

*Quality Learning & Caring...*



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Mr. Edward V. Grant Jr., Chief Examiner  
Office of the State Comptroller  
The Powers Building  
16 West Main Street – Suite 522  
Rochester, New York 14614-1608

Dear Mr. Grant and Fairport, Perinton Community:

The Fairport Central School District is in receipt of the draft audit report, *Financial Condition*, for the period July 1, 2003, through May 21, 2009, prepared by the Office of the State Comptroller. Our Board of Education and District Administrators thank Ms. Julie Goodness and Ms. Stephanie Howes for the professional nature in which they worked during the scope of the audit. The Office of the Comptroller committed time and expertise for an extensive review to assess the adequacy and appropriateness of the internal controls Fairport has in place to safeguard District assets. The assessment included evaluation of financial oversight, cash receipts and disbursements, purchasing, payroll, and personnel services. We are most proud to note that this report presents not a single material finding or procedural weakness in these areas.

In addition, as part of our exit interview, we learned that the local field staff had presented a proposal to the State Comptroller's Office recommending a positive audit of the District's internal controls and safeguards for Information Technology (IT). We are hopeful that the Comptroller's Office will act on the proposal identifying it as a best practices approach that could be shared with others in the field of IT in education.

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

Over the last five years, the demands for change in education have been many and the ability to anticipate needs has become more challenging. The work of schools has been driven by new mandates for student achievement and new requirements for fiscal accountability measures. At the same time, schools are forced to adjust to contingent budget caps, mid-year cuts, and unprecedented national and state economic uncertainty. On November 19, State Comptroller Thomas DiNapoli released the *2009 Annual Report on Local Governments* that included the following statement.

We need to reserve our tendency to buy time through short-term budgeting gimmicks and instead act decisively to put our State's finances on a solid foundation for long-term growth. Recently, I announced that New York State may face a current year budget gap of as much as \$4.1 billion this year and \$38 billion through 2012-13—a reflection of Albany's structurally imbalanced budgets that too often put off hard choices. The structural imbalance in the State budget puts our local government partners in a perilous and unpredictable situation.

By these very standards, the Fairport Central School District is in a strong financial condition. Credit analysts from Standard & Poor's Rating Services assessed a long-term credit rating of AA/Stable. These reports have indicated that prudent budgeting practices and ample designated reserves contribute to a strong financial position. The most recent report states that "The stable outlook reflects Standard & Poor's continued expectation that the district's financial position will remain stable and that management will continue to manage budgetary pressures adequately."

We welcomed the opportunity to review the District's financial condition with the Office of the State Comptroller. We have thoroughly reviewed and discussed the findings and recommendations of the Report and will use it as a tool to reflect on best practices and make corrective action where necessary.

However, there is specific tone in the draft report that amplifies subjective opinions with respect to the District's fiscal operations and financial condition that are concerning and disappointing. In an audit report such as this, it is inappropriate to use inflammatory phrases based on subjective opinion. Further, it is inaccurate to report that the District accumulated funds that should be used to benefit taxpayers without noting that the data from the Comptroller's own chart shows that the District has allocated \$8.7 million since 2003-04 to reduce taxes. We are compelled and pleased to point to the fact that during the last five years the average tax rate change is -1.12% per year.

In responding to the Report's recommendations, we will specifically address the following.

- The importance of conservative budget practices
- The value and purpose of fund balance
- The on-going practices of avoiding debt and leveling taxes
- The appropriateness of maintaining legal reserves

The very same strong and sound budgeting principles that Mr. DiNapoli is calling for in his recent communication are practiced by the Fairport School District. Yet, they are called in question in the Audit Report. It is with these principles in mind that we have considered and now respond to the recommendations.

### **Response to Specific Recommendations**

1. *District Officials should prepare, and the board should approve, budgets that realistically estimate the revenues and appropriations needed to finance District operations.*

The District takes its responsibility for managing budgets very seriously. The Board of Education understands its legal responsibility for fiscal oversight and performs its fiduciary responsibility on behalf of the School District and its taxpayers. It is the District's intent and objective to take a conservative approach to budgeting that provides long term stability in support of quality educational programs that are expected by the community. The budget development process of a school district is more cooperative, open, and transparent than any other municipality or agency of the State.

The Comptroller presents an opinion that the budgeting practices of the District are unrealistic and overly conservative. The District disagrees with these subjective opinions and contends that its approach is both appropriate and warranted.

Schools are faced with a variety of complex and unpredictable issues when preparing revenue budgets. State aid, which represents approximately one-third of the District's revenues, has been highly volatile as a result of the State's own financial difficulties.

Historically, New York State has had late state budgets, has threatened cuts to specific aid categories, has extended (delayed) transportation payments for capital bus purchases over five years, has frozen the Foundation Aid formula, and has imposed a Deficit Reduction Assessment in the amount of \$3.6 million to Fairport Schools. Currently, New York State is proposing a Gap Elimination Adjustment that would impose a \$2.37 million mid-year state aid cut to the District in the 2009-10 fiscal year. Additionally, state aid projections provided by the Governor's proposal and legislative budget proposals each year are based on projected data provided in the previous year. Final state aid runs are not available until November of the year in which the aid is received. In essence, the District is budgeting eighteen months in advance with projections that are based on old data.

The District is very proud of the fact that interest earnings on investments were maximized through diligent cash flow management and investment practices. During the period of economic growth between 2006 and 2008, interest rates increased dramatically. Our experience tells us that it is prudent not to become dependent upon higher interest rates because they are neither predictable nor reliable in the long term. We are currently confronted with the dramatic reduction of interest rates that are running more than ten times lower than they were two years ago. Therefore, the District's practice of budgeting interest rates has been very effective in recent times.

Sales tax revenue is another income stream that is unpredictable in the wake of Monroe County's attempt to alter pre-existing sharing agreements with local schools. The County's questionable commitment and the uncertainty of retail sales volume during poor economic times make this revenue source less reliable.

Due to these consistent external threats of revenue shortfall—be it sales tax litigation or projections of mid-year state aid reductions to balance state deficits—the District takes a transparent, fiscally responsible, and proactive approach to curtail spending to mitigate the impact of the potential loss in revenue. If the revenue loss occurs, then the District is protected. If these events do not materialize within the fiscal year, then the unspent funds create surplus.

The expenditure side of the budget provides additional challenges—the cost of fuel, pensions, and health care being the most volatile. These expenditures require a conservative approach when planning budgets. Forecasts for rising employee pension costs and trends for rising health care costs that exceed 11% per year dictate that a conservative approach is prudent, reasonable, and responsible planning.

The District has been put on notice that increases in employer contribution rates for the New York State Employees' Retirement System are imminent and will continue to be an issue. The New York State Retirement System strongly cautioned districts to plan for rising rates when doing long-range budget planning. We received the following official communication from the retirement system in the December 2008 issue of Employer E-News:

**Economic Conditions Mean Cautious Planning**

Employer contribution rates depend on the value of the Common Retirement Fund (the Fund) and our investments' assumed rate of return. Over time, if the Fund experiences a higher than expected rate of return, contribution rates decrease; if the Fund fails to meet its expected rate of return, then contribution rates must increase. While 2010 rates are lower than 2009, if the current economic conditions result in continued investment performance below the Fund's assumed earnings, then you should be prepared for contribution rates for 2011 and beyond to rise.

Similarly, the Employer Contribution Rate (ECR) for the New York State Teachers' Retirement System is equally impacted by the rate of return of the Fund's investments. While the contribution rate was proposed to decrease slightly in 2009-10, it is important to note that the true cost of the benefit structure is approximately 12% of salary paid. While the same warning highlighted above applies to the Teachers' Retirement Fund, TRS stated it a little differently in its February 2009 Administrative Bulletin:

As you are likely aware, the capital markets have been decidedly negative over the past several months. Although asset performance is not the only factor in the determination of a new ECR, it is likely our next year's ECR (applying to 2010-11 salaries) will represent a significant increase.

These types of notices demonstrate the volatility of the expenditures the District must estimate during the budgeting process. Therefore, maintaining budgets at current levels, rather than reducing to lower rate levels that are clearly temporary, is a reasonable and responsible approach to avoiding significant spikes in the budget and tax rates.

In 2004, the District joined with area schools to form a health consortium that made a significant change in the funding methodology of our health care plans. The District transitioned into this plan over several years and the savings were significant. While the consortium was in its infancy, the District had to plan for rates based on health care trend analysis. When the experience of the plan proved to be better than trend, the rates were set at the lower level realizing savings to those participating in the plan. As the District moved employee groups into this plan, savings were

realized. The District's premiums are more than 30% below what they would have been had we not made the change and exceeds \$2 million in annual savings. This is not conservative budgeting; it is sound decision making to save costs. The District does not apologize for making sound business decisions that reduce costs. The taxpayers and students benefit from the results of this approach.

We disagree with the Comptroller's implications that the District's budgeting practices are unrealistic. It is because of these budgeting practices that we are able to provide and maintain quality educational programs for the students of the Fairport Central School District in a manner that reflects the community's expectations. We are proud of the fact that these budgeting practices have allowed the District to successfully continue its mission in these challenging economic times.

2. *District Officials should use the surplus fund balance identified in this report in a manner that benefits District taxpayers. Such uses could include, but are not limited to:*

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

We are pleased that the Comptroller's report states that the District reported unreserved, unappropriated fund balance at a level that complied with statute. Therefore, the Comptroller's suggestion that conservative budgeting practices circumvented statutory controls and that surplus funds were not used to benefit district taxpayers is mystifying. Contrary to this suggested opinion, the Board of Education regularly reviews the District's financial condition and acts in a manner consistent with the Comptroller's recommendations. Specifically, the District has allocated funds to voter-authorized capital reserves and other necessary reserves that prepare the District for known obligations and safeguard against unforeseen circumstances.

It is not possible to simply pay off debt, as suggested in this recommendation. The District is precluded from paying off debt due to call provisions that do not allow the bonds to be paid in advance. However, the District has allocated funds to pay for voter-approved capital improvements as a one time expenditure. By doing so, the District reduces its obligation for future debt. This is an excellent use of funds that will directly benefit taxpayers for years to come.

This recommendation includes using funds to reduce property taxes. As shown on the table on page 8 of the Comptroller's report, the District has allocated \$8.7 million since 2003-04 to reduce taxes by appropriating year-end fund balance in the subsequent fiscal year. In fact, the appropriated fund balance in the current 2009-10 budget was increased from \$1.5 million to \$2 million to further reduce the tax levy by \$500,000. With a final tax levy reduction of -1.02% and a tax rate reduction of -1.84%, the school district was able to ease the tax burden on the local community during very difficult economic times. We disagree with the Comptroller's reasoning

that the appropriated fund balance simply increased the surplus in the following year. If the District did not use \$2 million to balance the budget and offset taxes, then the tax levy would have risen by 3.25%. In fact, the average percentage change in the tax levy for the last five years is 2.16% and the average tax rate change is -1.12% during the same period.

- 3. The Board should review all reserves to determine if the amounts reserved are necessary, reasonable, and in compliance with statutory requirements. To the extent that they are not, the Board should reduce the reserves to reasonable levels or discontinue the reserves in compliance with legal restrictions.*

The Board of Education does review all reserves before the close of each fiscal year with a focus on long range planning. Further, the Audit Committee reviews the financial condition of the District, including reserves, with the external auditor prior to the release of its financial statements. Additionally, the external auditor presents the audited financial statements to the Board annually. The District contends that all of its reserves are necessary, reasonable, and in compliance with statutory requirements.

The Comptroller's report suggests that the District has more than \$11 million in excess General Fund reserve balances as of June 30, 2008. The report further suggests that the balance in three of the reserves noted should be zero. This opinion leaves us puzzled. If the Comptroller does not believe that certain reserves are necessary, then why are these reserves legal, and why do they exist?

## **The District's Reserves**

### Capital Bus Reserve

The voters authorized the Capital Bus Reserve in 2002. The reserve was established for a ten-year period with an ultimate limit of \$8,000,000. The Comptroller's report opines that the balance of \$4,811,450 is excessive, especially when the Capital Bus Reserve funds are not used toward bus purchases. This statement is clearly unsubstantiated as the reserve was established in accordance with statutory requirements including a voter authorized purpose, term, and ultimate limit of the fund. Additionally, a capital reserve fund is a *Savings* account intended as a mechanism to reserve and accumulate funds over time for future use, not as a vehicle to finance current needs. This reserve allows the Board to manage spikes in the cost of buses due to inflation or regulatory mandates. The reserve also enables the District to expand the fleet when necessary to ensure student safety. Finally, this Capital Bus Reserve was of critical value by avoiding tax increases when New York State extended state aid payments for bus purchases over five years.

### Liability Reserve & Insurance Reserve

The Comptroller's report confirms that these reserves were established appropriately under General Municipal Law. Contributions to the reserves are limited to 5% of the District's budget for each, and the reserves can be used to fund liability claims brought against the District and uninsured losses, claims, actions, or judgments. The Comptroller questions the necessity of these

reserves due to the fact that the District has not had to use them. The District did expend \$82,375 out of the Insurance Reserve for mold remediation that was not covered by insurance. The District is pleased that it has not paid significant claims from these reserves and has taken necessary proactive steps to ensure that reserves are available in the event that unforeseen circumstances arise in the future.

#### Repair Reserve

The Comptroller's report again confirms that this reserve has been established appropriately within the law. The District is pleased that it has not had emergency repair needs that are significant enough to require the use of this reserve. However, the District has taken necessary, proactive steps to ensure that reserves are available in the event that an unforeseen significant emergency arises.

#### Employee Benefit Accrued Liability Reserve (EBALR)

This reserve was established under General Municipal Law. The purpose of the EBALR is for paying the cash payment of the monetary value of accrued and accumulated but unused sick leave, personal leave, holiday leave, vacation time, and time allowances granted in lieu of overtime compensation. Statute also allows for the EBALR to be used to pay any other forms of payment of accrued, but unliquidated, time earned by employees when they leave District service. The District has an obligation to pay certain employees an incremental payment upon retirement when they have completed at least fifteen years of service. It is important to note that this payment is not a retirement incentive but rather a payment of accrued, but unliquidated earnings, that are payable upon retirement.

#### Unemployment Insurance (UI) Reserve

This reserve was established under the General Municipal Law to reimburse the State Unemployment Insurance Fund for payments made to claimants. There are no provisions that limit balances in this reserve. We find it illogical that the State Comptroller would criticize the District for funding an unemployment insurance reserve during a time of unprecedented unemployment.

#### *4. District officials should ensure that liabilities are properly recognized and recorded.*

The Comptroller recommended that District officials should ensure that liabilities are properly recognized and recorded. This type of recommendation implies that, in some manner, liabilities have not been properly recorded in the past; that is not accurate. In addition, the Comptroller's decision to use terms such as "improper accounting" and "accounting errors" is not only inflammatory but incorrect.

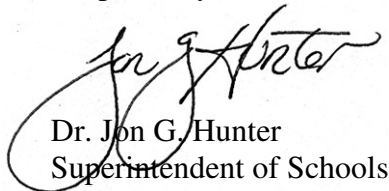
During the scope of the Comptroller's audit, the District has had six years worth of financial statement audits expressing the statements present fairly in all material respects and are in

conformity with Generally Accepted Accounting Principles. No adjustments have been made to the District's financial records from either the external or internal auditor in regard to the recognition and recording of liabilities.

The Comptroller has chosen to criticize the District's practice of recording one year's estimated cost of retiree health insurance as an accrued liability. This entry originated in the 2002-03 fiscal year when the District, in discussion with the District's external auditor, made the determination that this was an acceptable and proactive accounting position. The accrual was a fiscally responsible way to provide initial funding for the District's annual other post employment benefits cost as obligated by General Accounting Standards Board Statement #45. The Department of Audit and Control has proposed legislation to establish an irrevocable trust, however, it has not been passed into law yet. New York State has not appropriately provided a means by which to allow the District to comply with these obligations. The State Comptroller has recognized that under the current state of the law, school districts do not have a legal mechanism by which to allocate funds for these liabilities. The District has reviewed this accrual annually and applied a consistent and widely accepted application to the District's largest obligation. This is a very relevant and complex accounting issue, and the District will continue to review it.

We appreciate the opportunity to have responded to this audit report. The District's approach to budgeting and long term financial planning has demonstrated fiscal responsibility and secured a healthy financial future that reflects the community's commitment to education. In the Comptroller's document, *Responding to an OSC Audit Report: Audit Response and Corrective Action Plans*, it is stated that the information in this audit response "allows us (OSC) to correct any inaccuracies in our report before it is finalized." Our response is thorough and factual. It confirms the very best accounting practices as well as the principles of budgeting ascribed to by the Comptroller, Mr. DiNapoli. We know that the Comptroller's office will review this response and hope that revisions are made so that this audit report might be effectively used as a tool to identify opportunities for improvement.

Respectfully submitted,



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