accounted for encumbrances, the unreserved, unappropriated fund balance at June 30, 2008 would have exceeded the legal limit.

The District's budgetary practices have consistently resulted in operating surpluses that District officials have used to increase various reserve funds without disclosure in the budget that this was the intended purpose. This lack of transparency to the public has resulted in a significant accumulation of resources. Had these practices not occurred, real property taxes could have been lower during this five-year period, because the Board would have been required to comply with the statutory limit for fund balance and appropriated more fund balance to reduce the tax levy.

Recommendations

7. The Board and District officials should review their current budgeting practices and provide the most accurate representation of projected appropriations and revenues based upon all information available.
8. District officials should develop a plan to use the surplus fund balance identified in this report in a manner that benefits District taxpayers. In order to provide appropriate transparency, the use of this surplus should be done through the budget process with public disclosure. Such uses could include, but are not limited to:
 - Increasing necessary reserves
 - Paying off debt

¹⁶ The Board of Cooperative Educational Services (BOCES)

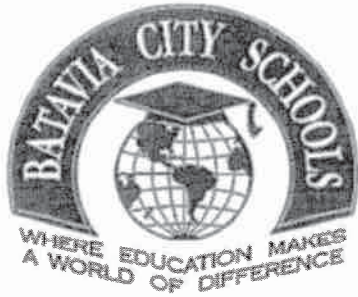
- Financing one-time expenditures
 - Reducing District property taxes.
9. The Board should review all reserves and determine if the amounts reserved are necessary, reasonable and in compliance with statutory requirements.
 10. District officials should identify the composition of the balance in the debt service fund, properly report and use statutorily restricted moneys to pay debt and establish capital reserves, if that is the Board's intent, in compliance with statutory requirements.
 11. District officials should analyze year-end encumbrances to ensure that they are reasonable and supported.

APPENDIX A

RESPONSE FROM DISTRICT OFFICIALS

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

The District's response letter refers to an attachment that supports the response letter. Because the District's response letter provides sufficient detail of its actions, we did not include the attachment in Appendix A.



Batavia City Schools

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October 28, 2009

Robert Meller, Chief Examiner
Office of the State Comptroller
Division of Local Government and School Accountability
295 Main Street, Room 1032
Buffalo, New York 14203-2510

Dear Mr. Meller:

The Batavia City School District is in receipt of the draft audit report "Internal Controls Over Selected Financial Operations" for the period July 1, 2007 – May 20, 2009, prepared by the Office of the State Comptroller. On behalf of the Board of Education and the District's Administration, we would like to thank the local field staff of the Comptroller's office. They were professional and courteous in working with our business office and other District staff.

We have carefully reviewed the findings and recommendations presented. To the extent that the Comptroller's audit represents an examination of the District's business operations for statutory and regulatory compliance, we appreciate this opportunity to review our financial management practices and oversight.

The audit report contains a number of conclusions and broad statements that we believe reflect subjective opinions and incorrect conclusions by the Comptroller's office with respect to the District's financial management specifically in the area of reserves, fund balance management, and internal controls over payroll.

We believe that our overall approach to financial management accomplishes these important goals for the students and families of our District.

1. Maintain a reliable and consistent curricular and extracurricular program that enhances the lives and futures of the children of the City of Batavia School District.

Our District has received accolades and honors based on the results our students have achieved. For the last several years, we have been recognized multiple times by the State Education Department for being a "high achieving, gap closing District," and by *Business First* as an "over achiever." Our high school was featured in a publication as one of 10 high achieving high schools in NYS by SUNY Albany's "Just For Kids - What Makes High Schools Work (2008)." The Batavia City School District was the Spring 2008 site visit for best practices in Technology for the National School Boards Association. All of these remarkable achievements have one

common theme and that is a high rate of proficiency in student achievement accompanied by a high rate of students who are eligible for free or reduced lunch. In schools that serve students from wealthy homes, it is not surprising to see high rates of student proficiency, but unfortunately schools with high free and reduced lunch eligibility usually do not have high rates of student proficiency. The District's percentages of proficient students as measured by the NYS Assessments have grown steadily since 2002. The District curricular program extends beyond SED mandates by offering Advanced Placement courses and Advanced Studies courses for college credit, vocational programs, accelerated middle school classes and a program for gifted and talented elementary pupils. A District Universal pre-Kindergarten program is housed at two of our elementary schools and provides transportation for 80 pre-kindergarten students. The District provides additional reading support through certified staff assigned to each building throughout the District. The percentage of time Special Education students are mainstreamed into the general education classrooms is far greater than is what is required by SED. Our average class size is well below that of comparable Districts and our staff to student ratio (including counselors) ranks among the best in the area. Each building has a full time Library Media Specialist, a school nurse, and at least one counselor.

Our program offers music and art to all students even though it is not mandated by New York State. We offer a comprehensive athletic program with all levels of play (modified through varsity), individual musical instrument lessons, performing music ensembles for elementary through high school students, drama, school newspapers, yearbooks, and a club for just about any student interest that exists. When our students are surveyed, they express a strong affinity for school and for learning.

2. **Stabilize the tax commitment for the citizens and taxpayers of the City of Batavia School District by maintaining minimal changes in the tax levy (see attached chart).**
3. **Protect programs that we believe are in the best interests of the students in the face of increasing uncertainty about economic conditions in the State of New York.**

We pride ourselves on having very low staff turnover. This is essential to our success because research shows that experience in a certain subject or at a specific grade level leads to increased proficiency for the staff member. During the first year of a new grade level assignment, results can be uncertain for both students and staff. Therefore, it is important for us to maintain staffing levels in order to achieve consistency in our program. Like other school Districts, the majority of our expenses come from personnel costs (approximately 75%). The majority of that staff is assigned directly to serving students as teachers, teacher aides, counselors, coaches etc. Even slight fluctuations in State Aid affect our ability to maintain our favorable staff to student ratio. Each year brings increased expenditures in the areas of salary, health insurance, and payments to the retirement systems. Our goal is to budget in such a way that fluctuations in State Aid have only minor effects on our ability to meet staffing needs.

4. **Plan for the long term future needs that may arise.**

We plan for the long term future needs that may arise by preparing budgets that are conservative on both the revenues and expenditures in order to account for any uncertain situations that could occur well over one year away from when the budget is developed and voted on. In terms of revenue estimates, 42% of the funds needed come from the local tax levy and 47% from State or Federal Aid. If revenue from New York State or the Federal government

is deceased after budget adoption, adjustments in program and employee staffing may be necessary. If there is no decrease in the amount of aid, the excess funds are used for cash flow, and then returned back to the taxpayer in appropriated fund balance or applied to reserve funds. In terms of expenditures, the estimates are conservative because of potential cuts in grant funding, or increases in other areas of the budget that become apparent after the budget process. For example, employer contribution to both employees and teachers retirement systems, health care rates, utilities and changes in student population which may require additional staffing or services for those students that require an individual education program (IEP) can change after the budget is completed. Again, surpluses are either returned back to the taxpayers in appropriated fund balance, one-time year end purchases, or used to fund reserves.

See
Note 1
Page 32

5. Work within our legal authority under both Education and General Municipal laws with the consistent guidance of our external auditors and legal counsel.

District officials and the Board of Education take their fiduciary responsibility with extreme seriousness. We understand the enormity of the trust that has been placed in us. To that end, we believe that communicating our financial circumstances to our taxpayers has always been a priority of the highest order. We are concerned that the overall tone of the audit report sends a message that is contrary to our above stated philosophy and beliefs. There are also several misleading statements that are unsupported by the detail that is offered. Finally, every year the District is required to have an independent audit of its financial statements. The unqualified audit reports and the communications received by the Board of Education over the last several years from the external auditor regarding the independent audits appear to conflict with the Comptroller's audit report.

See
Note 2
Page 32

Response to specific findings highlighted in the Audit Report - Payroll.

We believe that the actual errors in employee compensation over the two-year period identified in the audit is actually closer to **\$5,511.65** – an amount significantly less than the amount cited in the report. During this period, the District would have processed close to \$45 million in payroll. This level of error represents **0.01%** of the \$45 million payroll that was processed during the two-year audit study.

See
Note 3
Page 32

In general, the internal controls over employee compensation have been a challenge for a District our size. We have never employed a District official whose sole responsibility is human resources even though we employ about 500 people. The responsibilities for controlling procedures related to employee compensation have always been shared between the superintendent's office and the business office. Currently four out of six business office employees are brand new to their jobs and three of them are brand new to the District. A subsequent vacancy occurred and due to fiscal concerns, has not replaced. There was a change in the office of Superintendent. All of these conditions made it more likely that changes in practices could occur resulting in minor oversights. In any case, the District is committed to taking key steps to monitor and adjust systems and cross checks that make oversights less likely.

In the section of the report labeled Audit Results, the report states that “10 of 17 employees or 59 percent were overpaid or received compensation which was not provided for in the applicable contracts....in total we identified more than \$50,000 in overpayments.” We vehemently object to this assertion. In particular, later detail in the report uses words such as “questionable salary increases and unsupported compensation.” As we will show in our response, when District officials investigated these specific situations, the payments **were** in compliance with the intent of negotiated CBAs. However, we agree that some contract language may need revision in order to improve clarity.

Employee Compensation

- Response to section entitled Overpayment: An investigation was conducted on behalf of the Board of Education relative to the administrator who was allegedly overpaid because of payment on Step 9 rather than Step 8 of the CBA. The investigation included a conversation with a Board member from July 2000 (hire date) and the previous Superintendent. They recollect being directly involved in the salary negotiation that brought this administrator to the District and remember that in order to give her any raise from her, then current position, the District needed to offer her the highest step on the Batavia Administrators Contract, which was Step 9. Also, the District maintained an Employee Data Sheet in each personnel folder that was used at that time to record all professional employees’ salary and attendance. This administrator’s data sheet indicates that in 2000-01 she was appointed as a 12 month employee on Step 9 and shows a base salary of \$84,321 rather than Step 8 (\$81,962). The appointment letter and Board Minutes stating she was hired on Step 8 reflect a simple clerical error. Based on these facts, the Board passed a resolution at its November 2, 2009 meeting correcting the clerical error in the original appointment letter and Board of Education Minutes from that meeting. Therefore, based on the preponderance of this evidence, we disagree with its inclusion in the “more than \$50,000 in improper and unsupported overpayments.”
- Response to section entitled Questionable Salary Increases: One of the goals of the District’s negotiations for the 2008-11 Administrative Contract was to eliminate the responsibility factor in administrative salaries. This change makes administrative salaries much more transparent. During negotiations, it was agreed that in lieu of the responsibility factor, administrators would receive a 4% raise over their 2007-08 salary, as opposed to their 2007-08 “base” salary. The previous Administrative Contract (2005-2008) specifically states that the raise will be given over the “base” salary, while the 2008-2011 contract eliminates the word “base” and indicates the raise will be given over the 2007-08 salary. Because the negotiated language included 07-08 salary (not base salary), two individuals’ previous longevity payments were also rolled into the new salary. Again, we disagree with its inclusion in the “more than \$50,000 in improper and unsupported overpayments.”
- Response to section entitled Unsupported Compensation: An investigation was conducted on behalf of the board of Education relative to the specific instances subsequently presented in the report.

See
Note 4
Page 32

See
Note 5
Page 32

- a) We acknowledge that \$2,133.35 for three employees represents payroll errors.
- b) For \$1,406.75, our investigation proved inconclusive. We have been unable to locate the supporting documentation.
- c) In three instances which total \$1,263.87, additional supporting documentation was found and could have initially been given to the auditor had she reviewed the specific findings with the Business Administrator. Instead she asked an employee who was new to her position, who did not have the documentation.
- d) For \$1,695.05 for two employees involves vague contract language involving longevity. The actual payments were accurate according to the practice that had been in place for many years. Contractual language will be adjusted for the single remaining employee. Once again this new language will lead to greater transparency.

Again, we disagree with a portion of these instances being included in "more than \$50,000 in improper and unsupported overpayments."

See Note 6 Page 33

- Response to section entitled Administrators' Longevity: During 2008 negotiations with the Administrative bargaining unit, the District agreed to give credit for past administrative experience beyond administrative years in the Batavia District. This provision was intended to incent experienced administrators to stay in the District as opposed to leaving for higher salaries offered by Districts in the Buffalo and Rochester areas. Also, it enhances the District's ability to attract experienced administrators from these areas while maintaining our salary schedule. Once again, had the auditor asked the Superintendent, who oversees the Employee Personnel Files, we could have shown her the supporting documents used to verify previous administrative experience. Once the former superintendent had verified previous administrative experience, he used a spreadsheet to calculate longevities and provided that for the Business Administrator to use in the calculation of raises. This spreadsheet was shared with the auditor. Once again, we disagree with this \$6,500 being included in "more than \$50,000 in improper and unsupported overpayments."
- Response to section entitled Separation Payments: We acknowledge this amount totaling \$1,971.55 was paid either in error, or lacking supporting documentation.

See Note 7 Page 33

Recommendation # 1. The Board should take the necessary action to recover any salary and separation payments determined to have been improperly made or credited to current and former District employees.

District Response:

The Board will evaluate the cost effectiveness of potential recovery of any salary and separation payments that were made in error.

Recommendation #2. District officials should establish comprehensive payroll procedures to ensure that employee compensation is properly calculated and all salary payments, including any longevity and separation payments are paid in accordance with applicable contracts.

Recommendation #3. To enhance controls, the Business Administrator or other appropriate official designated by the Board should review all salary calculations, separation payments and adjustments.

Recommendation #4. As the official designated by the Board to certify payroll, the Business Administrator should review bi-weekly payrolls for accuracy and completeness in a timely manner.

District Response:

The District is now using its financial [REDACTED] software [REDACTED] more effectively than it was when it was first initiated in January 2007. For example, the software automates the process of providing salary notices. Providing salary notices to all staff allows District officials and employees to become more aware of how salary changes have been calculated and to ask questions regarding calculations. In the salary notices, each compensation area is broken out and the amount is defined. Employees are also required to sign and return the salary notice. In 2008-09 annual salary notices were provided for all instructional staff and in 2009-10 for all staff. The District believes the notices will help us identify potential errors earlier in the year and reduce the risk of overpayment. Another change is the inclusion of accrued leave time on each employee's pay stub. Again, we believe this practice will help us identify potential errors before employee separation. Those accrued leave records were also internally audited within the last year.

Based on current staffing, the Business Administrator is ultimately responsible for ensuring that the information in the salary notice is in compliance with each collective bargaining agreement (CBA). As the District staff continues to become more sophisticated users of [REDACTED], changes in internal processes will continue to evolve. The District will be able to use the software to maximize the performance of the system and to minimize human errors. Ensuring that the data in [REDACTED] is correct is a time consuming, staff intensive process. However, the reward will be great. As information moves through the different phases of budget, negotiations, and finally payroll, there will be more automation and less risk of human error.

Certification of the accuracy of payroll continues to be a major priority for the Business Administrator and must be completed before staff are paid.

Recommendation #5. District officials should establish procedures to provide for an independent review of leave records to ensure they are supported by timesheet entries by employees.

District Response:

Recording of leave time is now handled directly by the building secretaries, who are entering absences and employee substitutes into [REDACTED] for each employee. The purpose is to make attendance entries as accurate as possible in order to document accumulated leave time. At this time, our staffing limitations do not allow for a complete audit of each staff member's attendance records, but a representative sample is audited each payroll by the payroll clerk. The District will request that the internal auditor test a representative sample annually.

Recommendation #6. *The Board should designate an appropriate District official, independent of the payroll process, to review salary calculations, non-routine salary adjustments, and separation payments to confirm they are accurate and in compliance with applicable employment agreements before the payments are processed and distributed.*

District Response:

The District is initiating a review of all collective bargaining agreements with the assistance of a labor relations attorney, to clarify vague language and identify practices that are not clearly documented, in preparation for the next round of District negotiations. Also, as required by the Five Point plan, the District is required to have an internal audit performed each year. We have effective procedures in place with salary calculations and non-routine salary adjustments being reviewed by the Business Administrator, but as a cross check, the Board will ask the internal auditor to assess risk in salary calculations, non-routine salary adjustments and separation payments, and have additional testing performed each year.

Financial Condition

The audit report also appears to be inconsistent with guidance set forth in the Comptroller's document titled, *Local Government Management Guide – Reserves*. That document states:

In our personal lives, saving or putting money aside to finance future needs is a common practice. Unquestionably, strong arguments can be advanced for accumulating funds. The disputable philosophy, "live for today and let tomorrow take care of itself" can easily be refuted with many savings slogans such as "prepare for a rainy day."

These practices are equally important for New York's local governments. Legally established reserves can provide many benefits to municipalities and their citizens. Available moneys can be set aside to finance all or part of planned projects, thereby reducing the need to issue costly debt. Reserves can provide a degree of financial stability. In uncertain economic times, reserve funds may give managers options other than cutting services or raising taxes. In good times, moneys not needed for current purposes can often be set aside for future benefit. (LGMG – at p. 1, emphasis added).

The guidance goes on to state the following:

Municipalities, like any other entity, need to accumulate funds for future contingencies. However, if the adopted budget is on the mark total revenues plus appropriated fund balance would equal total expenditures with a zero fund balance remaining at the end of the fiscal year, leaving nothing to accumulate. In accordance with state statutes, many municipalities may include in their budgets an amount for estimated unappropriated, unreserved fund balances for each fund. Such estimate may not exceed a reasonable amount, consistent with prudent budgeting practices, necessary to ensure the orderly operation of the government (see Town Law, § 107[1][b], Village Law, §5-506[1][c], and County Law §355[1][g]).

Fortunately, municipalities are not precluded from setting aside and accumulating funds. This is accomplished by establishing reserve funds, which provide a means for raising money today, investing it

and spending the money and earnings in the future. **The decision to establish reserve funds, other than “mandatory” reserves, is left up to the governing board of each municipality.** The purpose of this chapter is to offer a reference document on legally authorized reserve funds. Hopefully, it will serve to acquaint officials with legal requirements so that the establishment and use of reserve funds comply with law. (LGMG – at p. 2, *emphasis added*).

See
Note 8
Page 33

Recommendation # 7. The Board and District officials should review their current budgeting practices and provide the most accurate representation of projected appropriations and revenues based upon all the information available.

District Response to Recommendation #7:

One of our budgeting practices has been based on the fact that we serve a low to mid-income population which makes us eligible for significant grant funding each year. However, the grant approval cycle does not coincide with the fiscal year. We anticipate that grant funding could be cut from year to year, putting important programs in jeopardy. Therefore, we budget expenses that are usually funded through grants. If grant funds are received, the money budgeted for those expenses becomes surplus. Also, there are sometimes spikes in expenses over which we have no control, i.e. utilities, employer contributions to retirement systems etc. We try to create a buffer to protect both programs and taxpayers. On the revenue side, surplus is also generated by a conservative approach to budgeting aid from New York State. The economic conditions, i.e. 2008-09, offer potential for aid to be reduced while school and established programs are in session. More to the point, the Governor is recommending State Aid cuts for this school year. If a mid-year budget cut is realized, staff will need to be laid off putting programs in jeopardy. Finally, the NYS Budget is historically finalized well into our budget process and actual numbers are not available until almost half way through our fiscal year. By budgeting the previous year’s amount for anticipated aid, we protect the District from the vagaries of the political process.

Recommendation #8. District officials should develop a plan to use the surplus fund balance identified in this report in a manner that benefits District taxpayers. In order to provide appropriate transparency, the use of this surplus should be done through the budget process with public disclosure. Such uses could include, but are not limited to:

- Increasing necessary reserves
- Paying off debt
- Financing one-time expenditures
- Reducing District property taxes

District Response to Recommendation #8:

We believe that we do use surplus in ways that are beneficial to our taxpayers. We do use surplus to increase necessary reserves, finance one-time expenditures, and reduce District property taxes. In fact, the District’s tax levy declined in 2007-08 and 2008-09, and remained flat in 2009-10. The tax rate has declined the last three years in a row for a total of 9.3% (see six year history provided in attachment). If we are required to identify the transfers that will be made to

See
Note 9
Page 33

reserves as part of the budget process, NYS needs to provide the appropriate account codes in order to allow Districts to budget for transfer to all allowed reserves.

See
Note 10
Page 33

Recommendation # 9. The Board shall review all reserves and determine if the amounts reserved are necessary, reasonable and in compliance with a statutory requirements.

District Response to Recommendation #9:

The Board of Education will establish a policy to conduct an annual review of all reserve funds as part of the budget process. During this review, the Audit Committee and the Board will review a listing of each reserve and the funds therein, learn of any payments made from each reserve in the recent past, receive a briefing on the statutes related to the reserve and any limits on funding or spending the funds, and receive an analysis of projected needs for the reserves in the upcoming fiscal year and make a recommendation on how to fund those needs.

Recommendation #10. District officials should identify the composition of the balance in the debt service fund, properly report and use statutorily restricted moneys to pay debt and establish capital reserves, if that is the Board's intent, in compliance with statutory requirements.

District Response to Recommendation #10:

It is important to note, that this fund was originally established with the help and guidance of the District's external auditor. Going forward, we will seek legal counsel on the establishment and maintenance of the Debt Service Fund. We will work with the District's fiscal advisor in order to identify the composition of the current balances. Then the Board will review legal advice and counsel before making changes to this reserve.

Recommendation #11. District officials should analyze year-end encumbrances to ensure that they are reasonable and supported.

District Response to Recommendations #11:

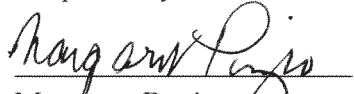
Many years ago, the Board identified technology resources as a priority to enhance the education of the students in Batavia. A strategy for funding was developed which included the use of BOCES aid. The original technology purchases were made through a capital project and the aid generated allowed the District in subsequent years to complete multiple phases of the District's technology vision. Later on, this philosophy was further enhanced by using year end surplus funds to expedite one-time purchases planned for the following year. This, in turn, generated more aid and allowed the District's students to realize many advantages from technology at an accelerated pace. Other administrative software upgrades were funded in the same manner. One of these is [REDACTED] which has been integral to the District's ability to establish internal controls. Following this practice has allowed the District to fund necessary one-time purchases that arise due to unforeseen circumstances.


See
Note 11
Page 33

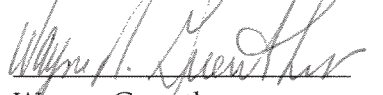
Conclusion


As stated earlier, the Board takes its responsibility for fiscal oversight extremely seriously and we are committed to taking whatever steps are needed to monitor and adjust systems and cross checks that make errors less likely. We believe that what we have achieved both in the area of high quality programs and student achievement results, as well as a reasonably stable local contribution from taxpayers, is remarkable for a small city District like ours. While we appreciate this opportunity to scrutinize our financial management practices and plan to improve them, we do not believe that it is the intention of this audit to substitute the Comptroller’s judgment for that of the District’s Board and administrative staff. Thus while we respectfully acknowledge the expertise of the Comptroller’s office, it is our view that our work in these matters through our daily operations, annual budgeting and long-term financial planning, has controlled costs for the District taxpayers over time and placed the District in a secure financial position for the future, while providing a high quality education for District residents.

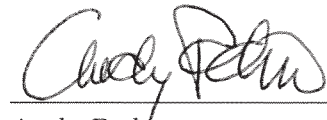
Respectfully submitted,



Margaret Puzio
Superintendent of Schools

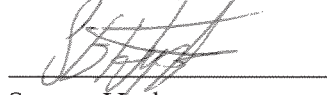

Gail Stevens
Vice President, Board of Education



Wayne Guenther
Board of Education Member


Steven Mountain
Board of Education Member


Andy Pedro
President, Board of Education


Patrick Burk
Board of Education Member


Steven Hyde
Board of Education Member


Gary Stich
Board of Education Member

Attachment

APPENDIX B

OSC COMMENTS ON THE DISTRICT'S RESPONSE

Note 1

The District did not use appropriated fund balance to finance operations in the fiscal years they generated an operating surplus (i.e., reported revenues exceeded reported expenditures).

We disagree with the District's conclusion that they need to purposefully budget in a manner which will generate operating surpluses to adequately plan for unexpected issues. The District is allowed and should retain a portion of fund balance, referred to as unreserved, unappropriated fund balance, to address unexpected cash flow issues and unanticipated occurrences. However, they must do so within the limits established by Real Property Tax Law and should not use other means, including budgeting practices, to purposefully collect or withhold more funds than legally allowed or necessary.

Note 2

The District's external auditor's reports attest to the accuracy of the District's financial statements. This is significantly different than our audit objectives, which were to examine financial condition and internal controls over payroll.

Note 3

During our testing, District personnel were unable to provide adequate supporting documentation for some of these payments; therefore, we were unable to determine whether some of the payments were proper or whether they were erroneous overpayments. Further, our sample of payroll transactions was selected using a risk based approach and cannot be projected onto the entire population; therefore, we find the District's statements to be both inaccurate and misleading.

Note 4

We were provided with three records indicating the administrator was to start on Step 8 instead of Step 9. The records included Board minutes approving her appointment, a letter from the Superintendent announcing the approval of her appointment by the Board, and a letter of acceptance signed by the Administrator indicating she agreed to start on Step 8 of the CBA.

Note 5

In our report, we questioned whether it was the intent of all parties to add increases totaling \$11,721 permanently to the salaries of five administrators, because the contract provisions did not clearly communicate whether this should be done; this was not consistent with past practice. During our exit discussion, a Board member admitted that had he known the intent of this provision he would not have approved the agreement.

Note 6

We discussed the payroll findings at length with the Superintendent and the Business Administrator prior to concluding the audit. The Business Administrator expressed interest in investigating only one of the unsupported payments further. We also consulted with both the current and former payroll clerk who processed the payments in question, in an attempt to locate the applicable supporting documentation.

Note 7

The Business Administrator indicated that the former Superintendent verified the prior experience of the administrators receiving additional longevity totaling \$6,500, as a result of years of service to other district(s), but he was unsure of the process used and was unable to provide supporting documentation. We also requested the information from the personnel clerk and reviewed applicable files, but found no documentation was maintained in the files or with the personnel clerk. Further, when we brought this matter to the attention of the current Superintendent of Schools, she did not indicate that she had this documentation.

Note 8

There is nothing in our report that is inconsistent with the Management Guide quoted. We recognize that reserves can serve as a helpful financial tool. However, reserves must be used in compliance with statutory restrictions, and in a manner that represents a prudent and transparent use of taxpayer funds.

Note 9

In our report, we refer to the increases in the amount of real property taxes levied by the District to fund operations, from approximately \$14.8 million in 2003-04 to approximately \$17.3 million in 2007-08. In their response, the District touts declines in their tax rate. Tax rates may have decreased over this period because of changes in the District's taxable assessed valuation levels, not because of a decrease in the tax levy.

Note 10

For appropriate account codes, District officials should refer to the publication entitled "Accounting and Reporting Manual for School Districts" issued by the Office of the State Comptroller.

Note 11

The District's explanation as outlined in their response to recommendation 11 does not constitute an appropriate use of encumbrance accounting.

APPENDIX C

AUDIT METHODOLOGY AND STANDARDS

Our overall goal was to assess the adequacy of the internal controls put in place by officials to safeguard District assets. To accomplish this, we performed an initial assessment of the internal controls so that we could design our audit to focus on those areas most at risk. Our initial assessment included evaluations of the following areas: financial oversight, cash receipts and disbursements, purchasing, payroll and personal services, and information technology.

During the initial assessment, we interviewed appropriate District officials, performed limited tests of transactions and reviewed pertinent documents, such as District policies and procedures manuals, Board minutes, and financial records and reports. In addition, we obtained information directly from the computerized financial databases and then analyzed it electronically using computer-assisted techniques. This approach provided us with additional information about the District's financial transactions as recorded in its databases. Further, we reviewed the District's internal controls and procedures over the computerized financial databases to help ensure that the information produced by such systems was reliable.

After reviewing the information gathered during our initial assessment, we determined where weaknesses existed, and evaluated those weaknesses for the risk of potential fraud, theft and/or professional misconduct. We then decided on the reported objectives and scope by selecting for audit those areas most at risk. We selected financial condition and internal controls over payroll for further audit testing.

To accomplish the objectives of this audit, we performed the following audit procedures for the payroll scope area:

- We reviewed the District's written payroll policies and regulations.
- We interviewed staff to gain an understanding of the District's payroll and personnel process and procedures.
- We examined collective bargaining agreements, individual employee contracts, Board minutes, payroll registers, employee earnings reports, time sheets, leave accrual records and other appropriate supporting documentation.
- We reviewed the calculations used by District personnel to determine employee compensation including base salary, pay increases, salary adjustments, stipends and longevity for the 2007-08 and 2008-09 fiscal years for a judgmentally selected sample of 17 employees. We compared these calculations to the applicable contract provisions to determine whether the calculations were accurate and supported.
- We reviewed the total amount of compensation paid to these 17 employees during the 2007-08 and 2008-09 fiscal years to ensure the employees were paid in accordance with contract provisions and received only the compensation to which they were entitled.

- We reviewed the calculations used by District personnel to determine the separation payments and benefits for six employees. We compared these calculations to the applicable contract specifications to determine whether the calculations were accurate and/or supported.

To accomplish the objectives of this audit, we performed the following audit procedures for the financial condition scope area:

- We reviewed audited financial statements and budget to actual reports to analyze changes in fund balance as a result of annual operations. We also examined the components of fund balance for adherence to statutory requirements.
- We identified and analyzed specific budget lines with significant budget to actual variances and interviewed District officials to determine the methods used to estimate certain appropriations and revenues items.
- We reviewed relevant statutory provisions and analyzed the activity in the District's five reserve funds. Specifically, we evaluated if the use of reserve monies complied with statutory requirements and if balances appeared reasonable. We also examined Board resolutions to determine if each reserve was properly established.
- We interviewed District officials concerning procedures and the basis used to determine reserve levels.
- We also examined the tax levy increases/decreases from 2003-04 thru 2008-09.
- We reviewed the legitimacy of the reserve for encumbrances reported at June 30, 2008 by requesting and reviewing the supporting invoices and documentation for 33 encumbrances.

We conducted this performance audit in accordance with generally accepted government auditing standards (GAGAS). Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

APPENDIX D

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