Office of the New York State Comptroller

Division of Local Government
& School Accountability

Grand Island Central School District

Internal Controls Over Financial Condition and Potential Conflict of Interest

Report of Examination

Period Covered:

July 1, 2007 — December 24, 2008

2009M-50

Thomas P. DiNapoli

Table of Contents

		Page
AUTHORITY LETTER		2
EXECUTIVE SUMMARY		3
INTRODUCTION		5
	Background	5
	Objectives	5
	Scope and Methodology	5
	Comments of District Officials and Corrective Action	6
FINANCIAL CONDITION		7
	Budgeting and Use of Fund Balance	7
	Reserve Funds	10
	Reserve for Encumbrances	11
	Recommendations	12
POTENTIAL CONFLICT OF INTEREST		14
	Recommendations	16
APPENDIX A	Response From District Officials	17
APPENDIX B	Audit Methodology and Standards	21
APPENDIX C	How to Obtain Additional Copies of the Report	23
APPENDIX D	Local Regional Office Listing	24

State of New York
Office of the State Comptroller

Division of Local Government
and School Accountability

July 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 Grand Island Central School District, entitled Internal Controls Over Financial Condition and Potential Conflict of Interest. 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 Grand Island Central 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 Assistant Superintendent for Finance plays a key role in the daily administration of the Business Office and has several employees to assist her with these functions.

Scope and Objectives

The objectives of our audit were to evaluate the District's financial condition, budgetary practices and internal controls over potential conflicts of interest for the period July 1, 2007 to December 24, 2008. For the purposes of trend analysis, we examined financial statements and budget reports back to the 2004-05 fiscal year. Our audit addressed the following related questions:

- Does the Board properly manage District finances by ensuring budgets are realistic and supported, and by properly establishing and maintaining reserve funds?

- Does the District have adequate procedures to help identify and prevent potential conflicts of interest?

Audit Results

The District has accumulated approximately $3.5 million[1] 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.

District officials did not prepare reasonable budgets for the 2004-05 through the 2007-08 fiscal years. They consistently overestimated expenditures and underestimated revenues, even though data was often available to develop more accurate budget estimates. As a result of these practices, the District generated general fund operating surpluses totaling $12 million during a four-year period. A consistent pattern of year-end surpluses indicates that budget estimates have been inaccurate. Consequently, real property taxes may have been unnecessarily increased. While the District appropriates approximately

[1] Includes appropriated fund balance of $2 million, Debt Reserve of $900,000 and reserve for encumbrances of $600,000.

$2 million in fund balance each year, it is not used as intended because the District's budgetary practices have consistently resulted in operating surpluses during the last four fiscal years.

We also analyzed the District's four reserve funds, totaling $9.4 million at June 30, 2008, reported in the general fund for reasonableness and adherence to statutory requirements. We determined that the Employee Benefit Accrued Liability Reserve and Capital Reserve were properly established and reasonably funded. In addition, the District improperly reports a Debt Reserve in the general fund (instead of the Debt Service Fund) and does not have a plan to use Debt Reserve monies, which totaled more than $900,000 at June 30, 2008. The District also overstated its reserve for encumbrances by an average of $650,000 each year. These actions in effect reduce unreserved, unappropriated fund balance, which is subject to a statutorily imposed limit. Had these practices not occurred, real property taxes could have been lower, because the Board would have been required to comply with the statutory limit for fund balance.

Finally, we evaluated a potential conflict of interest with the Board President, relative to his employment with an architectural firm that the District hired. Based in part upon written representations[2] from the Board President and an individual from the architectural firm, a prohibited conflict of interest does not appear to exist. However, there is a risk to the District going forward. As a member of the Board, the Board President may be put in a position to approve changes to a capital project and/or modify terms of the contractual relationship with Cannon, his employer. Furthermore, the Board President's roles, responsibilities and/or assignments at Cannon could change in the future. Any of these actions could, at a minimum, affect the Board President's objectivity and may result in a future prohibited conflict of interest. Board members are held to a higher ethical standard and must be mindful to avoid any appearance of impropriety in order to preserve the trust of the community they serve.

Comments of District Officials

The results of our audit and recommendations have been discussed with District officials and their comments, which appear in Appendix A, have been considered in preparing this report. District officials generally agreed with the recommendations and indicated they would take corrective action.

[2] Subsequent to our exit conference with District officials

Introduction

Background

The Grand Island Central School District (District) is located in the Town of Grand Island within Erie County and covers approximately 28 square miles. 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. The Assistant Superintendent for Finance plays a key role in the daily administration of the Business Office and has several employees to assist her with these functions.

There are five schools in operation within the District, with approximately 3,230 students and 550 employees. The District's general fund appropriations for the 2008-09 fiscal year were $50.5 million, funded primarily with State aid, real property taxes, sales tax and grants.

Objectives

The objectives of our audit were to evaluate the District's financial condition, budgetary practices and internal controls over potential conflicts of interest. Our audit addressed the following related questions:

- Does the Board properly manage District finances by ensuring budgets are realistic and supported, and by properly establishing and maintaining reserve funds?

- Does the District have adequate procedures to help identify and prevent potential conflicts of interest?

Scope and Methodology

During this audit, we evaluated the District's financial condition, budgetary practices and controls in place to detect potential conflicts of interest for the period July 1, 2007 to December 24, 2008. For the purposes of trend analysis, we examined financial statements and budget reports back to the 2004-05 fiscal year.

We conducted our audit in accordance with generally accepted government auditing standards (GAGAS). More information on such standards and the methodology used in performing this audit are included in Appendix B 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. District officials generally agreed with the recommendations and indicated they would take corrective action.

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 forwarded to our office within 90 days. To the extent practicable, implementation of the CAP must begin by the end of the next fiscal year. For more information on preparing and filing your CAP, please refer to our brochure, *Responding to an OSC Audit Report*, which you received with the draft audit report. The Board should make the CAP available for public review in the District Clerk's office.

Financial Condition

A school district's financial condition is a factor in determining its ability to provide educational services to the students within the district. The Board, Superintendent and Assistant Superintendent for Finance are accountable to district taxpayers for the use of district resources, and are responsible for effective financial planning and management of district operations. One of the most important tools for managing a district's financial condition is the budget process. District officials must ensure that budgets are prepared, adopted and modified in a prudent manner, accurately depicting the district's financial activity while also using available resources to responsibly lower the tax burden of its residents.

The District has accumulated approximately $3.5 million[3] 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. While the District appropriates approximately $2 million in fund balance each year, it is not needed because the District's budgetary practices have consistently resulted in operating surpluses. The District does not have a plan to use its Debt Reserve, which had a balance of more than $900,000 at June 30, 2008. The District also overstated its reserve for encumbrances by an average of $650,000 each year. These actions in effect reduce unreserved, unappropriated fund balance, which is subject to a statutorily imposed limit.[4] Had these practices not occurred, real property taxes could have been lower, because the Board would have been required to comply with the statutory limit for fund balance.

Budgeting and Use of Fund Balance

The Board is responsible for preparing and presenting the district budget, or spending plan, to the public for vote. In preparing the budget, the Board is responsible for estimating what the district will receive in revenue (e.g., State aid, sales tax), how much fund balance will 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. A school district's annual budget must also include reasonable estimates of appropriations required to fund expenditures in the coming year. Accurate estimates help ensure that the levy of real property taxes is not greater than necessary.

[3] Includes appropriated fund balance of $2 million, Debt Reserve of $900,000 and reserve for encumbrances of $600,000.

[4] Real Property Tax Law currently limits the unreserved, unappropriated fund balance to no more than 4 percent of the ensuing fiscal year's budget. Any fund balance over this percentage must be used to reduce the ensuing fiscal year's tax levy (appropriated) or transferred to a legally established reserve.

We reviewed five complete Board financial information packets, four of which were for the months of March and April 2008, to determine what type of financial information and reports the Board was receiving. Generally, the Board received adequate information concerning the current budget and the progress of budget development. However, we did not find any information regarding fund balance projections. Without this data, the Board is limited in its ability to evaluate anticipated increases/decreases to fund balance which may prompt the Board to consider adjustments to the amount of fund balance appropriated to reduce the following year's tax levy.

There are three components of a school district's fund balance. Reserved fund balance represents moneys that the District has set aside and may only be used for specific purposes. Unreserved fund balance represents uncommitted funds. The portion of the unreserved fund balance that is used to help finance the next fiscal year's budget is referred to as appropriated fund balance and the remaining portion, used for cash flow purposes and unanticipated expenditures, is referred to as unreserved, unappropriated fund balance.

District officials did not prepare reasonable budgets for the 2004-05 through the 2007-08 fiscal years. They consistently overestimated expenditures and underestimated revenues, even though data was often available to develop more accurate budget estimates. District officials indicated that in past years the District was in poor fiscal health. Therefore, the Board's goal was to improve the District's financial condition by increasing fund balance levels. The Assistant Superintendent for Finance acknowledged that to achieve the Board's goal she intentionally overestimated appropriations to result in year-end surpluses. For example, total salary appropriations were overestimated by $4 million or approximately $1 million in each of the last four years. The Assistant Superintendent for Finance indicated that it is difficult to forecast certain variables such as overtime or the number of employees who plan to retire. She also indicated that certain salaries are paid for through grants and because of the uncertainty of these grants, occasionally the District receives more grant funds than originally anticipated. However, collective bargaining agreements identify the increases in salary and hourly rates. Therefore, the District has the information needed to reasonably estimate the upcoming year's salary expenditures.

The District also consistently underestimated revenues over the last four fiscal years, as summarized in the following table.[5] The District

[5] The overall revenue variances are even more profound when compared to revenues excluding real property taxes, as illustrated in the table. Because school districts generally receive all real property taxes levied, District officials need only estimate those remaining revenues, which comprise approximately half of all revenues received by the District.

underestimated revenues by a total of $7.2 million or approximately $1.8 million per year. For example, Lottery and BOCES aid have been underestimated by a combined average total of over $770,000 each year. The Assistant Superintendent for Finance indicated that she is very cautious and conservative with revenue estimates.

Fiscal Year	2004-05	2005-06	2006-07	2007-08	Total
Estimated Revenues (1) (2)	$15,651,120	$17,234,142	$17,988,463	$19,272,193	$70,145,918
Actual Revenues (2)	$16,842,093	$19,131,649	$19,764,583	$21,590,146	$77,328,472
Underestimated Revenues	$1,190,973	$1,897,507	$1,776,120	$2,317,953	$7,182,554
Appropriations (3)	$40,612,262	$42,764,295	$45,601,005	$47,390,798	$176,368,360
Actual Expenditures	$37,146,105	$40,242,377	$41,906,867	$43,412,640	$162,707,989
Over-Budgeted Expenditures	$3,466,157	$2,521,918	$3,694,138	$3,978,158	$13,660,371
Total Budget Variance	**$4,657,130**	**$4,419,425**	**$5,470,258**	**$6,296,111**	**$20,842,925**
(1) Does not include appropriated fund balance, which is a financing source but not a revenue					
(2) Does not include the tax levy as school districts generally receive all taxes levied					
(3) Does not include reserve for encumbrances					

The results of these budgeting practices was to make it appear that the District needed to both raise taxes and use accumulated fund balance to close projected budget gaps, when in reality the District's budget would result in an operating surplus each of the four years. For example, because these inaccurate budgets showed that the District would have a budget shortfall, the District appropriated $2 million of fund balance each year to reduce the annual tax levy. When properly used, this would result in a planned operating deficit each year. However, the District generated operating surpluses totaling $12 million during this four-year period. This represents an average operating surplus of approximately $3 million in each of the last four fiscal years. As a result of inaccurate budget estimates, the appropriated fund balance was never used as a financing source. In reality, the budget variances were so significant that fund balance actually increased from $5.1 million to $14.7 million during this four year period.

Fiscal Year	2004-05	2005-06	2006-07	2007-08	Total
Actual Revenues	$39,559,885	$42,438,940	$45,206,701	$47,530,040	$174,735,566
Actual Expenditures	$37,146,105	$40,242,377	$41,906,867	$43,412,640	$162,707,989
Operating Surplus	$2,413,780	$2,196,563	$3,299,834	$4,117,400	$12,027,577
Appropriated Fund Balance (4)	$2,250,000	$2,000,000	$2,000,000	$2,000,000	
Unreserved Fund Balance at June 30	$931,676	$912,327	$1,429,137	$2,019,503	
Reserved Fund Balance (5)	$1,956,688	$4,410,814	$7,197,696	$10,692,730	
Year End Total Fund Balance	$5,138,364	$7,323,141	$10,626,833	$14,712,233	
(4) Funds designated by the District to be used towards the reduction of the tax levy					
(5) Including reserve for encumbrances					

During this same four-year period, real property taxes have increased, in total, by $3.1 million which is approximately 17 percent or an average of 4.2 percent each year. As previously stated, this occurred during years where the District had an average operating surplus of $3 million per year. We analyzed the change in overall fund balance if the real property tax levy had stayed at the 2004-05 fiscal year level of approximately $18.5 million and determined that the District's fund balance would still have increased by over $4 million. Appropriations for the 2008-09 fiscal year increased by $3 million (6.5 percent) over the prior fiscal year and real property taxes also increased by almost $1 million (4 percent). Based upon prior year results, we expect the District will again end the year with an operating surplus.

Budgeting and levying taxes which result in year-end surpluses, and then using the resulting surpluses to increase reserves, does not provide adequate accountability to taxpayers for how their resources are used. A more transparent and appropriate method would be to estimate overall appropriations more accurately and include a specific budgetary appropriation for the intended purpose of funding reserves. Including an accurate estimate of the amount the Board intends to set aside for reserves at the time the budget is presented allows voters the opportunity to decide whether they concur with this use of their tax money.

Reserve Funds

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. Funding reserves at greater than reasonable

levels essentially results in real property tax levies that are higher than necessary.

Over the last four fiscal years, the District's general fund reserve balances have increased by $7.8 million or over 500 percent, with a cumulative balance of $9.4 million at June 30, 2008. We analyzed these reserve funds for reasonableness and adherence to statutory requirements. We determined that the Employee Benefit Accrued Liability Reserve ($4.5 million) and Capital Reserve ($3.8 million) were properly established and reasonably funded at June 30, 2008. However, the District has not been using moneys set aside in a Debt Reserve for their intended purpose.

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. A Debt Reserve should be reported in the Debt Service Fund, which is separate from the general fund. These funds 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. As of June 30, 2008, the balance in the District's reported Debt Reserve was $929,453. District officials confirmed that this reserve is increased from interest earnings on bond proceeds. The District improperly reports the reserve in the general fund and has not made any debt service payments from this reserve since at least the 2003-04 fiscal year. The District has not established a plan for how this money will be used. The District levies taxes annually to pay debt service instead of properly using moneys in the Debt Reserve for that purpose. Because these moneys are restricted to pay debt service, they should be used for that purpose.

Reserve for Encumbrances

Encumbrances represent commitments for unperformed contracts for goods and services. Their use is intended as a budgetary control to help prevent expenditures from exceeding appropriations. At the close of a fiscal year, a district segregates a portion of fund balance to, essentially, transfer appropriations from one fiscal year into the next for such remaining commitments, against which the related expenditures will be charged when the goods or services are delivered in the subsequent fiscal year. This segregation of fund balance is known as a reserve for encumbrances.

The District's audited financial statements included a reserve for encumbrances at June 30, 2007 and June 30, 2008 of $900,576 and $1,280,219, respectively. We reviewed supporting documentation for 17 encumbrances outstanding at June 30, 2007 totaling $793,700 and 18 encumbrances outstanding at June 30, 2008 totaling $828,200. We determined that approximately $683,000 at June 30, 2007 and $621,000 at June 30, 2008 were inappropriately classified as encumbrances for

various reasons. For example, an encumbrance for utilities of almost $500,000 was outstanding at June 30, 2008. Utilities generally are not considered unfulfilled commitments at year-end and, therefore, any encumbrances for this purpose should have lapsed at fiscal year end. Over $465,000 of this encumbrance was subsequently canceled in the next fiscal year. This same situation occurred for the prior year, resulting in $260,000 improperly encumbered.

There were also several examples of encumbrances that were commitments of the next fiscal year. For example, on June 21, 2007 a purchase order was generated for $4,584 for the purchase of fall and winter sports uniforms. This is an expenditure of the next school year and should have been encumbered 10 days later, in the correct fiscal year. We also found encumbrances established that were not based on genuine commitments; rather they were for anticipated future needs that never materialized. For example, on June 21, 2007 a purchase order for $1,000 was generated for the purchase of tennis windscreens. However, the order was never placed and the purchase order was subsequently canceled one year later.

Encumbrances should be supported by purchase orders that were issued before the end of a fiscal year, for which the goods and services had been ordered but not yet received. By incorrectly encumbering funds, the District sheltered an average of more than $650,000 of unreserved fund balance for each of the last two fiscal years. Had District officials correctly accounted for encumbrances, the unreserved, unappropriated fund balance at year-end would have exceeded the allowable legal limit in each of the last two fiscal years.

A District official stated that they had recently converted to a new financial software system that handles encumbrances differently than their old system. Therefore, she attributed most of these prior discrepancies to a lack of understanding of the new financial software system.

Recommendations

1. The Board and District officials should develop revenue and appropriation estimates for the annual budget that are realistic and monitor financial activity to ensure that operations stay within the budget.

2. District officials should include budget appropriations for the amount the Board intends to use to fund reserves.

3. District officials should 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.

4. The Board should ensure that it receives financial reports that contain necessary information to monitor financial condition and adopt realistic and supported budgets.

5. The District should use moneys in the Debt Reserve to pay debt service and reduce the reliance on the tax levy to fund these costs.

6. District officials should analyze year-end encumbrances to ensure that they are reasonable and supported. The audit committee should ask the independent auditors to review the reserve for encumbrances balance as part of their audit.

Potential Conflict of Interest

Unless an exception applies, article 18 of the General Municipal Law (GML) prohibits school district officers and employees from having an "interest" in a contract with the district for which they serve when they also have the power, individually or as a board member, to negotiate, prepare, authorize or approve the contract; to authorize or approve payment under the contract; to audit bills or claims under the contract; or to appoint an officer or employee with any of those powers or duties. A "contract" includes any "agreement" with a municipality.[6] A school district officer is considered to have an interest in a contract when he or she receives a direct or indirect financial or material benefit as a result of the contract. In addition, a school district officer is deemed to have an interest in a contract with a corporation of which the school district officer or employee is an officer, director, employee or stockholder. One of the exceptions in the GML is when a municipal officer or employee has an interest that is prohibited solely by reason of his or her employment as an officer or employee of the contracting firm, if (1) the remuneration of the private employment will not be directly affected as a result of the contract and (2) the duties of the private employment do not directly involve the procurement, preparation or performance of any part of the contract.

In general, interests in actual or proposed contracts on the part of a municipal officer or employee, or his or her spouse, must be publicly disclosed in writing to the municipal officer or employee's immediate supervisor and to the governing board of the municipality. The written disclosure must be made part of and be set forth in the official record of the proceedings of the board.

In November 2007, the Board President was selected to be a member of a Request for Proposal (RFP) review committee to evaluate potential architectural[7] candidates for a proposed District capital project. One of the reasons the Board President was selected for this committee was his expertise in the field of project management and architecture. From the six firms that submitted a proposal for review, the committee interviewed three firms and subsequently recommended Cannon Design (Cannon) to the Board. In January

[6] Article 18 of GML indicates that a municipality means county, city, town, village, school district, et al.

[7] The architectural firm selected will be paid a contract fee that will be worth between 6 to 8 percent of total construction costs. As of the completion of fieldwork, the project scope has not been determined; therefore, a total construction cost estimate cannot be determined.

2008, the Board officially selected Cannon as the District's Architect of Record for the proposed capital project. Three months later, in April 2008, the Board President announced during a regular Board meeting that he had accepted employment with Cannon. However, he did not provide the Board with written disclosure as to the nature and extent of his relationship with Cannon as required under GML.

The Board President and an individual from Cannon each provided us with written representation[8] regarding their relationship and the sequence of events that occurred previous to the Board President being offered and accepting employment with Cannon. Both individuals represented that they had once worked for the same company and have a long-standing professional relationship. They also represented that casual employment conversations have occurred periodically over the years, but neither informal nor formal employment offers occurred during the selection process. The Board President indicated that he apprised the committee of any connections he may have with any of the final candidates during the selection process. Both the Board President and the individual from Cannon indicated that interviews for the position that the Board President accepted at Cannon did not take place until after the Architect of Record selection was announced. Further, they represented that the subsequent job offer was completely unrelated to the selection of Cannon by the Board as the Architect of Record.

The representative for Cannon verbally indicated that the Board President is not an officer of the company, does not have any financial interest in the company, did not receive any hiring bonus, nor will he have any involvement in the contract between the District and Cannon, now or in the future. Therefore, while the Board President may have acquired an interest in the contract between the District and Cannon when he accepted employment with the company, it appears that the interest falls within an exception and therefore is not prohibited under the GML.

However, there is a risk to the District going forward. As a member of the Board, the Board President may be put in a position to approve changes to a capital project and/or modify terms of the contractual relationship with Cannon. Furthermore, the Board President's roles, responsibilities and/or assignments at Cannon could change in the future. Any of these actions could, at a minimum, affect the Board President's objectivity and may result in a future prohibited conflict of interest. Board members are held to a higher ethical standard and must be mindful to avoid any appearance of impropriety in order to preserve the trust of the community they serve.

[8] Subsequent to our exit conference with District officials

Recommendations

7. The Board should evaluate its policies concerning District officers and employees who are involved in the contract selection process. Officers and employees who have any personal or professional connections with a potential vendor should remove themselves from the selection process.

8. The Board President should formally disclose the nature and extent of his relationship with Cannon as required by General Municipal Law.

9. The Board President should have no future involvement with any decision making concerning Cannon and should be cognizant of any future changes in circumstances that would result in a prohibited conflict of interest.

APPENDIX A

RESPONSE FROM DISTRICT OFFICIALS

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

Grand Island Central School District

1100 Ransom Road
Grand Island, New York 14072
Telephone (716) 773-8800
Fax (716) 773-8843
www.k12.ginet.org

Robert W. Christmann
Superintendent of Schools

Loraine A. Ingrasci
Assistant Superintendent for Finance and Support Services

Karen S. Karmazin, Ed. D.
Assistant Superintendent for Curriculum and Instruction

Carol A. Jones
Director Pupil Personnel Services

MEMORANDUM

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

FROM: Board of Education, Grand Island Central School District

DATE: July 9, 2009

RE: Response to Preliminary Draft Report for Grand Island Central School District

This is the response of the Grand Island Central School District ("District") to the preliminary draft findings of the audit by the Office of the State Comptroller. The Board of Education appreciates the auditors' thorough review and the opportunity to discuss the preliminary findings to better understand the findings and the recommendations and learn more about the Comptroller's recommendations for school district financing.

After that discussion and a careful review of the recommendations in the preliminary draft report, the Board embraces each of the recommendations and will follow through with their implementation. The Board welcomes the input and guidance offered about financial and budget procedures that will further strengthen the District's sound financial condition.

As noted in the preliminary draft report, as recently as 2002-03, this District was on the edge of solvency, with a fund balance of only $7,112 (.000198% of the overall budget). The Board addressed this precarious financial situation by adopting conservative financial procedures which have successfully built the necessary reserves to restore the District to a sound financial basis. The Board recognizes that future savings to build further such reserves for future expenditures now must be allocated to, and reported in, the appropriate budget lines and authorized reserve accounts. Therefore, the Board embraces recommendations 1 through 6 to

reallocate funds among appropriate accounts. These actions are consistent with the Board's conservative financial approach that stabilized the tax rate, which is especially important now given the current economic crisis, the alarming projections for future state revenue, and the pending huge increases in public employers' rates of contribution into the State's retirement system.

Of course, because the Board intentionally adopted very conservative fiscal practices in response to a barely solvent fiscal condition, the Board disagrees with the characterization in the preliminary draft report that the resulting budgets were not "reasonable" under the circumstances. This conservative fiscal approach resulted in the District building a sound margin for unforeseen economic downturns (a margin that has proved only too necessary as a result of the current economic crisis). However, the Board recognizes that the audit report does not suggest that the Board should take a less conservative approach to its budget, but rather provides guidance on the allocation and reporting of funds to implement such a conservative fiscal approach through authorized reserve funds. Therefore, the District embraces the recommendations to do so, such as recommendations 2, 3, 5, and 6, which recommend that the District change the budget lines in which it reports certain of its funds and allocate money saved for specific purposes to particular reserve accounts provided for such purposes (such as for building projects, debts, and encumbrances). The Board will direct the reallocation of funds consistent with these recommendations for building necessary reserves.

The Board also appreciates the careful review of the role of members of the Board and the cautionary advice about the possibility that future circumstances could arise that might create the appearance of a conflict of interest. The District accepts and will implement recommendations 7 through 9, including a further disclosure as requested by recommendation 8 by the Board President regarding his employment relationship. Although outside the scope of the period covered by the preliminary draft report, the Board President already disclosed his employment in writing to the Board, and is more than willing to provide additional details as to the scope of his employment. The Board President continually has recused himself, and abstained from any action as a Board member, on any matters that related to his employer, and will continue to do so (as recommended by recommendation number 9).

The Board will ask its legal advisors to evaluate its policies concerning District officers and employees involved in contract selection procedures and contract administration as suggested in recommendation number 7.

In sum, the Board is very appreciative of the extensive time spent by the auditors at the District and the guidance they have provided, particularly in suggesting a reallocation of funds among budget lines to meet the formal requirements for the building of fund balances and savings accounts for anticipated future expenses by using the reserve accounts described by State law and regulation.

Richard Little, Jr.
Grand Island Central School District
Board of Education President

APPENDIX B

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 upon the reported objective and scope by selecting for audit those areas most at risk. We selected financial condition, budgetary practices and internal controls over potential conflicts of interest for further audit testing. To accomplish the objectives of this audit, we performed the following audit procedures:

- We reviewed audited financial statements and budget to actual reports for 2004-05, 2005-06, 2006-07 and 2007-08 to analyze changes in fund balance as a result of annual operations. We also examined the components of fund balance for adherence to statute.

- We reviewed expenditure and revenue projections for the 2008-09 fiscal year.

- We identified and analyzed specific budget lines with significant budget to actual variances. We interviewed District officials to determine the methods used to estimate certain appropriations and revenues items.

- We reviewed the legitimacy of the reserve for encumbrances reported at June 30, 2007 and June 30, 2008 by testing a sample of encumbrances and determining whether goods and services were subsequently received and paid for.

- We determined whether balances were reasonable and supported in the District's reserve funds. We also examined Board resolutions to determine if each reserve was properly established. We interviewed District officials concerning procedures used to determine reserve levels.

- We examined the District's compensated absences calculation as it relates to the EBALR.

- We analyzed the tax levy and components of fund balance from the 2004-05 thru 2008-09 fiscal years.

- We reviewed District policies and the GML concerning conflicts of interest.

- We reviewed documentation concerning the process used to select an architectural firm for a future capital project.

- We interviewed District officials, the Board President, and an individual from Cannon Design and reviewed written representations to gain an understanding of relevant events occurring prior to the Board President's acceptance of a job offer from Cannon.

We conducted our 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 C

HOW TO OBTAIN ADDITIONAL COPIES OF THE REPORT

To obtain copies of this report, write or visit our web page:

Office of the State Comptroller
Public Information Office
110 State Street, 15th Floor
Albany, New York 12236
(518) 474-4015
http://www.osc.state.ny.us/localgov/

APPENDIX D

OFFICE OF THE STATE COMPTROLLER
DIVISION OF LOCAL GOVERNMENT
AND SCHOOL ACCOUNTABILITY

Steven J. Hancox, Deputy Comptroller
John C. Traylor, Assistant Comptroller

LOCAL REGIONAL OFFICE LISTING

BUFFALO REGIONAL OFFICE
Robert Meller, Chief Examiner
Office of the State Comptroller
295 Main Street, Suite 1032
Buffalo, New York 14203-2510
(716) 847-3647 Fax (716) 847-3643
Email: Muni-Buffalo@osc.state.ny.us

Serving: Allegany, Cattaraugus, Chautauqua, Erie, Genesee, Niagara, Orleans, Wyoming counties

ROCHESTER REGIONAL OFFICE
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
(585) 454-2460 Fax (585) 454-3545
Email: Muni-Rochester@osc.state.ny.us

Serving: Cayuga, Chemung, Livingston, Monroe, Ontario, Schuyler, Seneca, Steuben, Wayne, Yates counties

SYRACUSE REGIONAL OFFICE
Eugene A. Camp, Chief Examiner
Office of the State Comptroller
State Office Building, Room 409
333 E. Washington Street
Syracuse, New York 13202-1428
(315) 428-4192 Fax (315) 426-2119
Email: Muni-Syracuse@osc.state.ny.us

Serving: Herkimer, Jefferson, Lewis, Madison, Oneida, Onondaga, Oswego, St. Lawrence counties

BINGHAMTON REGIONAL OFFICE
Patrick Carbone, Chief Examiner
Office of the State Comptroller
State Office Building, Room 1702
44 Hawley Street
Binghamton, New York 13901-4417
(607) 721-8306 Fax (607) 721-8313
Email: Muni-Binghamton@osc.state.ny.us

Serving: Broome, Chenango, Cortland, Delaware, Otsego, Schoharie, Sullivan, Tioga, Tompkins counties

GLENS FALLS REGIONAL OFFICE
Karl Smoczynski, Chief Examiner
Office of the State Comptroller
One Broad Street Plaza
Glens Falls, New York 12801-4396
(518) 793-0057 Fax (518) 793-5797
Email: Muni-GlensFalls@osc.state.ny.us

Serving: Clinton, Essex, Franklin, Fulton, Hamilton, Montgomery, Rensselaer, Saratoga, Warren, Washington counties

ALBANY REGIONAL OFFICE
Kenneth Madej, Chief Examiner
Office of the State Comptroller
22 Computer Drive West
Albany, New York 12205-1695
(518) 438-0093 Fax (518) 438-0367
Email: Muni-Albany@osc.state.ny.us

Serving: Albany, Columbia, Dutchess, Greene, Schenectady, Ulster counties

HAUPPAUGE REGIONAL OFFICE
Jeffrey P. Leonard, Chief Examiner
Office of the State Comptroller
NYS Office Building, Room 3A10
Veterans Memorial Highway
Hauppauge, New York 11788-5533
(631) 952-6534 Fax (631) 952-6530
Email: Muni-Hauppauge@osc.state.ny.us

Serving: Nassau, Suffolk counties

NEWBURGH REGIONAL OFFICE
Christopher Ellis, Chief Examiner
Office of the State Comptroller
33 Airport Center Drive, Suite 103
New Windsor, New York 12553-4725
(845) 567-0858 Fax (845) 567-0080
Email: Muni-Newburgh@osc.state.ny.us

Serving: Orange, Putnam, Rockland, Westchester counties