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July 15, 2010

Mr. Edward J. Zero, District Superintendent
Members of the Board of Education
Western Suffolk BOCES
507 Deer Park Road
Dix Hills, New York 11746

Report Number: S9-9-70

Dear Superintendent Zero and Members of the Board of Education:

A top priority of the Office of the State Comptroller is to help officials manage their resources efficiently and effectively and, by so doing, provide accountability for tax dollars spent to support operations. The Comptroller oversees the fiscal affairs of local governments statewide, as well as compliance with relevant statutes and observance of good business practices. This fiscal oversight is accomplished, in part, through our audits, which identify opportunities for improving operations and governance. Audits also can identify strategies to reduce costs and to strengthen controls intended to safeguard assets.

In accordance with these goals, we conducted an audit of six BOCES throughout New York State. The objective of our audit was to determine if these BOCES have been reserving excessive funds without informing their component and participating school districts. We included the Western Suffolk BOCES in this audit. Within the scope of this audit, we examined the policies and procedures of the Western Suffolk BOCES, the documentation to support reserve balances, and the reporting to component school districts for the period July 1, 2007 to June 30, 2009. For historical reserve fund activity, we reviewed reserve fund data for the period July 1, 2005 through June 30, 2007.

This report of examination letter contains our findings and recommendations specific to the Western Suffolk BOCES. We discussed the findings and recommendations with BOCES officials and considered their comments in preparing this report. At the completion of our audit of the six BOCES, we will prepare a global report that summarizes the significant issues we identified at all BOCES audited.

Summary of Findings

Our audit found that the Western Suffolk BOCES (BOCES) retained \$2.4 million¹ in a reserve fund that they lacked specific legal authority to have; these funds were allocated from school district moneys. During our audit period, BOCES used approximately \$4.2 million² in budgetary appropriations and operating surplus to fund four of its five reserves³ – a workers’ compensation reserve, an unemployment insurance reserve, an Employees’ Retirement System contribution reserve, and an employee benefit accrued liability reserve⁴ – without indicating to its districts that these moneys were allocated to the reserves. However, at the end of each fiscal year, if the reserve balance was greater than the limit prescribed by Board resolution, the excess reserve funds were returned to operating surplus. In addition, BOCES officials established the workers’ compensation reserve, which included over \$2.4 million as of June 30, 2009, without clear statutory authority for this type of reserve.

BOCES officials also did not establish policies and procedures for the funding and use of the reserves. However, the Board resolution from June 2006, establishing the reserves, provides guidelines on the balance in each reserve. Further, the BOCES provided documentation that supports the balances maintained in the reserve accounts.

BOCES’ failure to clearly report reserve allocations to the component and participating school districts has compromised the transparency of BOCES operations and denies the school districts complete knowledge of how BOCES is ultimately using money paid by districts for BOCES services.

Background and Methodology

The BOCES serves 18 component school districts in western Suffolk County. BOCES is governed by a seven-member Board of Education (Board) whose members were elected by the 18 component school districts. BOCES’ operating expenditures totaled \$151 million in the 2007-08 fiscal year. These costs are funded primarily by charges to school districts for services, and Federal and State grants. New York State Law and the Office of the State Comptroller provide guidance with respect to the establishment, funding, and use of BOCES reserves.

BOCES’ primary function is to provide educational programs and services to component and participating⁵ school districts and adult learners. The Board is responsible for establishing policies and procedures including documented plans for the funding and use of reserves. BOCES has approximately 1,700 employees working at campuses and in schools throughout the region.

¹ Includes the unauthorized workers’ compensation reserve of \$2.4 million

² Includes funding of the following reserves: workers’ compensation reserve of \$3.2 million, Employees’ Retirement System contribution reserve of \$60,000, unemployment insurance reserve of \$220,000, and employee benefits accrued liability reserve of \$725,000

³ This excludes Reserve for Encumbrances, which is an accounting designation for funds that are committed for goods or services ordered but not yet received by the end of the fiscal year in which they were ordered

⁴ BOCES refers to this reserve as a compensated absences reserve.

⁵ Component school districts (BOCES members) provide most of the funding for BOCES facilities and services. BOCES also serves “participating” school districts which elect to participate in one or more selected BOCES programs and are billed accordingly.

We examined the minutes of Board proceedings, accounting ledgers, financial statements, BOCES policies and procedures, and other reserve support materials and documentation.

BOCES can legally reserve funds for specific future uses, helping reduce its reliance on operating funds or borrowed moneys. Reserves must be established by Board resolution and in some instances⁶ require approval by a majority of the component school districts' Boards of Education. BOCES officials are responsible for developing policies and procedures to ensure that reserves comply with applicable laws, regulations, and good management practices concerning reserve establishment, funding, use, and reporting to the school districts. These policies and procedures should clearly indicate BOCES' plans for reserve funds, including the specific purpose for each reserve and the Board's intended method and level of funding.

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.

Established Reserves

Education Law and General Municipal Law (GML) define the types of reserves that can be established by a BOCES. Additionally, the law requires reserves to be established by Board resolution and in some instances requires approval by a majority of the component school districts' Boards of Education.

Most reserve funds are established to provide resources for an intended future use. An important concept to remember is that a reserve fund should be established with a clear intent or plan in mind regarding the future purpose, use and, when appropriate, replenishment of funds from the reserve. Reserve funds should not be merely a "parking lot" for excess cash or fund balance. Local governments, school districts and BOCES should balance the desirability of accumulating reserves for future needs with the obligation to make sure taxpayers are not overburdened by these practices. There should be a clear purpose or intent for reserve funds that aligns with statutory requirements.

During the audit period, BOCES maintained five reserve funds that totaled approximately \$18.9 million at June 30, 2009 (prior to year-end adjustments):⁷

⁶ For example, a career and technical equipment reserve

⁷ This excludes Reserve for Encumbrances, which is an accounting designation for funds that are committed for goods or services ordered but not yet received or paid for by the end of the fiscal year in which they were ordered.

Reserve Title	June 30, 2006	June 30, 2007	June 30, 2008	June 30, 2009⁸
Workers' Compensation Reserve	\$2,145,505	\$2,303,130	\$2,337,427	\$2,475,184
Unemployment Insurance Reserve	\$250,771	\$253,615	\$253,615	\$253,615
Employees' Retirement System (ERS) Contribution Reserve	\$947,893	\$1,064,629	\$1,082,010	\$1,162,784
Property and Casualty Insurance Reserve	\$412,377	\$400,000	\$400,000	\$400,000
Employee Benefit Accrued Liability Reserve	\$15,143,545	\$15,143,545	\$15,143,545	\$14,587,176
Total Reserves	\$18,900,091	\$19,164,919	\$19,216,597	\$18,878,759

BOCES officials properly established four of the five the reserve funds in June 2006⁹ by Board resolution, properly accounted for these reserve funds separately, and appropriately deposited interest earned to each reserve. However, although it was established by Board resolution, BOCES does not have clear legal authority to establish a workers' compensation reserve. Our findings regarding the funding of these reserves, disclosure of reserve allocations to the school districts, maintenance of reserve fund balances and use of the reserve funds, and the workers' compensation reserve are detailed below.

Funding Reserves and Disclosure to School Districts

Any governing board, including a BOCES Board, that is planning to establish and finance reserve funds on a regular basis should develop a detailed written policy that communicates to taxpayers why the money is being set aside, the board's financial objectives for the reserves, optimal funding levels, and conditions under which the assets will be utilized. All reserve fund transactions should be transparent to the public. Reserve funds are typically funded from amounts raised through the annual budget process, transfers from unexpended balances of existing appropriations, and surplus moneys. Ideally, amounts to be placed in reserve funds should be included in the annual budget. By making provisions to raise resources for reserve funds explicit in the proposed budget, the BOCES board gives its school districts and those districts' voters and residents an opportunity to know the board's plan for funding its reserves.

Operating surplus and/or budgetary appropriations used to fund reserves should be labeled as such and clearly communicated to BOCES' component and participating school districts, and consequently those districts' taxpayers. Although there is no statutory limit on the amount in most reserves, the balances in statutorily authorized reserves should be reasonable and based on intended future expenditures or estimable liabilities. Withdrawals from the reserves should comply with statute and be directly related to the purpose of the reserve.

⁸ June 30, 2009 data was unaudited and does not include year-end adjustments and transfers to reserves.

⁹ The original Board resolutions that created the reserves could not be located by BOCES officials.

BOCES allocated \$4.2 million¹⁰ to reserves during our audit period. However, we found that BOCES officials did not clearly report these reserve allocations to its districts during this time or for the prior two-year period July 1, 2005 to June 30, 2007. In addition, BOCES does not have any policies, procedures, or written plans for the funding and use of moneys allocated to reserves. Further, BOCES does not report to its districts that budgetary appropriations and operating surplus are used to fund the reserves or that excess in the reserves is refunded to operating surplus due to the districts. Therefore, these reserve fund allocations and disbursements were potentially made without the knowledge of component and participating school districts, and consequently those districts' taxpayers.

BOCES officials stated that transfers to reserves are included as budgeted expenditures in each Cooperative Services (CoSer)¹¹ budget and are also allocated from surplus. BOCES officials provide detailed CoSer budgets and a Central Administration budget to the component and participating school districts.¹² Budgeted allocations to the reserves are included as expenditures for fringe benefits in the individual CoSer budgets. This practice does not clearly indicate that these moneys are allocated to reserves; rather, they appear as budgeted expenditures. In addition, they do not provide a surplus report indicating the cost allocated to that district in the past year's budget, the actual expenditures associated with providing shared services to the district during the year, and any surplus or refund due and payable to that district or any other report that identifies surplus funds transferred to reserves. Therefore, money allocated to reserves is not clearly identified. Such lack of disclosure compromises the transparency of BOCES operations and denies the school districts complete knowledge of how BOCES is ultimately using money paid by districts for BOCES services.

Some Board members, who represent the 18 component school districts,¹³ told us that BOCES business officials provide monthly financial statements and reports that include the balance of each reserve. Board members also told us that they, and BOCES officials, verbally communicate information regarding reserve funding to the component school districts; however, there was no written documentation of this communication and therefore there is no evidence that all component and participating school districts have knowledge of BOCES' allocations to reserves.

Reserve Balances and Use of Funds

Although there is no statutory limit on the amount in most reserves, the balances in statutorily authorized reserves should be reasonable and based on intended future expenditures or estimable liabilities. In addition, reserve funds should be accounted for separately and interest earnings should be allocated to the reserves. Also, withdrawals from the reserves should comply with statute and be directly related to the purpose of the reserve.

¹⁰ Includes funding of the following reserves: workers' compensation reserve of \$3.2 million, Employees' Retirement System (ERS) contribution reserve of \$60,000, unemployment insurance reserve of \$220,000, and employee benefits accrued liability reserve of \$725,000

¹¹ The main vehicle for BOCES services provided to its school districts. CoSers programs must be approved by the State Education Department (SED).

¹² For the CoSers programs in which they participate

¹³ Although the seven Board members represent all 18 component school districts, each originates from one of the component school districts.

Expenditures from BOCES reserves were in compliance with statute and directly related to the purpose of the reserve.¹⁴ BOCES properly accounted for each reserve separately and appropriately deposited interest earnings to the reserves. In addition, the balances of the reserve funds were either adequately supported with related liability calculations or they were in compliance with the Board's documented funding plans.¹⁵

Unemployment Insurance Reserve – The Board established this reserve in June 2006¹⁶ for funding payments to reimburse the State Unemployment Insurance Fund for actual claims filed. We found that payments made from this reserve during our audit period (averaging \$62,000 a year) were in compliance with statute and directly related to the purpose of the reserve. The balance as of June 2009 (prior to year-end adjustments) was approximately \$254,000 and is in compliance with the Board's documented funding plan for this reserve. During our audit period, BOCES deposited \$219,479 from budgetary appropriations into the reserve, without identifying these moneys as reserve allocations. In addition, BOCES returned \$106,328 to operating surplus to reduce the reserve fund balance to the Board's planned funding level, resulting in no change to the end of year balance of the reserve. Although BOCES has a documented plan for the funding of this reserve, they do not have a specific documented plan for use of the money in this reserve.

ERS Contribution Reserve – The Board established this reserve in June 2006¹⁷ for the purpose of paying BOCES share of payments to ERS. The balance as of June 2009 (prior to year-end adjustments) was \$1,162,784 and is in compliance with the Board's documented funding plan for the reserve. However, in 2009 BOCES allocated \$60,000 from operating surplus to fund this reserve, without disclosing these allocations to component school districts. No payments were made from this reserve during our audit period; payments to ERS are currently made from budgeted appropriations. In 2008 BOCES returned \$18,260 to operating surplus to reduce the reserve fund balance to the Board's planned funding level. While BOCES has a documented plan for the funding of this reserve, they do not have a specific documented plan for the use of the funds.

Property and Casualty Insurance Reserve – The Board established this reserve in June 2006.¹⁸ BOCES officials stated that this reserve was created for the payment of claims that are not covered under current insurance policies. The balance as of June 2009 (prior to year-end adjustments) was \$400,000 and is in compliance with the Board's documented funding plan for the reserve. No payments have been made directly from this reserve account and no deposits have been made to the reserve during our audit period. Although BOCES has a documented plan for the funding of the reserve, they do not have a specific documented plan for use of the money in this reserve.

¹⁴ There were no payments made from the Employees' Retirement System (ERS) contribution reserve or the property and casualty insurance reserve during the audit period.

¹⁵ For the unemployment insurance reserve, the calculation is based on the highest of the past five years of annual costs plus \$100,000 for catastrophic losses, the property and casualty insurance reserve is set at a limit of \$400,000, and the Employees' Retirement System contribution reserve is based on 5% of the most recent annual salary amount on which contributions have been made to the New York State Employees' Retirement System.

¹⁶ The Board resolution that originally created this reserve could not be located by BOCES officials.

¹⁷ Ibid

¹⁸ Ibid

The BOCES' lack of a specific plan for the use of these reserve funds – combined with the failure to report the allocations made to reserves – demonstrates inadequate planning and a lack of transparency in BOCES' reporting to the school districts.

Workers' Compensation Reserve

Currently there is no clear statutory authority for a BOCES to create a reserve for workers' compensation. However, BOCES established a workers' compensation reserve by Board resolution in June 2006¹⁹ and is using this reserve to accumulate money to pay for workers' compensation claims. During our audit period, BOCES officials allocated \$3,176,887 to this reserve using a combination of budgetary appropriations and operating surplus without clearly identifying these allocations as reserve funding.

BOCES' expenditures from this reserve averaged \$1,547,656 a year during our audit period. As of June 30, 2009, the balance in this reserve was over \$2.4 million. In absence of clear statutory authority and in view of the amount accumulated, BOCES officials should return the moneys in this reserve to operating funds and apportion the excess funds to the component and participating school districts.

Recommendations

1. The Board and BOCES officials should develop written policies and procedures to ensure that reserve funds are clearly authorized by law and properly established by Board vote in compliance with statutory requirements. These policies and procedures should include a specific plan for the funding and use of reserve funds.
2. The Board should ensure that participating and component districts are properly notified of BOCES' intent to fund reserves. Amounts budgeted for the purpose of funding reserves should be clearly identified.
3. The Board should review BOCES' legally established reserves and determine if the balances are necessary and reasonable. To the extent that they are not, BOCES officials should reduce the reserves to reasonable levels in compliance with statutory restrictions.
4. BOCES management should discontinue the use of its workers' compensation reserve. The funds in this reserve should be returned to operating funds and properly apportioned to the component and participating school districts.

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*

¹⁹ The Board resolution that originally created this reserve could not be located by BOCES officials.

OSC Audit Report, which you received with the draft audit report. The Board should make the CAP available for public review in the Clerk's office.

Our Office is available to assist you upon request. If you have any further questions, please contact Ann Singer, Chief of Regional and Statewide Projects, at (607) 721-8310.

Sincerely,

A handwritten signature in black ink, appearing to read "Steven J. Hancox".

Steven J. Hancox
Deputy Comptroller
Office of the State Comptroller
Division of Local Government
and School Accountability

APPENDIX A

RESPONSE FROM BOCES OFFICIALS

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

507 Deer Park Rd
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631/549-4900

Business Office/Payroll
FAX 631/623-4924
Accounts Payable
FAX 631/623-4921

April 8, 2010

██████████
Principal Examiner
Statewide & Regional Projects Unit
Division of Local Government and School Accountability
Office of the State Comptroller
295 Main Street, Room 1050
Buffalo, NY 14203-2510

**RESPONSE AND CORRECTIVE ACTION PLAN
REPORT OF EXAMINATION – RESERVE FUNDS**

Dear ██████████

Western Suffolk BOCES would like to thank the staff of the Office of the State Comptroller and especially the field team that was involved in the preparation of this report. We found the field team assigned to our BOCES to be competent, knowledgeable and professional in all aspects of the audit process.

We take most seriously the issues addressed in the audit and have and will continue to carefully review the areas commented upon.

Established Reserves

We agree that General Municipal Law (GML) section 6-j workmen's compensation reserve fund does not specifically include "BOCES" in item 1; however it does list BOCES under item 5 concerning the allocation of unused funds. We believe that BOCES conforms to the type of entity that was apparently intended when the law was established in that we are self funded and face exposure similar to school districts who are included under this section.

See
Note 1
Page 12

The State Education Department (SED) has submitted legislation to include BOCES under item one of the statute. We will monitor action on the legislation and make the required adjustment to the reserve should it not be successful.

Funding and Use of Reserves

There is no legal requirement that the board adopt a policy on the funding and use of reserves. The board’s resolutions (specifically the resolution of June 13, 2006) contain the funding formulas and the statute restricts the use of funds once they are allocated to a reserve. It is not clear what a policy would add to the documentation of this issue but the board is currently considering a policy addressing the various issues concerning the funding and use of reserves.

See
Note 2
Page 12

Disclosure and Reporting to Component School Districts

It has been our practice to include transfers to two of the reserves in appropriations in the various cosers in the tentative budget distributed to component districts. As noted, these amounts are perhaps labeled ambiguously however we are unable to locate more appropriate expenditure coding (specific codes for transfers to reserves) in the Uniform System of Accounts. The following amounts have been transferred to reserves pursuant to those budgetary appropriations during the past three years:

See
Note 3
Page 12

Workers Comp and Unemployment:	
2006-2007	\$1,210,269
2007-2008	\$1,526,461
2008-2009	\$1,557,511

Other transfers to reserves from available program balances at year end have totaled a net amount of \$220,023 during the same three year period. As noted, surplus funds in reserves have been returned to the general fund.

We are unaware of any legal requirement that the BOCES report to the components on the specific issue of allocation of funds to reserves. The BOCES reports in many ways, formal and informal, to the components. These include meetings with Superintendents and Business Officials, shared services guides, service request forms, the annual tentative budget etc. The reserve balances are fully disclosed in our audited financial statements which we will make available to component districts.

See
Note 4
Page 12

In summary we plan to take appropriate steps to address the recommendations contained in the report.

We appreciate the opportunity to respond to the significant matters addressed by the report.

Yours very truly,



Warren E. Taylor
Chief Financial Officer

APPENDIX B

OSC COMMENTS ON BOCES' RESPONSE

Note 1

BOCES currently lack specific authority to have a workers' compensation reserve. Historical amendments to General Municipal Law Section 6-j, specifically that of subsection 5, do not illustrate intent by state policymakers to add BOCES to the entities that are authorized to have such a reserve. BOCES can choose to pursue changes to the statute through the State Legislature.

Note 2

Policies and procedures, including a written plan for the funding and use of BOCES reserve funds, provide a clear intent for reserves, provide guidance for future administrators, and enhance the transparency and accountability of BOCES' use of reserve funds. BOCES should incorporate good management practices in their daily operations whether they are required by law or not.

Note 3

We have provided BOCES officials with guidance on budgeting for reserve funding and recording related transactions.

Note 4

BOCES should be transparent in its reporting to component and participating school districts regarding BOCES' finances, including the use of reserve funds, whether there is a specific legal requirement to do so or not. BOCES operates with taxpayer money and has the responsibility clearly report the intended use and ultimate disposition of all monies collected.