

# PERFORMANCE AUDIT REPORT

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## School Districts – General Fund Balances

Applying for Referendum Exceptions,  
Designating Funds, and Increasing Taxes

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January 2023



Commonwealth of Pennsylvania  
Department of the Auditor General

Timothy L. DeFoor • Auditor General

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Commonwealth of Pennsylvania  
Department of the Auditor General  
Harrisburg, PA 17120-0018  
Facebook: Pennsylvania Auditor General  
Twitter: @PAAuditorGen  
www.PaAuditor.gov

TIMOTHY L. DEFOOR  
AUDITOR GENERAL

January 11, 2023

Dr. Jeffrey S. Fecher, Superintendent  
Abington School District  
970 Highland Avenue  
Abington, PA 19001

Dr. Rob McGee, Superintendent  
Neshaminy School District  
2250 Langhorne-Yardley Road  
Langhorne, PA 19047

Dr. Joseph J. Roy, Superintendent  
Bethlehem Area School District  
1516 Sycamore Street  
Bethlehem, PA 18017-6099

Dr. Melissa Friez, Superintendent  
North Allegheny School District  
200 Hillvue Lane  
Pittsburgh, PA 15237-5391

Mr. Michael W. Daniels, Superintendent  
Canon-McMillan School District  
One North Jefferson Avenue  
Canonsburg, PA 15317

Dr. Todd M. Bauer, Superintendent  
North Penn School District  
401 East Hancock Street  
Lansdale, PA 19446

Mr. Michael J. Bromirski, Superintendent  
Hempfield School District  
200 Church Street  
Landisville, PA 17538-1332

Mr. Joseph S. Kovalchik, Superintendent  
Northampton Area School District  
2014 Laubach Avenue  
Northampton, PA 18067

Mr. Matthew Przywara, Acting  
Superintendent  
School District of Lancaster  
251 South Prince Street  
Lancaster, PA 17603

Dr. Philip B. Gale, Superintendent  
Penn Manor School District  
P.O. Box 1001  
Millersville, PA 17551-0301

Ms. Megan Shafer, Acting Superintendent  
Lower Merion School District  
301 East Montgomery Avenue  
Ardmore, PA 19003

Dr. Robert Sokolowski, Superintendent  
West Chester Area School District  
782 Springdale Drive  
Exton, PA 19341

Dear Superintendents:

This report contains the results of the Department of the Auditor General's performance audit related to the evaluation of 12 selected school districts' (districts) General Fund balances. This audit was conducted pursuant to authority derived from Article VIII, Section 10 of the Constitution of the Commonwealth of Pennsylvania, The Fiscal Code (72 P.S. §§ 402 and 403), and in accordance with generally accepted *Government Auditing Standards*, issued by the Comptroller General of the United States.<sup>1</sup> 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.

Our performance audit covered the period July 1, 2017, through June 30, 2021, and included the following two objectives:

- Determine whether each School District appropriately used the Pennsylvania Department of Education (PDE) referendum exception method to raise local school property taxes (taxes).
- Determine if each School District ensured that fund balances were properly designated and used for intended purposes.

Our methodology to satisfy these objectives along with our evaluation of management's internal controls significant to these objectives, is included in *Appendix A* of this report.

This report presents an *Overall Summary and Recommendations* which includes three recommendations to the Pennsylvania General Assembly and two recommendations to PDE along with district-specific information and recommendations for each of the 12 districts evaluated in the section entitled *Audit Procedures and Results, School District Responses, and Auditor's Conclusions for the Twelve Districts Selected for Review*. While we report the results of our review for the 12 selected districts, similar conditions could occur with any district throughout the commonwealth.

As discussed in the *Overall Summary and Recommendations*, we found that school districts have common practices to allow for increasing taxes while holding large balances of funds. Although the districts remained in compliance with the Pennsylvania Public School Code (PSC), we believe district practices circumvent the intent of the PSC threshold to keep districts from increasing taxes when sufficient appropriate funds are available. Our audit report discloses that the 12 districts had an average of \$360 million of unused, unrestricted funds in their respective General Funds while increasing taxes 37 of a possible 48 times during our four-year audit period.

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<sup>1</sup> U.S. Government Accountability Office. *Government Auditing Standards*. 2018 Revision Technical Update April 2021.

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Common district practices include adopting policy and/or procedures to reduce the unassigned General Fund balance each year below the PSC threshold to have the ability to increase taxes every year. The districts reduce the unassigned fund balance by designating and/or transferring funds. Conservative budgeting also assists districts in meeting the PSC threshold to raise taxes.

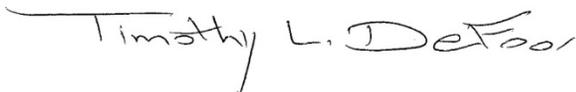
We additionally found districts routinely requested referendum exceptions to increase taxes above the inflationary index (index) with PDE's approval while having sufficient funds available in its General Fund for the pension obligations and special education costs included in the districts' respective requests.

We further found that while districts were in compliance with legal requirements for designating General Fund monies as committed or assigned funds, in many cases these funds were not used for their designated purposes over multiple years. Districts increased taxes below, at, or above the index in spite of having these unused unrestricted funds.

The overall results of this audit should raise concerns due to the districts' common yet questionable practices that are placing an excess burden on taxpayers across Pennsylvania. We are hopeful that the General Assembly and PDE will consider taking a close look at these practices and reviewing the PSC, Act 1, and PDE guidelines for possible clarification and improvement.

In closing, we would like to thank the district Superintendents and school district staff for their cooperation and assistance during the audit. We reserve the right to follow up at an appropriate time to determine whether and to what extent our recommendations have been implemented.

Sincerely,

A handwritten signature in black ink that reads "Timothy L. DeFoor". The signature is written in a cursive style with a horizontal line extending to the left of the first name.

Timothy L. DeFoor  
Auditor General

**A Performance Audit**

**School Districts – General Fund Balances  
Applying for Referendum Exceptions, Designating Funds, and  
Increasing Taxes**

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## A Performance Audit

### School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes

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#### **Overall Summary and Recommendations – By adhering to the letter of the law rather than the intent of the law, school districts are raising taxes while holding millions of dollars in their General Fund accounts.**

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This audit was performed in response to concerns raised by taxpayers and members of the Pennsylvania General Assembly regarding the practice of school districts raising local property taxes without voter approval, while maintaining large General Fund balances with unspent and appropriate funds. Act 1 of 2006, known as the Taxpayer Relief Act,<sup>2</sup> was intended to give voters a greater say when a school district needed to raise property taxes beyond limits set by the law. Yet, school districts were raising taxes through exceptions granted by the state, while continuing to have sufficient funds in the General Fund to cover any budget shortfalls.

According to the Pennsylvania Public School Code (PSC), a district may raise taxes if the estimated ending unreserved, undesignated fund balance as reported in the annual General Fund budget is below 8% of the estimated budgeted expenditures.<sup>3</sup> If the district meets this threshold, then it may raise taxes to the limits set by the annual inflationary index as calculated by the Pennsylvania Department of Education (PDE). If a district wants to increase taxes beyond the limit, the law allows it to either seek voter approval through referendum or go directly to PDE for an exception to increase taxes without voter approval.

We selected 12 school districts from across the Commonwealth with approved referendum exceptions and substantial Governmental Fund balances.<sup>4</sup> These districts represent a cross-section of Pennsylvania communities, from rural to urban and poorer to wealthier tax bases. All these districts have applied to PDE for referendum exceptions to increase taxes without voter approval and the exceptions have been granted. The two most common types of referendum exceptions the 12 districts applied for were for pension obligations and special education expenditures. We reviewed the districts' financial position and budgeting practices for their General Fund for the audit period July 1, 2017, through June 30, 2021 (also referred to as fiscal year ended [FYE] June 30, 2018, 2019, 2020, and 2021).

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<sup>2</sup> The Title of Act 1 is as follows, in part: "An act providing for taxation by school districts, ... for tax relief in first class cities, for school district choice and voter participation, for other school district options...; restricting the power of certain school districts to levy, assess, and collect taxes; ..." See 53 P.S. § 6926.101.

<sup>3</sup> The PSC states that the unreserved, undesignated fund balance is to be "less than the percentages" to raise taxes; however, PDE requires that the unassigned fund balance not exceed the percentages listed in the PSC. Therefore, although we indicate that the threshold is to be below 8%, we considered 8% or below compliant for purposes of this audit. See *Appendix E* for definitions of terms used in this report.

<sup>4</sup> The General Fund and Capital Funds are part of the Governmental Funds. See more details regarding our criteria for selecting the 12 districts in the *Introduction and Background* section of this report.

## A Performance Audit

### School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes

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We evaluated whether each district appropriately used the PDE referendum exception method to raise local taxes. We also determined whether each district ensured its General Fund balances were properly designated as committed and assigned and used in a timely manner for intended purposes.

While each of the 12 districts were compliant with the law and PDE regulations, we found the following common yet questionable practices that lawfully allowed these 12 districts to raise taxes 37 of the 48 times districts were eligible to raise taxes during the audit period.<sup>5</sup> These tax increases took place while having an average of more than \$360 million collectively in their respective General Funds. We also noted districts accumulated millions of dollars for multiple years in the General Fund while giving the perception in their preliminary and final adopted budgets that the district needed tax revenue to balance the budget.

#### Common Practices

**All of the school boards adopted policies or practices to maintain the unassigned fund balance to meet the law’s threshold to reserve the right to raise taxes annually.** We found 8 of the 12 districts have written policy to keep the unassigned fund balance below the threshold to be able to increase taxes every year. The other 4 districts also maintain the unassigned fund balance below the threshold without having it as a written policy. See *Appendix C* for details on the reported unassigned fund balance as a percentage of estimated expenditures for each of the four fiscal years.

**Each of the 12 districts had sufficient unused funds that should have negated some of the 37 tax increases that were assessed on taxpayers during the audit period.** See *Appendix B* for the available funds that were appropriable, as further explained below, while raising taxes below, at, or above the index.

**It was common practice for school boards to transfer excess surplus funds in the General Fund to other Capital Funds that were not budgeted to be transferred.** We found that the 12 districts collectively budgeted \$93 million to transfer available General Funds to Capital Funds for capital improvement projects, but actually transferred \$195 million, while also increasing taxes.<sup>6</sup> Maintaining excess surplus funds as unassigned fund balance in the General Fund until these funds are appropriately budgeted for as interfund transfers in the following fiscal year would provide greater transparency as to the districts’ operating surpluses and where they are being transferred.

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<sup>5</sup> This refers to the 48 fiscal years as calculated based on 12 districts times the four-year audit period. See *Appendix B* for the details for each of the 12 districts reviewed.

<sup>6</sup> See *Appendix D* for details of budgeted transfers versus actual transfers.

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### School Districts – General Fund Balances

#### Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes

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**Applying for referendum exceptions was used as a regular budgeting tool, rather than an extreme measure to meet a fiscal shortfall.** Districts routinely applied for referendum exceptions and proposed to increase taxes without using committed and assigned funds to balance budgets. Five of the 12 districts did raise taxes above the index. Further, school boards routinely underestimated revenue and overestimated expenditures in budgets, enabling the districts to meet the law’s threshold to raise taxes.

#### **Unassigned versus Unrestricted**

When the noted trends became apparent, we performed analysis for each of the 12 districts to determine if they would have been able to raise taxes if the threshold was calculated based on unrestricted fund balance, which also includes the committed and assigned funds since they are appropriable, rather than the current practice of using unassigned fund balance.<sup>7</sup> We found that if the threshold was based on unrestricted fund balance, which includes committed and assigned funds, only 5 of the 12 districts would have had the opportunity to raise taxes 11 times during the four-year audit period. This one change from “unreserved, undesignated” to “unrestricted” to the law would have reduced the districts collective potential 48 tax increases to 11 potential tax increases. Due to the compounding effect of tax increases year over year, millions of taxpayers’ dollars now sit in the districts’ coffers. The 12 districts collectively had more than \$390 million in their respective General Funds as committed, assigned, and unassigned as of FYE June 30, 2021.

Each of the 12 districts had funds designated as assigned and/or committed but not spent for the designated purpose for several years. Districts largely responded that this practice is not prohibited by law, it is an acceptable practice to set funds aside, and having the excess funds provides for better bond ratings. Several districts had the same funds committed but unspent for the entire four-year audit period. Some districts did use the funds as intended, some districts transferred the funds for capital projects, but most had the funds unspent for multiple years.

#### **Legislative Intent of Act 1**

When the Pennsylvania General Assembly passed Act 1, it intended to give taxpayers property tax relief and greater input on how their tax dollars were being used by local school boards. It did not intend for districts to be able to raise taxes every year while simultaneously holding excess available funds. Absent legislative revision to the law, school boards will continue the practice of committing, assigning, and transferring millions of surplus dollars while routinely increasing taxes. The districts indicated this to us in their responses. They referred to the law and noted these were prudent, legal business practices.

Overall, they stated if the district remains compliant with any **explicit** legal requirements and regulations, the Board has the authority to do what it feels is in the best interest of the district and

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<sup>7</sup> See *Appendix C* for details of the 12 districts.

## A Performance Audit

### School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes

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its taxpayers. Similarly, transferring excess surplus funds from the General Fund to other Capital Funds, whether budgeted or not budgeted, is lawful if the Board approves the transfer. They also claimed that since their budget process begins more than 6 months prior to the start of the fiscal year and prior to the adopted state budget, many uncertainties exist when the next fiscal year's budgets are prepared which require guesswork and conservative estimates. Yet despite holding millions of dollars unused for years, the districts want flexibility to raise taxes annually by keeping the unreserved, undesignated or the "unassigned" fund balance below the legal threshold.<sup>8</sup>

We disagree with these practices.

The intent of the law was to avoid increasing taxes if the district has available "appropriable" funds. Specifically, the threshold to increase taxes requires a district have a General Fund "unreserved, undesignated" balance of less than a certain percent of total budgeted expenditures.<sup>9</sup> PDE and the districts define the estimated ending "unreserved, undesignated" fund balance as the estimated ending "unassigned" fund balance. However, Subsection (c) of Section 688 of the Pennsylvania School Code defines it as:

...that portion of the fund balance which is appropriable for expenditure or not legally or otherwise segregated for a specific or tentative future use, projected for the close of the school year for which a school district's budget was adopted and held in the General Fund accounts of the school district.<sup>10</sup>

This definition indicates the ending fund balance should include available (appropriable) funds that are not designated (legally or otherwise segregated) for use (specific or tentative) for the current fiscal year's adopted budget (the close of the school year for which a budget was adopted) and are in the General Fund. Therefore, we believe the committed and assigned funds should be counted towards the threshold when not actually used for the designated purposes in a timely manner.

Additionally, Act 1 provides no direction or details as to what funds are considered available for balancing the preliminary budget, and charges PDE with the approval of the referendum

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<sup>8</sup> As discussed later, PDE and the districts interpret the unreserved, undesignated fund balance as the unassigned fund balance. See *Appendix E* for further details on definitions of these terms.

<sup>9</sup> Pursuant to Subsection (a) of Section 688 (relating to **Limitations on certain unreserved fund balances**) of the PSC, an 8% limit applies to districts with estimated total budgeted expenditures equal to or exceeding \$19 million. The 12 districts' total estimated budgeted expenditures exceeded \$19 million; therefore, each of the 12 districts had to have less than 8% in unassigned fund balance to raise taxes annually. See 24 P.S. § 6-688(a).

<sup>10</sup> See 24 P.S. § 6-688(c).

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### School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes

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exceptions, for which PDE has provided guidelines.<sup>11</sup> The districts do not include commitments or assignments since PDE’s instructions and forms do not require the districts to take the prior year surplus or recorded commitments and assignments into consideration when calculating available funds for the preliminary budget or the expenditures in question. This lack of inclusion allows districts to transfer the surpluses to other Capital Funds, or even maintain funds as committed or assigned for the same type of expenditure it is requesting to raise taxes above the index. For instance, we found 9 of the 12 districts transferred \$102 million more than budgeted during the audit period, and 9 of the 12 districts had assignments or commitments for pension obligations not used for multiple years while requesting referendum exceptions to increase taxes above the index for pension costs.

The overall results of this audit should raise concerns due to the districts’ common yet questionable practices that are placing an excess burden on taxpayers across Pennsylvania. We are hopeful that the General Assembly and PDE will consider taking a close look at these practices and review the law and PDE guidelines for possible clarification and improvement. Simply because certain budgetary practices are not specifically prohibited by law does not necessarily mean that those practices serve the best interests of taxpayers.

We illustrate district-specific information for each of the 12 districts in the section entitled *Audit Procedures and Results, School District Responses, and Auditor’s Conclusions for the Twelve Districts Selected for Review*. While we report the results of our review for the 12 selected districts, similar conditions could occur with any district in Pennsylvania.

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### Overall Recommendations

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We recommend that the **Pennsylvania General Assembly** consider our recommendations to each respective school district for the purpose of doing an in-depth review and possible clarification and improvement of current laws with regard to the following:

- When and if (i.e., the criteria needed) a referendum exception should be applied for.
- What should be considered as the allowable appropriate fund balance; should it be the unreserved, undesignated which is currently defined as unassigned fund balance, or should it be unrestricted funds which would include committed and assigned fund balance.
- How referendum exceptions, raising local school property taxes, and raising taxes above the index relate to school districts’ General Funds.

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<sup>11</sup> Subsection (j) of Section 333 of Act 1, 53 P.S. § 6926.333(j) (see in particular Subsection (j)(3)); PDE’s most recent guidelines: [Property Tax Referendum Exception Guidelines 202223 \(pa.gov\)](https://www.pade.state.pa.us/property-tax-referendum-exception-guidelines-202223).

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### School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes

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We believe this effort would be in the interest of decreasing the excess burden on taxpayers across the state. Further, we note this could be accomplished through a legislatively created Task Force made up of experts in the field established by statute or resolution at the General Assembly's discretion. The task force could assist by considering items in statute for clarification and improvement noted above, along with considering other related items, such as:

- Should the fiscal year end date for school districts move from June 30<sup>th</sup> to September 30<sup>th</sup> or after so that the districts have more accurate information for budgeting estimates regarding actual state and federal funding levels?
- What percentage of funds should be allowable in the General Fund as committed, assigned, and unassigned to raise taxes?

We also provide the following specific recommendations to the General Assembly:

1. Add a provision to Act 1, as amended, that requires districts to use committed and assigned General Fund balances and the prior fiscal year's surplus funds prior to requesting a referendum exception to raise taxes above the index.
2. Revise the Pennsylvania School Code's terminology used in the determination of the mandated threshold for raising taxes from *unreserved, undesignated* to *unrestricted* to include committed and assigned funds in the calculation to prevent school districts from retaining millions of dollars in General Fund commitments and assignments while increasing taxes.
3. Determine if there should be parameters around budgeting practices and transferring operating surpluses while increasing taxes. For instance, requiring that all transfers from the General Fund be considered unassigned funds and included as interfund transfers on a General Fund budget prior to being transferred to other Governmental Funds.

We recommend **PDE**:

1. Review and revise the process of approving referendum exceptions if the district has committed and assigned General Fund balances. Based on our audit results, school districts have adequate funding for the related expenditures, are transferring excess surpluses, and are not using designated funds timely or to balance the preliminary budget prior to requesting to increase taxes above the index for the very same type of expenditure.
2. Consider revising the PDE Property Tax Referendum Exception Guidelines accordingly.

## **A Performance Audit**

### **School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes**

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We provide recommendations for each individual district in this report in *Audit Procedures and Results, School District Responses, and Auditor’s Conclusions for the Twelve Districts Selected for Review*.

## A Performance Audit

### School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes

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## Introduction and Background

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This report by the Department of the Auditor General (Department) presents the results of a performance audit for 12 of the 500 school districts (district(s)) in the Commonwealth of Pennsylvania. This audit was conducted under the authority of Sections 402 and 403 of The Fiscal Code and in accordance with Article VIII, Section 10 of the Constitution of Pennsylvania, which authorizes the Department to audit any entity funded or financially aided by the Commonwealth, including districts “**as far as may be necessary to satisfy the department** that the money received was expended or is being expended for no purpose other than that for which it was paid.”<sup>12</sup>

The audit was performed in accordance with applicable *Government Auditing Standards* (GAS), issued by the Comptroller General of the United States.<sup>13</sup> Our audit scope was July 1, 2017, through June 30, 2021, which covers the districts’ fiscal years ended (FYE) June 30, 2018, 2019, 2020, and 2021.

The **first objective** of our audit was to determine whether each of the selected districts appropriately used the referendum exception method to raise local school property taxes (taxes).<sup>14</sup> The **second objective** included determining if each district ensured that fund balances were properly designated and used for intended purposes.<sup>15</sup> In lieu of conducting financial audit procedures to test the districts’ data, we reviewed and relied upon the reports and supporting audit opinions of the independent accounting firms that conducted the annual audits of each district for the FYE June 30, 2018, 2019, 2020, and 2021, including review of the independent accounting firms’ assessments of the districts’ internal controls.<sup>16</sup>

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<sup>12</sup> See 72 P.S. §§ 402 and 403 and Pa. Const. art. VIII, Sec. 10. (Emphasis added.) The authority to conduct performance audits derives from the 2004 Pennsylvania Commonwealth Court decision in *Dep’t of the Aud. Gen. v. State Emp. Ret. Sys.*, citing to the prior case in the matter, which plainly concluded that the Auditor General (and his Department) under Article VIII, Section 10 of the Constitution and Section 402 and Section 403 of The Fiscal Code has the authority to conduct performance audits of, among others, a public agency (such as a school district) receiving state funds at his discretion. (Emphasis added). See *Dep’t of the Aud. Gen. v. State Emp. Ret. Sys., et al.*, 860 A.2d 206 at 214 (Pa. Cmwlth. 2004).

<sup>13</sup> U.S. Government Accountability Office. *Government Auditing Standards*. 2018 Revision Technical Update April 2021.

<sup>14</sup> See the Taxpayer Relief Act, Act 1 of 2006, as amended, 53 P.S. § 6926.301 *et seq.* and the PDE Referendum Exception Requirements, 53 P.S. § 6926.333(a)(1)-(2), amended by Act 25 of 2011.

<sup>15</sup> See the Public School Code, 24 P.S. §§ 6-687 (as last amended by Act 16 of 2019) and 6-688 (as added by Act 48 of 2003).

<sup>16</sup> U.S. Government Accountability Office. *Government Auditing Standards*. 2018 Revision Technical Update April 2021, Paragraphs 8.80 and 8.81, describe requirements for using the work of other auditors. These standards state that auditors should determine whether other auditors have conducted audits that could be relevant to current audit objectives. If auditors use the work of other auditors, they should perform procedures that provide sufficient basis for using that work.

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In the sections that follow, we will provide information in regard to what is a General Fund, classifications of the General Fund balance, the referendum exception method to increase taxes above the inflationary index (index), and how each of the 12 districts were selected to be a part of this audit.<sup>17</sup>

#### What is a General Fund?

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Districts in Pennsylvania utilize fund accounting for greater financial accountability. Fund accounting uses separate Funds to record specific activity for different purposes. These Funds can include Capital Projects Funds, Debt Service Funds, and the General Fund. The focus of this audit is on the General Fund. Each district uses its General Fund to record general operations, such as the revenues generated from taxes, state subsidy payments, and federal grants; and expenditures to operate the district's educational programs, such as administrators' and teachers' salaries, textbooks, and utilities.

The General Fund's balance is the result of the accumulation of operating revenues minus expenditures. If the annual revenues **exceed** annual expenditures, the district has an ending surplus. If annual revenues are **less** than annual expenditures, the district has an ending deficit. A surplus adds to the General Fund's balance and a deficit subtracts from the General Fund's balance.<sup>18</sup>

The accumulation of surpluses or significant fund balance in the General Fund has been a popular issue of public interest for several years due to certain districts' continued practice of increasing local taxes.<sup>19</sup> As of June 30, 2020, the Commonwealth had 500 districts with more than **\$5 billion** in General Fund balances.<sup>20</sup> The 12 districts selected for this performance audit had **nearly \$380 million of the \$5 billion** in their General Funds.

Districts are permitted to increase taxes for several reasons, including, but not limited to, maintenance for infrastructure, building new infrastructure, and increases for annual expenditures like pension costs, healthcare benefits, and charter school tuition.

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<sup>17</sup> See *Appendix E* for definitions of terms used in this report.

<sup>18</sup> For simplicity purposes, this explanation of surplus and deficit does not include results from intergovernmental fund transfers or other financing sources and uses.

<sup>19</sup> Pennsylvania School Boards Association, A Closer Look, "A Balanced Look at School District Fund Balances," [www.ppsba.org](http://www.ppsba.org).

<sup>20</sup> General Fund balances compiled by the Department of the Auditor General staff from data extracted from PDE's website that provides amounts reported by the districts on the annual financial reports.

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The PSC requires districts to certify and adopt an annual budget for the General Fund prior to the start of each fiscal year.<sup>21</sup> Depending on the total estimated expenditures in the budget of a district, taxes cannot be raised unless the General Fund unassigned fund balance (explained in the next section) is below a certain percent of total estimated expenditures.<sup>22</sup> Due to this requirement, it is imperative for a district to complete its annual budget as accurately as possible since this information has a direct impact on the district's taxes.

The General Fund's balance is like a savings account. As a savings account, the district should consider future needs and the economic climate along with potential freezes in state funding or delays in state subsidy payments.

### Classifications of the General Fund Balance

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Fund balances are to be maintained by the districts in accordance with the PDE accounting bulletins and the Governmental Accounting Standards Board (GASB) Statement #54 – Fund Balance Reporting and Governmental Fund Type Definitions. Fund balances are to reflect a classification based on the constraints put on the funds.

Districts can designate the General Fund's balance into the following categories:

**Non-spendable** – amounts in the General Fund that cannot be spent because they are not in a cash form or because the funds are legally or contractually required to be maintained, e.g., inventory.

**Restricted** – amounts set aside for a specific purpose imposed by law or external parties, such as creditors or grantors.

**Committed** – amounts set aside for specific purposes approved by formal action of the Board of Directors of a district. Once committed, it takes the same type of formal action to de-commit the funds for a different purpose.

**Assigned** – amounts set aside for a specific purpose that are not restricted or committed. The assignment of funds and the un-assignment of the funds does not require formal approval of the district's Board of Directors unless the district's policy requires it.

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<sup>21</sup> PSC, 24 P.S. § 6-687(a)(1).

<sup>22</sup> Pursuant to Section 688(a) of the PSC, an 8% limit applies to districts with estimated total expenditures equal to or exceeding \$19 million. The 12 districts' total expenditures exceeded \$19 million, therefore estimated unassigned fund balance had to be below 8% of estimated expenditures to raise taxes to the index. See 24 P.S. § 6-688(a).

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**Unassigned** – amounts that are spendable that are not categorized in the above designations.

### The Referendum Exception Method

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School districts can raise taxes above the index by either obtaining the approval from the district’s voters on a referendum ballot, or by qualifying for one of the four specific referendum exceptions provided by Act 1 of 2006 (the Taxpayer Relief Act), as amended.

The referendum exceptions<sup>23</sup> include the following four areas of costs:

1. Grandfathered Construction Debt<sup>24</sup>
2. Electoral Construction Debt<sup>25</sup>
3. Special Education Costs
4. Retirement Contributions to the Public School Employees’ Retirement System (PSERS)

In September of each year, PDE sets the index for each district. Districts that submit an annual budget with an estimated unassigned fund balance below a set percent of estimated expenditures can raise taxes to the PDE index.<sup>26</sup> Districts that want to increase taxes above the index have to go to local taxpayers via a referendum ballot question to vote on whether a tax increase above the index is permitted or apply to PDE for a referendum exception.<sup>27</sup> It is the responsibility of PDE to review and approve or deny the referendum exception.<sup>28</sup>

### How the 12 Districts Were Selected

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We selected a total of **12 districts** to be a part of our audit. The following **five districts** were selected because each had fiscal years not audited by the Department of the Auditor General since June 30, 2017, had at least \$100 million in expenditures during the FYE June 30, 2020, had a total General Fund balance greater than 8% of total expenditures as of FYE June 30, 2020 (as

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<sup>23</sup> 53 P.S. § 6926.333(f), (n). *See also* [Property Tax Referendum Exception Guidelines 202223 \(pa.gov\)](#), page 4.

<sup>24</sup> Grandfathered construction debt is debt incurred for construction projects prior to the effective date of Act 72 of 2004 or Act 1 of 2006.

<sup>25</sup> Electoral Construction Debt is voter-approved debt incurred under the Local Government Unit Debt Act.

<sup>26</sup> *See* the PSC, 24 P.S. § 6-688(a) and (b).

<sup>27</sup> *See* the Taxpayer Relief Act, 53 P.S. § 6926.333(f) and (n) (pertaining to the four school district referendum exceptions under Act 1 of 2006, as amended by Act 25 of 2011).

<sup>28</sup> This performance audit of the school districts did not include an audit of PDE’s procedures and processes.

## A Performance Audit

### School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes

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opposed to unassigned General Fund balance), and proposed to raise taxes using a PDE referendum exception for the FYE June 30, 2018, 2019, and 2020:<sup>29</sup>

1. Bethlehem Area School District, Northampton County and Lehigh County
2. Hempfield School District, Lancaster County
3. Neshaminy School District, Bucks County
4. North Allegheny School District, Allegheny County
5. Northampton Area School District, Northampton County

The other **seven districts** were selected because each had fiscal years not audited by the Department of the Auditor General since June 30, 2017, each had a total balance for Governmental Funds greater than \$60 million as of the FYE June 30, 2020 (as opposed to just the General Fund balance), and each proposed to raise local taxes using a PDE referendum exception at least once during the audit period. The additional seven districts are:

1. Abington School District, Montgomery County
2. Canon-McMillan School District, Washington County
3. School District of Lancaster, Lancaster County
4. Lower Merion School District, Montgomery County
5. North Penn School District, Montgomery County
6. Penn Manor School District, Lancaster County
7. West Chester Area School District, Chester County and Delaware County

See *Appendix A – Objectives, Scope, Methodology, and Data Reliability* for more information.

**DISCLAIMER:** Please note that this audit is a performance audit and presents requirements of prudent stewardship of taxpayer funds, advancing transparency, best business practices, relevant provisions of law, and related recommendations pertaining to requesting referendum exceptions as they relate to school districts' General Funds, the raising of local school property taxes, and the raising of taxes above the PSC index.

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<sup>29</sup> We did not use data from the FYE June 30, 2021, because this data was not available when we selected the districts for our audit.

## A Performance Audit

### School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes

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#### **Audit Procedures and Results, School District Responses, and Auditor’s Conclusions for the Twelve Districts Selected for Review**

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As part of this performance audit, we selected twelve school districts and reviewed each district’s annual audited financial statements, budget information, and other documentation for the fiscal years ended (FYE) June 30, 2018, 2019, 2020, and 2021, in order to achieve our **two audit objectives**.<sup>30</sup>

For **Objective 1**, we performed audit procedures to determine whether each school district appropriately used referendum exceptions to increase local school property taxes (taxes). These procedures included, but were not limited to:

- Determining whether the respective Board of Directors (Board) approved resolutions to not increase taxes above the index or approved the preliminary budget used to request a referendum exception.
- Verifying the Pennsylvania Department of Education (PDE) approved the referendum exception(s) and validating that the school district’s tax increases complied with PDE’s approvals.
- Evaluating whether the school district’s anticipated revenues and expenditures warranted a tax raise above the index.
- Assessing whether the school district’s Unrestricted General Fund Balance was sufficient to avoid asking PDE for a referendum exception.<sup>31</sup>

For **Objective 2**, we performed audit procedures to determine if each school district ensured that fund balances were properly designated and used for intended purposes. These procedures included, but were not limited to:

- Verifying the respective Board approved appropriate resolutions to designate General Funds as commitments and assignments.
- Determining if the assigned and committed fund balances were used timely.

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<sup>30</sup> See the *Introduction and Background* section of this report for the criteria used to select the twelve school districts.

<sup>31</sup> Unrestricted fund balance includes commitments, assignments, and unassigned fund balance in alignment with GASB 54.

## **A Performance Audit**

### **School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes**

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- Determining if the district’s policy requires the Board to maintain the unassigned fund balance below the Pennsylvania Public School Code (PSC) threshold to raise taxes annually.<sup>32</sup>
- Reviewing budget versus actual General Fund transfers to other Governmental Funds for reasonableness.

Based on the above procedures and information from district management, we outline the audit results for each district individually in the following section.

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<sup>32</sup> 24 P.S. § 1-101 *et seq.*, see in particular, Section 688 (relating to Limitations on certain unreserved fund balances) of the PSC. *See* 24 P.S. § 6-688.

## A Performance Audit

### School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes

#### Abington School District

Abington School District’s (Abington) revenues and expenditures ranged from \$150 million to \$172 million during the four FYE June 30, 2018, 2019, 2020, and 2021.<sup>33</sup> The following table summarizes Abington’s information for referendum exceptions requested by fiscal year, the funds available in its General Fund at the beginning of each fiscal year (July 1), whether taxes were raised, and whether taxes were raised above the index.

**Table #1**

FYE June 30	Did the District Request a Referendum Exception? <sup>a/</sup>	Type of Exception Requested <sup>b/</sup>	Total Amount Approved	General Funds Available July 1 <sup>c/</sup>	Taxes were Raised	Taxes Were Raised Above the Index <sup>f/</sup>
2018	Yes	Pension Obligations <sup>e/</sup>	\$ 602,578	\$40,757,021	Yes	Yes
2019	Yes	Pension Obligations and Special Education Costs	\$ 1,087,186	\$42,134,221	No	No
2020	No <sup>d/</sup>	N/A	N/A	\$42,810,865	No	No
2021	Yes	Special Education Costs	\$ 903,197	\$38,405,249	No	No

<sup>a/</sup> - Based on PDE’s applicable year’s Report on Referendum Exceptions, the district did or did not request a referendum exception to raise taxes above the index.

<sup>b/</sup> - Act 1 of 2006, as amended, provides four different types of referendum exceptions based on type of expenditure costs, see the *Introduction and Background* section of this report. See Taxpayer Relief Act, 53 P.S. § 6926.101 *et seq.*

<sup>c/</sup> - The amount of funds available to Abington at the beginning of the fiscal year; for instance, for the FYE June 30, 2018, the amount available for appropriation by the Board on July 1, 2017, was \$40,757,021.<sup>34</sup>

<sup>d/</sup> - Abington’s preliminary budget did not require an increase above the index and therefore no type of referendum exception was requested.

<sup>e/</sup> - Pension obligations refer to the retirement contributions made by the school district to the Public School Employees’ Retirement System (PSERS).

<sup>33</sup> The range of revenues and expenditures is based on the Preliminary Budgets used to apply for the referendum exceptions.

<sup>34</sup> The table includes funds committed in the General Fund that are available for use if the Board so directs. Also, the available funds listed have been unspent for several years and remain available for the Board to recommit for other types of expenditures.

## A Performance Audit

### School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes

<sup>f/</sup> - Taxes were raised above the index within the approved PDE referendum exception.

N/A – Not applicable

*Sources: Produced by staff of the Department of the Auditor General based on information in the PDE's referendum reports and Abington's audited financial statements for the FYE June 30, 2017, 2018, 2019, 2020, and 2021.*

Based on our audit procedures we did not find non-compliance with law or regulations. However, we found the following issues regarding prudent stewardship of taxpayer funds:

- Abington routinely requests referendum exceptions using conservative budgeting practices and raised taxes above the index for the FYE June 30, 2018, despite having sufficient funding for anticipated annual expenditures.
- Abington designates its entire General Fund as commitments and has not used the funds timely.

The following two sections describe these results in more detail.

#### **Abington routinely requests referendum exceptions using conservative budgeting practices and raised taxes above the index for the FYE June 30, 2018, despite having sufficient funding for anticipated annual expenditures.**

Abington applied for referendum exceptions to raise taxes above the index for the FYE June 30, 2018, 2019, and 2021. It used the approved referendum exception for the FYE June 30, 2018, to increase taxes above the index. When questioned Abington's Chief Financial Officer (CFO) explained that the district's Board routinely applies for referendum exceptions as a budgetary tool to reserve the option to increase taxes above the index until adoption of the final budget in June of each year.

Based on Act 1 of 2006, as amended, Section 333(a)(1), an additional tax rate increase above the index may be requested if needed to balance the preliminary budget.<sup>35</sup> By requesting a referendum exception, the district is indicating that the tax increase above the index is needed due to insufficient available funding. However, we found that Abington had sufficient funding available to balance the budget which negated the need to apply for referendum exceptions for the FYE June 30, 2018, 2019, and 2021, for the following reasons:

<sup>35</sup> Subsection (a)(1) of Section 333 (relating to public referendum requirements for increasing certain taxes) of the Taxpayer Relief Act. Please note at Subsection (a)(2) of the act states as follows: "(2) This section shall apply to each board of school directors beginning with any proposed tax increase that takes effect in the 2007-2008 fiscal year and each fiscal year thereafter." See 53 P.S. § 6926.333(a)(1)-(2).

## A Performance Audit

### School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes

- Abington’s business office created preliminary and final budgets that were excessively conservative. Specifically, these budgets reported beginning and ending General Fund balances that were \$10 million to \$20 million lower than actual balances. This is illustrated in the table below for the FYE June 30, 2018.

**Table #2**

	Preliminary Budget	Adopted Budget	Audited Financial Statements
Beginning Fund Balance	\$ 30,416,083	\$ 30,416,083	\$ 40,981,979
Revenue	\$ 150,035,232	\$ 150,818,989	\$ 152,961,912
Expenditures	\$ 158,230,751	\$ 159,283,771	\$ 151,415,935
(Deficit)/Surplus	\$ (8,195,519)	\$ (8,464,782)	\$ 1,545,977
Ending Fund Balance	\$ 22,220,564	\$ 21,951,301	\$ 42,527,956

*Sources: Produced by staff of the Department of the Auditor General based on information in Abington’s Board approved Preliminary Budget, Adopted Budget, and audited financial statements for the FYE June 30, 2018.*

While we recognize that budgets are estimates, PDE’s manual for General Fund budgets indicates the estimated beginning fund balance “should be the same as, or very close to, the ending fund balance from the previous fiscal year.”<sup>36</sup> Therefore, since the FYE June 30, 2018 budget is being completed during FYE June 30, 2017, the estimated beginning fund balance should be close to the ending balance from FYE June 30, 2016, which was \$40,524,320, or more than \$10 million more than the \$30,416,083 estimated by Abington. Therefore, Abington had more than adequate funding and Abington did not need to apply for the referendum exceptions for pension costs and/or special education costs during the three FYE June 30, 2018, 2019, and 2021. According to Abington’s CFO, the Board prefers to use conservative estimates.

- Abington had sufficient funds committed specifically for the type of expenditure used for the referendum exception it sought. For example, on June 27, 2017, prior to the start of the 2018 fiscal year and prior to raising taxes on residents for that year, Abington’s Board passed a resolution to commit 25% of its estimated General Fund balance, or \$7.5 million, for pension obligations. Therefore, Abington had adequate funding and did not need to apply for the referendum exception for pension costs totaling \$602,578 as listed

<sup>36</sup> Pennsylvania Department of Education, “Consolidated Financial Reporting System-General Fund Budget (CFRS-GFB) General User Manual”, dated November 2021.

## A Performance Audit

### School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes

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in Table #1 above.<sup>37</sup> The CFO acknowledged that the commitment for pension obligations was not spent during the audit period.

Our results demonstrate that Abington had sufficient funding and did not need to apply for referendum exceptions to meet its pension obligations and/or special education costs during the FYE June 30, 2018, 2019, and 2021. Additionally, the district presented preliminary budgets to the taxpayers and PDE that suggested the district had insufficient funds to balance its budget while it had millions of dollars available for anticipated expenditures. The process of applying for unnecessary referendum exceptions wasted time and resources for the district and PDE. Further, the tax increase above the index that occurred for the FYE June 30, 2018, was not needed and the resulting funds were not spent in FYE June 30, 2018.<sup>38</sup> Therefore, the Board placed an unnecessary excess burden on district taxpayers.

#### **Abington designates its entire General Fund as commitments and has not used the funds timely.**

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General Fund balances can be designated as committed, assigned, or unassigned.<sup>39</sup> The PSC prohibits districts from increasing taxes if its unassigned fund balance in the General Fund is greater than 8% of the next fiscal year's budgeted expenditures.<sup>40</sup> By reducing the unassigned fund balance every year to zero, Abington can increase taxes even though it has sufficient funds for anticipated expenditures in its General Fund.

During our audit period, Abington committed its available funds in the General Fund to capital projects, pension obligations, and pandemic-related expenses based on percentages recommended by the CFO and approved by the Board. The following table illustrates Abington's General Fund balances:

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<sup>37</sup> While this calls into question the reason PDE approved the referendum exceptions, this is not an audit of PDE's procedures and processes.

<sup>38</sup> The approved referendum exception to increase taxes above the index was \$602,578 and the operating results led to an increase in the amount of funds available in the General Fund by \$1.5 million for the FYE June 30, 2018.

<sup>39</sup> The General Fund classifications are described in more detail in the *Introduction and Background* section of this report.

<sup>40</sup> 24 P.S. § 6-688(a).

## A Performance Audit

### School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes

**Table #3**

FYE June 30				
General Fund - Fund Balances	2018	2019	2020	2021
Committed:				
Capital projects	\$ 33,915,337	\$34,248,692	\$ 30,486,641	\$ 23,233,412
Pension obligations	\$ 8,218,884	\$ 8,562,173	\$ 7,918,608	\$ 9,957,176
Pandemic-related expenses	\$ -	\$ -	\$ 1,187,791	\$ -
Assigned	\$ -	\$ -	\$ -	\$ -
Unassigned	\$ -	\$ -	\$ -	\$ -
<b>Total Committed, Assigned, and Unassigned Fund Balance</b>	<b>\$ 42,134,221</b>	<b>\$42,810,865</b>	<b>\$ 39,593,040</b>	<b>\$ 33,190,588</b>

Source: Produced by staff of the Department of the Auditor General based on information in Abington's audited financial statements for the FYE June 30, 2018, 2019, 2020, and 2021.

Based on our audit procedures, we found:

- On an annual basis, prior to the end of the reporting period in June, Abington's Board formally approved resolutions to commit funds for specific purposes in the General Fund based on recommendations from its CFO. As a result, Abington complied with the applicable PDE requirement for commitments.<sup>41</sup>
- Abington's policy states the General Fund balance is not to be used as a revenue source to offset operating deficiencies. As a result,
  - The Board designates the entire General Fund balance as commitments to eliminate having any unassigned General Fund balance, as shown in Table #3 above. When questioned about this practice, Abington's CFO indicated that the district's Board designates the entire General Fund as commitments to provide the Board with control over all spending. This practice requires formal action by the Board to be committed and decommitted.
  - The policy requires that current year revenues be sufficient to offset current year expenditures; however, the budgets contradict the policy and utilize fund balance to offset the higher expenditures and resulting deficits as illustrated in Table #2

<sup>41</sup> PDE Accounting Bulletin #2010-01, effective fiscal year 2010-11, and thereafter, requires commitment classifications for specific purposes be the result of a formal action by the school's highest level of authority, which in this case is the Board. The PDE bulletin provides that the Board's approval to commit the funds be before the end of the fiscal year and the amounts can be determined after the fiscal year. Additionally, assignments of funds do not require formal action by the Board.

## **A Performance Audit**

### **School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes**

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above. Although the final audited operating results led to a surplus for the FYE June 30, 2018, Abington proposed to use the fund balance if needed and in contradiction to the policy.

As a best business practice, the Board should reconsider its practice of committing the entire General Fund balance. Having an unassigned fund balance would provide funds for balancing its budget, unexpected costs, or emergency circumstances.

- Although it appears the district’s financial condition is declining due to the General Fund’s balance decreasing from \$42 million on July 1, 2017, to \$33 million on June 30, 2021, we noted the district transferred \$11.5 million from the General Fund to its Capital Projects Fund during the four-year audit period. This was \$4.6 million more than it had budgeted to transfer in the adopted final budgets.
- District management indicated that it had no capital project plan despite committing the majority of its General Fund for capital projects. As a result, the district did not spend the funds designated for capital projects timely. Since the General Fund is financed from local, state, and federal sources, these funds are generally for financing the current operations of the school district.<sup>42</sup> As illustrated in the chart, \$23 million of the committed funds for capital projects remained unspent from July 1, 2018, through June 30, 2021. Had these unspent funds been maintained as unassigned, the district would have exceeded the 8% PSC threshold and would not have been able to increase taxes for the FYE June 30, 2018. According to the CFO, the district is currently conducting a feasibility study to determine its capital project needs.
- District management acknowledged that it did not use the funds designated for pension obligations because the revenues were adequate each year to cover the expenditures. Had the district maintained the unspent committed funds as unassigned fund balance and provided reasonable estimates in its budgets, the district would have exceeded the PSC threshold and would not have been able to increase taxes for the FYE June 30, 2018.

Based on our audit results, Abington’s policy allows it to increase taxes while retaining millions of dollars of unspent funds for several years in its General Fund.

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<sup>42</sup> Manual of Accounting and Financial Reporting for Pennsylvania Local Educational Agencies (LEAs). Maintained by: PA Office of the Budget, Office of Comptroller Operations Central Agencies & School Finance Unit. Revised August 2016.

## **A Performance Audit**

### **School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes**

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#### **Recommendations for Abington School District**

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While we did not find non-compliance with law or regulations, we offer the following recommendations to Abington School District to improve stewardship of taxpayer funds:

1. Refrain from applying for referendum exceptions unless the district has utilized unspent funds in the General Fund's commitments and/or assignments. Additionally, refrain from applying for referendum exceptions if funds have been set aside specifically for the type of expenditure that is being requested prior to increasing taxes above the index.
2. Pass a resolution during the preliminary budget phase to not increase taxes above the district's index when budgetary needs can be met with existing available funds in the General Fund.
3. More accurately reflect fund balances in its General Fund for the preliminary and adopted budgets.
4. As a best business practice, revise the General Fund policy to eliminate the restriction of using the General Fund as a revenue source when needed for an operating deficit, unexpected costs, or emergency circumstances.
5. As a best business practice, end its practice of committing all funds in the General Fund and maintain excess surplus funds in the unassigned fund balance to negate the need to raise taxes in future years.
6. If the district has designations for funds that are not used in the next fiscal year as intended, the Board should repurpose the funds or the funds should be considered as unassigned fund balance in the General Fund.
7. Reconsider the practice of transferring surplus funds to the Capital Projects Fund unless the funds were specifically budgeted for and disclosed to the taxpayers. Excess surplus funds should be maintained in the General Fund as unassigned fund balances for future operation costs to lessen the burden on taxpayers. This will ensure tax increases are appropriate and needed.

## A Performance Audit

### School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes

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## Abington School District's Response

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Abington School District  
Abington, PA 19001  
Phone (215) 884-4700

November 17, 2022

Peggy L. Morningstar, CPA, CFE, Esquire  
Senior Audit Manager  
Bureau of Performance Audits  
Department of the Auditor General  
Finance Building  
Harrisburg, PA 17120

Dear Ms. Morningstar:

Thank you for your efforts and your team's efforts in preparing and providing the draft Performance Audit Report, as well as, an opportunity to comment on the report. We understand that the report indicates that your team did not find non-compliance with the law and regulations. Additionally, the report appropriately recognizes that the district raised taxes only one year of the four subject years 2018 through 2021. We have reviewed the report and its recommendations for Abington School District. Comments regarding the recommendations follow.

- 1. Refrain from applying for referendum exceptions unless the district has utilized unspent funds in the General Fund's commitments and/or assignments. Additionally, refrain from applying for referendum exceptions if you have funds set aside specifically for the type of expenditure that is being requested prior to increasing taxes above the index.**
- 2. Pass a resolution during the preliminary budget phase to not increase taxes above the district's index when budgetary needs can be met with existing funds in the General Fund.**

Since Act 1 was passed, school districts are required to start the budget process for the July 1 through June 30 fiscal year in December or early January. Absent a particularly high index, it is difficult to justify not applying for any exceptions during that budgetary process, with the understanding that the district is under no obligation to accept them. In fact, in 2019, the district qualified for nearly \$1.1 million in exceptions, but it did not take exceptions and it did not raise taxes.

## **A Performance Audit**

### **School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes**

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At the time that a district must put forth a preliminary budget or declare that it will not raise taxes by more than the index, the district has less than half of the current year's data upon which to base a budget and no information regarding the coming year. The district has no idea what state and federal funding levels will be. The district does not even know what its own tax base will be. In many cases, collective bargaining agreements could be undetermined, significant assessment appeals could be outstanding, as could other litigation matters. Staffing needs based upon enrollment and special education population, health insurance costs, and utility costs are all unknowns. Given the dearth of reliable information available during the preliminary budget window, the district has generally viewed it as prudent to maintain flexibility early in the budget process.

**3. More accurately reflect fund balances in its General Fund for the preliminary and adopted budget.**

With respect to the preliminary budget, the district must use the starting fund balance based upon the prior year's audited financial statements less the amount of fund balance that the district is budgeted to use in the then-current year. As such, if the district underspends its budgetary authority, the actual fund balance to start the upcoming school year will necessarily be higher than it was in the preliminary budget. With respect to final budgets, the district will consider the recommendation for the final budget adoption and determine whether it can adjust the budgeted starting fund balance to reflect more closely the difference between actual revenue and expenses for the then-current year prior to the completion of the district's audit process.

**4. As a best business practice, revise the General Fund policy to eliminate the restriction of using the General Fund as a revenue source when needed for an operating deficit, unexpected costs, or an emergency circumstance.**

The district will take the recommendation under advisement and give its due consideration upon discussion with the district solicitor and audit firm.

**5. As a best business practice, end its practice of committing all funds in the General Fund and maintain excess surplus in the unassigned fund balance to negate the need to raise taxes in future years General Fund.**

The district will take the recommendation under advisement and give it due consideration upon discussion with the district solicitor and audit firm.

**6. If the district has designations for funds that are not used in the next fiscal year as intended, the Board should repurpose the funds or the funds should be considered unassigned fund balance in the General Fund.**

## A Performance Audit

### School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes

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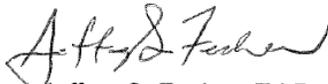
The district does not agree that committed funds not spent in one year should necessarily be considered unassigned fund balance as such a practice may arbitrarily undermine the district's ability to plan for contingencies.

- 7. Reconsider the practice of transferring surplus funds to the Capital Projects Fund unless the funds were specifically budgeted for and disclosed to the taxpayers. Excess surplus funds should be maintained in the General Fund as unassigned fund balances for future operation costs to lessen the burden on taxpayers. This will ensure that tax increases are appropriate and needed.**

All transfers to the capital projects funds are made by the Board of School Directors at a public meeting. The district does not know what "excess surplus funds" are, but to the extent that it is intended to mean the excess of annual revenues over actual expenditures, the district does not share the Auditor General's opinion that such surpluses "should be maintained in the General Fund as unassigned fund balances" and is not aware of any authority requiring such treatment. While the district appreciates the concern over its tax increases, again, there was only one tax increase over the course of the four years at issue.

In conclusion, management of the General Fund - fund balance within the parameters of the School Code, Act 1, and the Generally Accepted Accounting Principles established by the Governmental Accounting Standards Board, is a matter of local control. The Abington School District appreciates that there are different approaches to how to best manage its financial affairs. The district has been open and transparent about its budgeting process. Each year, at public, televised meetings of the Board of School Directors, the administration makes at least five separate budget presentations, detailing the last audited General Fund - fund balance, the fund balance budgeted for the start of the then-current fiscal year, and the projected fund balance at the end of the then-current fiscal year.

Sincerely,



Jeffrey S. Fecher, Ed.D.  
Superintendent of Schools

JSF/tmf

## **A Performance Audit**

### **School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes**

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#### **Auditor’s Conclusion to Abington School District’s Response**

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The Abington School District (Abington) emphasizes its compliance with the Public School Code (PSC), Act 1 of 2006 (the Taxpayer Relief Act), and accounting principles; it states that management of the district’s General Fund is a matter of local control; and it generally disagrees with our recommendations. The district disagrees with having an unassigned fund balance in the General Fund since its practice is to commit the funds in the General Fund or to transfer the funds to the Capital Projects Fund. Below we address the district’s disagreement along with certain areas we believe warrant further comment based on Abington’s response.

#### **Recommendation 1 and 2**

Abington responded that due to the budget process starting in December for the following July 1 through June 30 fiscal year and due to the “dearth of reliable information”, the district believes it is “prudent to maintain flexibility” and apply for referendum exceptions early in the budget process since the district is not obligated to use them.

Although the budget process is one of several unknown variables, applying for referendum exceptions is an indication of insufficient funds to cover certain types of expenditures, such as, pension obligations and special education costs. Abington had more than \$38 million in available funds in the General Fund each year which went unused during our four-year audit period. Applying for \$2.6 million in referendum exceptions suggested the district had insufficient funds when it actually had \$38 million of unused funds. We believe this may be misleading to taxpayers and perhaps an unnecessary practice of applying for the referendum exceptions as a budgetary tool.

The practice of requesting referendum exceptions annually should be discontinued by Abington and passing a resolution during the preliminary budget phase to not increase taxes above the index should be further explored by Abington’s Board of Directors.

#### **Recommendation 3**

We are encouraged that Abington agreed to consider the recommendation to reflect more accurate beginning fund balance for its final budget. However, we believe the district has sufficient information mid-year to apply this to its preliminary budget as well.

#### **Recommendation 4 and 5**

We are encouraged that Abington agreed to consider these recommendations.

## **A Performance Audit**

### **School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes**

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#### **Recommendation 6**

Abington responded that it disagrees with this recommendation to consider unspent committed funds as unassigned fund balance in the General Fund. Abington indicated that the practice of considering the funds unassigned “may arbitrarily undermine the district’s ability to plan for contingencies.” While we recognize Abington reviewed its more than \$38 million each year to revise the amounts committed for future capital improvement expenditures, pension obligations, or pandemic related expenditures, we believe reducing the unassigned fund balance to zero each year as a sensible business practice leaves no funds for balancing its budget, unexpected costs, or emergency circumstances.

We also recognize that Abington is conducting a feasibility study for capital improvements needed at the district; however, the district had more than \$40 million of unspent funds when it increased taxes during FYE June 30, 2018, and it transferred \$11.5 million from the General Fund to its Capital Projects Fund during the audit period, which was \$4.6 million more than budgeted. Had the district not designated the funds as committed or transferred the funds to another Fund, Abington would have been well over the PSC threshold and not permitted to increase taxes.

#### **Recommendation 7**

Abington responded that it does not agree with this recommendation that surplus funds should be maintained in the General Fund as unassigned fund balances to lessen the future burden on taxpayers and there is no authority to require it. It also comments that the district only increased taxes once during the course of the four-year audit period. We agree there is no requirement to do so as the district responded. However, as a matter of prudent stewardship of taxpayer funds, we found that the district had ample funding in its General Fund. Although this funding was designated as committed for capital improvement expenditures, pension obligations, or pandemic related expenditures, it was sufficient to fund the operations of the district the year it increased taxes above the index.

## A Performance Audit

### School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes

#### Bethlehem Area School District

Bethlehem Area School District's (Bethlehem) revenues and expenditures ranged from \$275 million to \$311 million during the four FYE June 30, 2018, 2019, 2020, and 2021.<sup>43</sup> The following table summarizes Bethlehem's information for referendum exceptions requested by fiscal year, the funds available in its General Fund at the beginning of each fiscal year (July 1), whether taxes were raised, and whether taxes were raised above the index.

**Table #1**

FYE June 30	Did the District Request a Referendum Exception? <sup>a/</sup>	Type of Exception Requested <sup>b/</sup>	Total Amount Approved	General Funds Available July 1 <sup>c/</sup>	Taxes were Raised	Taxes Were Raised Above the Index
2018	Yes	Pension Obligations and Special Education Costs <sup>d/</sup>	\$3,359,702	\$30,483,175	Yes	No
2019	Yes	Special Education Costs	\$2,362,390	\$33,667,787	Yes	No
2020	Yes	Special Education Costs	\$ 844,619	\$39,366,308	No <sup>c/</sup>	No
2021	Yes	Special Education Costs	\$1,851,517	\$38,311,403	No <sup>c/</sup>	No

<sup>a/</sup> - Based on PDE's applicable year's Report on Referendum Exceptions, the district did or did not request a referendum exception to raise taxes above the index.  
<sup>b/</sup> - Act 1 of 2006, as amended, provides four different types of referendum exceptions based on type of expenditure costs, see the *Introduction and Background* section of this report. See Taxpayer Relief Act, 53 P.S. § 6926.101 *et seq.*  
<sup>c/</sup> - The amount of funds available to Bethlehem at the beginning of the fiscal year; for instance, for the FYE June 30, 2018, the amount available for appropriation by the Board on July 1, 2017, was \$30,483,175.<sup>44</sup>

<sup>43</sup> The range of revenues and expenditures is based on the Preliminary Budgets used to apply for the referendum exceptions.

<sup>44</sup> The table includes funds committed and/or assigned in the General Fund that are available for use if the Board so directs. Also, the available funds listed have been unspent for several years and remain available for the Board to recommit or reassign for other types of expenditures.

## A Performance Audit

### School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes

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<sup>d/</sup> - Pension obligations refer to the retirement contributions made by the school district to the Public School Employees' Retirement System (PSERS).

<sup>e/</sup> - The district did not raise taxes but there was a mandatory tax rate rebalancing between Bethlehem's two counties (Northampton County and Lehigh County).

*Sources: Produced by staff of the Department of the Auditor General based on information in the PDE's referendum reports and Bethlehem's audited financial statements for the FYE June 30, 2017, 2018, 2019, 2020, and 2021.*

Based on our audit procedures, we did not find non-compliance with law or regulations. However, we found the following issues regarding prudent stewardship of taxpayer funds:

- Bethlehem routinely requests referendum exceptions despite having sufficient funding for anticipated annual expenditures.
- Bethlehem designates its General Fund as commitments and assignments to increase taxes while retaining millions of dollars not used timely for designated purposes.

The following two sections describe these results in more detail.

#### **Bethlehem routinely requests referendum exceptions despite having sufficient funding for anticipated annual expenditures.**

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Bethlehem applied for referendum exceptions to raise taxes above the index for the FYE June 30, 2018, 2019, 2020, and 2021. Although Bethlehem raised taxes in the FYE June 30, 2018, and 2019, it did not use the approved referendum exceptions to increase taxes above the index. When questioned Bethlehem's Chief Financial Officer (CFO) explained that the district's Board routinely applies for referendum exceptions to preserve the option to increase taxes above the index until the final budget is adopted in June of each year.

Based on Act 1 of 2006, as amended, Section 333(a)(1), an additional tax rate increase above the index may be requested if needed to balance the preliminary budget.<sup>45</sup> By requesting a referendum exception, the district is indicating that the tax increase above the index is needed due to insufficient available funding. However, we found that Bethlehem had sufficient funding available to balance the budget which negated the need to apply for referendum exceptions for the FYE June 30, 2018, 2019, 2020, and 2021, for the following reasons:

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<sup>45</sup> Subsection (a)(1) of Section 333 (relating to public referendum requirements for increasing certain taxes) of the Taxpayer Relief Act. Please note at Subsection (a)(2) of the act states as follows: "(2) This section shall apply to each board of school directors beginning with any proposed tax increase that takes effect in the 2007-2008 fiscal year and each fiscal year thereafter." See 53 P.S. § 6926.333(a)(1)-(2).

## A Performance Audit

### School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes

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- Bethlehem had an average of \$15.7 million in its estimated ending unassigned fund balance listed on the preliminary budgets for each of the FYE June 30, 2018, 2019, 2020, and 2021. Therefore, Bethlehem did not need to apply for referendum exceptions and propose an increase in taxes above the index because the funds it had were sufficient to balance its preliminary budgets.<sup>46</sup>
- Bethlehem had sufficient funds assigned specifically for the type of expenditures used for the referendum exception it sought. For example, the Board passed a resolution each year to assign funds for pension obligations. Therefore, Bethlehem did not need to apply for the referendum exception for pension costs in the FYE June 30, 2018, because the assignment of \$3 million as of July 1, 2017, was more than the requested pension amount of \$677,619 of the total \$3,359,702 listed in Table 1 above.
- Bethlehem assigned \$4 million to \$5.4 million each year for balancing the budget. Therefore, Bethlehem did not need to apply for the referendum exceptions because it had more than adequate funding to meet the anticipated increases for both pension obligations and special education costs as listed in Table #1 above.
- The CFO acknowledged that the two assignments for pension obligations and balancing the budget were not spent and therefore, they were unnecessary. Therefore, Bethlehem did not need to apply for referendum exceptions since both assignments remained unspent as of the FYE June 30, 2021.<sup>47</sup>

Our results demonstrate that Bethlehem had sufficient funding and did not have to apply for referendum exceptions to meet its pension obligations and/or special education costs during the FYE June 30, 2018, 2019, 2020, and 2021. Additionally, the district presented preliminary budgets to the taxpayers and PDE that suggest the district had insufficient funds to balance its budget while it had millions of dollars available for anticipated expenditures. The process of applying for unnecessary referendum exceptions wasted time and resources for the district and PDE.

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<sup>46</sup> While this calls into question the reason PDE approved the referendum exceptions, this is not an audit of PDE's procedures and processes.

<sup>47</sup> The amount assigned for balancing the budget changed each year but remained unspent because Bethlehem experienced operating surpluses each fiscal year audited.

## A Performance Audit

### School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes

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#### **Bethlehem designates its General Fund as commitments and assignments to increase taxes while retaining millions of dollars not used timely for designated purposes.**

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General Fund balances can be designated as committed, assigned, or unassigned.<sup>48</sup> The PSC prohibits districts from increasing taxes if its unassigned fund balance in the General Fund is greater than 8% of the next fiscal year’s budgeted expenditures.<sup>49</sup> By reducing the unassigned fund balance every year to below 8%, Bethlehem can increase taxes even though it has sufficient funds for anticipated expenditures in its General Fund.

During our audit period, Bethlehem committed and assigned its available funds in the General Fund to capital improvements, pension obligations, and funding for budget deficits based on resolutions approved by the Board. The following table illustrates Bethlehem’s General Fund balances:

**Table #2**

FYE June 30				
General Fund - Fund Balances	2018	2019	2020	2021
Committed:				
Capital improvements	\$ 7,000,000	\$ 12,000,000	\$ 12,000,000	\$ 16,000,000
Assigned:				
Pension obligations	\$ 4,000,000	\$ 4,000,000	\$ 4,000,000	\$ 4,000,000
Funding to balance the budget	\$ 5,000,000	\$ 4,813,488	\$ 4,053,155	\$ 4,496,478
Unassigned	\$ 17,667,787	\$ 18,552,820	\$ 18,258,248	\$ 21,645,375
<b>Total Committed, Assigned, and Unassigned Fund Balance</b>	<b>\$ 33,667,787</b>	<b>\$ 39,366,308</b>	<b>\$ 38,311,403</b>	<b>\$ 46,141,853</b>

*Source: Produced by staff of the Department of the Auditor General based on information in Bethlehem’s audited financial statements for the FYE June 30, 2018, 2019, 2020, and 2021.*

Based on our audit procedures, we found:

- On an annual basis, prior to the end of the fiscal year in June, Bethlehem’s Board formally approved resolutions to commit funds for capital improvements with the amounts to be determined by the district’s administration in concert with the audited

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<sup>48</sup> The General Fund classifications are described in more detail in the *Introduction and Background* section of this report.

<sup>49</sup> 24 P.S. § 6-688(a).

## A Performance Audit

### School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes

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financial statements. Prior to the completion of the financial statements, the Board approved the amounts to be committed and/or assigned in the General Fund. As a result, Bethlehem complied with the applicable PDE requirements for commitments and assignments.<sup>50</sup>

- Bethlehem’s policy states the General Fund’s unassigned fund balance is to be maintained between five percent (5%) and eight percent (8%) of budgeted expenditures. We found that the district complied with this policy and maintained its unassigned fund balance between 5% and 8% for each of the four years audited. However, this policy ensures the district can raise taxes every year while holding millions of dollars of funds that are unspent in the General Fund’s commitments and assignments. Each year, Bethlehem’s Board approves commitments and assignments to reduce the unassigned General Fund balance within the range established by the policy. For instance, the unassigned fund balance was reduced by \$16 million to \$17.67 million and was only 6.6% of budgeted expenditures, allowing the Board to raise taxes for the FYE June 30, 2018.<sup>51</sup>
- Bethlehem did not use the funds designated as assigned for its pension obligations or for balancing the budget in any of the four years audited because the revenues were adequate each year to cover the expenditures.
- Bethlehem did not use funds committed for capital improvements and the Board increased the commitment to \$16 million during the four-year audit period. Additionally, Bethlehem had sufficient surplus funds in the General Fund to transfer \$9.75 million to its Capital Projects Fund and \$5 million to its Capital Reserve Fund during the four-year audit period. These amounts significantly exceeded the planned transfers of only \$148,000 listed in the final adopted budgets, as illustrated in the table below.

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<sup>50</sup> PDE Accounting Bulletin #2010-01, effective fiscal year 2010-11, and thereafter, requires commitment classifications for specific purposes be the result of a formal action by the school’s highest level of authority, which in this case is the Board. The PDE bulletin provides that the Board’s approval to commit the funds be before the end of the fiscal year and the amounts can be determined after the fiscal year. Additionally, assignments of funds do not require formal action by the Board.

<sup>51</sup> The district also raised taxes below the index for the FYE June 30, 2019, while having more than \$33 million in its General Fund.

## A Performance Audit

### School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes

Table #3

Budget Transfers Versus Actual Transfers					
	FYE June 30				
	2018	2019	2020	2021	Total
Budget	\$ -	\$ -	\$ 148,000	\$ -	\$ 148,000
Actual	\$2,750,000	\$4,000,000	\$5,000,000	\$3,000,000	\$14,750,000

*Source: Produced by staff of the Department of the Auditor General based on information in Bethlehem's final adopted budgets and audited financial statements for the FYE June 30, 2018, 2019, 2020, and 2021.*

While we recognize that the district needs capital improvement funds, it should be transparent with its budgets and increase taxes for capital projects through a referendum vote.

Based on our audit results, had the district retained the more than \$8 million of unspent assignments and the more than \$14 million of unbudgeted transfers as unassigned fund balance, it would have exceeded the PSC threshold and been unable to increase taxes until the funds were spent for general operations. However, Bethlehem's policy allows it to increase taxes while retaining millions of dollars of unspent funds for several years. The Board should reconsider its policies and practices to help lessen the tax burden on its taxpayers.

### Recommendations for Bethlehem Area School District

While we did not find non-compliance with law or regulations, we offer the following recommendations to Bethlehem Area School District to improve stewardship of taxpayer funds:

1. Refrain from applying for referendum exceptions unless the district has utilized unspent funds in the General Fund's commitments and/or assignments. Additionally, refrain from applying for referendum exceptions if funds have been set aside specifically for the type of expenditure that is being requested prior to increasing taxes above the index.
2. Pass a resolution during the preliminary budget phase to not increase taxes above the district's index when budgetary needs can be met with existing available funds in the General Fund.
3. As a best business practice, revise the General Fund policy to eliminate the restriction of maintaining excess surplus funds in the unassigned fund balance.

## **A Performance Audit**

### **School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes**

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4. If the district has designations for funds that are not used in the next fiscal year as intended, the Board should repurpose the funds or the funds should be considered as unassigned fund balance in the General Fund.
5. Reconsider the practice of transferring surplus funds to the Capital Projects Fund and Capital Reserve Fund unless the funds were specifically budgeted for and disclosed to the taxpayers. Excess surplus funds should be maintained in the General Fund as unassigned fund balances for future operation costs to lessen the burden on taxpayers. This will ensure tax increases are appropriate and needed.

## A Performance Audit

### School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes

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## Bethlehem Area School District's Response

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**BETHLEHEM**  
AREA SCHOOL DISTRICT

**BUSINESS OFFICE**  
**EDUCATION CENTER**  
1516 Sycamore Street  
Bethlehem, PA 18017-6099  
610-861-0500 Extension 60201

November 18, 2022

Peggy L. Morningstar, CPA, CFE, Esquire  
Senior Audit Manager  
Bureau of Performance Audits  
Department of the Auditor General  
Finance Building  
Harrisburg, PA 17120

Sent via email: [PMorningstar@paauditor.gov](mailto:PMorningstar@paauditor.gov)

Dear Ms. Morningstar:

Duly elected school directors own the burden of passing a balanced budget each year. School Directors make the hard decision to balance educational needs against the community's ability to pay via property taxes. This decision making is made more difficult because the Bethlehem Area School District (BASD) has been one of the 100 most underfunded districts by the state during the years of this audit. Estimates typically put the underfunding dollar amount at over \$20 million PER year.

The Commonwealth's underfunding of BASD combined with the mysteries of the state budgeting process place BASD in a difficult position. While the state budget is not passed until the end of June of the calendar year, School Directors must decide whether or not to apply for exceptions as early as December of that same calendar year. District level budgetary questions are unanswered only half way through the current budget year when the decision whether or not to apply for exceptions must be made. Those district level questions are greatly magnified by having no way to know what state level funding might look like. Add into this uncertain budget mix the state legislature's propensity to advance policies that divert public dollars from public schools to private/parochial schools via voucher-like programs while blocking reasonable policies to address overpayment to charter schools for special education tuition and cyber charter schools - and you have a fiscal environment that creates real uncertainties for large, complex districts like the Bethlehem Area School District

Under the above circumstances, it would be irresponsible for the School Directors to not keep open all budget options at such an early date in the budget process. The Auditor General's office may hold a different opinion from that of the duly elected School Directors, but it is the school board's decision to make. We note, as the report notes, **that based on your audit procedures, BASD was in compliance with law or regulations.** Additionally, in two of the four years audited, BASD did not raise taxes at all. In the other two years, BASD raised taxes below the Index. This demonstrates the district's conservative approach to budgeting and keen eye on minimizing the tax burden on our community.

## A Performance Audit

### School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes

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In the 2021-2022 and 2022-2023 budget years as state funding to BASD increased significantly, the School Directors voted not to apply for any exceptions. We also do not plan to apply for exceptions for the 2023-2024 budget thanks to increased state funding and prudent district budgeting.

With the above narrative providing context, the District's response to audit recommendations can be found below.

1. The District recommends that language on Page 9 (top of page) be changed from "Based on our audit procedures, we did not find non-compliance with law or regulations" to "Based on our audit procedures, Bethlehem Area School District was in compliance with law or regulations for the years audited." Stating the findings in the affirmative rather than the confusing "we did not find non-compliance" helps to clarify for the reader.
2. Similarly, on Page 13 replace "While we did not find non-compliance with law or regulations" with "While the audit found the District was in compliance with law or regulations...."
3. As to Recommendation #1 - The District will take the Auditor General's recommendation into consideration while weighing the many unknown variables regarding revenues and expenses and while continuing to comply with applicable law and regulations.
4. As to Recommendation #2 - The District will continue to comply with applicable law and regulations. Please note that the District has not raised taxes above the Act 1 Index during the period under examination.
5. As to Recommendation #3 - The District will continue to comply with applicable law and regulations. "Best practice" for financial policies and practices varies depending on the authority or agency cited.
6. As to Recommendation #4 - The District will implement this recommendation from the Audit Report. Prior to Act 1 of 2006, school districts mainly focused on one budget year since real estate taxes could be raised to balance any single year's budget. Passage of Act 1 negated single year budgeting because of the cap. In today's financial world, one rationale for commitment or assignment of fund balance is that it assists with long-term financial planning and that practice benefits taxpayers and students, both current and future. It is the responsibility of administration and the Board of School Directors to develop, not only a current budget, but a multi-year plan in order to educate the students of BASD, maintain the physical plant of 22 school buildings, honor employee contracts, satisfy debt obligations and make charter school payments-without exceeding the Act 1 Index and exceptions. This plan or budget, is developed based on existing facts (enrollment, employment contracts and related benefits, debt, etc.) AND includes assumptions about FUTURE educational programing and economic changes.

Recommendation 4, focused on one fiscal year, is very short-sighted when you consider the number of physical structures that need to be maintained and the long-term debt commitments the District has. While it is your opinion that fund balance is a public savings account, this is not the opinion of Moody's or Standard & Poor's. A favorable fund balance and plan for capital expenditures helps a district achieve a better credit rating which usually results in a lower interest rate on borrowing or the refunding of existing debt. A lower interest rate translates into savings to tax payers for years to come.

## A Performance Audit

### School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes

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During 2020 and 2021, the District received millions of dollars of federal aid which had to be spent before local funds and that added to BASD's fund balance. Unanticipated federal funds have probably ended but the need to repair and renovate our buildings will not. To that end, public meetings are scheduled at the end of this month to begin planning for significant renovations at three (3) of our elementary schools. The capital reserve commitment may help reduce borrowing for those projects and potentially save taxpayers hundreds of thousands of dollars because of the significant increase in interest rates for debt.

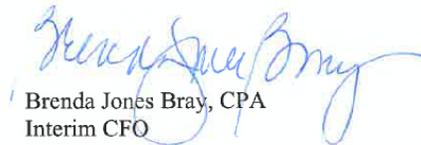
7. As to Recommendation #5 - The District will continue to comply with applicable law and regulations. The District recognizes the need to be clear about the purpose of funds in the Capital Projects fund such as for anticipated future building renovation costs.

Regarding transparency, each year, the CFO gives budget presentations at six (6) or more school board and committee meetings. (Ironically, if a district opts to pass the resolution not to exceed the Act 1 Index, as is suggested in this review, fewer public budget discussions occur than a regular budget year.) All BASD presentations can be viewed and reviewed in BoardDocs or on YouTube; both accessible through the District's website. There is also a page on the website dedicated to District Budget. Each year's audit, since 2008, can also be found on the website. The independent auditors attend a Finance Committee each year to review the massive audit report they issue. As you know, there is also exhaustive information about all Pennsylvania school districts on PDE's website. In my opinion, there is more than adequate public disclosure and transparency about the finances of BASD.

Respectfully submitted,



Joseph J. Roy, Ed.D.  
Superintendent of Schools



Brenda Jones Bray, CPA  
Interim CFO



## A Performance Audit

### School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes

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#### **Auditor’s Conclusion to Bethlehem Area School District’s Response**

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The Bethlehem Area School District (Bethlehem) emphasizes its compliance with laws and regulations; the Board of Directors (Board) role to decide to apply for referendum exceptions and raise taxes; and its conservative approach to budgeting. The district generally agreed to consider our recommendations. Below we address the district’s assertions we believe warrant further comment based on Bethlehem’s response.

#### **Recommendation 1**

We are encouraged that Bethlehem agreed to consider the recommendation.

Although the budget process has several unknown variables, applying for referendum exceptions suggests there were insufficient funds to cover certain types of expenditures, such as, pension obligations and special education costs. Bethlehem had more than \$30 million in available funds in the General Fund each year which went unused during our four-year audit period. Applying for \$8.4 million in referendum exceptions implied the district had insufficient funds when it actually had \$30 million of unused funds. We believe this may be misleading to taxpayers and perhaps an unnecessary practice of applying for the referendum exceptions as a budgetary tool.

#### **Recommendation 2**

We are encouraged that Bethlehem agreed to consider the recommendation.

#### **Recommendation 3**

Bethlehem responded that it will comply with applicable law and regulations and that best practices for policies and procedures varies depending on the authority or agency cited. This statement does not address the fact that Bethlehem’s policy and practice of maintaining the General Fund unassigned fund balance between five percent (5%) and eight percent (8%) is written to comply with the PSC to remain below 8% to allow for increasing taxes *every year* while holding millions of dollars of unspent funds in the General Fund as commitments and assignments.

By transferring funds and/or designating funds for potential future use, the district was able to raise taxes both FYE June 30, 2018, and 2019, when the tax revenue was unneeded. The increased taxes increased the General Fund balance to more than \$46 million by FYE June 30, 2021, and provided an additional \$14.75 million to transfer to the Capital Projects Fund and Capital Reserve Fund during our four-year audit period. The \$14.75 million was \$14.6 million more than budgeted. Therefore, the district’s policy is not permitting the excess funds to remain

## **A Performance Audit**

### **School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes**

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as unassigned fund balance in the General Fund to alleviate future tax increases for potential operating shortfalls in the budget.

#### **Recommendation 4**

We are encouraged that Bethlehem agreed to consider the recommendation. Based on the district's multi-year plan to maintain 22 district buildings, honor employee contracts, satisfy debt obligations, and make charter school payments, we still believe the General Fund's commitments and assignments that have not been used for multiple years should be reconsidered for current fiscal operating purposes before raising taxes.

Additionally, the district asserted that having a favorable fund balance and a plan for capital expenditures provides a better credit rating which results in lower interest rates and ultimately savings to the taxpayers in later years. However, the district appears to have taken this to an unjustifiable level by having \$46 million in General Fund balance as of FYE June 30, 2021. Although the district indicates this fund balance is due to an increase in federal aid during FYE June 30, 2020, and 2021, we question this assertion since the audited financial statements indicate federal funding decreased \$2.3 million in FYE June 30, 2020, and then increased only \$4 million for the FYE June 30, 2021.

#### **Recommendation 5**

Bethlehem did not specifically agree or disagree with the recommendation but acknowledged the need to be compliant with law and regulations and the need to be "clear" regarding the purpose of funds in the Capital Projects Fund. Although the district indicated the many ways it is being transparent with budget presentations, committee meetings, and website materials, Bethlehem did not address the fact that it transferred \$14.6 million more than budgeted to the Capital Projects and Capital Reserve Funds. While we recognize that the district needs capital improvement funds, budgeting to transfer \$148,000 but then actually transferring \$14.75 million gives the appearance of non-transparency.

## A Performance Audit

### School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes

#### Canon-McMillan School District

Canon-McMillan School District’s (Canon-McMillan) revenues and expenditures ranged from \$82 million to \$92 million during the four FYE June 30, 2018, 2019, 2020, and 2021.<sup>52</sup> The following table summarizes Canon-McMillan’s information for referendum exceptions requested by fiscal year, the funds available in its General Fund at the beginning of each fiscal year (July 1), whether taxes were raised, and whether taxes were raised above the index.

**Table #1**

FYE June 30	Did the District Request a Referendum Exception? <sup>a/</sup>	Type of Exception Requested <sup>b/</sup>	Total Amount Approved	General Funds Available July 1 <sup>c/</sup>	Taxes were Raised	Taxes Were Raised Above the Index
2018	No	N/A	N/A	\$2,880,628	<b>Yes</b>	No
2019	No	N/A	N/A	\$4,471,432	<b>Yes</b>	No
2020	Yes	Pension Obligations and Special Education Costs <sup>d/</sup>	\$190,294	\$6,144,419	<b>Yes</b>	No
2021	No	N/A	N/A	\$9,441,843	<b>Yes</b>	No

<sup>a/</sup> - Based on PDE’s applicable year’s Report on Referendum Exceptions, the district did or did not request a referendum exception to raise taxes above the index.

<sup>b/</sup> - Act 1 of 2006, as amended, provides four different types of referendum exceptions based on type of expenditure costs, see the *Introduction and Background* section of this report. See Taxpayer Relief Act, 53 P.S. § 6926.101 *et seq.*

<sup>c/</sup> - The amount of funds available to Canon-McMillan at the beginning of the fiscal year; for instance, for the FYE June 30, 2018, the amount available for appropriation by the Board on July 1, 2017, was \$2,880,628.<sup>53</sup>

<sup>d/</sup> - Pension obligations refer to the retirement contributions made by the school district to the Public School Employees’ Retirement System (PSERS).

N/A – Not applicable

Sources: Produced by staff of the Department of the Auditor General based on information in the PDE’s referendum reports and Canon-McMillan’s audited financial statements for the FYE June 30, 2017, 2018, 2019, 2020, and 2021.

<sup>52</sup> The range of revenues and expenditures is based on the final adopted General Fund Budgets.

<sup>53</sup> The table includes funds committed and/or assigned in the General Fund that are available for use if the Board so directs. Also, the available funds listed have been unspent for several years and remain available for the Board to recommit or reassign for other types of expenditures.

## A Performance Audit

### School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes

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Based on our audit procedures, we did not find non-compliance with law or regulations. We did, however, find the following issues regarding prudent stewardship of taxpayer funds:

- Canon-McMillan applied for referendum exceptions despite having sufficient funding for anticipated annual expenditures.
- Canon-McMillan increased taxes despite having unspent committed funds and while transferring millions of dollars each year.

The following two sections describe these results in more detail.

#### **Canon-McMillan applied for referendum exceptions despite having sufficient funding for anticipated annual expenditures.**

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Canon-McMillan applied for referendum exceptions to raise taxes above the index for the FYE June 30, 2020. Although the district increased taxes each of the four FYE June 30, 2018, 2019, 2020, and 2021, it did not use the approved referendum exceptions to increase taxes above the index. When questioned about this, Canon-McMillan's Director of Business & Finance (Director) explained that the district sought the referendum exceptions for the FYE June 30, 2020, because the district believed its funding could be decreased, employees were asked to take a wage freeze, and renewal of the teachers' contract was in negotiations.

Based on Act 1 of 2006, as amended, Section 333(a)(1), an additional tax rate increase above the index may be requested if needed to balance the preliminary budget.<sup>54</sup> By requesting a referendum exception, the district is indicating that the tax increase above the index is needed due to insufficient available funding. However, we found that Canon-McMillan had sufficient funding available to balance their budget which negated the need to apply for referendum exceptions for the FYE June 30, 2020, for the following reasons:

- Canon-McMillan had a projected \$2.97 million beginning unassigned fund balance and \$4.2 million ending unassigned fund balance in its preliminary budget for the FYE June 30, 2020. Therefore, the proposed tax increase was increasing the unassigned fund balance by more than \$1 million and Canon-McMillan did not need to apply for referendum exceptions because the funds it had were sufficient for the requested \$190,294 referendum exceptions.

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<sup>54</sup> Subsection (a)(1) of Section 333 (relating to public referendum requirements for increasing certain taxes) of the Taxpayer Relief Act. Please note at Subsection (a)(2) of the act states as follows: "(2) This section shall apply to each board of school directors beginning with any proposed tax increase that takes effect in the 2007-2008 fiscal year and each fiscal year thereafter." See 53 P.S. § 6926.333(a)(1)-(2).

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### School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes

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- Canon-McMillan had sufficient funds committed specifically for the type of expenditure used for the referendum exception sought. For example, the Board had committed \$1.5 million in October 2012 for pension obligations. Therefore, Canon-McMillan did not need to apply for a referendum exception for pension costs totaling \$11,864 of the \$190,294 listed in Table #1 above. The Director acknowledged that the commitment of \$1.5 million was not spent or needed during the FYE June 30, 2020.
- Canon-McMillan’s preliminary budget for the FYE June 30, 2020, projected an operating surplus of \$1.27 million, resulting in an increase to the unassigned fund balance to \$4.2 million.<sup>55</sup> Therefore, Canon-McMillan did not need to apply for the referendum exceptions because it had more than adequate funding to meet its pension obligations and special education costs exceptions listed in Table #1 above.

Our results demonstrate that Canon-McMillan had sufficient funding and did not have to apply for referendum exceptions to meet its pension obligations and/or special education costs during the FYE June 30, 2020. Additionally, the district presented preliminary budgets to the taxpayers and PDE that suggested that the district had insufficient funds to balance its budget while it had millions of dollars available for anticipated expenditures. The process of applying for unnecessary referendum exceptions for the FYE June 30, 2020, wasted time and resources for the district and PDE.

### **Canon-McMillan increased taxes despite having unused committed funds and while transferring millions of dollars each year.**

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General Fund balances can be designated as committed, assigned, or unassigned.<sup>56</sup> The PSC prohibits districts from increasing taxes if its unassigned fund balance in the General Fund is greater than 8% of the next fiscal year’s budgeted expenditures.<sup>57</sup> By reducing the unassigned fund balance every year to below 8%, Canon-McMillan can and did increase taxes at or below the index even though it had sufficient funds for anticipated expenditures in its General Fund each of the FYE June 30, 2018, 2019, 2020, and 2021.

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<sup>55</sup> While this calls into question the reason PDE approved the referendum exceptions, this is not an audit of PDE’s procedures and processes.

<sup>56</sup> The General Fund classifications are described in more detail in the *Introduction and Background* section of this report.

<sup>57</sup> 24 P.S. § 6-688(a).

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### School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes

During our audit period, Canon-McMillan had committed and assigned funds in the General Fund for pension obligations, athletics, and potential budget deficits. The following table illustrates Canon-McMillan’s General Fund balances:

**Table #2**

General Fund - Fund Balances	FYE June 30			
	2018	2019	2020	2021
Committed:				
Pension obligations <sup>a/</sup>	\$ 1,500,000	\$ 1,500,000	\$ 1,500,000	\$ 1,500,000
Assigned:				
Athletics	\$ 153,758	\$ 175,101	\$ 209,273	\$ 189,741
Budget deficit	\$ 880	\$ -	\$ 675,655 <sup>b/</sup>	\$ -
Unassigned	\$ 2,970,552	\$ 4,644,419	\$ 7,266,181	\$ 7,609,360
<b>Total Committed, Assigned, and Unassigned Fund Balance</b>	<b>\$ 4,625,190</b>	<b>\$ 6,319,520</b>	<b>\$ 9,651,109</b>	<b>\$ 9,299,101</b>

<sup>a/</sup> - The committed pension obligation of \$1.5 million was approved by the Board October 8, 2012, and remained unspent through June 30, 2021.  
<sup>b/</sup> - The FYE June 30, 2020 assignment for budget deficit was to provide funds for operations in FYE June 30, 2021, if needed.

Source: Produced by staff of the Department of the Auditor General based on information in Canon-McMillan audited financial statements for the FYE June 30, 2018, 2019, 2020, and 2021.

Based on our audit procedures, we found:

- Canon-McMillan approved a resolution on October 8, 2012, to commit \$1.5 million for pension obligations. The Director indicated that these funds were committed due to the anticipated increases in pension obligations. The Board has not taken formal action to remove the commitment and the funds therefore remain unspent in the General Fund. Although unspent for a decade, Canon-McMillan complied with the applicable PDE requirement for the initial approval of the commitment.<sup>58</sup>
- Canon-McMillan’s policy states the General Fund unassigned fund balance is to be maintained between two percent (2%) and eight percent (8%) of budgeted expenditures. If it falls below one percent (1%), the Board is to pursue efforts to

<sup>58</sup> PDE Accounting Bulletin #2010-01, effective fiscal year 2010-11, and thereafter, requires commitment classifications for specific purposes be the result of a formal action by the school’s highest level of authority, which in this case is the Board. The PDE bulletin provides that the Board’s approval to commit the funds be before the end of the fiscal year and the amounts can be determined after the fiscal year. Additionally, assignments of funds do not require formal action by the Board.

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increase revenues and/or decrease expenditures until 1% is attained. We found Canon-McMillan partially complied because it maintained its unassigned fund balance between 2% and 8% each of the four years audited. However, the district raised taxes all four fiscal years while having more than 1% in its unassigned fund balance. The Director stated the intent of the policy is to avoid negative fund balance and not to set limitations on taxation.

- Although Canon-McMillan’s General Fund balances appear minimal as listed in the Table #2 above, and the adopted budgets only listed planned interfund transfers at \$0 to \$150,000 each fiscal year, we found that the district actually transferred \$20.2 million of operating surpluses from the General Fund to the Capital Projects Fund during the four-year period, as illustrated below.<sup>59</sup>

**Table #3**

Budgeted Transfers Versus Actual Transfers					
	FYE June 30				
	2018	2019	2020	2021	Total
Budget	\$ 139,650	\$ 150,000	\$ 150,000	\$ -	\$ 439,650
Actual	\$8,551,565	\$1,000,000	\$1,909,153	\$8,742,573	\$20,203,291

*Source: Produced by staff of the Department of the Auditor General based on information in Canon-McMillan’s final adopted budgets and audited financial statements for the FYE June 30, 2018, 2019, 2020, and 2021.*

Had the district retained the \$8.5 million it transferred in FYE 2018 in its unassigned General Fund balance, it would have exceeded the PSC threshold and would not have been allowed to raise taxes the subsequent three fiscal years without using the funds for general operations or receiving authorization from local voters. Posing a referendum question to taxpayers would provide greater transparency to the taxpayers if the taxes raised are for capital project purposes rather than general operations.

Unlike other districts that hold millions of dollars in commitments and assignments in the General Fund, we found that Canon-McMillan transfers its operating surpluses to the Capital Projects Fund. While this approach may reduce borrowing to improve district capital assets, raising taxes every year places an undue burden on the district’s taxpayers and appears less transparent than using a voter referendum to authorize an increase in taxes for specific capital

<sup>59</sup> Canon-McMillan’s Capital Projects Fund includes a Capital Reserve Fund with a balance of \$11,771,006 and a Construction Fund with a balance of \$77,501,585 as of FYE June 30, 2021, used for the district’s long range capital improvement plan.

## **A Performance Audit**

### **School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes**

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projects. Further, this excess burden was compounded in future years because the Board did not reverse the unneeded tax increases imposed.

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#### **Recommendations for Canon-McMillan School District**

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While we did not find non-compliance with law or regulations, we offer the following recommendations to Canon-McMillan School District to improve stewardship of taxpayer funds:

1. Refrain from applying for referendum exceptions unless the district has utilized unspent funds in the General Fund's commitments and/or assignments. Additionally, refrain from applying for referendum exceptions if funds have been set aside specifically for the type of expenditure that is being requested prior to increasing taxes above the index.
2. Pass a resolution during the preliminary budget phase to not increase taxes above the school district's index when budgetary needs can be met with existing available funds in the General Fund.
3. As a best business practice, revise the General Fund policy to eliminate the restriction of maintaining excess surplus funds in the unassigned fund balance.
4. If the district has designations for funds that are not used in the next fiscal year as intended, the Board should repurpose the funds or the funds should be considered as unassigned fund balance in the General Fund.
5. Reconsider the practice of transferring surplus funds to the Capital Projects Fund unless the funds were specifically budgeted for and disclosed to the taxpayers. Excess surplus funds should be maintained in the General Fund as unassigned fund balances for future operation costs to lessen the burden on taxpayers. This will ensure tax increases are appropriate and needed.

## A Performance Audit

### School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes

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## Canon-McMillan School District's Response

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SCHOOL DISTRICT

ONE NORTH JEFFERSON AVENUE  
CANONSBURG, PENNSYLVANIA 15317  
(724) 746-2940  
FAX (724) 746-9184

COMMITMENT TO EXCELLENCE

November 18, 2022

MICHAEL W. DANIELS, M.S.  
Superintendent of Schools

SCOTT W. CHAMBERS, M.Ed.  
Assistant Superintendent

JONI MANSMANN, M.Ed.  
Director of Business and Finance

TIMOTHY J. McCULLOUGH, M.S.  
Director of Human Resources

GRACE M. LANI, M.P.M.  
Director of Curriculum and Instruction

Dear Mr. Scott D. King,

I am writing to provide a response to the draft Auditor General's Report that was sent to me on Thursday, November 10<sup>th</sup>. First, I want to thank you and your team for meeting with Ms. Mansmann, our Solicitor Trish Andrews and me last Thursday for our exit interview. Further, we appreciate you providing an opportunity for the District to submit a rebuttal, which you explained will be included, verbatim, with the Auditor General's final report.

As we discussed in our exit interview, in the letter we received dated November 4, 2022 from you, you stated that the draft audit procedures and results pertained to the evaluation of our school district's "compliance with laws and regulations pertaining to fund balances." Despite acknowledging that the Canon-McMillan School District was fully in compliance with all laws and regulations, your report continues to contain inaccurate and misleading information and statements regarding the district's budgeting process that we requested be changed in your report.

Unfortunately, despite this meeting and the changes that were made as a result thereof, we continue to believe that core elements from the overall financial landscape of the Canon-McMillan School District, while provided to the Auditor General on multiple inquiry responses, were completely absent of any mention in the report provided to us. I will work through the draft report to provide you with area(s) of concern.

This is the first area of factual concern that was misrepresented in the draft report. On page 1, it is stated the audit objectives:

*First Objective: To determine whether each of the selected districts appropriately used the referendum exception method to raise local school property taxes.*

At both our exit conference on November 9<sup>th</sup> as well as in the exit interview conducted with our Director of Finance on June 23<sup>rd</sup> and again in correspondence on October 3, 2022, Ms. Morningstar reported that the district followed the referendum process as prescribed to school districts by the legislature. This is the one and only instance where the Canon-McMillan School District applied for exceptions since the inception of Act 1. As is also written in the report, the exceptions were not sought or utilized, only applied for, **thus this should have been out of the scope of the first objective.** *The district's ability to raise taxes to the index is within their purview and is not in violation of any law or regulation pertaining to the District's fund balance or otherwise.*

*Second Objective: to determine if each district ensured that fund balances were properly designated and used for intended purposes.*

The Mission of the Canon-McMillan School District, in partnership with the community, is to invest in our greatest resource, our students. We strive to teach, challenge and support all students to prepare them for college and careers with the information and skills necessary to compete, achieve and serve as leaders in a global economy as ethical and responsible citizens.  
We are an equal rights and opportunity school district.

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### School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes

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The School District's Director of Finance demonstrated that this objective was met through board meetings, motions, resolutions and other data and documents submitted to the Auditor General's office throughout this audit that began in March of 2022. Ms. Morningstar herself also provided that, in terms of fund balance, **the district was in compliance**. An excerpt from October 3<sup>rd</sup> correspondence from Ms. Morningstar is below.

*We confirmed compliance with the Public-School Code and the School District's General Fund Policy regarding the estimated unassigned ending fund balance as a percentage of estimated expenditures. Your district's unassigned fund balance met the Public-School Code (PSC) threshold of less than 8% of estimated expenditures for all 4 fiscal years reviewed (FYE 2018, 2019, 2020, and 2021). However, your General Fund policy indicates a threshold of less than 1% to raise taxes/revenue. We noted that none of the 4 years had an unassigned fund balance of less than 1% on the final adopted budget. Please provide an explanation by close of business October 6, 2022, of why the district increased taxes FYE 2018, 2019, 2020, and 2021 while having more than the 1% threshold in unassigned fund balance as a percentage of budgeted expenditures.*

The next area of factual concern is from page 2 of the Auditor General's report. The Canon-McMillan School District has been working through a much needed long range capital improvement plan that has been shared publically and with the Auditor General multiple times and in multiple methods of communication. **It is grossly misleading that the Canon-McMillan School District has a significant contribution to the \$340 million in fund balance of the 12 school districts selected for this performance audit.** See Auditor General's letter dated 11/10/22, page 4. This page details how the districts were selected.

*The other seven districts* were selected because each had fiscal years not audited by the Department of the Auditor General since June 30, 2017, **each had a total balance for all Fund types greater than \$60 million as of the FYE June 30, 2020 ....**

**This selection criteria is flawed and was communicated in our exit conference on November 9, 2022. The Canon-McMillan School District should not be included in this audit by way of the scope and methodology set forth by the Auditor General on Page 4. The Auditor General included in this total fund amount, construction (bond) proceeds. These cannot by law be used for any other expenditure or purpose other than what is stated in the legal binding bond document as the "use of funds". Thus the fund balance of the Canon-McMillan School District is nowhere near the \$60 Million threshold.**

**It is also insinuated but also inaccurately reported that the Canon-McMillan School District did not adopt budgets within the Pennsylvania Public School Code requirements. The Canon-McMillan School District did meet those requirements. Thus, it should be stated here as perhaps other districts did not.**

Page 3 of the November 10<sup>th</sup> letter received by me includes a section on the classification of the General Fund Balance. While the district is in agreement with the designations set forth, what is missing is information regarding the School Board of Director's Policy #620 – Fund Balance. The District's policy goes above what is required by law. Although this policy and detailed information was provided multiple times, this section is absent of any of that information. The pattern of missing information is concerning and a disappointment as it should be the purpose of the Auditor General's office to provide a comprehensive audit of financial information. Instead it seems as is noted in footnote #16 on page 4, that the Auditor General's real issue is with PDE and the current legislation.

Another area of factual concern is on Page 6 of the Auditor's General 11/10 draft report. What is outlined is what was required for Objective #1 and the district's response to the Auditor General's Office.

## A Performance Audit

### School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes

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- Determining whether the respective Board of Directors (Board) approved resolutions to not increase taxes above the index or approved the preliminary budget used to request referendum exceptions. **Documentation submitted to the Auditor General's Office confirms the Canon-McMillan School District met this requirement.**
- Verifying the Pennsylvania Department of Education (PDE) approved the referendum exception(s) and validation that the school district tax increases complied with PDE's approvals. **Documentation submitted to the Auditor General's office confirms the Canon- McMillan School District met this requirement.**
- Evaluating whether the school district's anticipated revenues and expenses warranted a tax raise above the index. **Confirmed. The Canon-McMillan School District upon further refinement of the preliminary budget, did not utilize their ability to raise taxes above the allowable tax index.**
- Assessing whether the school district's Unrestricted General Fund Balance was sufficient to avoid asking PDE for a referendum exceptions. **Confirmed. The Canon-McMillan School District upon further refinement of the budget, did not require PDE referendum exceptions or a tax increase above the allowable tax index. It should be noted that there is no law or regulation that prohibits a school district from asking PDE for a referendum exception based on the District's fund balance.**

**Again, it is the District's assertion that based on the Auditor General's selection criteria, the Canon-McMillan School District did not meet the requirements to be included in this audit.**

Continuing on Page 6 and onto page 7 of the Auditor General Draft Report, it is outlined what was required for Objective #2 and the district's provided response to the Auditor General's Office.

- Verifying the Board approved appropriate resolutions to designate General Funds as commitment and assignments. **This was confirmed through various verbal and written responses as well as information publicly available to the Auditor General's office and the public. The Canon-McMillan School District met these requirements.**
- Determining if the assigned and committed fund balances were used timely. **The Canon-McMillan School District did not obligate itself to a firm designated time frame for expending these funds but rather, provided in multiple modes of communication to the Auditor General's Office, their long range plan. This plan has also been publically presented and captured in transcription, at Act 34 hearings as required by the State of Pennsylvania. This information has been provided at public board meetings, district website, parent council meetings, board committee meetings, etc... The time-line, though not firmly delineated for the long range capital improvement plan, had parameters that were slightly expanded due to the pandemic. But for the most part, the district was able to stay on target. Thus, we clearly had a plan to use the funds in a timeline in accordance with our long range planning.**
- Determining if the district's policy requires the Board to maintain the unassigned fund balance below the Pennsylvania Public School Code (PSC) threshold to raise taxes annually. **Confirmed that the Canon-McMillan School District Board Policy is in line with the Pennsylvania Public School Code (PSC) threshold to raise taxes annually. There is no requirement for board policy to be below that.**
- Reviewing budget versus actual General Fund transfers to other Governmental Funds for reasonableness. **The Canon-McMillan School District clearly provided justifications and rationales in many public modes of communication to its stakeholders. The justifications and rationales are in alignment with the School District's Long Range Capital Improvement Plan. The Auditor General's office was provided timely, detailed documentation throughout the audit.**

## A Performance Audit

### School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes

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Once again it is the Canon-McMillan's assertion that based on the Auditor General's selection criteria, the school district did not meet this requirements to be included in this audit.

On Pages 8-10 of the Auditor General's Report, please see a very detailed audit response letter dated May 5, 2022 to Ms. Morningstar. In this letter it is explained in great detail why the district has funds committed for PSERS. Additionally, it was also explained in detail why in December and January, when the district just began negotiations, it was not known what would be needed for salaries and benefits. The context that was provided to the Auditor General's office was that in prior contracts, all district employees had taken a pay freeze of some sort due to the financial cliff and lack of state revenue and uncertainty after the AARA funds. All of this was occurring when the district added staff, based on increasing enrollments. But, along with that were drastic mandatory PSERS increases. The timing of our application for the referendum process occurred when we were experiencing uncertain teacher negotiations outcomes and at a time where the district and state budget timelines were not in alignment, which was no fault of the district.

Therefore, the Canon-McMillan School District **did not** inappropriately apply for referendum exceptions. On the contrary, all laws, regulations, rules and procedures were followed by the district. Of special note is that the district DID NOT accept or utilize the approved tax increases over the Act 1 index once additional information became available to make an informed budgetary decision. The district resorted to following the guidelines with a tax increase which was below the index and which is allowable. Lastly, when taking into consideration the public long range facility plan, the Auditor General's Office should be able to understand that bond proceeds are not allowed to be used (and they were not) for general fund expenditures, as per the law. The amount of fund balance portrayed in this report and in the footnote, does not reflect the fact that the district maintained compliance in following the established guidelines. This is misleading and is a gross misstatement of facts. Instead, when referring to fund balance and surplus, all bond proceeds should be subtracted from any mention of surplus amounts. The district did borrowings in 2014, 2017 and 2019 for Capital Improvement Building Projects (new elementary school, high school expansion, stadium Title IX and safety concerns renovation and an issue to terminate a swap transaction from the early 2000's: \$25,350,000, \$44,255,000, \$24,825,000. And most recently, a bond was sought in 2019 for a new middle school at \$65,455,000. Not once in this report does the Auditor General make that distinction when it comes to these bond proceeds being in a committed restricted status and not available for General Fund expenses. The district, as part of the bond process, must seek a bond rating. I have included an addendum to this letter. It is an excerpt from the 2016 S&P Ratings Report where debt, PSERS, and reserves are all addressed and reasons the district's bond rating (which cost tax payers) was not raised.

The heading: **Canon-McMillan applied for referendum exceptions despite having sufficient funding for anticipated annual expenditures**, is not based on law or prescribed school code process or procedures. Nothing in the legislature, or the process, limits a school district's ability to apply for exceptions. It is not factual that this was an inappropriate or illegal act as is insinuated by this heading. As is outlined throughout this letter, many important factual contextual factors are missing in this "finding". The second heading: **Canon-McMillan increased taxes despite having used committed funds and while transferring millions of dollars each year** is also not factually correct. The district is allowed to raise taxes to the index. Insinuating that the district violated some law or legislation is a gross misstatement of the law.

It is concerning that, nowhere in the report does it appear that the Canon-McMillan School District has very low taxes and currently ranks 13<sup>th</sup> out of 15 in Washington County. This omission drastically changes the financial landscape of the Canon-McMillan School District, as portrayed by the Auditor General's Office. The report also fails to mention or report that, of the 12 school districts picked for this special performance audit, the Canon-McMillan School District ranks the lowest in taxation. The report is also silent on where we stand with fund balance in our County/IU. We are in the middle to lower end of the list but we are portrayed as having a high fund balance. Among the 12 school districts picked for this special performance audit, Canon-McMillan is the lowest in terms of fund balance. This information was included in numerous

## A Performance Audit

### School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes

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district correspondences throughout the special audit and specifically appeared in our district Snapshot, as well as on our district website. Also noticeably absent from the AGs report is any mention of the Act 34 Public Hearings (which are prescribed by law) and where public discourse was conducted in regards to total construction costs and taxation. Lastly, there is no mention of the district's Standard & Poors Rating Reports that have been completed multiple times before, during and after this audit window. An excerpt of one those reports from 2016 is attached. The recommendations provided therein are contrary to the findings in this report and can have an adverse effect on taxpayer's future taxation.

The recommendations provided in the report are not aligned with state timelines, legislative action or prescribed processes and not, in all cases, best practices for the School District or tax payers without additional context of individual district situations and reference to the current state of the economy.

***In conclusion, the Auditor General's office should be strongly urged to revise their draft report as it is written, without adding the factual information I included in this letter. To not do so would be a gross representation of the finances of the Canon-McMillan School District.***

Sincerely,  
CANON-McMILLAN SCHOOL DISTRICT



Michael Daniels

Cc:  
Ms. Peggy Morningstar  
Ms. Patricia Andrews  
Ms. Joni Mansmann

## A Performance Audit

### School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes

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#### Auditor’s Conclusion to Canon-McMillan School District’s Response

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The Canon-McMillan School District (Canon-McMillan) emphasizes its compliance with laws and regulations; its dissatisfaction with the audit report results not including details of what the district believes should be in the audit report; and its possible misunderstanding of the audit criteria used to select the school districts that were subject to this performance audit. The district generally disagreed with the recommendations as they are not “aligned with state timelines, legislative action or prescribed processes...” and therefore, Canon-McMillan did not specifically address any of our recommendations. Instead, Canon-McMillan’s response discussed items it disagreed with in the *Introduction and Background* section of the audit report, its compliance with the audit procedures performed for the audit, how the audit objectives do not apply to the district, and its dislike of the statement headings in the report. Below we will address the Canon-McMillan’s assertions in order of its response that we believe warrant further comment.

Canon-McMillan responded that while our audit report noted that it was in compliance with laws and regulations, our report contained inaccurate and misleading information regarding the district’s budgeting process that it requested be changed. We disagree. When we questioned Canon-McMillan at the exit conference whether there were any factual inaccuracies in the audit results section of the report for Canon-McMillan, the district agreed none of the information in the results was incorrect.

Canon-McMillan stated in its response that core elements from its overall financial landscape, while provided to the Auditor General on multiple inquiry responses, were completely absent of any mention in the report. We reviewed the numerous documents provided of the district’s financial landscape, and found that while important on the merits of their individual relevance, the documents are not needed to address the core issues of requesting referendum exceptions. It was evident that Canon-McMillan had sufficient funding for its expenditures, all while increasing taxes while having unused committed funds and transferred millions of dollars not budgeted. Rather than addressing these issues, the district’s response asserts the district should not have been included in our audit, as discussed below.

In its response, Canon-McMillan believes that since referendum exceptions were only applied for but not utilized that this means that the district should have been out of scope for our first audit objective. Our first audit objective, however, included procedures to determine whether **applying** for the referendum exceptions was appropriate. Based on Canon-McMillan’s preliminary budget having a more than \$1 million surplus for the FYE June 30, 2020, it appeared the district did not need to apply for the referendum exceptions totaling \$190,294.

## A Performance Audit

### School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes

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Additionally, the district had \$1.5 million committed for pension costs since October 2012 that it had not used, and it had unassigned funds of nearly \$3 million that would have been sufficient to cover the \$190,294 of referendum exceptions. We acknowledge that the district did not use the approved referendum exceptions, but the mere fact of not using it is irrelevant in light of our stated objectives.

Canon-McMillan further responded that the district's ability to raise taxes to the index is within their purview and is not a violation of any law or regulation pertaining to the district's fund balance or otherwise. We agree that based on the district designating or transferring funds in the General Fund and its policy to maintain an unassigned fund balance below the Pennsylvania Public School Code (PSC) threshold, Canon-McMillan is not in violation of law or the PSC. However, the district transferring \$19.5 million more than budgeted during the four-year audit period while raising taxes each year gives the appearance that the district had the funds needed to alleviate increasing taxes.

Canon-McMillan stated in its response that it is grossly misleading to state that it had a significant contribution to the \$380 million in fund balance of the 12 school districts selected for this performance audit. To clarify Canon-McMillan's assertion, we report in the *Introduction and Background* section of this report that the total General Fund balances collectively for all twelve districts selected for the audit is \$380 million as of June 30, 2020. We do not state Canon-McMillan is a significant contributor, but only that it is one of the twelve districts.

Canon-McMillan further suggested that our selection criteria is flawed due to including funds from all Fund types, which includes bond proceeds. We disagree and clarified during our exit conference that the second criteria for selecting districts was based on total balance of all Fund types, which included Capital Projects/Reserves Funds. Canon-McMillan, along with six other districts, fell into this criterion.

Canon-McMillan also suggested that our report insinuated and inaccurately reported that Canon-McMillan did not adopt budgets within the PSC requirements. We disagree and reiterate our report indicated that based on our audit procedures, we did not find non-compliance with laws or regulations. However, we found issues regarding prudent stewardship of taxpayer funds.

Canon-McMillan stated it is concerned with missing financial information and believes the purpose of the Auditor General's office to provide a comprehensive audit of financial information. We disagree in that this is a performance audit with specific audit objectives and is not a comprehensive financial audit. While Canon-McMillan made efforts to make these statements, it did not respond to the specific issues or the recommendations that we reported.

Canon-McMillan asserts that it seems the auditors real issues are with PDE and the current legislation. While we will consider recommendations for PDE and the General Assembly in the

## A Performance Audit

### School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes

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*Overall Summary and Recommendations* section of our report based on the reoccurring issues we have reported, we disagree, in that Canon-McMillan applied for referendum exceptions and raised taxes, albeit below or at the index, despite appearing to have sufficient funds. As included in our report to Canon-McMillan, we clarified in a footnote that our audit is not of PDE's procedures.

Canon-McMillan states in its response that the fund balance portrayed in our audit report does not reflect the fact that the district maintained compliance with following established guidelines. Canon-McMillan further stated that our report is misleading and is a gross misstatement of facts when we referred to fund balance and surplus amounts because bond proceeds should be subtracted from these surplus amounts. Canon-McMillan's assertions, however, are inaccurate. The report does not include bond proceeds within the surplus amounts reported, as asserted by Canon-McMillan. We report that Canon-McMillan transferred \$20.2 million of General Fund surplus (operating revenue less operating expenditures, which does not include bond proceeds) to its Capital Projects Fund. We do clarify in the related footnote that Canon-McMillan's Capital Projects Fund includes a Capital Reserve Fund and a Construction Fund, both used for the district's long range capital improvement plan. The balances listed in the footnote for each of these funds would include the transferred surpluses from the General Fund and bond proceeds. However, we do not incorrectly or in any other manner insinuate that the bond proceeds are included in the General Fund surplus that we reported, as claimed by Canon-McMillan.

Canon-McMillan disagreed with our statement heading that it applied for referendum exceptions despite having sufficient funding for anticipated annual expenditures because this is not based on law or prescribed regulatory process or procedures. Canon-McMillan stated that nothing in the law limits a school district's ability to apply for exceptions, and that we improperly insinuated this was an inappropriate or illegal act. We disagree with this characterization, as we clearly state in our report that we found no noncompliance with the law (i.e., the PSC and/or Act 1 of 2006, as amended) or the regulations. However, we further state that for prudent stewardship of taxpayer funds, Act 1, as amended, Section 333(a)(1), provides that an additional tax rate increase above the index may be requested if needed to balance the preliminary budget.<sup>60</sup> By requesting a referendum exception, the district is implying that the tax increase above the index is needed due to insufficient available funding. Based on the district's preliminary budget for FYE June 30, 2020, the district had a projected surplus of more than \$1 million, an additional \$1.5 million commitment set aside since October 2012 that it had not used for pension costs, and an unassigned fund balance of nearly \$3 million which would have been sufficient to cover the \$190,294 of referendum exceptions.

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<sup>60</sup> Subsection (a)(1) of Section 333 (relating to public referendum requirements for increasing certain taxes) of the Taxpayer Relief Act. Please note at Subsection (a)(2) of the act states as follows: "(2) This section shall apply to each board of school directors beginning with any proposed tax increase that takes effect in the 2007-2008 fiscal year and each fiscal year thereafter." See 53 P.S. § 6926.333(a)(1)-(2).

## **A Performance Audit**

### **School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes**

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Canon-McMillan also asserted that our statement heading that it increased taxes despite having unused committed funds and while transferring millions of dollars each year is not factually correct. Canon-McMillan stated the district is allowed to raise taxes to the index and that our report insinuates that the district violated law, which is in the district's view a gross misstatement of the law. We must disagree here again and believe it is important to distinguish between what the report actually states as being factually correct from Canon-McMillan's perception of an insinuation of violating unspecified legal requirements. We reiterate again that our report clearly states that we found no noncompliance with law (PSC and/or Act 1) or the regulations. Our statement is factually correct, in that Canon-McMillan raised taxes each of the four years reviewed while having unused committed funds and while transferring millions of dollars from the General Fund to the Capital Projects Fund. At our exit conference, Canon-McMillan's Director of Business & Finance agreed none of the information in the report was inaccurate, but instead took issue with the absence of information that was not subject to the audit. Accordingly, by Canon-McMillan's own admission, it agreed with the factual reporting in our report.

Canon-McMillan stated that our recommendations provided in the report are not aligned with state timelines, legislative action, or prescribed processes and not, in all cases, best practices for the school district or taxpayers without additional context of individual district situations and reference to the current state of the economy. We disagree, and our recommendations to Canon-McMillan address each condition listed in the report. We will, however, also consider recommendations for PDE and the General Assembly in the *Overall Summary and Recommendations* section of this audit report based on the reoccurring issues we have found for all 12 districts.

In conclusion, Canon-McMillan stated that the Department of the Auditor General should be strongly urged to revise their draft report as it is written, and that without adding the factual information included in its response would be a gross representation of the finances of the district. The reported results for Canon-McMillan are based on its own detailed records, including but not limited to, its budgets and annual audited financial statements. Moreover, when asked for specific examples of factual inaccuracies, Canon-McMillan was unable to provide any and in fact, admitted that the report was factually accurate. While no edits are deemed necessary because we stand by our factually accurate conclusions, the district's response will be included in our audit report verbatim.

## A Performance Audit

### School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes

#### Hempfield School District

Hempfield School District’s (Hempfield) revenues and expenditures ranged from \$120 million to \$130 million during the four FYE June 30, 2018, 2019, 2020, and 2021.<sup>61</sup> The following table summarizes Hempfield’s information for referendum exceptions requested by fiscal year, the funds available in its General Fund at the beginning of each fiscal year (July 1), whether taxes were raised, and whether taxes were raised above the index.

**Table #1**

FYE June 30	Did the District Request a Referendum Exception? <sup>a/</sup>	Type of Exception Requested <sup>b/</sup>	Total Amount Approved	General Funds Available July 1 <sup>c/</sup>	Taxes were Raised	Taxes Were Raised Above the Index
2018	Yes	Pension Obligations and Special Education Costs <sup>d/</sup>	\$ 476,600	\$14,467,647	Yes	No
2019	Yes	Pension Obligations and Special Education Costs	\$ 998,428	\$13,856,242	Yes	No
2020	Yes	Special Education Costs	\$ 1,017,836	\$14,726,602	Yes	No
2021	Yes	Special Education Costs	\$ 1,286,361	\$18,008,899	No	No

<sup>a/</sup> - Based on PDE’s applicable year’s Report on Referendum Exceptions, the district did or did not request a referendum exception to raise taxes above the index.  
<sup>b/</sup> - Act 1 of 2006, as amended, provides four different types of referendum exceptions based on type of expenditure costs, see the *Introduction and Background* section of this report. See Taxpayer Relief Act, 53 P.S. § 6926.101 *et seq.*

<sup>61</sup> The range of revenues and expenditures is based on the Preliminary Budgets used to apply for the referendum exceptions.

## A Performance Audit

### School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes

<sup>c/</sup> - The amount of funds available to Hempfield for the fiscal year as of July 1; for instance, for FYE June 30, 2018, the amount available for appropriation by the Board on July 1, 2017, was \$14,467,647.<sup>62</sup>

<sup>d/</sup> - Pension obligations refer to the retirement contributions made by the school district to the Public School Employees' Retirement System (PSERS).

*Sources: Produced by staff of the Department of the Auditor General based on information in the PDE's referendum reports and Hempfield's audited financial statements for the FYE June 30, 2017, 2018, 2019, 2020, and 2021.*

Based on our audit procedures, we did not find non-compliance with law or regulations. However, we found the following issues regarding prudent stewardship of taxpayer funds:

- Hempfield routinely requests referendum exceptions despite having sufficient funds available in its General Fund for anticipated annual expenditures.
- Hempfield designates its General Fund as commitments and assignments allowing it to increase taxes while retaining millions of dollars not used timely for designated purposes.

The following two sections describe these results in more detail.

#### **Hempfield routinely requests referendum exceptions despite having sufficient funds available in its General Fund for anticipated annual expenditures.**

Hempfield applied for referendum exceptions to raise taxes above the index for the FYE June 30, 2018, 2019, 2020, and 2021. Although Hempfield raised taxes in the FYE June 30, 2018, 2019, and 2020, it did not use the approved referendum exception(s) to raise taxes above the index. When questioned, Hempfield's Chief Financial and Operations Officer (CFOO) explained that the district's Board routinely applies for referendum exceptions to preserve the option to increase taxes above the index until the final budget is adopted in June of each year.

Based on Act 1 of 2006, as amended, Section 333(a)(1), the additional tax rate increase above the index may be requested if needed to balance the preliminary budget.<sup>63</sup> By requesting referendum exceptions, the district is indicating that the tax increase is needed due to insufficient available funding. However, we found that Hempfield had sufficient funding available to balance the budget, which negated the need to apply for referendum exceptions for the FYE June 30, 2018, 2019, 2020, and 2021, for the following reasons:

<sup>62</sup> The table includes funds committed and/or assigned in the General Fund that are funds available for use if the Board so directs. Also, the available funds listed have been unspent for several years and remain available for the Board to recommit or reassign for other types of expenditures.

<sup>63</sup> Subsection (a)(1) of Section 333 (relating to public referendum requirements for increasing certain taxes) of the Taxpayer Relief Act. Please note at Subsection (a)(2) of the act states as follows: "(2) This section shall apply to each board of school directors beginning with any proposed tax increase that takes effect in the 2007-2008 fiscal year and each fiscal year thereafter." See 53 P.S. § 6926.333(a)(1)-(2).

## A Performance Audit

### School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes

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- Hempfield had an average of \$8.6 million in its estimated ending unassigned fund balance listed on its preliminary budgets for the FYE June 30, 2018, 2019, 2020, and 2021. Therefore, Hempfield did not need to apply for the referendum exceptions and propose an increase in taxes above the index because the funds it had were sufficient to balance its preliminary budgets.<sup>64</sup>
- Hempfield had sufficient funds committed specifically for the type of expenditures used for the referendum exception it sought. For example, the Board passed a resolution to commit funds for pension obligations in June of each year. Although the resolution did not specify the amount to be committed until the completion of the financial audit for the prior period, Hempfield had \$3 million or more committed each of the four years audited. Therefore, Hempfield did not need to apply for the referendum exceptions for pension costs in any of the four years requested because the amount committed was more than the requested pension amount.

Our results demonstrate that Hempfield had sufficient funding and did not need to apply for referendum exceptions to meet its pension obligations and/or special education costs for the FYE June 30, 2018, 2019, 2020, and 2021. Additionally, the district presented preliminary budgets to the taxpayers and PDE that suggested the district had insufficient funds to balance its budget while it had millions of dollars available for anticipated expenditures. The process of applying for unnecessary referendum exceptions wasted time and resources for the district and PDE.

### **Hempfield designates its General Fund as commitments and assignments allowing it to increase taxes while retaining millions of dollars not used timely for designated purposes.**

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General Fund balances can be designated as committed, assigned, or unassigned.<sup>65</sup> The PSC **prohibits** districts from increasing taxes if its unassigned fund balance in the General Fund is **greater than 8%** of the next fiscal year's budgeted expenditures.<sup>66</sup> By reducing the unassigned fund balance every year to below 8%, Hempfield can increase taxes even though it has sufficient funds for anticipated expenditures in its General Fund.

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<sup>64</sup> While this calls into question the reason PDE approved the referendum exceptions, this is not an audit of PDE's procedures and processes.

<sup>65</sup> The General Fund classifications are described in more detail in the *Introduction and Background* section of this report.

<sup>66</sup> 24 P.S. § 6-688(a).

## A Performance Audit

### School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes

During our audit period, Hempfield committed or assigned its available funds in the General Fund for pension obligations, capital projects, and pandemic costs based on resolutions approved by the Board. The following table illustrates Hempfield’s General Fund balances:

**Table #2**

General Fund - Fund Balances	FYE June 30			
	2018	2019	2020	2021
Committed:				
Pension obligations	\$ 4,018,173	\$ 3,166,583	\$ 3,000,000	\$ 3,000,000
Assigned:				
Capital projects	\$ 1,000,000	\$ 2,000,000	\$ 2,000,000	\$ 7,902,343
Pandemic costs	\$ -	\$ -	\$ 3,900,000	\$ -
Unassigned	\$ 8,838,069	\$ 9,560,019	\$ 9,108,899	\$ 10,000,000
<b>Total Committed, Assigned, and Unassigned Fund Balance</b>	<b>\$ 13,856,242</b>	<b>\$ 14,726,602</b>	<b>\$ 18,008,899</b>	<b>\$ 20,902,343</b>

Source: Produced by staff of the Department of the Auditor General based on information in Hempfield’s audited financial statements for the FYE June 30, 2018, 2019, 2020, and 2021.

Based on our audit procedures, we found:

- On an annual basis, prior to the end of the fiscal year in June, Hempfield’s Board formally approved a resolution that authorized the CFOO to commit or assign funds for needed costs, such as retirement costs, health care costs, and future capital projects, with the amounts to be determined prior to the completion of the financial statements. We found that Hempfield complied with the applicable PDE requirement for commitments and assignments.<sup>67</sup>
- Hempfield’s policy states that the General Fund’s unassigned fund balance is to be maintained between five percent (5%) and eight percent (8%) of budgeted expenditures, and if the unassigned portion falls below three percent (3%), the Board will pursue increasing revenues and/or decreasing expenditures. We found that, in contradiction to its policy, the Board increased taxes for the FYE June 30, 2018, 2019, and 2020, while having unassigned fund balances of 5% to 6% of budgeted expenditures. Hempfield’s CFOO explained that the district does not consider falling below the 3% requirement as

<sup>67</sup> PDE Accounting Bulletin #2010-01, effective fiscal year 2010-11, and thereafter, requires commitment classifications for specific purposes be the result of a formal action by the school’s highest level of authority, which in this case is the Board. The PDE bulletin provides that the Board’s approval to commit the funds be before the end of the fiscal year and the amounts can be determined after the fiscal year. Additionally, assignments of funds do not require formal action by the Board.

## **A Performance Audit**

### **School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes**

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mandatory to increase taxes. Additionally, Hempfield’s policy ensures the district can raise taxes every year without a referendum vote while having millions of unspent funds in the General Fund’s commitments and assignments.

- Hempfield did not use the funds committed for pension obligations in any of the four years audited because the revenues were adequate each year to cover the expenditures incurred during the fiscal year.
- Hempfield did not use the funds designated as assignments for capital projects in any of the four years audited and the Board increased the assignment to \$7.9 million by the FYE June 30, 2021.
- Hempfield had sufficient surplus funds in the General Fund to transfer \$13 million to its Capital Projects Fund during the four-year audit period. While we acknowledge that the district budgeted the interfund transfers, we question if the tax increases were truly transparent to the Board and to the taxpayers because the debt service amounts listed in the final adopted budgets were reported on the wrong line with interfund transfers. The district should use the correct lines in the budget for debt service and interfund transfers.

Based on our audit results, had the district retained the unspent assignments and commitments as unassigned fund balance, it would have exceeded the PSC threshold and been unable to increase taxes without a referendum vote until the funds were spent for general operations. However, Hempfield’s policy allows it to increase taxes while retaining millions of dollars of unspent funds for several years in its General Fund. The Board should reconsider its policy and practices to help lessen the tax burden on its taxpayers.

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### **Recommendations for Hempfield School District**

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While we did not find non-compliance with law or regulations, we offer the following recommendations to Hempfield School District to improve stewardship of taxpayer funds:

1. Refrain from applying for referendum exceptions unless the district has utilized unspent funds in the General Fund’s commitments and/or assignments. Additionally, refrain from applying for referendum exceptions if funds have been set aside specifically for the type of expenditure that is being requested prior to increasing taxes above the index.
2. Pass a resolution during the preliminary budget phase to not increase taxes above the district’s index when budgetary needs can be met with existing available funds in the General Fund.

## **A Performance Audit**

### **School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes**

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3. As a best business practice, revise the General Fund policy to eliminate the restriction of maintaining excess surplus funds in the unassigned fund balance.
4. If the district has designations for funds that are not used in the next fiscal year as intended, the Board should repurpose the funds or the funds should be considered as unassigned fund balance in the General Fund.
5. Reconsider the practice of transferring surplus funds to the Capital Projects Fund unless the funds were specifically budgeted for and disclosed to the taxpayers. Excess surplus funds should be maintained in the General Fund as unassigned fund balances for future operation costs to lessen the burden on taxpayers. This will ensure tax increases are appropriate and needed.

## A Performance Audit

### School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes

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## Hempfield School District's Response

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200 Church Street  
Landisville, PA 17538-1332  
P :: 717.898.5570  
F :: 717.898.5628  
www.hempfieldsd.org

**Mark Brooks**  
Chief Financial & Operations Officer

December 21, 2022

The District would like to thank the Auditors General's office staff for conducting a performance audit for Hempfield School District and finding that the District was in compliance with all laws and regulations as it pertains to the Act 1 Budgeting process. Additionally, recognizing the Board's constitutional right to raise and administer funds for the betterment of the education of the youth in their community.

The following were the Recommendations for Hempfield School District

1. *"Refrain from applying for referendum exceptions unless the district has utilized unspent funds in the General Fund's commitments and/or assignments. Additionally, refrain from applying for referendum exceptions if you have funds set aside specifically for the type of expenditure that is being requested prior to increasing taxes above the index."*

The District will consider this recommendation however the decision to either make a proposed preliminary budget public and apply for exceptions under Act 1 or approve a resolution pursuant to Section 311(d)(1) indicating that it will not raise the rate of any tax by more than its index must be left to the School Board. In addition, because new school board members are elected every two years, each board must be provided the opportunity to decide for itself which approach is in the best fiduciary interest of the District and its taxpayers.

2. *"Pass a resolution during the preliminary budget phase to not increase taxes above the district's index when budgetary needs can be met with existing available funds in the General Fund."*

Consistent with our answer to the first recommendation the District will consider this approach during each budget season but reserves this important decision to the Board of Directors. We would further note that the approach of applying for exceptions and preparing a proposed preliminary budget is a more public and transparent approach to preparing a final budget.

3. *"As a best business practice, revise the General Fund Policy to eliminate the restriction of maintaining excess surplus funds in the unassigned fund balance."*

To the extent the recommendation herein is targeting Board Policy, 620, Fund Balance, the policy provides the necessary fiscal flexibility to the Board and Administration to budget as may be necessary for the needs of the district and community. As this audit has clearly pointed out, the District violated no laws or regulations in how it budgets on a yearly basis. Moreover, the District would add the audit dismisses the realities of non-negotiable liabilities that absolutely require the District have the necessary flexibility to budget accordingly. For instance, the District's total budgeted expenditures for PSERSs exceeds the \$19 million dollar threshold as outlined in 24 P.S. 6-688. In other words, the obligations on District budgets- special education, pension, capital, and healthcare- absolutely necessitate flexibility in budgeting. Revising our policy would defeat this purpose.

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The mission of the Hempfield School District is to provide safe and supportive environments, engaging experiences, and rigorous educational opportunities that inspire all students to excel in their chosen pathway and grow as lifelong learners and contributing citizens.

## A Performance Audit

### School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes

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4. *“If the district has designations for funds that are not used in the next fiscal year as intended, the Board should repurpose the funds or the funds should be considered as unassigned fund balance in the General Fund.”*

**The District disagrees with this recommendation.** It would be fiscal negligence if the District simply budgeted one year at a time. The reason the District has been fiscally sound is due to our multi year budgeting practice. For instance, the district has and continues to designate funds to assigned funds such as the capital reserve fund. For example this fund is used to not only to provide minor capital building improvements, but major building renovations or new construction. Prior to 2012, the Commonwealth funded a school construction and improvement fund referred to as PlanCon. This fund allowed school district to apply for and receive state funds to offset the cost of construction and or renovation. Act 82 of 2012 authorized a Moratorium on the acceptance of new PlanCon applications. These funds were paid out over a 20 year period to reduce the burden on local tax payers. The district is preparing to undertake a \$100 Million dollar plus building renovation/new construction project. The moratorium was effective October 1, 2012.

The district participates in a self-funded medical plan. The district maintains funds in a reserve account to provide budget leveling. In the event the district experiences an extraordinary medical event, they are able to cover this unexpected cost, without negatively impacting programs.

5. *“Reconsider the practice of transferring surplus funds to the Capital Projects Fund unless the funds were specifically budgeted for and disclosed to the taxpayers. Excess surplus funds should be maintained in the General Fund as unassigned fund balances for future operation costs to lessen the burden on taxpayers. This will ensure tax increases as appropriate and needed.”*
- The district maintains a short and long term capital projects plans which are discussed publically annually. This plan includes estimated costs for improvements. In order to maintain the taxpayer’s investment in the infrastructure the District has adopted a best practice of self-funding these projects whenever possible.

*Hempfield did not use the funds committed for pension obligations in any of the four years audited because revenues were adequate each years to cover the expenditures incurred during the fiscal year.*

The District has established a restricted fund to address unpredictable PSERS increases – PSERS Employer Contribution Rate that is assessed to the school district increases annually. The additional rate increase is predicated by the previous year’s portfolio performance. During period of stock market declines the school districts share is increased, in periods when the stock market is performing well the rate is still a fixed increase which is approved by the PSERS Board, since the pension program report has an unfunded liability of close to \$50 Billion dollars. (3)

*Hempfield did not use the funds designed as assignments for capital projects in any of the four years audited and the Board increased the assignment to \$7.9 million by the FYE June 30, 2021.*

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## A Performance Audit

### School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes

The district has identified several major renovation/new construction projects to address aging infrastructure, new programming initiatives, projected increasing enrollments. These projects have been and continue to be discussed publically. The Board has chosen to designate funds to these projects in an effort 1. Reduce the need to obtain long term financing, 2. To maintain its Moody's rating and 3. Providing the district flexibility in its planning phase.

*Hempfield had sufficient surplus funds in the General Fund to transfer \$13 million to its Capital Projects Fund during the four-year audit period. While we acknowledge that the district budgeted the interfund transfers we question if the tax increases were truly transparent to the Board and to the taxpayers because the amounts listed in the final adopted budgets were reported on the wrong line with debt service payments. The district should use the correct line in the budget for interfund transfers.*

The District did provide transparency about financial matters during their public committee meetings. The District was provided guidance from our local auditor for the interfund budget transfers.

Disclaimer: Please note that this audit is a performance audit and presents requirements of prudent stewardship of taxpayer funds, advancing transparency, best business practices, relevant provision of law, and related recommendations pertaining to requesting referendum exceptions as they relate to school districts' General Fund, the raising of school property taxes, and the raising of taxes above the PSC index.

Recommend that the Table 1 also include columns listing the actual tax increase amount, the allowed index amount and the allowed adjusted index amount were to further demonstrate transparency.

FYE June 30	Did the District Request a referendum Exception?	Type of Exception Requested	Total Amount Requests & Approved	Funds Available July 1 (Prior year)	Taxes were Raised	Taxes Raised Above the Index	Amount of Tax Increase	Index	Adjusted Index
17-18	Yes	Pension & Special Ed	\$476,600	\$14,467,647	Yes	No	1%	2.5%	2.5%
18-19	Yes	Pension & Special Ed	\$998,428	\$13,856,242	Yes	No	1%	2.4%	2.4%
19-20	Yes	Special Education	\$1,017,836	\$14,726,602	Yes	No	2.15%	2.3%	2.7%
20-21	Yes	Special Education	\$1,286,361	\$18,008,899	No	No	0%	2.6%	3.0%
4-year average							1.0375%	2.45%	2.65%

Factors that the Board took into consideration in making their decisions to apply for Referendum exceptions include:

The 8% fund balance does not cover 1 months of expenses including payroll and benefits.

A conservative budgeting approach

Unpredictability of revenue streams – State funding amounts, Earn income tax, Real Estate reassessments, are all factors in the decision making process.

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## A Performance Audit

### School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes

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Timing of funds due the district

You have identified the systemic problem with the Act 1 budgeting process. Districts are required to develop a preliminary budget in January for the next School Year. At that time the district does not have a clear guidance of level of state funding will be received. In an effort to be more transparent a recommendation would be for the State to approve school funding a year in advance. This method would provide more transparency to the tax payers of both the state and the local district, as well as eliminating the guessing game as to what level the state will find the district.

1. [http://www.21csf.org/best-home/docuploads/pub/331\\_StateofOurSchools2016.pdf](http://www.21csf.org/best-home/docuploads/pub/331_StateofOurSchools2016.pdf) 2.
2. [http://www.pareportcard.org/PARC2014/downloads/PA\\_2014\\_RC\\_Schools.pdf](http://www.pareportcard.org/PARC2014/downloads/PA_2014_RC_Schools.pdf)
3. <https://www.pennlive.com/news/2021/07/the-66-billion-question-how-can-we-fix-pas-pension-crisis.html>

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## A Performance Audit

### School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes

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#### **Auditor’s Conclusion to Hempfield School District’s Response**

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The Hempfield School District (Hempfield) emphasizes its compliance with laws and regulations, the Board of Directors (Board) role to decide to apply for referendum exceptions and raise taxes, and its conservative approach to budgeting. The district generally agreed to consider our recommendations. Below we address the district’s assertions we believe warrant further comment based on Hempfield’s response.

#### **Recommendation 1**

We are encouraged that Hempfield agreed to consider the recommendation.

#### **Recommendation 2**

We are encouraged that Hempfield agreed to consider the recommendation.

#### **Recommendation 3**

Hempfield disagrees with revising its policy and states that revising its policy would defeat the purpose of having the necessary fiscal flexibility needed for the Board and district administration to budget each year. We disagree and reiterate that keeping the unassigned fund balance below the PSC threshold provides an avenue to raise taxes every year, as Hempfield did three of the four years of our audit period, while having balances of committed, assigned, and unassigned funds totaling more than \$13 million that have been unused for multiple years. It is important to acknowledge that the report advocates for additional transparency in both the budgeting process and the methodology used in seeking exceptions to referendum-based tax increases. The report does not, however, seek to limit budget flexibility of necessary funds, but that those funds should be obtained in a transparent way that is consistent with both the letter and spirit of the PSC.

#### **Recommendation 4**

Hempfield does not agree with this recommendation regarding the reserve for its self-medical insurance, pension obligations, or capital projects commitments and/or assignments.

The district indicated the pension commitment is restricted for unpredictable PSERS increases and based on an annual review of several factors.

We encourage the district to continue to review its committed and assigned fund balances in its General Fund for appropriate designations when not utilized for a period of years.

## **A Performance Audit**

### **School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes**

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#### **Recommendation 5**

Hempfield indicated that the transfers and debt service payments were combined on the interfund transfer budget line, were made public, and were based on guidance from local auditors. We are encouraged the district will share our recommendation with its local auditors.

## A Performance Audit

### School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes

#### School District of Lancaster

School District of Lancaster’s (Lancaster) revenues and expenditures ranged from \$208 million to \$233 million during the four FYE June 30, 2018, 2019, 2020, and 2021.<sup>68</sup> The following table summarizes Lancaster’s information for referendum exceptions requested by fiscal year, the funds available in its General Fund at the beginning of each fiscal year (July 1), whether taxes were raised, and whether taxes were raised above the index.

**Table #1**

FYE June 30	Did the District Request a Referendum Exception? <sup>a/</sup>	Type of Exception Requested <sup>b/</sup>	Total Amount Approved	General Funds Available July 1 <sup>c/</sup>	Taxes were Raised	Taxes Were Raised Above the Index
2018	No	N/A	N/A	\$29,036,399	Yes	No
2019	No	N/A	N/A	\$28,761,156	Yes	No
2020	No	N/A	N/A	\$29,995,393	Yes	No
2021	Yes	Special Education Costs	\$1,724,337	\$30,390,245	Yes	No

<sup>a/</sup> - Based on PDE’s applicable year’s Report on Referendum Exceptions, the district did or did not request a referendum exception to raise taxes above the index.  
<sup>b/</sup> - Act 1 of 2006, as amended, provides four different types of referendum exceptions based on type of expenditure costs, see the *Introduction and Background* section of this report. See Taxpayer Relief Act, 53 P.S. § 6926.101 *et seq.*  
<sup>c/</sup> - The amount of funds available to Lancaster at the beginning of the fiscal year; for instance, for FYE June 30, 2018, the amount available for appropriation by the Board on July 1, 2017, was \$29,036,399.<sup>69</sup>  
N/A – Not applicable

Sources: Produced by staff of the Department of the Auditor General based on information in the PDE’s referendum reports and Lancaster’s audited financial statements for the FYE June 30, 2017, 2018, 2019, 2020, and 2021.

<sup>68</sup> The range of revenues and expenditures is based on the final adopted General Fund budgets.

<sup>69</sup> The table includes funds committed and assigned funds in the General Fund that are available for use if the Board so directs. Also, the available funds listed have been unspent for several years and remain available for the Board to recommit or reassign for other types of expenditures.

## A Performance Audit

### School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes

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Based on our audit procedures, we did not find non-compliance with law or regulations. However, we found the following issues regarding prudent stewardship of taxpayer funds:

- Lancaster applied for a referendum exception despite having sufficient funding for anticipated annual expenditures.
- Lancaster increased taxes despite having unspent committed and assigned funds.

The following two sections describe these results in more detail.

#### **Lancaster applied for a referendum exception despite having sufficient funding for anticipated annual expenditures.**

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Lancaster applied for a referendum exception to raise taxes above the index for the FYE June 30, 2021. Although Lancaster increased taxes each of the four FYE June 30, 2018, 2019, 2020, and 2021, it did not use the approved referendum exception to raise the taxes above the index. When questioned, Lancaster’s Director of Finance (Director) explained that the district applied for the referendum exception for the FYE June 30, 2021, due to the “many unknowns with state funding and the pandemic situation” but decided not to increase taxes above the index.

Based on Act 1 of 2006, as amended, Section 333(a)(1), the additional tax rate increase above the index may be requested if needed to balance the preliminary budget.<sup>70</sup> By using a referendum exception, the district is indicating that the tax increase is needed due to insufficient available funding. However, we found that Lancaster had sufficient funding available to balance the budget, which negated the need to apply for the referendum exception for the FYE June 30, 2021, for the following reasons:

- Lancaster had sufficient funds in its unassigned fund balance. The projected ending unassigned fund balance in its preliminary budget was \$20 million for the FYE June 30, 2021. These funds were sufficient to balance the preliminary budget. Therefore, Lancaster did not need to apply for a referendum exception for potential increases in special education costs of \$1,724,337 as listed in Table #1 above.
- Lancaster maintained an average of \$6 million in commitments and assignments not used for the three years leading up to the FYE June 30, 2021. These funds could have

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<sup>70</sup> Subsection (a)(1) of Section 333 (relating to public referendum requirements for increasing certain taxes) of the Taxpayer Relief Act. Please note at Subsection (a)(2) of the act states as follows: “(2) This section shall apply to each board of school directors beginning with any proposed tax increase that takes effect in the 2007-2008 fiscal year and each fiscal year thereafter.” See 53 P.S. § 6926.333(a)(1)-(2).

## A Performance Audit

### School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes

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been repurposed by the Board if needed for other expenditures, including special education costs. Therefore, Lancaster did not need to apply for a referendum exception for potential increases in special education costs of \$1,724,337 as listed in Table #1 above.

Our results demonstrate that Lancaster had sufficient funding and did not have to apply for a referendum exception to meet its special education costs for the FYE June 30, 2021. Additionally, the district presented a preliminary budget to the taxpayers and PDE for the FYE June 30, 2021, that suggested the district had insufficient funds to balance its budget while it had millions of dollars available for anticipated expenditures. The process of applying for an unnecessary referendum exception for the FYE June 30, 2021, wasted time and resources for the district and PDE.

#### **Lancaster increased taxes despite having unspent committed and assigned funds.**

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General Fund balances can be designated as committed, assigned, or unassigned.<sup>71</sup> The PSC **prohibits** districts from increasing taxes if its unassigned fund balance in the General Fund is **greater than 8%** of the next fiscal year's budgeted expenditures.<sup>72</sup> By reducing the unassigned fund balance every year to below 8%, Lancaster increased taxes at or below the index even though it had sufficient funds for anticipated expenditures in its General Fund each of the FYE June 30, 2018, 2019, 2020, and 2021.

During our four-year audit period, Lancaster committed and assigned available funds in the General Fund for fiscal stabilization, security, technology, repairs/maintenance, and student activities. The following table illustrates Lancaster's General Fund balances:

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<sup>71</sup> The General Fund classifications are described in more detail in the *Introduction and Background* section of this report.

<sup>72</sup> 24 P.S. § 6-688(a).

## A Performance Audit

### School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes

Table #2

FYE June 30				
General Fund - Fund Balances	2018	2019	2020	2021
Committed:				
Fiscal stabilization	\$ -	\$ -	\$ -	\$ 5,000,000
Security projects	\$ 1,000,000	\$ 1,000,000	\$ 1,000,000	\$ -
Technology projects	\$ 2,500,000	\$ 2,500,000	\$ 2,500,000	\$ -
Assigned:				
Repairs and maintenance	\$ 2,750,000	\$ 2,750,000	\$ 2,750,000	\$ 2,750,000
Student activities	\$ 138,476	\$ 138,476	\$ 198,215	\$ 198,215
Unassigned	\$ 22,511,156	\$ 23,745,393	\$ 24,140,245	\$ 17,210,188
<b>Total Committed, Assigned, and Unassigned Fund Balance</b>	<b>\$ 28,899,632</b>	<b>\$ 30,133,869</b>	<b>\$ 30,588,460</b>	<b>\$ 25,158,403</b>

Source: Produced by staff of the Department of the Auditor General based on information in Lancaster's audited financial statements for the FYE June 30, 2018, 2019, 2020, and 2021.

Based on our audit procedures, we found:

- Lancaster's Board formally approved a resolution in June 2018 for the commitments and assignments in the General Fund as listed in Table #2 above.<sup>73</sup> However, we found that the Board approved reducing the security project commitment by \$300,000 for the FYE June 30, 2019, and it was not accurately reflected in the audited financial statements. Although the Board complied with the applicable PDE requirement for commitments, the financial statements did not accurately reflect the change. While this appears to have been an oversight, the district should ensure all approved resolutions are accurately recorded.
- Lancaster had sufficient surplus funds to transfer \$4 million not budgeted to its Capital Projects Fund FYE June 30, 2018.<sup>74</sup> Had Lancaster retained these funds in its unassigned fund balance, it would not have been able to increase taxes without a referendum vote the following fiscal years until the unassigned fund balance was less than the PSC threshold.

<sup>73</sup> PDE Accounting Bulletin #2010-01, effective fiscal year 2010-11, and thereafter, requires commitment classifications for specific purposes be the result of a formal action by the school's highest level of authority, which in this case is the Board. The PDE bulletin provides that the Board's approval to commit the funds be before the end of the fiscal year and the amounts can be determined after the fiscal year. Additionally, assignments of funds do not require formal action by the Board.

<sup>74</sup> The final adopted budget for the FYE June 30, 2018, did not include any amount for interfund transfers on the line item "Interfund Out".

## A Performance Audit

### School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes

- Lancaster maintained an assignment of \$2,750,000 for repairs and maintenance for the four-year audit period. According to the Director, the funds are set aside for roof and air conditioning and heating repairs, as needed. Rather than assigning these funds, had the district retained these funds in its unassigned fund balance, it would not have been able to increase taxes the following fiscal years without a referendum vote until the unassigned fund balance was less than the PSC threshold.
  
- Although Lancaster’s policy does not require that the unassigned fund balance remain below the PSC 8% threshold, we found that Lancaster’s final reported budgets estimated ending unassigned fund balance below the PSC threshold each of the four years audited. This in turn allowed Lancaster to increase taxes at or below the index each year. However, the actual ending unassigned fund balance was on average \$6 million more than estimated for the three FYE June 30, 2018, 2019, and 2020. The table below provides the estimated expenditures reported each year, the calculated PSC 8% threshold that would disallow the district to increase taxes, and the amount the district reported which is below the index.

**Table #3**

Analysis of the Adopted Final Budget Unassigned Fund Balance				
	FYE June 30			
	2018	2019	2020	2021
Estimated Expenditures	\$210,604,211	\$219,386,149	\$230,441,774	\$233,100,644
PSC 8%Threshold	\$ 16,848,337	\$ 17,550,892	\$ 18,435,342	\$ 18,648,052
Estimated Ending Unassigned Fund Balance	\$ 16,609,828	\$ 17,540,278	\$ 18,299,680	\$ 16,463,837
Difference	\$ 238,509	\$ 10,614	\$ 135,662	\$ 2,184,215
Actual Ending Unassigned Fund Balance	\$ 22,511,156	\$ 23,745,393	\$ 24,140,245	\$ 17,210,188

*Source: Produced by staff of the Department of the Auditor General based on information in Lancaster’s Board approved adopted final General Fund Balance budgets and audited financial statements for the FYE June 30, 2018, 2019, 2020, and 2021.*

While we recognize the budgets are based on estimates, the above results in the appearance of questionable budgeting practices. For instance, if the district reported \$10,614 more as estimated ending unassigned fund balance in FYE June 30, 2019, it would not have been able to raise taxes without a referendum vote because it would have been above the PSC threshold.

Based on our audit results, had the district retained the transferred funds and/or unspent funds in the unassigned fund balance as explained above, Lancaster would have had more than the PSC

## **A Performance Audit**

### **School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes**

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threshold disallowing it to raise taxes without a referendum vote until the unassigned fund balance was below the threshold. While we realize districts need capital improvement funds, security and technology updates, and sufficient unassigned fund balance for unexpected costs and good credit ratings, it should be more accurate and transparent in its budgeting practices.

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### **Recommendations for School District of Lancaster**

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While we did not find non-compliance with law or regulations, we offer the following recommendations to School District of Lancaster to improve stewardship of taxpayer funds:

1. Refrain from applying for referendum exceptions unless the district has utilized unspent funds in the General Fund's commitments and/or assignments. Additionally, refrain from applying for referendum exceptions if funds have been set aside specifically for the type of expenditure that is being requested prior to increasing taxes above the index.
2. Pass a resolution during the preliminary budget phase to not increase taxes above the district's index when budgetary needs can be met with existing available funds in the General Fund.
3. If the district has designations for funds that are not used in the next fiscal year as intended, the Board should repurpose the funds or the funds should be considered as unassigned fund balance in the General Fund.
4. Ensure financial transactions that are approved by the Board are properly recorded.
5. Reconsider the practice of transferring surplus funds to the Capital Projects Fund unless there is a specific need or purpose. Excess surplus funds should be maintained in the General Fund as unassigned fund balances to meet future operation costs to reduce the burden on taxpayers. This will ensure tax increases are appropriate and needed.

## A Performance Audit

### School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes

#### School District of Lancaster’s Response



December 5, 2022

Scott D. King

Director of Bureau Audits

Commonwealth of Pennsylvania

Department of the Auditor General

Harrisburg, PA 17120-0018

Re: Performance Audit Report Response

Dear Mr. King,

Per your letter dated November 18, 2022, regarding the Performance Audit Report Response-Draft Audit Results and Recommendation, this is our response to your comments.

We reviewed your report that states there were no findings of non-compliance with law or regulations for the audited years of June 30, 2018, 2019, 2020 and 2021.

Per your report, the first objective of the audit was to determine whether each of the selected districts appropriately used the referendum exception method to raise local school property taxes, and the second objective included determining if each district ensured that fund balances were properly designated and used for intended purposes.

The School District of Lancaster is an urban, high-needs school district that faces many challenges such as aging buildings, a large (18%) special education population and growing numbers of refugee students and families in transition. The School District of Lancaster complies with the requirement not to exceed 8% of the next year’s budgeted expenditures for funds balance. We disagree with your statement on Page 12 that says “appearance of questionable budgeting practices” related to PCS 8% threshold in FYE June 30, 2019.

School boards are required by law to apply for exceptions months before approving a final budget, which is also approved before the state Legislature appropriates basic education funding. It is common practice for school boards to apply for exceptions in the interest of prudence and, when more information about expenditures and state subsidies becomes known, limit tax increases to the Act 1 index—or below. In doing this, the District continues to be in compliance with state rules and regulations.

**Kim Reynolds | Director of Finance**  
**School District of Lancaster**  
251 South Prince Street | Lancaster, PA 17603  
717.299.2700



[www.SDLancaster.org](http://www.SDLancaster.org)

## A Performance Audit

### School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes

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#### Response to Recommendation from the School District of Lancaster

Noted: "We did not find any non-compliance with laws and regulations"

- 1) Refrain from applying for referendum exceptions unless the district has utilized unspent funds in the General Fund's commitments and/or assignments. Additionally, refrain from applying for referendum exceptions if you have funds set aside specifically for the type of expenditure that is being requested prior to increasing taxes above the index.
  - a. Recommendation noted: The District applied for one referendum exception during the four audited years and did not use it to raise taxes above the index. Financial unknowns such as rising pension costs and PlanCon reimbursement uncertainties made it prudent for the District to apply for referendum exceptions. It is unreasonable and financial imprudent for boards to commit usage of fund reserves in advance of critical information coming from the state on what it may, or may do with budget allocations. That issue is further complicated by dynamic changes in state funding formula metrics that are also not known in most cases until June of each fiscal year. The action to apply for exceptions to hold open board options until more knowns are evident is prescribed local board authority, it is prudent, sound and lawful. We disagree with the recommendation.
  
- 2) Pass a resolution during the preliminary budget phase to not increase taxes above the district's index when budgetary needs can be met with existing available funds in the General Fund.
  - a. Recommendation noted: The Board reviews and discusses all tax increases in public settings and makes decisions based on the "known" information at that time. The District did not raise taxes above the index during the four years audited. Whether or not to pass such a resolution is local board authority and control by statute.



## A Performance Audit

### School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes

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- 3) If the district has designations for funds that are not used in the next fiscal year as intended, the Board should repurpose the funds or the funds should be considered as unassigned fund balance in the General Fund.
  - a. Recommendation noted: Due to District issues such as age of buildings and technology needs, it is prudent to designate fund balance for unexpected maintenance projects and instructional expenses. Designations made are often for many funds that avoid costs as well mitigate shock costs that can disrupt general fund operations and programs serving students. They are designed to protect the general fund. These protections (the designations) do not just disappear in a year, or even years where good stewardship tax payer resources and experiences favor the district. They serve to stabilize potential disruptions and pay for unexpected, but reasonably anticipated variability in costs that can strike. Every year these positions are evaluated.
  
- 4) Ensure financial transactions that are approved by the Board are properly recorded.
  - a. Recommendation noted: The District complies with required financial statement representation as audited by an independent auditor and the state’s prescribed AFR reporting and manual.
  
- 5) Reconsider the practice of transferring surplus funds to the Capital Projects Fund unless there is a specific need or purpose. Excess surplus funds should be maintained in the General Fund as unassigned fund balances to meet future operation costs to reduce the burden on taxpayers. This will ensure tax increases are appropriate and needed.
  - a. Recommendation noted: The District was planning for a \$90 million dollar building renovation project and found it fiscally responsible to transfer those funds to decrease future tax increases due to future debt. Such transfers are clearly provided for in the school code and the district evaluated its future capital intensive infrastructure needs and acted accordingly, and prudently, with the tax payer resources provided. Pay as you go methodology and portions thereof for capital intensive projects avoid borrowing and issuance costs and represent a component of the district’s responsibility to care for the \$100’s of millions in dollars of their infrastructure and buildings tax payers entrust us to manage. The state has stopped funding all PlanCon activities so either districts



## A Performance Audit

### School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes

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prepare as best they can with capital formation, or they let repairs and upgrades lapse. Leaving the monies as a rule in the General Fund also will serve to use one time reserves for ongoing and rapidly growing costs including inflationary growth which if not monitored well can lead to the district to a deficit position rapidly.

We look forward to the opportunity to speak with you during the exit conference to address these concerns. If you have further questions, please contact me.

Sincerely,

Kimberly Reynolds

**Kim Reynolds | Director of Finance**  
**School District of Lancaster**  
251 South Prince Street | Lancaster, PA 17603  
717.299.2700



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## **A Performance Audit**

### **School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes**

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#### **Auditor’s Conclusion to the School District of Lancaster’s Response**

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The School District of Lancaster (Lancaster) emphasizes its compliance with laws and regulations, the Board of Directors (Board) role and timing to apply for referendum exceptions, and its conservative approach to budgeting. The district generally disagrees with our recommendations. Below we address the district’s assertions we believe warrant further comment based on Lancaster’s response.

#### **Recommendation 1**

Lancaster responded that it is the local Board’s authority to apply for referendum exceptions, and in the case of financial unknowns, it is prudent, sound, and lawful to apply. While we generally agree that it is legally permissible to apply for referendum exceptions, we reiterate our recommendation which suggests the district refrain from applying when it has funds available to fund the amount sought through respective referendum exceptions.

#### **Recommendation 2**

We are encouraged that the district has passed resolutions to not increase taxes above the index.

#### **Recommendation 3**

We are encouraged that the district evaluates its designations of the General Fund annually.

#### **Recommendation 4**

Lancaster responded that it complies with financial reporting requirements. However, it did not address our recommendation on how it will ensure financial transactions are properly recorded when approved by the Board and reiterate Lancaster should do so.

#### **Recommendation 5**

Lancaster responded that it transferred funds from the General Fund to the Capital Projects Fund to help alleviate potential future tax increases due to future debt. While we agree using surplus funds for decreasing debt is a prudent way of using taxpayers’ resources, we reiterate that the district should include these types of transfers in its General Fund budget documents. If there are surplus funds, the district should include them in unassigned fund balance or add them to the following year’s budget for transfer so taxpayers have more information regarding where and when the funds are being transferred.

## A Performance Audit

### School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes

#### Lower Merion School District

Lower Merion School District’s (Lower Merion) revenues and expenditures ranged from \$258 million to \$288 million during the four FYE June 30, 2018, 2019, 2020, and 2021.<sup>75</sup> The following table summarizes Lower Merion’s information for referendum exceptions requested by fiscal year, the funds available in its General Fund at the beginning of each fiscal year (July 1), whether taxes were raised, and whether taxes were raised above the index.

**Table #1**

FYE June 30	Did the District Request a Referendum Exception? <sup>a/</sup>	Type of Exception Requested <sup>b/</sup>	Total Amount Approved	General Funds Available July 1 <sup>c/</sup>	Taxes were Raised	Taxes Were Raised Above the Index
2018	Yes	Pension Obligations and Special Education Costs <sup>d/</sup>	\$2,805,325	\$50,516,884	Yes	No
2019	No	N/A	N/A	\$50,371,038	Yes	No
2020	No	N/A	N/A	\$20,226,200	Yes	No
2021	No	N/A	N/A	\$20,483,767	Yes	No

<sup>a/</sup> - Based on PDE’s applicable year’s Report on Referendum Exceptions, the district did or did not request a referendum exception to raise taxes above the index.

<sup>b/</sup> - Act 1 of 2006, as amended, provides four different types of referendum exceptions based on type of expenditure costs, see the *Introduction and Background* section of this report. See Taxpayer Relief Act, 53 P.S. § 6926.101 *et seq.*

<sup>c/</sup> - The amount of funds available to Lower Merion at the beginning of the fiscal year; for instance, for FYE June 30, 2018, the amount available for appropriation by the Board on July 1, 2017, was \$50,516,884.<sup>76</sup>

<sup>d/</sup> - Pension obligations refer to the retirement contributions made by the school district to the Public School Employees’ Retirement System (PSERS).

N/A – Not applicable

*Sources: Produced by staff of the Department of the Auditor General based on information in the PDE’s referendum reports and Lower Merion’s audited financial statements for the FYE June 30, 2017, 2018, 2019, 2020, and 2021.*

Based on our audit procedures, we did not find non-compliance with law or regulations. However, we found the following issues regarding prudent stewardship of taxpayer funds:

<sup>75</sup> The range of revenues and expenditures is based on the final adopted General Fund Budgets.

<sup>76</sup> The table includes funds committed in the General Fund that are available for use if the Board so directs. Also, the available funds listed have been unspent for several years and remain available for the Board to recommit for other types of expenditures. The assignments for a punitive class action in the FYE June 30, 2019, 2020, and 2021, were not included as funds available.

## A Performance Audit

### School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes

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- Lower Merion requested referendum exceptions for the FYE June 30, 2018, despite having sufficient funds available in its General Fund for anticipated annual expenditures.
- Lower Merion increased taxes despite having unspent committed funds and while transferring millions of dollars each year.

The following two sections describe these results in more detail.

#### **Lower Merion requested referendum exceptions for the FYE June 30, 2018, despite having sufficient funds available in the General Fund for anticipated annual expenditures.**

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Lower Merion applied for referendum exceptions for pension obligations and special education costs to raise taxes above the index for the FYE June 30, 2018. Although Lower Merion did not use the approved referendum exceptions to increase taxes above the index, it did increase taxes at or below the index for the FYE June 30, 2018, 2019, 2020, and 2021. When questioned, Lower Merion’s Business Manager explained that the district’s Board opted to apply for the referendum exceptions based on information it had at the time, but ultimately it did not use the approved referendum exceptions to raise taxes above the index.

Based on Act 1 of 2006, as amended, Section 333(a)(1), the additional tax rate increase above the index may be requested if needed to balance the preliminary budget.<sup>77</sup> By requesting a referendum exception, the district is indicating that the tax increase above the index is needed due to insufficient available funding. However, we found that Lower Merion had sufficient funding available to balance the budget, which negated the need to apply for referendum exceptions for the FYE June 30, 2018, for the following reasons:

- Lower Merion’s business office created preliminary and final budgets that were overly conservative.<sup>78</sup> Specifically, the budgets for the four FYE June 30, 2018, 2019, 2020, and 2021, estimated revenues low and expenditures high, creating variances as much as \$22.2 million as illustrated for the FYE June 30, 2018, in the table below.

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<sup>77</sup> Subsection (a)(1) of Section 333 (relating to public referendum requirements for increasing certain taxes) of the Taxpayer Relief Act. Please note at Subsection (a)(2) of the act states as follows: “(2) This section shall apply to each board of school directors beginning with any proposed tax increase that takes effect in the 2007-2008 fiscal year and each fiscal year thereafter.” See 53 P.S. § 6926.333(a)(1)-(2).

<sup>78</sup> The Department of the Auditor General’s *Limited Procedures Engagement* of Lower Merion School District, dated October 2017, reported the district consistently budgeted conservatively resulting in variances between \$11 million and \$20 million each year for the FYE June 30, 2012, through 2016. Follow-up to these issues is included within the results of our current audit report.

## A Performance Audit

### School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes

**Table #2**

Budgeted Deficit Versus Actual Surplus	
FYE June 30	
2018	
Budgeted Operating Surplus (deficit) <sup>a/</sup>	\$ (6,452,826)
Actual Operating Surplus <sup>b/</sup>	\$15,760,195
Variance	\$22,213,021
<p><sup>a/</sup> - To calculate the budget's deficit, we subtracted revenues from expenditures, and we excluded the budgeted interfund transfers since the "actual" operating surplus is calculated without financing sources (uses).  <sup>b/</sup> - To calculate the operating actual surplus, we subtracted revenues from expenditures prior to financing sources (uses) listed in the audited financial statements.</p>	

*Sources: Produced by staff of the Department of the Auditor General based on information in Lower Merion's Board approved preliminary General Fund budget and audited financial statements for the FYE June 30, 2018.*

While we recognize that budgets are based on estimates, the estimates should be reasonable since the results effect the ending fund balance and ultimately whether taxes will be increased.

- Lower Merion had a projected \$20 million beginning and \$14 million ending unassigned fund balance in its preliminary budget for the FYE June 30, 2018. Therefore, Lower Merion did not need to apply for referendum exceptions because these funds were sufficient for the requested \$2,805,325 referendum exceptions listed in Table #1 above.
- Lower Merion had sufficient funds committed specifically for the type of expenditure used for the referendum exception it sought.<sup>79</sup> For example, the Board passed a resolution each year to commit \$10.3 million to \$15.3 million for pension obligations. These funds were committed, but were not used, to balance the preliminary budget. Therefore, Lower Merion did not need to apply for a referendum exception for pension costs totaling \$903,628 of the \$2,805,325 listed in Table #1 above. The Business Manager acknowledged that the commitment of \$15.3 million was not spent during the FYE June 30, 2018, or thereafter, and was decreased to \$10.3 million for FYE June 30, 2021.

Our results demonstrate that Lower Merion had sufficient funding and did not have to apply for referendum exceptions to meet its pension obligations and/or special education costs during the

<sup>79</sup> The Department of the Auditor General's *Limited Procedures Engagement* of Lower Merion School District, dated October 2017, reported the district maintained a stable \$56.2 million General Fund balance with a significant unspent commitment for pension obligations during the FYE June 30, 2012, through 2016. Follow-up to these issues is included within the results of our current audit report.

## A Performance Audit

### School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes

FYE June 30, 2018. Additionally, the district presented preliminary budgets to the taxpayers and PDE that suggested the district had insufficient funds to balance its budget while it had millions of dollars available for anticipated expenditures. The process of applying for unnecessary referendum exceptions for the FYE June 30, 2018 wasted time and resources for the district and PDE.

### Lower Merion increased taxes despite having unspent committed funds and while transferring millions of dollars each year.

General Fund balances can be designated as committed, assigned, or unassigned.<sup>80</sup> The PSC **prohibits** districts from increasing taxes if its unassigned fund balance in the General Fund is greater than **8%** of the next fiscal year’s budgeted expenditures.<sup>81</sup> By reducing the unassigned fund balance every year to below the 8% threshold, Lower Merion increased taxes even though it has sufficient funds for anticipated expenditures in its General Fund.

During our audit period, Lower Merion committed and assigned its available funds in the General Fund to capital projects, pension obligations, healthcare costs, bond rate stabilization, and for a punitive class action. The following table illustrates Lower Merion’s General Fund balances:

**Table #3**

General Fund - Fund Balances	FYE June 30			
	2018	2019	2020	2021
Committed:				
Capital projects	\$15,000,000	\$ -	\$ -	\$ -
Pension obligations	\$15,300,000	\$15,300,000	\$15,300,000	\$10,300,000
Healthcare benefits	\$ 5,000,000	\$ 5,000,000	\$ 5,000,000	\$ 5,000,000
Bond rate stabilization	\$ 500,000	\$ 500,000	\$ 500,000	\$ -
Assigned:				
Punitive class action	\$ -	\$16,928,673	\$16,928,673	\$21,471,296
Unassigned	\$20,071,038	\$ 4,926,200	\$ 5,183,767	\$ 6,085,384
<b>Total Committed, Assigned, and Unassigned Fund Balance</b>	<b>\$55,871,038</b>	<b>\$42,654,873</b>	<b>\$42,912,440</b>	<b>\$42,856,680</b>

Source: Produced by staff of the Department of the Auditor General based on information in Lower Merion’s audited financial statements for the FYE June 30, 2018, 2019, 2020, and 2021.

<sup>80</sup> The General Fund classifications are described in more detail in the *Introduction and Background* section of this report.

<sup>81</sup> 24 P.S. § 6-688(a).

## A Performance Audit

### School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes

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Based on our audit procedures, we found:

- On an annual basis, prior to the end of the fiscal year in June, Lower Merion’s Board formally approved resolutions to commit and/or assign funds for specific purposes based on recommendations from its Business Manager. As a result, Lower Merion complied with the applicable PDE requirement for commitments.<sup>82</sup>
- General Fund is financed from local, state, and federal sources and the funds are generally available to finance the current operations of the school district.<sup>83</sup> Since the district has not used the funds that are committed for pension obligations or healthcare benefits during the four years reviewed, these funds have not been used timely.<sup>84</sup> Maintaining the funds as commitments without timely using the funds for the intended purposes could give the appearance of circumventing the PSC threshold to raise taxes by classifying unassigned funds as commitments.
- Although it appears the district’s financial condition is declining due to a decrease in the General Fund’s balance from \$56 million on July 1, 2017, to less than \$43 million on June 30, 2021, we noted the district transferred \$65 million from the General Fund to its Capital Projects Fund and Capital Reserve Fund during this four-year period, as illustrated in the table below. This was \$36.5 million more than budgeted as interfund transfers on its approved final adopted budgets.

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<sup>82</sup> PDE Accounting Bulletin #2010-01, effective fiscal year 2010-11, and thereafter, requires commitment classifications for specific purposes be the result of a formal action by the school’s highest level of authority, which in this case is the Board. The PDE bulletin provides that the Board’s approval to commit the funds be before the end of the fiscal year and the amounts can be determined after the fiscal year. Additionally, assignments of funds do not require formal action by the Board.

<sup>83</sup> Manual of Accounting and Financial Reporting for Pennsylvania Local Educational Agencies (LEAs). Maintained by: PA Office of the Budget, Office of Comptroller Operations Central Agencies & School Finance Unit. Revised August 2016.

<sup>84</sup> The prior Department of the Auditor General’s report dated October 2017, entitled a “Limited Procedures Engagement” of Lower Merion School District, reported an observation that the district persistently projected annual deficits despite realizing annual surpluses and maintaining a steady \$56 million General Fund balance. Our prior audit disclosed the district had significant funds totaling \$35.8 million committed and unspent for the five FYE June 30, 2012, 2013, 2014, 2015, and 2016.

## A Performance Audit

### School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes

Table #4

Budgeted Transfers Versus Actual Transfers					
FYE June 30					
	2018	2019	2020	2021	Total
Budget	\$ 2,186,756	\$22,187,482	\$ 4,513,284	\$ 62,000	\$28,949,522
Actual	\$13,579,796	\$34,900,000	\$11,614,914	\$5,339,454	\$65,434,164

*Source: Produced by staff of the Department of the Auditor General based on information in Lower Merion's final adopted budgets and audited financial statements for the FYE June 30, 2018, 2019, 2020, and 2021.*

- Had the district maintained \$23 million, approximately half of its General Fund balance, as unassigned fund balance each year rather than committing or transferring the funds, it would have exceeded the PSC threshold and would not have been able to increase taxes without a voter referendum for FYE June 30, 2018, 2019, 2020, and 2021.

Based on our audit results, Lower Merion increased taxes while retaining and transferring millions of dollars of unspent funds. The unnecessary increase of taxes places an undue burden on the district's taxpayers. Further, the increased tax burden was compounded in future years because the Board did not reverse the previous unneeded tax increases.

### Recommendations for Lower Merion School District

While we did not find non-compliance with law or regulations, we offer the following recommendations to Lower Merion School District to improve stewardship of taxpayer funds:

1. Refrain from applying for referendum exceptions unless the district has utilized unspent funds in the General Fund's commitments and/or assignments. Additionally, refrain from applying for referendum exceptions if funds have been set aside specifically for the type of expenditure that is being requested prior to increasing taxes above the index.
2. Pass a resolution during the preliminary budget phase to not increase taxes above the district's index when budgetary needs can be met with existing available funds in the General Fund.
3. More accurately reflect revenues and expenditures for its General Fund in the preliminary and adopted General Fund budgets.

## **A Performance Audit**

### **School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes**

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4. If the district has designations for funds that are not used in the next fiscal year as intended, the Board should repurpose the funds or the funds should be considered as unassigned fund balance in the General Fund.
5. Reconsider the practice of transferring surplus funds to the Capital Projects Fund and Capital Reserves Fund unless the funds were specifically budgeted for and disclosed to the taxpayers. Excess surplus funds should be maintained in the General Fund as unassigned fund balances for future operation costs to lessen the burden on taxpayers. This will ensure tax increases are appropriate and needed.

## A Performance Audit

### School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes

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## Lower Merion School District’s Response

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#### MANAGEMENT COMMENTS

##### Summary

The Administration of Lower Merion School District appreciates the opportunity to respond to the draft Performance Audit report (“draft report”) received on November 14, 2022. Our management comments are provided with the hope of addressing many of the assertions made throughout the report and to show the Auditor General the ways in which the recommendations contained in the report are either already being implemented or have been made redundant by the commitments made by the District in the recently court-approved settlement of the Wolk et al. v. Lower Merion School District budget litigation (“Budget Litigation Settlement”).

As a threshold matter, the District notes the following:

- **The District is in full compliance with laws and regulations:** The draft report confirms that there is no finding that the District failed to comply with law or regulations. To the contrary, the draft report in fact indicates that the District was in compliance with the Public School Code in enacting its tax increases.
- **Public process:** The District budget reflects public input received through a variety of forums, including regular Board meetings, public budget workshops, committee meetings and community comments. Each year the District’s Finance Committee hosts a series of detailed, in-depth presentations on key areas of the budget, including curriculum and instruction, facilities, transportation, staffing and special education. The District also maintains online and video resources related to the budget, which can be found in the budget section of the District website at <https://www.lmsd.org/departments/business/budget/1718>.
- **Enrollment Uncertainty and Absence of Collective Bargaining Agreement:** No school district in Pennsylvania has been impacted more by enrollment growth in recent years than Lower Merion School District. Since 2008, LMSD has had the largest growth in the Commonwealth by total number of students (nearly 1,500 additional students) and the second-fastest enrollment growth rate (more than 21%) according to the Pennsylvania Department of Education. As the 2016-17 school year opened, enrollment in the District was nearly 8,400 students for the first time since the early 1970’s. The last time LMSD enrolled this many students, the District operated 15 schools (ten K-6 elementary schools, three 7-9 junior high schools and two 10-12 senior high schools).

Additionally, the District was in the process of negotiating a collective bargaining agreement with its entire unionized labor force, professional and non-professional, which negotiations were not resolved at the time the exception was applied for.

These factors provide context to the uncertainty around the District’s 2017-2018 budgeting process. That year was the only year in which the District applied for, but did not ultimately take, exceptions. Notably, this application is the principal reason the District is even being audited in the first place.

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## A Performance Audit

### School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes

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- **Common Practices:** The District utilizes accounting and budgeting practices that are standard for school districts across the Commonwealth. In fact, every state and independent audit of the District over the past eight years (eight total) has affirmed the District's full compliance with applicable laws and regulations. The District has consistently been lauded for strong fiscal management by credit ratings agencies. Moody's has affirmed Aaa bond rating for Lower Merion School District which is the highest rating assigned to a government entity, thereby reducing the District's debt service at substantial savings to the taxpayers.

#### Relevant Terms of Budget Litigation Settlement

On October 20, 2022, the Court of Common Pleas of Montgomery County approved the Budget Litigation Settlement which contained the following provision relevant to the draft report:

Beginning with the 2022-2023 fiscal year, in the event there is more than a 2% variance between budgeted and actual expenditures and revenues for a fiscal year, 50% of the surplus realized by the District for that fiscal year will be credited to the taxpayers. This surplus is separate from and in addition to the rebates the District has agreed to provide in tax years 2023, 2024, and 2025.

A. The numbers used to calculate the percentage of the variance and any taxpayer credit for a fiscal year will be taken from the General Fund Budgetary Comparison Schedule in the Independent Auditor's Report. An example is shown below from the Independent Auditor's Report for the Fiscal Year ending June 30, 2021:

# A Performance Audit

## School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes



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**LOWER MERION SCHOOL DISTRICT**  
Required Supplementary Information  
Budgetary Comparison Schedule  
General Fund  
For the Year Ended June 30, 2021

	Original Budget	Amended Budget	Actual	Variance with Final Budget - Positive (Negative)
<b>Revenues:</b>				
Local Revenues	\$ 240,434,196	\$ 240,434,196	\$ 243,640,730	\$ 3,206,534
State Program Revenues	41,360,144	41,360,144	41,171,788	(188,356)
Federal Program Revenues	1,542,000	1,542,000	3,331,889	1,789,889
<b>TOTAL REVENUES</b>	<b>283,336,340</b>	<b>283,336,340</b>	<b>288,144,407</b>	<b>4,808,067</b>
<b>Expenditures:</b>				
Regular Programs	113,878,090	113,709,090	113,709,053	37
Special Programs	50,060,512	48,746,112	48,746,050	62
Vocational Programs	425,000	504,000	503,963	37
Other Instructional Programs	1,288,280	825,262	825,134	128
Pupil Personnel Services	11,005,007	10,744,707	10,744,705	2
Instructional Staff Services	7,294,810	6,538,035	6,538,035	0
Administrative Services	15,194,632	16,241,632	16,241,486	146
Pupil Health	4,665,499	4,097,799	4,097,793	6
Business Services	1,545,092	1,403,892	1,403,795	97
Operation and Maintenance of Plant Services	20,869,267	21,292,467	21,292,271	196
Student Transportation Services	16,810,262	14,069,062	14,069,021	41
Central and Other Support Services	8,971,479	8,256,879	8,255,798	81
Student Activities	5,921,192	5,231,342	5,231,305	37
Community Services	254,200	245,100	245,040	60
Debt Service	28,982,373	29,349,573	29,349,561	12
<b>TOTAL EXPENDITURES</b>	<b>287,167,695</b>	<b>281,253,952</b>	<b>281,253,010</b>	<b>942</b>
<b>EXCESS (DEFICIENCY) OF REVENUES OVER EXPENDITURES</b>	<b>(3,831,355)</b>	<b>2,082,388</b>	<b>6,891,397</b>	<b>4,809,009</b>
<b>Other Financing Uses:</b>				
Budgetary Reserve	(800,000)	0	0	0
Intergovernmental Transfers Out	(62,000)	(5,368,943)	(5,368,943)	0
Refunds of Prior Years' Revenues	0	(1,406,600)	(1,406,705)	94
<b>TOTAL OTHER FINANCING USES</b>	<b>(862,000)</b>	<b>(6,775,743)</b>	<b>(6,775,648)</b>	<b>94</b>
<b>NET CHANGE IN FUND BALANCES</b>	<b>\$ (4,693,355)</b>	<b>\$ (4,693,355)</b>	<b>115,748</b>	<b>\$ 4,809,103</b>
Fund Balance - July 1, 2020			43,033,339	
<b>FUND BALANCE - JUNE 30, 2021</b>			<b>\$ 43,149,087</b>	

B. The expenditures and revenues used to calculate the percentage of the variance and any taxpayer credit for each fiscal year will be taken from the General Fund Budgetary Comparison Schedule in the Independent Auditor's Report. An example is shown below from the Independent Auditor's Report for the fiscal year ending June 30, 2021:

1. Revenue Variance = Actual Total Revenues – Original Budget Total Revenues
2. Expenditure Variance = Original Budget Total Expenditures – Actual Total Expenditures
3. Budgetary Reserve Variance = Original Budget Budgetary Reserve
4. Total Variance = Revenue Variance + Expenditure Variance + Budgetary Reserve Variance
5. 2% Allowance = Actual Total Expenditures \* 2%
6. Excess Variance = Total Variance – 2% Allowance
7. Taxpayer Credit = If Excess Variance is a positive number then Excess Variance \* 50%; If Excess Variance is a negative number then zero

## A Performance Audit

### School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes

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As an example, the calculation if the provisions had been in place for the 2020–2021 fiscal year is shown below.

	Original Budget	Actual	Variance
<b>Revenues</b>	283,336,340	288,144,407	4,808,067
<b>Total Expenditures</b>	287,167,695	281,253,010	5,914,685
<b>Budgetary Reserves</b>	800,000	0	800,000
<b>Total Variance</b>			11,522,752
<b>2% Allowance</b>			5,625,060
<b>Excess Variance</b>			5,897,692
<b>Taxpayer Credit</b>			2,948,846

C. The taxpayer credit calculation shall be made and publicized at the public meeting when the Independent Audit is accepted by the District’s Board of Directors (“the Board”). The taxpayer credit will then be applied to the tax bills in the subsequent fiscal year. For clarification and as an example, the Independent Auditor’s Report for the 2020–2021 fiscal year was accepted by the Board on January 24, 2022, and if these provisions had been in place at that time, the taxpayer credit would have applied to the bills sent for the 2022–2023 fiscal year.

D. Unbudgeted interfund transfers shall not be included in the calculated 2% variance.

E. Proceeds from any bond refinancing that occurs may be applied to the debt service fund without being considered revenues or interfund transfers.

F. The District can budget for interfund transfers to the capital reserve fund as long as the following conditions are met:

1. The District specifies (1) the amount of money that will be transferred, and (2) the item(s) the budgeted money will be used to purchase,
2. The District spends or encumbers the money within five fiscal years of the transfer or must seek leave of Court to extend that time period;
3. The District makes the transfer before the end of the fiscal year for which it has been budgeted; and
4. The District does not budget funds from elsewhere to pay for the same items that are the subject of the budgeted-for interfund transfer.

F. The District must maintain buildings and grounds in good repair, and monies in the capital reserve fund can be used for capital improvements in the order of urgency as determined by the Board. Monies transferred into the capital reserve fund pursuant to this

## A Performance Audit

### School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes

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Stipulated Consent Order will not be considered unspent if a more urgent capital improvement becomes required, as long as the money is encumbered by the time originally designated.

G. If the District does not encumber the funds subject to the budgeted interfund transfer by the end of the period it specified in making the initial transfer, it shall credit the unencumbered funds to the taxpayers in the following fiscal year.

H. The process outlined in Paragraph A – G, above, will continue until the 2025-2026 fiscal year. At the end of the 2025-2026 fiscal year, if there has been no year in which the variance between budgeted and actual expenditures and revenues is in excess of 2%, the Board may determine at its sole discretion whether to continue or discontinue these processes. If there have been years in which actual varied from budgeted expenditures in excess of 2%, the Board will continue these processes until there have been three out of four years in which the variance between budgeted and actual expenditures does not exceed more than 2%, at which point the Board may determine at its sole discretion whether to continue or discontinue the processes.

I. In the event the Board determines that it is in the District’s best interest to create additional funds during the time period of the Stipulated Consent Order, the District’s transfers to those newly created funds will be governed by the procedures set forth in this Stipulated Consent Order.

J. If a statute is enacted or amended or if accounting principles are promulgated that are inconsistent with the terms of the procedures outlined in Paragraphs A – G, above, the Parties will meet and confer to identify procedures for the District to remain in compliance with Paragraphs A – G, above, and the newly promulgated law or accounting principles. In the event the Parties are not able to reach agreement, either Party may make an application to the Court.

As demonstrated in the next section, these budget controls make the draft report’s recommendations redundant generally Recommendation Nos. 3 through 5 are superfluous.

#### Comments on Recommendations

Here are our comments on the specific recommendations for the School District.

- 1. Refrain from applying for referendum exceptions unless the district has utilized unspent funds in the General Fund's commitments and/or assignments. Additionally, refrain from applying for referendum exceptions if you have funds set aside specifically for the type of expenditure that is being requested prior to increasing taxes above the index.**

For every year relevant to this audit, the District did exactly that. Only in FYE 2018 did the District apply for a referendum exception, one the District did not end up taking in any event. That exception was for the expected PSERS increase.

It is incorrect to state that the District’s commitment to stabilization of future PSERS expenses meant that the District had committed the funding for a PSERS increase for a particular year. To the contrary, the commitment of funds for PSERS stabilization has kept the District insulated from future drastic increases in its PSERS employer contribution rate.

The District has limited ability to control its PSERS obligations from year to year because the contribution rate is established by the General Assembly. As can be seen from the chart below, the rate can fluctuate significantly from year to year:

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### School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes

HISTORY OF EMPLOYER CONTRIBUTION RATES					
Fiscal Year	Employer Normal Cost %	Employer Pension Rate %	Act 5 Defined Contribution %*	Health Care Contributions %	Total Employer Contribution %
08/09	6.68	4.00	NA	0.76	4.76
09/10	7.35	4.00	NA	0.78	4.78
10/11	8.08	5.00	NA	0.64	5.64
11/12	8.12	8.00	NA	0.65	8.65
12/13	8.66	11.50	NA	0.86	12.36
13/14	8.57	16.00	NA	0.93	16.93
14/15	8.46	20.50	NA	0.90	21.40
15/16	8.38	25.00	NA	0.84	25.84
16/17	8.31	29.20	NA	0.83	30.03
17/18	7.70	31.74	NA	0.83	32.57
18/19	7.59	32.60	NA	0.83	33.43
19/20	7.49	33.36	0.09	0.84	34.29
20/21	7.37	33.51	0.18	0.82	34.51
<b>21/22</b>	<b>7.20</b>	<b>33.99</b>	<b>0.15</b>	<b>0.80</b>	<b>34.94</b>

\*Estimated average DC contribution rate. The actual employer DC contribution rate will be based on each employer's Class T-G, Class T-H, and Class DC membership.

Therefore, in order to financially plan for years when the PSERS rate may spike upwards unexpectedly, the District commits fund balance to a PSERS stabilization fund, much like the Commonwealth of Pennsylvania does with its own **Budget Stabilization Reserve Fund** for which the Commonwealth received accolades, not criticism:

<https://www.bizjournals.com/philadelphia/news/2018/07/12/tom-wolf-torsella-rainy-day-fund-pew.html>

As to the requested exception for PSERS, while the District's PSERS obligation for FYE 2018 was expected to be about \$20 million, the state projected that within five years of FYE 2018 this amount would increase to over \$25 million, a point at which reserves will be needed to offset the increases, something that the District had anticipated and for which it had prepared for several years – well before the 2017 Auditor General audit, for which the then Auditor General had raised no prior concerns.

At the time of the preparation of the Preliminary Budget in February 2017, the District had not yet made a final determination regarding its ability to balance the budget without the use of these exceptions. As the refinement of the budget progressed, the District determined by June 2017 that it could balance its budget without the use of either the Special Education or Pension Obligation exceptions.

Therefore, while the District has no objection in principle to Recommendation No.1, it challenges the draft report's assertion that it has funds set aside specifically for the type of expenditure that is being requested prior to increasing taxes above the index.

## A Performance Audit

### School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes

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- 2. Pass a resolution during the preliminary budget phase to not increase taxes above the district's index when budgetary needs can be met with existing available funds in the General Fund.**

The District has in fact passed this resolution each year of this audit period, except for one, 2017-18.

Since Act 1 was passed, school districts are required to start the budget process for the July 1 – June 30 fiscal year in December or early January. Absent a particularly high index, it is generally difficult to justify not applying for any exceptions during that budgetary process, with the understanding that the District is under no obligation to accept them.

At the time that a district must put forth a preliminary budget or declare that it will not raise taxes by more than the index, the District has less than half of the current year's data upon which to base a budget and no information regarding the coming year. The District has no idea what state and federal funding levels will be. The District does not even know what its own tax base will be. In many cases, collective bargaining agreements could be undetermined, significant assessment appeals could be outstanding, as could other litigation matters. Staffing needs based upon enrollment and special education population, health insurance costs, and utility costs are all unknowns. Given the dearth of reliable information available during the preliminary budget window, the District may deem it prudent to maintain flexibility early in the budget process.

- 3. More accurately reflect revenues and expenditures for its General Fund in the preliminary and adopted General Fund budgets.**

This recommendation has been made superfluous. The Court-approved Budget Litigation Settlement, which provides for tax rebates if there is more than a 2% variance between budgeted and actual expenditures and revenues for a fiscal year.

- 4. If the district has designations for funds that are not used in the next fiscal year as intended, the Board should repurpose the funds or the funds should be considered as unassigned fund balance in the General Fund.**

Per Policy No. 620 Fund Balance, the District does exactly what this recommendation states. Policy 620, which was revised at the recommendation of the prior Auditor General Report and approved by the Pa. Department of Education, states:

On an annual basis, as part of the budget development process, the Business Manager<sup>1</sup> or designee shall ensure that an item is included on the agenda of a Finance Committee meeting for the Finance Committee to review the District's general fund commitments and reserves to determine whether they should be maintained, increased, or used for their

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<sup>1</sup> The report repeatedly refers to the Business Manager incorrectly as the Chief Financial Officer. In Lower Merion School District, this means that all budget recommendations to the Board come from the Superintendent, not the Business Manager.

## A Performance Audit

### School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes

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designated and authorized purposes. Any recommendations by the Committee<sup>2</sup> to modify the level or planned use of general fund commitments and reserves shall then be presented to the full Board for consideration.

- 5. Reconsider the practice of transferring surplus funds to the Capital Projects Fund and Capital Reserves Fund unless the funds were specifically budgeted for and disclosed to the taxpayers. Excess surplus funds should be maintained in the General Fund as unassigned fund balances for future operation costs to lessen the burden on taxpayers. This will ensure tax increases are appropriate and needed.**

The District appropriately, lawfully, and publicly authorized the transfer of funds to its capital reserve for each and every year under auditor review. According to the state accounting manual<sup>3</sup>, the District's practices are consistent with code; as referenced above, surpluses from the general operating fund may be transferred to capital reserve to fund budgeted capital reserve items.

Going forward, the Court-approved Budget Litigation Settlement mandates specific budgeting for the Capital Projects and Capital Reserves Fund so any funds transferred into these funds would have had to been budgeted for those funds. Funds budgeted for other purposes would be subject to the 2% variance and subject to rebate. Therefore, this recommendation is superfluous.

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<sup>2</sup> Contrary to the statement in the last paragraph of the draft report, it is the Finance Committee that makes the fund commitment recommendations to the Board, not the Business Manager (again incorrectly referred to as the CFO).

<sup>3</sup> Municipal Code P.L. 145, Act of April 30, 1943, also known as Purdon's 53§1431, accounts for (1) moneys transferred during any fiscal year from appropriations made for any particular purpose which may not be needed, (2) surplus moneys in the General Fund of the treasury of the LEA at the end of any fiscal year, and (3) interest earnings of the fund itself.

## A Performance Audit

### School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes

#### Auditor’s Conclusion to Lower Merion School District’s Response

The Lower Merion School District (Lower Merion) emphasizes its compliance with laws and regulations; its public process; the uncertainty of several factors for the budget process; and relevant provisions of a settlement agreement it has entered into that applies to areas noted in the report. Below we address the district’s disagreement along with certain areas we believe warrant further comment based on Lower Merion’s response.

#### **Recommendation 1**

Lower Merion indicated that its commitment for stabilization of future pension obligations meant the district had committed the funds for increases that would take place over several years and the commitment has kept the district insulated from drastic increases. Lower Merion also indicated that the prior Department of the Auditor General’s (Department) audit raised no prior concerns. We disagree, our current audit report and the prior Department report dated October 2017, entitled a “Limited Procedures Engagement” of Lower Merion School District, disclosed the district had significant funds committed and unspent since FYE June 30, 2012. Both, our prior audit report and the results in our current report indicate that the commitment should be repurposed if the funds are unspent for several years. As illustrated in the table below, the pension commitment has been reported by the Department since the FYE June 30, 2012, and while somewhat reduced, still remained at \$10.3 million as of the FYE June 30, 2021.

FYE June 30	Pension Commitment
2012	\$22,300,000
2013	\$22,300,000
2014	\$21,300,000
2015	\$21,300,000
2016	\$15,300,000
2017 <sup>a/</sup>	\$15,300,000
2018	\$15,300,000
2019	\$15,300,000
2020	\$15,300,000
2021	\$10,300,000

<sup>a/</sup> - FYE June 30, 2017 was not part of the prior or current audit.

*Source: Produced by staff of the Department of the Auditor General based on information in the prior Department report and documents provided by Lower Merion.*

The district also indicated that in February 2017, its preliminary budget for the FYE June 30, 2018, used the referendum exceptions to balance its budget and Lower Merion disagreed that it

## **A Performance Audit**

### **School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes**

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had funds set aside specifically for the type of expenditure requested prior to proposing to increase taxes above the index. As illustrated in the table above, the district had \$15,300,000 in commitments for pension obligations in that year. These funds were not used to balance the FYE June 30, 2018, preliminary budget. In fact, the preliminary budget reported the beginning and ending committed fund balance at \$35,800,000 (which included the \$15,300,000 pension commitment).

#### **Recommendation 2**

Lower Merion acknowledged that while it has passed resolutions to not increase taxes above the index since the FYE June 30, 2018, it is prudent to maintain the flexibility of applying for referendum exceptions due to the lack of reliable information during the time of the preliminary budget process. While we agree there are several unknown variables at the time of the preliminary budget, applying for referendum exceptions implies there are insufficient funds to cover certain types of expenditures, such as pension obligations and special education costs. We noted that Lower Merion had more than \$10.3 million in available funds for pension obligations in its General Fund each year which went unused during our four-year audit period. Applying for \$2.8 million in referendum exceptions for pension and special education costs suggested the district had insufficient funds when it actually had a commitment in the General Fund of \$15.3 million for pension obligations and an unassigned fund balance of \$20 million for special education costs.

We believe applying for referendum exceptions could be misleading to taxpayers and perhaps an unnecessary practice when funds are available. Moreover, and to the extent Lower Merion believes these funds will be needed in the future, they are always permitted to submit proposed tax increases to a referendum vote.

#### **Recommendation 3**

We are encouraged that Lower Merion settled its lawsuit and is providing tax rebates for budget variances going forward.

#### **Recommendation 4**

Lower Merion responded that it reviews its designated funds annually. We believe, however, that after several years of not using its commitment for particular types of expenditures such as its pension obligations, the commitment should be repurposed or considered as an unassigned fund balance. Had the district considered the pension commitment as unassigned fund balance in FYE June 30, 2018, it would have exceeded the PSC threshold and been unable to increase taxes during the FYE June 30, 2018, and thereafter without a referendum vote until the funds were spent for general operations.

## **A Performance Audit**

### **School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes**

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#### **Recommendation 5**

We are encouraged that Lower Merion's settlement agreement provides that excess funds in the General Fund will be tax rebates rather than transferred to the Capital Projects and Capital Reserves Funds.

## A Performance Audit

### School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes

#### Neshaminy School District

Neshaminy School District’s (Neshaminy) revenues and expenditures ranged from \$175 million to \$185 million during the four FYE June 30, 2018, 2019, 2020, and 2021.<sup>85</sup> The following table summarizes Neshaminy’s information for referendum exceptions requested by fiscal year, the funds available in its General Fund at the beginning of each fiscal year (July 1), whether taxes were raised, and whether taxes were raised above the index:

**Table #1**

Fiscal Year End	Did the District Request a Referendum Exception? <sup>a/</sup>	Type of Exception Requested <sup>b/</sup>	Total Amount Approved	General Funds Available July 1 <sup>c/</sup>	Taxes were Raised	Taxes Were Raised Above the Index
2018	Yes	Pension Obligations and Special Education Costs <sup>d/</sup>	\$3,678,504	\$34,260,871	Yes	No
2019	Yes	Pension Obligations and Special Education Costs	\$ 753,576	\$34,226,092	Yes	No
2020	Yes	Pension Obligations	\$ 32,260	\$42,440,162	Yes	No
2021	No	N/A	N/A	\$47,970,291	Yes	No

<sup>a/</sup> - Based on PDE’s applicable year’s Report on Referendum Exceptions, the district did or did not request a referendum exception to raise taxes above the index.  
<sup>b/</sup> - Act 1 of 2006, as amended, provides four different types of referendum exceptions based on type of expenditure costs, see the *Introduction and Background* section of this report. See Taxpayer Relief Act, 53 P.S. § 6926.101 *et seq.*  
<sup>c/</sup> - The amount of funds available to Neshaminy at the beginning of the fiscal year; for instance, for the FYE June 30, 2018, the amount available for appropriation by the Board on July 1, 2017, was \$34,260,871.<sup>86</sup>

<sup>85</sup> The range of revenues and expenditures is based on the final Adopted General Fund Budgets.

<sup>86</sup> The table includes funds committed and assigned in the General Fund that are available for use if the Board so directs. Also, the available funds listed have been unspent for several years and remain available for the Board to recommit or reassign for other types of expenditures.

## A Performance Audit

### School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes

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<sup>d/</sup> - Pension obligations refer to the retirement contributions made by the school district to the Public School Employees' Retirement System (PSERS).

N/A – Not applicable

*Sources: Produced by staff of the Department of the Auditor General based on information in the PDE's referendum reports and Neshaminy's audited financial statements for the FYE June 30, 2017, 2018, 2019, 2020, and 2021.*

Based on our audit procedures, we did not find non-compliance with law or regulations. However, we found the following issues regarding prudent stewardship of taxpayer funds:

- Neshaminy routinely requests referendum exceptions despite having sufficient funding for anticipated annual expenditures.
- Neshaminy designates its General Fund as commitments and assignments to increase taxes while retaining millions of dollars not used timely for designated purposes.

The following two sections describe these results in more detail.

#### **Neshaminy routinely requests referendum exceptions despite having sufficient funding for anticipated annual expenditures.**

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Neshaminy applied for referendum exceptions to raise taxes above the index for the FYE 2018, 2019, and 2020. Although Neshaminy increased taxes each of the four FYE June 30, 2018, 2019, 2020, and 2021, it did not use the approved referendum exceptions to increase taxes above the index. When questioned Neshaminy's Chief Financial Officer (CFO) stated that the district's former CFO routinely applied for referendum exceptions as a budget tool to keep the option of increasing taxes above the index available until the end of the budget process each year.

Based on Act 1 of 2006, as amended, Section 333 (a)(1), the additional tax rate increase above the index may be requested if needed to balance the preliminary budget.<sup>87</sup> By requesting referendum exceptions, the district is indicating that the tax increases are needed due to insufficient available funding. However, we found that Neshaminy had sufficient funding available to balance the budget which negated the need to apply for referendum exceptions for the FYE June 30, 2018, 2019, and 2020, for the following reasons:

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<sup>87</sup> Subsection (a)(1) of Section 333 (relating to public referendum requirements for increasing certain taxes) of the Taxpayer Relief Act. Please note at Subsection (a)(2) of the act states as follows: "(2) This section shall apply to each board of school directors beginning with any proposed tax increase that takes effect in the 2007-2008 fiscal year and each fiscal year thereafter." See 53 P.S. § 6926.333(a)(1)-(2).

## A Performance Audit

### School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes

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- Neshaminy’s preliminary budgets for FYE 2018, 2019, and 2020 each projected a balanced budget by increasing taxes above the index without using the more than \$31 million estimated General Fund balance. Additionally, each preliminary budget included an unassigned fund balance estimated at more than \$13 million. Therefore, Neshaminy had adequate funding and did not need to apply for the referendum exceptions and propose increases in taxes above the index because the funds it had were sufficient to balance its preliminary budgets.<sup>88</sup>
- Neshaminy had sufficient funds committed specifically for the type of expenditure used for the referendum exception it sought. For example, at the end of the FYE June 30, 2019, prior to the start of the next fiscal year and prior to raising taxes that year, the Board approved a \$15 million General Fund commitment for pension obligations. Therefore, Neshaminy had adequate funding and did not need to apply for the referendum exception for pension obligations totaling \$32,260 for the FYE June 30, 2020, as listed in Table #1 above. The CFO acknowledged that applying for referendum exceptions was routine, that the referendum exceptions were not needed, and that taxes were not raised above the index.

Our results demonstrate that Neshaminy had sufficient funding and did not need to apply for referendum exceptions to meet its pension obligations and/or special education costs during the FYE June 30, 2018, 2019, and 2020. Additionally, the district presented preliminary budgets to the taxpayers and PDE that suggested the district had insufficient funds to balance its budget while it had millions of dollars available for anticipated expenditures. The process of applying for unnecessary referendum exceptions wasted time and resources for the district and PDE.

### **Neshaminy designates its General Fund as commitments and assignments to increase taxes while retaining millions of dollars not used timely for designated purposes.**

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General Fund balances can be designated as committed, assigned, or unassigned.<sup>89</sup> The PSC **prohibits** districts from increasing taxes if its unassigned fund balance in the General Fund is greater than **8%** of the next fiscal year’s budgeted expenditures. By reducing the unassigned fund balance every year to below 8%, Neshaminy increased taxes at or below the index each of the FYE June 30, 2018, 2019, 2020, and 2021.

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<sup>88</sup> While this calls into question the reason PDE approved the referendum exceptions, this is not an audit of PDE’s procedures and processes.

<sup>89</sup> The General Fund classifications are described in more detail in the *Introduction and Background* section of this report.

## A Performance Audit

### School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes

During our audit period, Neshaminy had committed and assigned funds in the General Fund for pension obligations, capital projects, technology, health insurance, operating expenditures, and budget costs. The following table illustrates Neshaminy’s General Fund balances:

**Table #2**

General Fund - Fund Balances	FYE June 30			
	2018	2019	2020	2021
Committed:				
Pension obligations	\$ 12,000,000	\$ 15,000,000	\$ 15,000,000	\$ 15,000,000
Assigned:				
Capital projects	\$ 6,000,000	\$ 11,500,000	\$ 17,470,291	\$ 17,740,233
Technological infrastructure	\$ 800,000	\$ 1,500,000	\$ 1,500,000	\$ 1,500,000
Health insurance	\$ -	\$ -	\$ 2,374,756	\$ 1,720,782
Operating expenditures	\$ 750,820	\$ -	\$ -	\$ -
Subsequent year's budget	\$ 269,533	\$ -	\$ -	\$ -
Unassigned	\$ 14,405,739	\$ 14,440,162	\$ 14,000,000	\$ 14,384,517
<b>Total Committed, Assigned, and Unassigned Fund Balance</b>	<b>\$ 34,226,092</b>	<b>\$ 42,440,162</b>	<b>\$ 50,345,047</b>	<b>\$ 50,345,532</b>

Source: Produced by staff of the Department of the Auditor General based on information in Neshaminy’s audited financial statements for the FYE June 30, 2018, 2019, 2020, and 2021.

Based on our audit procedures, we found:

- On an annual basis, prior to the end of the fiscal year in June, Neshaminy’s Board formally approved resolutions to commit funds for specific purposes based on recommendations from its CFO. However, on June 25, 2019, the board approved to reduce the commitment for pension obligations by \$1.75 million for FYE June 30, 2019, but the amount was not accurately reflected in the audited financial statements.<sup>90</sup> Although the Board complied with the applicable PDE requirement for commitments, the financial statements did not accurately reflect the change. The current CFO indicated the omission was an error and the district administration did not do the proper accounting to reduce the committed fund balance per the board action.
- Neshaminy’s policy states the General Fund unassigned fund balance is to be maintained between four percent (4%) and eight percent (8%) of budgeted expenditures. If it falls below 4%, the Board is to pursue efforts to increase revenues

<sup>90</sup> PDE Accounting Bulletin #2010-01, effective fiscal year 2010-11, and thereafter, requires commitment classifications for specific purposes be the result of a formal action by the school’s highest level of authority, which in this case is the Board. The PDE bulletin provides that the Board’s approval to commit the funds be before the end of the fiscal year and the amounts can be determined after the fiscal year. Additionally, assignments of funds do not require formal action by the Board.

## **A Performance Audit**

### **School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes**

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and/or decrease expenditures until 4% is attained. We found the district partially complied with its policy because it maintained its unassigned fund balance between 4% and 8% each of the four years audited. However, the district raised taxes all four fiscal years while having more than 4% in its unassigned fund balance. The CFO stated the Board took proactive measures in raising revenues in the FYE June 30, 2018, 2019, 2020, and 2021, so that the unassigned fund balance would remain above the 4% level.

- Neshaminy did not use the funds committed for pension obligations of \$12 million to \$15 million and assigned for capital projects of \$6 million to \$17 million as listed in the Table #2 above. Therefore, these are funds available to the district for other types of expenditures if needed and if the Board so directs. Had the district retained \$3 million more in its unassigned fund balance, Neshaminy would have been over the PSC threshold each year and would not have been allowed to raise taxes without a voter referendum at or below the index like it did for the FYE June 30, 2018, 2019, 2020, and 2021.

Based on our audit results, Neshaminy's policy allows it to increase taxes while retaining millions of dollars of unspent funds in commitments and assignments in the General Fund. The Board should reconsider its policies and practices to help lessen the tax burden on its taxpayers. Further, this excess burden was compounded in future years because the Board did not reverse the unneeded tax increases.

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### **Recommendations for Neshaminy School District**

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While we did not find non-compliance with law or regulations, we offer the following recommendations to Neshaminy School District to improve stewardship of taxpayer funds:

1. Refrain from applying for referendum exceptions unless the district has utilized unspent funds in the General Fund's commitments and/or assignments. Additionally, refrain from applying for referendum exceptions if funds have been set aside specifically for the type of expenditure that is being requested prior to increasing taxes above the index.
2. Pass a resolution during the preliminary budget phase to not increase taxes above the district's index when budgetary needs can be met with existing available funds in the General Fund.
3. As a best business practice, revise the General Fund policy to eliminate the restriction of maintaining excess surplus funds in the unassigned fund balance.

## A Performance Audit

### School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes

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4. If the district has designations for funds that are not used in the next fiscal year as intended, the Board should repurpose the funds or the funds should be considered as unassigned fund balance in the General Fund.
5. Ensure financial transactions that are approved by the Board are properly recorded and reflected in the financial statements.

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### Neshaminy School District's Response

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**From:** McGee, Rob

**Sent:** Monday, November 28, 2022 1:44 PM

**Subject:** RE: Draft report of audit results - Neshaminy School District (audit to evaluate particular school districts' fund balances).

Hi Peggy,

Thank you for the Heads Up. (The email address didn't get my attention  
<[Dept\\_of\\_the\\_Auditor\\_General\\_Bureau\\_of\\_Performance@paauditor.gov](mailto:Dept_of_the_Auditor_General_Bureau_of_Performance@paauditor.gov)> )

We are in receipt of the Draft Report, agree with each findings and plan to comply with all recommendations (given Board Approval).

We will share the report with Board Leadership next week and the report will be an Agenda Item at the Board's January, 2023 Business Operations Committee Meeting.

My apologies for the late response  
Rob  
(unproofed)

**A Performance Audit**

**School Districts – General Fund Balances  
Applying for Referendum Exceptions, Designating Funds, and  
Increasing Taxes**

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**Auditor’s Conclusion to Neshaminy School District’s Response**

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The Neshaminy School District (Neshaminy) agreed with our audit results and indicates that it plans to comply with all the recommendations upon its Board’s approval. We are encouraged that Neshaminy agreed to consider our recommendations.

## A Performance Audit

### School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes

#### North Allegheny School District

North Allegheny School District’s (North Allegheny) revenues and expenditures ranged from \$158 million to \$181 million during the four FYE June 30, 2018, 2019, 2020, and 2021.<sup>91</sup> The following table summarizes North Allegheny’s information for referendum exceptions requested by fiscal year, the funds available in its General Fund at the beginning of each fiscal year (July 1), whether taxes were raised, and whether taxes were raised above the index.

**Table #1**

FYE June 30	Did the District Request a Referendum Exception? <sup>a/</sup>	Type of Exception Requested <sup>b/</sup>	Total Amount Approved	General Funds Available July 1 <sup>c/</sup>	Taxes were Raised	Taxes Were Raised Above the Index <sup>c/</sup>
2018	Yes	Pension Obligations and Special Education Costs <sup>d/</sup>	\$1,013,515	\$17,108,861	No	No
2019	Yes	Pension Obligations and Special Education Costs	\$ 131,265	\$16,781,453	Yes	Yes
2020	Yes	Pension Obligations and Special Education Costs	\$1,562,375	\$14,207,259	Yes	Yes
2021	Yes	Special Education Costs	\$2,754,419	\$18,897,001	No	No

<sup>a/</sup> - Based on PDE’s applicable year’s Report on Referendum Exceptions, the district did or did not request a referendum exception to raise taxes above the index.

<sup>b/</sup> - Act 1 of 2006, as amended, provides four different types of referendum exceptions based on type of expenditure costs, see the *Introduction and Background* section of this report. See Taxpayer Relief Act, 53 P.S. § 6926.101 *et seq.*

<sup>91</sup> The range of revenues and expenditures is based on the Preliminary Budgets used to apply for the referendum exceptions.

## A Performance Audit

### School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes

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<sup>c/</sup> - The amount of funds available to North Allegheny at the beginning of the fiscal year; for instance, for the FYE June 30, 2018, the amount available for appropriation by the Board on July 1, 2017, was \$17,108,861.<sup>92</sup>

<sup>d/</sup> - Pension obligations refer to the retirement contributions made by the school district to the Public School Employees' Retirement System (PSERS).

<sup>e/</sup> - Taxes were raised above the index within the approved PDE referendum exception.

*Sources: Produced by staff of the Department of the Auditor General based on information in the PDE's referendum reports and North Allegheny's audited financial statements for the FYE June 30, 2017, 2018, 2019, 2020, and 2021.*

Based on our audit procedures, we did not find non-compliance with law or regulations. However, we found the following issues regarding prudent stewardship of taxpayer funds:

- North Allegheny routinely requests referendum exceptions and raised taxes above the index twice during the audit period despite having sufficient funding for anticipated annual expenditures.
- North Allegheny designates its General Fund balances as assignments to increase taxes while transferring funds or retaining millions of dollars not used timely for designated purposes.

The following two sections describe these results in more detail.

#### **North Allegheny routinely requests referendum exceptions and raised taxes above the index twice during the audit period despite having sufficient funding for anticipated annual expenditures.**

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North Allegheny applied for referendum exceptions to raise taxes above the index for the FYE June 30, 2018, 2019, 2020, and 2021. North Allegheny used the approved referendum exceptions for the FYE June 30, 2019, and 2020, to increase taxes above the index. When questioned, North Allegheny's Assistant Director of Finance explained that the district's Board routinely applies for referendum exceptions as a budgetary tool to reserve the option of raising taxes above the index until adoption of the final budget in June of each year.

Based on Act 1 of 2006, as amended, Section 333(a)(1), the additional tax rate increase above the index may be requested if needed to balance the preliminary budget.<sup>93</sup> By using a referendum

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<sup>92</sup> The table includes funds committed and/or assigned in the General Fund that are available for use if the Board so directs. Also, the available funds listed have been unspent for several years and remain available for the Board to recommit and reassign for other types of expenditures.

<sup>93</sup> Subsection (a)(1) of Section 333 (relating to public referendum requirements for increasing certain taxes) of the Taxpayer Relief Act. Please note at Subsection (a)(2) of the act states as follows: "(2) This section shall apply to each

## A Performance Audit

### School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes

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exception, the district is indicating that the tax increase is needed due to insufficient available funding. However, we found that North Allegheny had sufficient funding available to balance the budget which negated the need to apply for referendum exceptions for the FYE June 30, 2018, 2019, 2020, and 2021 for the following reasons:

- North Allegheny had an average of \$13 million in its estimated ending unassigned fund balance listed on its preliminary budgets for each of the FYE June 30, 2018, 2019, 2020, and 2021.<sup>94</sup> Therefore, North Allegheny did not need to apply for referendum exceptions and propose an increase in taxes above the index because the funds it had were sufficient to balance its preliminary budgets.
- North Allegheny had sufficient funds assigned specifically for the type of expenditure used for the referendum exception it sought. The district assigned General Funds each year for pension obligations, as listed in Table #2 below, that were sufficient to fund the anticipated increases requested as referendum exceptions. Therefore, North Allegheny had adequate funding and did not need to apply for the referendum exceptions for pension costs any of the three years requested.

Our results demonstrate that North Allegheny had sufficient funding and did not need to apply for referendum exceptions to meet its pension obligations and/or special education costs during the FYE June 30, 2018, 2019, 2020, and 2021. Additionally, the district presented preliminary budgets to the taxpayers and PDE that suggested the district had insufficient funds to balance its budget while it had millions of dollars available for anticipated expenditures. The process of applying for unnecessary referendum exceptions wasted time and resources for the district and PDE. Further, the tax increases above the index that occurred for the FYE June 30, 2019, and 2020, were not needed and the resulting funds were not spent during the fiscal years.<sup>95</sup> Therefore, the Board placed an unnecessary excess burden on district taxpayers. This excess tax burden was compounded in future years because the Board did not reverse the unneeded tax increase.

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board of school directors beginning with any proposed tax increase that takes effect in the 2007-2008 fiscal year and each fiscal year thereafter.” See 53 P.S. § 6926.333(a)(1)-(2).

<sup>94</sup> While this calls into question the reason PDE approved the referendum exceptions, this is not an audit of PDE’s procedures and processes.

<sup>95</sup> The operating results led to an increase in unassigned fund balance in the General Fund and/or the Other Governmental Funds.

## A Performance Audit

### School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes

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#### North Allegheny designates its General Fund as assignments to increase taxes while transferring funds or retaining millions of dollars not used timely for designated purposes.

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General Fund balances can be designated as committed, assigned, or unassigned.<sup>96</sup> The PSC **prohibits** districts from increasing taxes if its unassigned fund balance in the General Fund is greater than **8%** of the next fiscal year’s budgeted expenditures.<sup>97</sup> By reducing the unassigned fund balance every year to meet the PSC 8% threshold, North Allegheny can increase taxes even though it is holding millions of dollars in its General Fund.

During our audit period, North Allegheny committed and assigned its available funds in the General Fund to future debt costs, pension obligations, textbooks, and athletics. The following table illustrates North Allegheny’s General Fund balances:

Table #2

General Fund - Fund Balances	FYE June 30			
	2018	2019	2020	2021
Committed:				
Future debt costs	\$ 4,872,071	\$ 4,042,070	\$ 2,947,193	\$ 2,114,618
Assigned:				
Pension obligations	\$ 1,784,774	\$ 3,434,774	\$ 2,684,774	\$ 3,184,774
Textbooks	\$ -	\$ 1,000,000	\$ -	\$ -
Athletics	\$ -	\$ 249,109	\$ 347,644	\$ 248,502
Unassigned	\$ 14,996,679	\$ 10,772,485	\$ 16,212,227	\$ 15,603,312
<b>Total Committed, Assigned, and Unassigned Fund Balance</b>	<b>\$ 21,653,524</b>	<b>\$ 19,498,438</b>	<b>\$ 22,191,838</b>	<b>\$ 21,151,206</b>

Source: Produced by staff of the Department of the Auditor General based on information in North Allegheny’s audited financial statements for the FYE June 30, 2018, 2019, 2020, and 2021.

Based on our audit procedures, we found:

- On an annual basis, in June, prior to the end of the reporting period, North Allegheny’s Board formally approved resolutions to commit funds for specific purposes in the General Fund based on recommendations from its Assistant Director of Finance.<sup>98</sup>

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<sup>96</sup> The General Fund classifications are described in more detail in the *Introduction and Background* section of this report.

<sup>97</sup> 24 P.S. § 6-688(a).

<sup>98</sup> PDE Accounting Bulletin #2010-01, effective fiscal year 2010-11, and thereafter, requires commitment classifications for specific purposes be the result of a formal action by the school’s highest level of authority, which in this case is the Board. The PDE bulletin provides that the Board’s approval to commit the funds be before the end

## A Performance Audit

### School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes

Therefore, North Allegheny complied with the applicable PDE requirement for commitments.

- North Allegheny’s policy states the General Fund unassigned fund balance is to be maintained between 3% and 8% of budgeted expenditures. We found the district complied with its policy each of the four years we audited. However, had the district reported \$302,000 more in its unassigned fund balance on the final adopted budgets for FYE June 30, 2019, and 2020, it would not have been able to increase taxes without a voter referendum either of those two years.
- It appears North Allegheny’s financial condition is stable due to the General Fund’s balance remaining at or about \$21 million between July 1, 2017, to FYE June 30, 2021; however, North Allegheny raised taxes above the index for the FYE June 30, 2019, and 2020, and it transferred \$10.6 million from the General Fund to its Technology Fund and Capital Reserve Fund during the four-year audit period, as listed in the table below. This was \$7.8 million more than it had budgeted to transfer in its adopted final budgets.

**Table #3**

Budget Transfers Versus Actual Transfers					
	FYE June 30				
	2018	2019	2020	2021	Total
Budget	\$189,000	\$1,426,200	\$1,150,000	\$ -	\$ 2,765,200
Actual	\$189,000	\$1,426,200	\$5,832,000	\$3,150,000	\$10,597,200

*Source: Produced by staff of the Department of the Auditor General based on information in North Allegheny’s final adopted budgets and audited financial statements for the FYE June 30, 2018, 2019, 2020, and 2021.*

While we recognize that North Allegheny needs technology and capital improvement funds, its budget should be transparent and, when the board determines it to be necessary, increase taxes through a referendum vote. Posing a referendum question would provide greater transparency to the taxpayers if the taxes raised are for particular purposes rather than general operations.

- North Allegheny management acknowledged that it did not use the funds designated for pension obligations because the revenues were adequate each year to cover the expenditures. Had North Allegheny maintained these unspent assigned funds as unassigned fund balance, the district would have exceeded the PSC threshold and would

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of the fiscal year and the amounts can be determined after the fiscal year. Additionally, assignments of funds do not require formal action by the Board.

## **A Performance Audit**

### **School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes**

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not have been able to increase taxes without a voter referendum for the FYE June 30, 2019, and 2020.

Based on our audit results, had North Allegheny retained the unspent assignments and the more than \$7.8 million of unbudgeted transfers as unassigned fund balance, it would have exceeded the PSC threshold and been unable to increase taxes during FYE June 30, 2019, and 2020, without a referendum vote until the funds were spent for general operations. However, North Allegheny's policy allows it to increase taxes while retaining millions of dollars of unspent funds for several years and while transferring funds. The Board should reconsider its policies and practices to help lessen the tax burden on its taxpayers.

### **Recommendations for North Allegheny School District**

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While we did not find non-compliance with law or regulations, we offer the following recommendations to North Allegheny School District to improve stewardship of taxpayer funds:

1. Refrain from applying for referendum exceptions unless the district has utilized unspent funds in the General Fund's commitments and/or assignments. Additionally, refrain from applying for referendum exceptions if funds have been set aside specifically for the type of expenditure that is being requested prior to increasing taxes above the index.
2. Pass a resolution during the preliminary budget phase to not increase taxes above the district's index when budgetary needs can be met with existing available funds in the General Fund.
3. As a best business practice, revise the General Fund policy to eliminate the restriction of maintaining excess surplus funds in the unassigned fund balance.
4. If the district has designations for funds that are not used in the next fiscal year as intended, the Board should repurpose the funds or the funds should be considered as unassigned fund balance in the General Fund.
5. Reconsider the practice of transferring surplus funds to the Technological Fund or Capital Reserve Fund unless the funds were specifically budgeted for and disclosed to the taxpayers. Excess surplus funds should be maintained in the General Fund as unassigned fund balances for future operation costs to lessen the burden on taxpayers. This will ensure tax increases are appropriate and needed.

## A Performance Audit

### School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes

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## North Allegheny School District's Response

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NORTH ALLEGHENY SCHOOL

*North Allegheny School District  
200 Hillvue Lane  
Pittsburgh, PA 15237-5391*

November 30, 2022

Scott D. King, CPA  
Director  
Bureau of Performance Audits

As requested by the draft audit results of North Allegheny's fund balances and use of referendum exceptions, please see below for our responses to the recommendations provided.

#### **Audit Recommendations:**

While we did not find non-compliance with law or regulations, we offer the following recommendations for North Allegheny School District to improve stewardship of taxpayer funds and advance transparency:

1. Refrain from applying for referendum exceptions unless the district has utilized unspent funds in the General Fund's commitments and/or assignments. Additionally, refrain from applying for referendum exceptions if you have funds set aside specifically for the type of expenditure that is being requested prior to increasing taxes above the index.

**District Response:** Agree, we will refrain from applying for referendum exceptions in the future unless the district's financial position is in a place that warrants the utilization of these exceptions as described above.

2. Pass a resolution during the preliminary budget phase to not increase taxes above the district's index when budgetary needs can be met with existing available funds in the General Fund.

**District Response:** Agree, when a referendum exception is not needed we will pass a resolution during the preliminary budget phase to not increase taxes above the district's index.

3. As a best business practice, revise the General Fund policy to eliminate the restriction of maintaining excess surplus funds in the unassigned fund balance.

**District Response:** We will provide this comment to the Board for consideration as we continuously update our Board policies based on PSBA recommendations. Currently the maximum of 8% of unassigned is based on PA Act 14 of 1949, section 688.

*Serving the educational needs of Bradford Woods Borough, Franklin Park Borough, Marshall Township, and Town of McCandless*

## A Performance Audit

### School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes

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4. If the district has designations for funds that are not used in the next fiscal year as intended, the Board should repurpose the funds or the funds should be considered as unassigned fund balance of the General Fund.

**District Response:** Agree that in some cases it does make sense that designations will be used in the following fiscal year and the unused portion will be released, including designations for next year purchase of textbooks and other large one-time purchases. However, we do feel that there are some instances where the designation crossing multiple years is appropriate and the district would need to build up and then utilize the designated balance over multiple years. Examples of this would include preparation for large multi-year projects, expected new/additional debt, stabilizing the impact of rising PSERS rates, and other similar items.

5. Reconsider the practice of transferring surplus funds to the Technological fund or Capital Reserve Fund unless the funds were specifically budgeted for and disclosed to the taxpayers. Excess surplus funds should be maintained in the General Fund as unassigned fund balances for future operation costs to lessen the burden of taxpayers. This will ensure tax increases are appropriate and needed.

**District Response:** In referencing the PDE Chart of accounts section B-2 in regards to Capital Reserve Funds, **Capital Reserve Fund**, per Municipal Code Section 1431 (School Districts ONLY) Authorized by Municipal Code P.L. 145, Act of April 30, 1943, also known as Purdon's 53 § 1431, accounts for:

- (1) monies transferred during any fiscal year from Appropriations made for any particular purpose which may not be needed,
- (2) surplus monies in the General Fund of the treasury of the LEA at the end of any fiscal year, and
- (3) interest earnings of the fund itself.

We do utilize all 3 funding methods permitted by the guidance to help maintain stable capital reserves for upcoming projects and other approved uses.

We look forward to our exit conference scheduled on December 2, 2022 to review the report and the responses provided above.

Sincerely,



Kermit J. Houser  
Asst Director of Finance, Treasurer

## A Performance Audit

### School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes

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#### **Auditor’s Conclusion to North Allegheny School District’s Response**

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The North Allegheny School District (North Allegheny) generally agreed to consider our recommendations. Below we address the district’s assertions we believe warrant further comment based on North Allegheny’s response.

#### **Recommendation 1**

We are encouraged that North Allegheny agreed to consider the recommendation.

#### **Recommendation 2**

We are encouraged that North Allegheny agreed to consider the recommendation.

#### **Recommendation 3**

We are encouraged that North Allegheny agreed to consider the recommendation and revise its policy. North Allegheny’s current policy provides for maintaining an unassigned fund balance in the General Fund between three percent (3%) and eight percent (8%). This policy is not a law or regulation and is written to comply with the PSC to remain below 8% to allow for increasing taxes every year while holding millions of dollars of unspent funds in the General Fund as commitments and assignments. The district’s policy is not permitting the excess unspent funds to remain as unassigned funds in the General Fund to alleviate future tax increases for potential operating shortfalls in the budget.

#### **Recommendation 4**

We are encouraged that North Allegheny agreed to consider the recommendation.

#### **Recommendation 5**

North Allegheny did not specifically agree or disagree with the recommendation but acknowledged that it is using funding methods allowed by law to transfer excess surplus funds in the General Fund to its Capital Reserve Fund. While we acknowledge the district’s compliance with law, our recommendation is that the district reconsider the 8% limit in the unassigned fund balance in the General Fund to alleviate the need to increase taxes.

## A Performance Audit

### School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes

#### North Penn School District

North Penn School District’s (North Penn) revenues and expenditures ranged from \$248 million to \$278 million during the four FYE June 30, 2018, 2019, 2020, and 2021.<sup>99</sup> The following table summarizes North Penn’s information for referendum exceptions requested by fiscal year, the funds available in its General Fund at the beginning of each fiscal year (July 1), whether taxes were raised, and whether taxes were raised above the index.

**Table #1**

FYE June 30	Did the District Request a Referendum Exception? <sup>a/</sup>	Type of Exception Requested <sup>b/</sup>	Total Amount Approved	General Funds Available July 1 <sup>c/</sup>	Taxes were Raised	Taxes Were Raised Above the Index <sup>c/</sup>
2018	No	N/A	N/A	\$37,750,278	Yes	No
2019	Yes	Pension Obligations and Special Education Costs <sup>d/</sup>	\$1,781,977	\$37,533,955	Yes	Yes
2020	Yes	Pension Obligations and Special Education Costs	\$1,453,237	\$38,070,589	Yes	No
2021	Yes	Special Education Costs	\$1,541,260	\$34,913,910	Yes	No

<sup>a/</sup> - Based on PDE’s applicable year’s Report on Referendum Exceptions, the district did or did not request a referendum exception to raise taxes above the index.  
<sup>b/</sup> - Act 1 of 2006, as amended, provides four different types of referendum exceptions based on type of expenditure costs, see the *Introduction and Background* section of this report. See Taxpayer Relief Act, 53 P.S. § 6926.101 *et seq.*  
<sup>c/</sup> - The amount of funds available to North Penn at the beginning of the fiscal year; for instance, for the FYE June 30, 2018, the amount available for appropriation by the Board on July 1, 2017, was \$37,750,278.<sup>100</sup>

<sup>99</sup> The range of revenues and expenditures is based on the final adopted General Fund budgets.

<sup>100</sup> The table includes funds committed in the General Fund that are available for use if the Board so directs. Also, the available funds listed have been unspent for several years and remain available for the Board to recommit for other types of expenditures.

## A Performance Audit

### School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes

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<sup>d/</sup> - Pension obligations refer to the retirement contributions made by the school district to the Public School Employees' Retirement System (PSERS).

<sup>e/</sup> - Taxes were raised above the index within the approved PDE referendum exception.

N/A – Not applicable

*Sources: Produced by staff of the Department of the Auditor General based on information in the PDE's referendum reports and North Penn's audited financial statements for FYE 2017, 2018, 2019, 2020, and 2021.*

Based on our audit procedures, we did not find non-compliance with law or regulations. However, we found the following issues regarding prudent stewardship of taxpayer funds:

- North Penn routinely requests referendum exceptions despite having sufficient funding for anticipated annual expenditures.
- North Penn increased taxes despite having unused committed funds and while transferring millions of dollars each year.

The following two sections describe these results in more detail.

#### **North Penn routinely requests referendum exceptions despite having sufficient funding for anticipated annual expenditures.**

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North Penn applied for referendum exceptions to raise taxes above the index for the FYE June 30, 2019, 2020, and 2021. Although North Penn raised taxes each of the four FYE June 30, 2018, 2019, 2020, and 2021, it only used the approved referendum exceptions to increase taxes above the index for the FYE June 30, 2019. When questioned, North Penn's Chief Financial Officer (CFO) explained that applying for referendum exceptions was a standard practice and is used as a budgetary tool for flexibility.

Based on Act 1 of 2006, as amended, Section 333(a)(1), an additional tax rate increase above the index may be requested if needed to balance the preliminary budget.<sup>101</sup> By requesting a referendum exception, the district is indicating that the tax increase above the index is needed due to insufficient available funding. However, we found that North Penn had sufficient funding available to balance its budget which negated the need to apply for referendum exceptions for the FYE June 30, 2019, 2020, and 2021, for the following reasons:

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<sup>101</sup> Subsection (a)(1) of Section 333 (relating to public referendum requirements for increasing certain taxes) of the Taxpayer Relief Act. Please note at Subsection (a)(2) of the act states as follows: "(2) This section shall apply to each board of school directors beginning with any proposed tax increase that takes effect in the 2007-2008 fiscal year and **each fiscal year thereafter.**" See 53 P.S. § 6926.333(a)(1)-(2).

## A Performance Audit

### School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes

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- North Penn had a projected \$35.9 million, \$40.2 million, and \$37.8 million beginning and ending estimated General Fund balance in its preliminary budgets for the three FYE June 30, 2019, 2020, and 2021, respectively.<sup>102</sup> Therefore, North Penn had adequate funding and did not need to apply for referendum exceptions for the three FYE June 30, 2019, 2020, and 2021, as listed in Table #1 above.
- North Penn had sufficient funds committed specifically for the type of expenditure used for the referendum exception sought. For example, the Board approved a \$16.8 million commitment for pension obligations as of FYE June 30, 2018 (see Table #2 below). These funds were sufficient for the pension referendum exceptions for both FYE June 30, 2019, and 2020. Therefore, North Penn did not need to apply for referendum exceptions for pension obligations for the FYE June 30, 2019, and 2020. The CFO acknowledged that the commitment of \$16.8 million was not spent or needed during the three FYE June 30, 2019, 2020, and 2021.<sup>103</sup>

Our results demonstrate that North Penn had sufficient funding and did not have to apply for referendum exceptions to meet its pension obligations and/or special education costs during the FYE June 30, 2019, 2020, and 2021. Additionally, the district presented preliminary budgets to the taxpayers and PDE that suggested the district had insufficient funds to balance its budget while it had millions of dollars available for anticipated expenditures. The process of applying for unnecessary referendum exceptions wasted time and resources for the district and PDE. Further, the tax increase above the index that occurred for the FYE June 30, 2019, was not needed and the resulting funds were not spent during the fiscal year.<sup>104</sup> Therefore, the Board placed an unnecessary excess burden on district taxpayers. This excess tax burden was compounded in future years because the Board did not reverse the unneeded tax increase.

### **North Penn increased taxes despite having unused committed funds and while transferring millions of dollars each year.**

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General Fund balances can be designated as committed, assigned, or unassigned.<sup>105</sup> The PSC prohibits districts from increasing taxes if its unassigned fund balance in the General Fund is

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<sup>102</sup> While this calls into question the reason PDE approved the referendum exceptions, this is not an audit of PDE's procedures and processes.

<sup>103</sup> The commitment was increased \$2.5 million in June 2017, and \$99,664 was used during the FYE June 30, 2018. Therefore, the balance of \$16.8 million was not used during the FYE June 30, 2019, 2020, and 2021.

<sup>104</sup> The approved referendum exceptions to increase taxes above the index were less than the operating results, prior to interfund transfers and other financing sources (uses).

<sup>105</sup> The General Fund classifications are described in more detail in the *Introduction and Background* section of this report.

## A Performance Audit

### School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes

greater than 8% of the next fiscal year’s budgeted expenditures.<sup>106</sup> By reducing the unassigned fund balance every year to below 8%, North Penn increased taxes even though it had sufficient funds for anticipated expenditures in its General Fund each of the FYE June 30, 2018, 2019, 2020, and 2021.

During our audit period, North Penn had committed and assigned funds in the General Fund for pension obligations and self-funded insurance. The following table illustrates North Penn’s General Fund balances:

**Table #2**

FYE June 30				
General Fund - Fund Balances	2018	2019	2020	2021
Committed:				
PSERS stabilization	\$16,806,523	\$16,806,523	\$16,806,523	\$16,806,523
Assigned:				
Self-funded insurance	\$ 2,700,000	\$ 2,700,000	\$ 2,700,000	\$ 2,700,000
Unassigned	\$20,727,432	\$21,264,066	\$18,107,387	\$21,753,255
<b>Total Committed, Assigned, and Unassigned Fund Balance</b>	<b>\$40,233,955</b>	<b>\$40,770,589</b>	<b>\$37,613,910</b>	<b>\$41,259,778</b>

Source: Produced by staff of the Department of the Auditor General based on information North Penn’s audited financial statements for the FYE June 30, 2018, 2019, 2020, and 2021.

Based on our audit procedures, we found:

- North Penn approved a resolution on June 15, 2017, to increase the commitment for Pension obligations by \$2.5 million. The commitment remained at \$16.8 million for the FYE June 30, 2018, 2019, 2020, and 2021. North Penn complied with the applicable PDE requirement for the initial approval of the commitment.<sup>107</sup>
- North Penn’s policy states the General Fund unassigned fund balance is not to exceed 8% of the budgeted expenditures, and if it does, the district will commit or assign the excess funds. We found that the district partially complied with this policy and maintained its unassigned fund balance below 8%. Additionally, rather than increasing the commitments and assignments in the General Fund, North Penn transferred funds to the Capital

<sup>106</sup> 24 P.S. § 6-688(a).

<sup>107</sup> PDE Accounting Bulletin #2010-01, effective fiscal year 2010-11, and thereafter, requires commitment classifications for specific purposes be the result of a formal action by the school’s highest level of authority, which in this case is the Board. The PDE bulletin provides that the Board’s approval to commit the funds be before the end of the fiscal year and the amounts can be determined after the fiscal year. Additionally, assignments of funds do not require formal action by the Board.

## A Performance Audit

### School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes

Reserve Fund in excess of what was listed in its final adopted budgets, as illustrated in the following table:

**Table #3**

Budget Transfers Versus Actual Transfers					
	FYE June 30				
	2018	2019	2020	2021	Total
Budget	\$ -	\$ -	\$ 500,000	\$1,733,417	\$ 2,233,417
Actual	\$3,687,284	\$3,309,196	\$2,500,000	\$5,233,417 <sup>a/</sup>	\$14,729,897

<sup>a/</sup> - This transfer amount does not include the \$1,500,000 transferred to the Extended Care Fund which was also not included in the final adopted budget for budgeted interfund transfers.

Source: Produced by staff of the Department of the Auditor General based on information in North Penn's final adopted budgets and audited financial statements for the FYE June 30, 2018, 2019, 2020, and 2021.

While we recognize that the district needs capital improvement funds, it should be transparent with its budgets and increase taxes for capital projects through a referendum vote.

Based on our audit results, had the district retained the funds it transferred each year or its unspent commitments as unassigned fund balance, it would not have been able to increase taxes without a voter referendum any of the four FYE June 30, 2018, 2019, 2020, and 2021. This is because the funds would have exceeded the PSC threshold and, therefore, North Penn would have been unable to increase taxes until the funds were spent for general operations. However, North Penn's policy allows it to increase taxes while retaining millions of dollars of unspent funds for several years. The Board should reconsider its policies and practices to help lessen the tax burden on its taxpayers as a matter of prudent stewardship.

### Recommendations for North Penn School District

While we did not find non-compliance with law or regulations, we offer the following recommendations to North Penn School District to improve stewardship of taxpayer funds:

1. Refrain from applying for referendum exceptions unless the district has utilized unspent funds in the General Fund's commitments and/or assignments. Additionally, refrain from applying for referendum exceptions when funds have been set aside specifically for the type of expenditure that is being requested prior to increasing taxes above the index.

## **A Performance Audit**

### **School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes**

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2. Pass a resolution during the preliminary budget phase to not increase taxes above the district's index when budgetary needs can be met with existing available funds in the General Fund.
3. As a best business practice, revise the General Fund policy to eliminate the restriction of maintaining excess surplus funds in the unassigned fund balance.
4. If the district has designations for funds that are not used in the next fiscal year as intended, the Board should repurpose the funds or the funds should be considered as unassigned fund balance in the General Fund.
5. Reconsider the practice of transferring surplus funds to the Capital Reserve Fund unless the funds were specifically budgeted for and disclosed to the taxpayers. Excess surplus funds should be maintained in the General Fund as unassigned fund balances for future operation costs to lessen the burden on taxpayers. This will ensure tax increases are appropriate and needed.

## A Performance Audit

### School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes

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#### North Penn School District's Response

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NORTH PENN SCHOOL DISTRICT  
RESPONSE TO AUDIT RESULTS  
AUDITOR GENERAL'S PERFORMANCE AUDIT REPORT  
FISCAL YEARS ENDING JUNE 30, 2018, 2019, 2020 AND 2021

**North Penn routinely requests referendum exceptions despite having sufficient funding for anticipated annual expenditures**

**Management Response:**

The District agrees with the Auditor General's report which found NO non-compliance with laws or regulations for North Penn School District. The District also concurs with the data provided in Table #1 illustrating the referendum exceptions during the four FYE June 30, 2018, 2019, 2020, and 2021.

The applications for referendum exceptions were permitted by law and were made with School Board approval as required. The Pennsylvania Department of Education also approved the referendum exception requests. This allowed for flexibility during the budget process as the Act 1 budget timeline requires a preliminary budget to be presented in January or even earlier. Referendum exceptions were used in only one of the three years when a referendum request was submitted. Application for referendum exceptions never means a School Board will ultimately use those exceptions for the final budget adoption. The decision by the School Board to request the referendum exceptions is the essence of local control.

The statement that the district had "sufficient funds" in the unassigned fund balance is a matter of subjective opinion. North Penn School District's unassigned fund balance in each of the years in question was below the statutory limit of 8.0% of expenditures, as certified in the PDE-2028 submission. North Penn's Aa1 Moody's bond rating is primarily due to the balanced level of fund balance which ultimately saves the taxpayers money in interest expense when borrowing for capital projects. North Penn School District is one of approximately twenty school districts in the Commonwealth with a Aa1 Moody's bond rating or higher, according to the latest analysis provided to us from Public Financial Management. The impact of the bond rating on interest expense as well as the prudent use of funds potentially available from the district's fund balance will factor into the financial aspects of the district's ability to fund imminent and necessary high school and middle school construction projects estimated to be more than \$600 million.

The District will take the Auditor General's recommendations under advisement.

## A Performance Audit

### School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes

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**North Penn increased taxes despite having unused committed funds and while transferring millions of dollars each year.**

**Management Response:**

The District agrees with the Auditor General's report which found NO non-compliance with laws or regulations for North Penn School District. The District also concurs with the data provided in Table #2 illustrating the General Fund balances during the four FYE June 30, 2018, 2019, 2020, and 2021. The District also concurs with the data provided in Table #3 illustrating budgeted transfers versus actual transfers. North Penn School District's unassigned fund balance in each of the years in question was below the statutory limit of 8.0% of expenditures, as certified in the PDE-2028

submission. North Penn's Aa1 Moody's bond rating is primarily due to the balanced level of fund balance which ultimately saves the taxpayers money in interest expense when borrowing for capital projects. North Penn School District is one of approximately twenty school districts in the Commonwealth with a Aa1 Moody's bond rating or higher, according to the latest analysis provided to us from Public Financial Management. The impact of the bond rating on interest expense as well as the prudent use of funds potentially available from the district's fund balance will factor into the financial aspects of the district's ability to fund imminent and necessary high school and middle school construction projects estimated to be more than \$600 million.

North Penn School District's transfers to the Capital Reserve Fund were in compliance with auditing and Pennsylvania Department of Education regulations. The District has a 10-year capital plan with projects totaling over \$100 million so a transfer of unspent budget funds in a given fiscal year was a very financially prudent approach to fund these projects.

The District will take the Auditor General's recommendations under advisement.

  
Dr. Todd M. Bauer  
Superintendent of Schools  
North Penn School District

## **A Performance Audit**

### **School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes**

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#### **Auditor’s Conclusion to North Penn School District’s Response**

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The North Penn School District (North Penn) emphasized it was in compliance with laws and regulations and stated it will take the recommendations under advisement. Below we address certain areas we believe warrant further comment based on North Penn’s response.

#### **Recommendation 1 and 2:**

While North Penn acknowledged that it will take the recommendations under advisement, it also indicated that “sufficient funds” within the unassigned fund balance is a matter of subjective opinion. While this may be true, North Penn had more than \$34 million available to balance the preliminary budgets, including more than \$16 million committed for pension obligations and more than \$18 million in unassigned fund balance, both unused during our four-year audit period. We believe these funds should have been sufficient to balance the budgets for the less than \$2 million requested for pension and special education costs for each of the three years that North Penn applied for referendum exceptions. In fact, North Penn maintained an average General Fund balance of \$40.5 million during the four-year audit period.

#### **Recommendation 3, 4, and 5:**

We are encouraged the district will take the recommendations under advisement.

## A Performance Audit

### School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes

#### Northampton Area School District

Northampton Area School District’s (Northampton) revenues and expenditures ranged from \$99 million to \$114 million during the four FYE June 30, 2018, 2019, 2020, and 2021.<sup>108</sup> The following table summarizes Northampton’s information for referendum exceptions requested by fiscal year, the funds available in its General Fund at the beginning of each fiscal year (July 1), whether taxes were raised, and whether taxes were raised above the index.

**Table #1**

FYE June 30	Did the District Request a Referendum Exception? <sup>a/</sup>	Type of Exception Requested <sup>b/</sup>	Total Amount Approved	General Funds Available July 1 <sup>c/</sup>	Taxes were Raised	Taxes Were Raised Above the Index
2018	Yes	Pension Obligations and Special Education Costs <sup>d/</sup>	\$ 614,624	\$15,033,939	Yes	No
2019	Yes	Special Education Costs	\$ 943,250	\$12,482,717	Yes	No
2020	Yes	Special Education Costs	\$ 810,284	\$10,367,092	Yes	No
2021	Yes	Special Education Costs	\$2,230,103	\$10,073,366	No	No

<sup>a/</sup> - Based on PDE’s applicable year’s Report on Referendum Exceptions, the district did or did not request a referendum exception to raise taxes above the index.  
<sup>b/</sup> - Act 1 of 2006, as amended, provides four different types of referendum exceptions based on type of expenditure costs, see the *Introduction and Background* section of this report. See Taxpayer Relief Act, 53 P.S. § 6926.101 *et seq.*

<sup>108</sup> The range of revenues and expenditures is based on the Preliminary Budgets used to apply for the referendum exceptions.

## A Performance Audit

### School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes

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<sup>c/</sup> - The amount of funds available to Northampton at the beginning of the fiscal year; for instance, for the FYE June 30, 2018, the amount available for appropriation by the Board on July 1, 2017, was \$15,033,939.<sup>109</sup>

<sup>d/</sup> - Pension obligations refer to the retirement contributions made by the school district to the Public School Employees' Retirement System (PSERS).

<sup>e/</sup> - The amount requested was slightly more than approved by PDE.

*Sources: Produced by staff of the Department of the Auditor General based on information in the PDE's referendum reports and audited financial statements for the FYE 2017, 2018, 2019, 2020, and 2021.*

Based on our audit procedures, we did not find non-compliance with law or regulations. However, we found the following issues regarding prudent stewardship of taxpayer funds:

- Northampton routinely requests referendum exceptions despite having sufficient funding for anticipated annual expenditures.
- Northampton increased taxes despite having unused committed and assigned funds.

The following two sections describe these results in more detail.

#### **Northampton routinely requests referendum exceptions despite having sufficient funding for anticipated annual expenditures.**

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Northampton applied for referendum exceptions to raise taxes above the index each of the four FYE June 30, 2018, 2019, 2020, and 2021. Although Northampton raised taxes three of the four years, FYE June 30, 2018, 2019, and 2020, it did not use the approved referendum exceptions to increase taxes above the index. When questioned, Northampton's Business Administrator explained that the practice of applying for referendum exceptions was a routine practice to maintain a conservative outlook due to the many variables that exist during the budgeting process.

Based on Act 1 of 2006, as amended, Section 333(a)(1), an additional tax rate increase above the index may be requested if needed to balance the preliminary budget.<sup>110</sup> By requesting a referendum exception, the district is indicating that the tax increase above the index is needed due to insufficient available funding. However, we found that Northampton had sufficient

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<sup>109</sup> The table includes funds committed and/or assigned in the General Fund that are available for use if the Board so directs. Also, the available funds listed have been unspent for several years and remain available for the Board to recommit and/or reassign for other types of expenditures.

<sup>110</sup> Subsection (a)(1) of Section 333 (relating to public referendum requirements for increasing certain taxes) of the Taxpayer Relief Act. Please note at Subsection (a)(2) of the act states as follows: "(2) This section shall apply to each board of school directors beginning with any proposed tax increase that takes effect in the 2007-2008 fiscal year and **each fiscal year thereafter.**" See 53 P.S. § 6926.333(a)(1)-(2).

## A Performance Audit

### School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes

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funding available to balance its budget which negated the need to apply for referendum exceptions for the FYE June 30, 2018, 2019, 2020, and 2021, for the following reasons:

- Northampton had a projected \$7.9 million, \$8 million, \$7 million, and \$4.8 million ending estimated General Fund balance in its preliminary budgets for the four FYE June 30, 2018, 2019, 2020, and 2021, respectively.<sup>111</sup> Therefore, Northampton had adequate funding and did not need to apply for referendum exceptions for the four FYE June 30, 2018, 2019, 2020, and 2021, as listed in Table #1 above.
- Northampton had sufficient funds assigned specifically to balance the budget each year as shown in Table #2 below. These funds were sufficient for the pension and special education referendum exceptions for each year as listed in Table #1 above. Therefore, Northampton did not need to apply for referendum exceptions any of the four FYE June 30, 2018, 2019, 2020 and 2021. The Business Administrator acknowledged that the assignments were not spent or needed during the four FYE June 30, 2018, 2019, 2020, and 2021.

Our results demonstrate that Northampton had sufficient funding and did not have to apply for referendum exceptions to meet its pension obligations and/or special education costs during the FYE June 30, 2018, 2019, 2020, and 2021. Additionally, the district presented preliminary budgets to the taxpayers and PDE that suggested the district had insufficient funds to balance its budget while it had millions of dollars available for anticipated expenditures. The process of applying for unnecessary referendum exceptions wasted time and resources for the district and PDE.

### **Northampton increased taxes despite having unused committed and assigned funds.**

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General Fund balances can be designated as committed, assigned, or unassigned.<sup>112</sup> The PSC prohibits districts from increasing taxes if its unassigned fund balance in the General Fund is greater than 8% of the next fiscal year's budgeted expenditures.<sup>113</sup> By reducing the unassigned fund balance every year to below 8%, Northampton increased taxes even though it had sufficient funds for anticipated expenditures in its General Fund each of the FYE June 30, 2018, 2019, 2020, and 2021.

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<sup>111</sup> While this calls into question the reason PDE approved the referendum exceptions, this is not an audit of PDE's procedures and processes.

<sup>112</sup> The General Fund classifications are described in more detail in the *Introduction and Background* section of this report.

<sup>113</sup> 24 P.S. § 6-688(a).

## A Performance Audit

### School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes

During our audit period, Northampton had committed and assigned funds in the General Fund for facility maintenance, debt funding, healthcare obligations, Chromebooks ®<sup>114</sup>, student activities, and balancing the budget. The following table illustrates Northampton’s General Fund balances:

**Table #2**

General Fund - Fund Balances	FYE June 30			
	2018	2019	2020	2021
<b>Committed:</b>				
Facility capital maintenance projects	\$ 1,450,000	\$ 1,000,000	\$ 1,000,000	\$ 1,000,000
New elementary debt funding	\$ 400,000	\$ -	\$ -	\$ -
Healthcare obligations	\$ 103,402	\$ -	\$ -	\$ -
<b>Assigned:</b>				
Chromebook reserve	\$ 19,224	\$ 9,278	\$ 5,569	\$ 2,886
Student Activities	\$ -	\$ -	\$ -	\$ 40,701
Balance Budget	\$ 3,890,692	\$ 3,441,504	\$ 3,139,775	\$ 3,603,307
Unassigned	\$ 7,142,025	\$ 5,925,588	\$ 5,933,591	\$ 9,706,490
<b>Total Committed, Assigned, and Unassigned Fund Balance</b>	<b>\$ 13,005,343</b>	<b>\$ 10,376,370</b>	<b>\$ 10,078,935</b>	<b>\$ 14,353,384</b>

Source: Produced by staff of the Department of the Auditor General based on Northampton’s audited financial statements for the FYE June 30, 2018, 2019, 2020, and 2021.

Based on our audit procedures, we found:

- Northampton approves resolutions annually mid-year in December to increase or decrease commitments and assignments for the current fiscal year ending in June. Northampton complied with the applicable PDE requirement for the approval of the commitments.<sup>115</sup>
- Northampton’s policy states that the General Fund’s unassigned fund balance is to be maintained between five percent (5%) and eight percent (8%) of budgeted expenditures. If it falls below 5%, the Board is to pursue efforts to increase revenues and/or decrease expenditures until 5% is attained. We found Northampton partially complied with its policy because it maintained its unassigned fund balance between 5% and 8% each of the four years audited. However, the district raised taxes three fiscal years while having more than 5% in its unassigned fund balance. The Business Administrator stated that the

<sup>114</sup> Chromebooks are considered to be budget friendly laptops or tablets running on the Windows Operating System.

<sup>115</sup> PDE Accounting Bulletin #2010-01, effective fiscal year 2010-11, and thereafter, requires commitment classifications for specific purposes be the result of a formal action by the school’s highest level of authority, which in this case is the Board. The PDE bulletin provides that the Board’s approval to commit the funds be before the end of the fiscal year and the amounts can be determined after the fiscal year. Additionally, assignments of funds do not require formal action by the Board.

## **A Performance Audit**

### **School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes**

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district interprets the policy as a guideline and not as a strict rule, since it does not use the wording “must be below 5%”.

- The General Fund is financed from local, state, and federal sources. These funds are generally for financing the current operations of the school district.<sup>116</sup> Since Northampton has not used \$3 million of the funds that are assigned for balancing the budget, these funds have not been used timely. Maintaining the funds as assignments without timely using the funds gives the appearance that the district is circumventing the PSC threshold to raise taxes by classifying unassigned funds as assignments. Had the district retained these funds as unassigned fund balance, it would not have been able to increase taxes without a voter referendum for any of the three FYE June 30, 2018, 2019, and 2020, because it would have exceeded the PSC threshold.

Based on our audit results, Northampton’s policy allows it to increase taxes while retaining millions of dollars of unspent funds in the General Fund. The Board should reconsider its policies and practices to help lessen the tax burden on its taxpayers as a matter of prudent stewardship. Further, this excess burden was compounded in future years because the Board did not reverse the unneeded tax increases.

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### **Recommendations for Northampton Area School District**

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While we did not find non-compliance with law or regulations, we offer the following recommendations to Northampton Area School District to improve stewardship of taxpayer funds:

1. Refrain from applying for referendum exceptions unless the district has utilized unspent funds in the General Fund’s commitments and/or assignments. Additionally, refrain from applying for referendum exceptions if funds have been set aside specifically for the type of expenditure that is being requested prior to increasing taxes above the index.
2. Pass a resolution during the preliminary budget phase to not increase taxes above the district’s index when budgetary needs can be met with existing available funds in the General Fund.
3. As a best business practice, revise the General Fund policy to eliminate the restriction of maintaining excess surplus funds in the unassigned fund balance.

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<sup>116</sup> Manual of Accounting and Financial Reporting for Pennsylvania Local Educational Agencies (LEAs). Maintained by: PA Office of the Budget, Office of Comptroller Operations Central Agencies & School Finance Unit. Revised August 2016.

## **A Performance Audit**

### **School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes**

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4. If the district has designations for funds that are not used in the next fiscal year as intended, the Board should repurpose the funds or the funds should be considered as unassigned fund balance in the General Fund.

## A Performance Audit

### School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes

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#### Northampton Area School District's Response

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**From:** Kovalchik, Joseph - District Adm  
**Sent:** Monday, November 21, 2022 11:08 AM  
**To:** Dept of the Auditor General Bureau of Performance Audits  
**Subject:** Re: Draft report of audit results - Northampton Area School District (audit to evaluate particular school districts' fund balances).

**CAUTION:** This email originated from outside of the organization. Do not click links or open attachments unless you recognize the sender and know the content is safe.

Good morning,

As noted in the report, there was no non-compliance with law or regulations. Also, as noted in the report, the practice of applying for referendum exceptions was a routine practice to maintain a conservative outlook due to the many variables that exist during the state budgeting process. In the Northampton Area, we take a conservative approach because the state does not provide us with the allocated amounts to be received until June. Assigned and Committed Fund Balance amounts are estimated in December and the final Budget does not get approved until June. In addition, there is no timeframe when amounts in Assigned and Committed Fund Balance have to be spent. For example, the \$1,000,000 of Committed Fund Balance for facility capital maintenance projects was just uncommitted this year since the District has begun the project. How the fiscal year ends also determines Assigned and Committed Fund Balance amounts. By applying for referendum exceptions, the District has NEVER indicated to the taxpayers that there is insufficient available funding. In fact, the District had tax increases of 2.99%, 2.01%, 1.97% and 0.0% in the years audited all below the Act 1 Index and over the past 4 years the Districts average tax increase has been .87%, which is significantly lower than the Act 1 Index. If insufficient funding was a concern at the time of the initial budgeting process, the District would have gone above the Act 1 Index. And lastly, your definition and the District's definition of what is sufficient funding can be debated. It should also be noted the District did not apply for exceptions when completing the 2022-23 Budget.

Sincerely,

Joseph S. Kovalchik  
Superintendent of the Northampton Area School District

## A Performance Audit

### School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes

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#### **Auditor’s Conclusion to Northampton School District’s Response**

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The Northampton School District (Northampton) emphasized its compliance with laws and regulations, its routine practice to apply for referendum exceptions due to the uncertainty of several factors for the budget process, and its conservative approach. Below we address the district’s disagreement along with certain areas we believe warrant further comment based on Northampton’s response.

#### **Recommendation 1 and 2**

Northampton acknowledges that it was a routine practice to apply for referendum exceptions and that it has opted to pass a resolution to not propose to increase taxes above the index for the FYE June 30, 2023. Additionally, Northampton indicates that the “District has NEVER indicated to the taxpayers that there is insufficient available funding.” We disagree, in that applying for referendum exceptions to propose to increase taxes above the index rather than passing a resolution to not increase taxes above the index, suggests that the tax increase is needed to fund particular types of expenditures.

#### **Recommendation 3**

Although Northampton did not comment on whether it will revise its policy to remove the upper limit on the unassigned General Fund balance, we are encouraged that it did not expressly disagree with the recommendation.

#### **Recommendation 4**

Northampton responded that it reviews its designated funds annually. However, we believe that after several years of not using a commitment or assignment for the particular type of expenditure, such as an assignment to balance the budget, it should be considered unassigned fund balance. Had the district kept these funds as unassigned fund balance in FYE June 30, 2018, it would have exceeded the PSC threshold and been unable to increase taxes during the FYE June 30, 2018, without a referendum vote until the funds were spent for general operations.

## A Performance Audit

### School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes

#### Penn Manor School District

Penn Manor School District’s (Penn Manor) revenues and expenditures ranged from \$80 million to \$94 million during the four FYE June 30, 2018, 2019, 2020, and 2021.<sup>117</sup> The following table summarizes Penn Manor’s information for referendum exceptions requested by fiscal year, the funds available in its General Fund at the beginning of each fiscal year (July 1), whether taxes were raised, and whether taxes were raised above the index.

**Table #1**

FYE June 30	Did the District Request a Referendum Exception? <sup>a/</sup>	Type of Exception Requested <sup>b/</sup>	Total Amount Approved	General Funds Available July 1 <sup>c/</sup>	Taxes were Raised	Taxes Were Raised Above the Index <sup>e/</sup>
2018	Yes	Pension Obligations and Special Education Costs <sup>d/</sup>	\$452,356	\$16,664,260	Yes	Yes
2019	Yes	Special Education Costs	\$771,389	\$18,531,100	Yes	Yes
2020	Yes	Special Education Costs	\$320,381	\$19,290,382	Yes	Yes
2021	No	N/A	N/A	\$20,218,950	No	No

<sup>a/</sup> - Based on PDE’s applicable year’s Report on Referendum Exceptions, the district did or did not request a referendum exception to raise taxes above the index.  
<sup>b/</sup> - Act 1 of 2006, as amended, provides four different types of referendum exceptions based on type of expenditure costs, see the *Introduction and Background* section of this report. See Taxpayer Relief Act, 53 P.S. § 6926.101 *et seq.*  
<sup>c/</sup> - The amount of funds available to Penn Manor at the beginning of the fiscal year; for instance, for the FYE June 30, 2018, the amount available for appropriation by the Board on July 1, 2017, was \$16,664,260.<sup>118</sup>  
<sup>d/</sup> - Pension obligations refer to the retirement contributions made by the school district to the Public School Employees’ Retirement System (PSERS).  
<sup>e/</sup> - Taxes were raised above the index within the approved PDE referendum exception.  
N/A – Not applicable.

<sup>117</sup> The range of revenues and expenditures is based on the final adopted General Fund budgets.

<sup>118</sup> The table includes funds committed in the General Fund that are available for use if the Board so directs. Also, the available funds listed have been unspent for several years and remain available for the Board to recommit for other types of expenditures.

## A Performance Audit

### School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes

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*Sources: Produced by staff of the Department of the Auditor General based on information in the PDE's referendum reports and Penn Manor's audited financial statements for the FYE 2017, 2018, 2019, 2020, and 2021.*

Based on our audit procedures, we did not find non-compliance with law or regulations. However, we found the following issues regarding prudent stewardship of taxpayer funds:

- Penn Manor requested referendum exceptions and raised taxes above the index three times during the audit period despite having sufficient funds in its General Fund for anticipated annual expenditures.
- Penn Manor designates its General Fund as commitments allowing it to increase taxes while retaining millions of dollars not used timely for designated purposes.

The following two sections describe these results in more detail.

#### **Penn Manor requested referendum exceptions and raised taxes above the index three times during the audit period despite having sufficient funds in its General Fund for anticipated annual expenditures.**

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Penn Manor applied for referendum exceptions to raise taxes above the index for the FYE June 30, 2018, 2019, and 2020. It used the approved referendum exceptions during the FYE June 30, 2018, 2019, and 2020, to increase taxes above the index for pension obligations and/or special education costs. When questioned, Penn Manor's Chief Financial Officer explained that the district's Board does not routinely apply for referendum exceptions or increase taxes above the index; however, the audit happened to select the years that it did apply for and use the referendum exceptions.

Based on Act 1 of 2006, as amended, Section 333(a)(1), an additional tax rate increase above the index may be requested if needed to balance the preliminary budget.<sup>119</sup> By requesting a referendum exception, the district is indicating that the tax increase above the index is needed due to insufficient available funding. However, we found that Penn Manor had sufficient funding available to balance the budget, which negated the need to apply for referendum exceptions for the FYE June 30, 2018, 2019, and 2020, for the following reasons:

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<sup>119</sup> Subsection (a)(1) of Section 333 (relating to public referendum requirements for increasing certain taxes) of the Taxpayer Relief Act. Please note at Subsection (a)(2) of the act states as follows: "(2) This section shall apply to each board of school directors beginning with any proposed tax increase that takes effect in the 2007-2008 fiscal year and each fiscal year thereafter." See 53 P.S. § 6926.333(a)(1)-(2).

## A Performance Audit

### School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes

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- Penn Manor had an average of \$3 million in its estimated ending unassigned fund balance listed on the preliminary budgets for the FYE June 30, 2018, 2019, and 2020. Therefore, Penn Manor did not need to apply for referendum exceptions and propose an increase in taxes above the index because the funds it had were sufficient to balance its preliminary budgets.<sup>120</sup>
- Penn Manor had sufficient funds committed specifically for the type of expenditures used for the referendum exception it sought. For example, the Board passed a resolution on June 19, 2017, to designate \$2 million of its General Fund balance for pension obligations. Therefore, Penn Manor did not need to apply for the referendum exception for pension costs totaling \$239,683 of the \$452,356 listed in Table #1 above because the \$2 million designated was more than the amount requested for pension costs.

Our results demonstrate that Penn Manor had sufficient funding and did not need to apply for referendum exceptions to meet its pension obligations and/or special education costs for the FYE June 30, 2018, 2019, and 2020. Additionally, the district presented preliminary budgets to the taxpayers and PDE that suggested the district had insufficient funds to balance its budget while it had millions of dollars available for anticipated expenditures. The process of applying for unnecessary referendum exceptions wasted time and resources for the district and PDE. Further, the tax increase above the index that occurred during the FYE June 30, 2018, 2019, and 2020, was not needed and the resulting funds were not spent for general operations in the respective fiscal years.<sup>121</sup> Therefore, the Board placed an unnecessary, excess burden on district taxpayers. This excess tax burden was compounded in future years because the Board did not reverse the unneeded tax increases.

### **Penn Manor designates its General Fund as commitments allowing it to increase taxes while retaining millions of dollars not used timely for designated purposes.**

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General Fund balances can be designated as committed, assigned, or unassigned.<sup>122</sup> The PSC prohibits districts from increasing taxes if its unassigned fund balance in the General Fund is

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<sup>120</sup> While this calls into question the reason PDE approved the referendum exceptions, this audit did not focus on PDE's procedures and processes.

<sup>121</sup> The operating surplus for each year led to an increase in the General Fund balance and/or the funds transferred to the Capital Reserves Fund in excess of the approved referendum exceptions.

<sup>122</sup> The General Fund classifications are described in more detail in the *Introduction and Background* section of this report.

## A Performance Audit

### School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes

greater than 8% of the next fiscal year’s budgeted expenditures.<sup>123</sup> By reducing the unassigned fund balance every year to below 8%, Penn Manor can increase taxes even though it has sufficient funds for anticipated expenditures in its General Fund.

During our audit period, Penn Manor committed its available funds in the General Fund to several items, including, but not limited to, facilities maintenance, healthcare and pension costs, textbooks, and pandemic expenses. The following table illustrates Penn Manor’s General Fund balances:

**Table #2**

General Fund - Fund Balances	FYE June 30			
	2018	2019	2020	2021
Committed:				
Future capital projects & facilities repair	\$ 6,502,306	\$ 6,863,928	\$ 6,775,532	\$ 8,079,459
Healthcare stabilization	\$ 3,000,000	\$ -	\$ -	\$ -
Pension obligations	\$ 2,000,000	\$ -	\$ -	\$ -
Textbook and software upgrades	\$ 1,000,000	\$ 1,000,000	\$ -	\$ -
Technology replacement/upgrade	\$ -	\$ 2,000,000	\$ 1,500,000	\$ 1,500,000
Debt service stabilization	\$ -	\$ 3,000,000	\$ -	\$ -
Pandemic related 2020-2021	\$ -	\$ -	\$ 3,336,236	\$ -
Pandemic related 2021-2022	\$ -	\$ -	\$ 2,000,000	\$ 3,066,140
Pandemic related 2022-2023	\$ -	\$ -	\$ -	\$ 1,250,000
Assigned	\$ -	\$ -	\$ -	\$ -
Unassigned	\$ 6,028,794	\$ 6,426,454	\$ 6,607,182	\$ 6,876,408
<b>Total Committed, Assigned, and Unassigned Fund Balance</b>	<b>\$18,531,100</b>	<b>\$19,290,382</b>	<b>\$20,218,950</b>	<b>\$20,772,007</b>

Source: Produced by staff of the Department of the Auditor General based on information in Penn Manor’s audited financial statements for the FYE June 30, 2018, 2019, 2020, and 2021.

Based on our audit procedures, we found:

- On an annual basis, prior to the end of the reporting period in June, Penn Manor’s Board formally approved resolutions to commit funds for specific purposes in the General Fund. The Board also formally approved resolutions mid-fall for the commitments prior to the completion of the respective audited financial statements. As a result, Penn Manor complied with the applicable PDE requirements for commitments.<sup>124</sup>

<sup>123</sup> 24 P.S. § 6-688(a).

<sup>124</sup> PDE Accounting Bulletin #2010-01, effective fiscal year 2010-11, and thereafter, requires commitment classifications for specific purposes be the result of a formal action by the school’s highest level of authority, which in this case is the Board. The PDE bulletin provides that the Board’s approval to commit the funds be before the end

## A Performance Audit

### School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes

- Penn Manor’s policy states that the General Fund’s unassigned fund balance is to be maintained between six percent (6%) and eight percent (8%) of budgeted expenditures, and if the unassigned portion falls below 6%, the Board will pursue increasing revenues and/or decreasing expenditures, and if the unassigned fund balance is above 8%, the excess funds are to be used for nonrecurring expenditures and not for normal operating costs. We found that the district complied with its policy and maintained its actual unassigned fund balance above 7% while designating or committing excess funds. Penn Manor’s policy ensures the district can raise taxes every year without going to a referendum vote while holding millions of dollars of funds that are unspent in the General Fund’s commitments or transferred to other Funds.
- Penn Manor did not use the funds designated as commitments in any of the four years audited and the Board increased the commitments each year from \$10.9 million as of July 1, 2017, to \$13.9 million by the FYE June 30, 2021.
- Penn Manor had sufficient surplus funds in the General Fund to transfer \$12.5 million to its Capital Reserves Fund during the four-year audit period. While we acknowledge that the district budgeted a portion of funds for interfund transfers, it transferred a total of \$3.3 million more than budgeted for the FYE June 30, 2019, and 2021, as illustrated in the following table.

**Table #3**

Budget Transfers Versus Actual Transfers					
	FYE June 30				
	2018	2019	2020	2021	Total
Budget	\$2,903,895	\$3,664,378	\$2,085,300	\$ 510,000	\$ 9,163,573
Actual	\$2,903,896	\$3,966,078	\$2,073,300	\$3,569,587	\$12,512,861

*Source: Produced by staff of the Department of the Auditor General based on information in Penn Manor’s final adopted budgets and audited financial statements for the FYE June 30, 2018, 2019, 2020, and 2021.*

While we recognize that the district needs capital improvement funds, it should be transparent in its budget. The increased taxes for the FYE June 30, 2018, 2019, and 2020, compounded each year resulting in the additional surplus funds for the FYE June 20, 2021.

Based on our audit results, had the district retained the unspent commitments and the unbudgeted transfers as unassigned fund balance, it would have exceeded the PSC threshold and been unable

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of the fiscal year and the amounts can be determined after the fiscal year. Additionally, assignments of funds do not require formal action by the Board.

## **A Performance Audit**

### **School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes**

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to increase taxes during the FYE June 30, 2018, 2019, and 2020, without a referendum vote until the funds were spent for general operations. However, Penn Manor's policy allows it to increase taxes while retaining millions of dollars of unspent funds for several years in its General Fund. The Board should reconsider its policy and practices to help lessen the tax burden on its taxpayers.

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### **Recommendations for Penn Manor School District**

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While we did not find non-compliance with law or regulations, we offer the following recommendations to Penn Manor School District to improve stewardship of taxpayer funds:

1. Refrain from applying for referendum exceptions unless the district has utilized unspent funds in the General Fund's commitments and/or assignments. Additionally, refrain from applying for referendum exceptions if the district has funds set aside specifically for the type of expenditure that is being requested prior to increasing taxes above the index.
2. Pass a resolution during the preliminary budget phase to not increase taxes above the district's index when budgetary needs can be met with existing available funds in the General Fund.
3. As a best business practice, revise the General Fund policy to eliminate the restriction of maintaining excess surplus funds in the unassigned fund balance and to accommodate current practices regarding increasing taxes prior to reaching 6% of estimated expenditures.
4. If the district has designations for funds that are not used within a few years as intended, the Board should consider the funds as unassigned fund balance in the General Fund.
5. Reconsider the practice of transferring surplus funds to the Capital Reserves Fund unless the funds were specifically budgeted for and disclosed to the taxpayers. Excess surplus funds should be maintained in the General Fund as unassigned fund balances for future operation costs to lessen the burden on taxpayers. This will ensure tax increases are appropriate and needed.

## A Performance Audit

### School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes

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## Penn Manor School District's Response

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*A Better Community...One Student at a Time*

### PENN MANOR SCHOOL DISTRICT

P.O. Box 1001 • Millersville, PA 17551-0301

Phone (717) 872-9500 • Fax (717) 872-9505

[www.pennmanor.net](http://www.pennmanor.net)

An Equal Opportunity Employer

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**Philip B. Gale, Ed.D.**  
Superintendent  
[philip.gale@pennmanor.net](mailto:philip.gale@pennmanor.net)

December 2, 2022

Scott D. King  
Director, Bureau of Performance Audits  
Commonwealth of Pennsylvania  
Department of the Auditor General  
Harrisburg, PA 17120-0018

RE: Performance Audit Report Response

Dear Mr. King,

As per your letter dated November 18, 2022, we are responding to the Performance Audit Report, Draft Audit Results and Recommendations.

We have reviewed the Draft Audit Report and are pleased with your assessment that you did not find non-compliance with any law or regulations when reviewing the fiscal years ending June 30, 2018, 2019, 2020 and 2021.

Per your report, the first objective of the audit was to determine whether each of the selected districts appropriately used the referendum exception method to raise local school property taxes, and the second objective included determining if each district ensured that fund balances were properly designated and used for intended purposes.

While your report states that you did not find any non-compliance with laws or regulations, you conclude there were issues regarding prudent stewardship of taxpayer funds. However, your report does not contain any reference to the \$100 million high school renovation project that the district was in the midst of or that the tax increases, fund commitments and interfund transfers were all part of a multi-year district strategy that had been discussed in public sessions and approved by the board of directors. These actions were taken in an effort to lower the amount of bond financing required and to build millage capacity to accommodate the resulting additional debt burden. The use of exceptions was necessary to cover the rising pension and special education costs as the district used what remained of the Act 1 Index to build millage capacity and raise funds to be directly used for the high school construction project.

All actions regarding the use of Act 1 Exceptions, property tax increases, commitment of funds, and interfund transfers were taken in public sessions after board discussion.

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**Gerard A. Egan, Ed.D.**  
Assistant Superintendent for  
Elementary Education  
[jerry.egan@pennmanor.net](mailto:jerry.egan@pennmanor.net)

**Christopher L. Johnston**  
Chief Financial Officer  
[chris.johnston@pennmanor.net](mailto:chris.johnston@pennmanor.net)

**Peggy A. Anastasio, Ed.D.**  
Director of Student  
Support Services  
[peggy.anastasio@pennmanor.net](mailto:peggy.anastasio@pennmanor.net)

**Krista Cox, Ed.D.**  
Assistant Superintendent for  
Secondary Education  
[krista.cox@pennmanor.net](mailto:krista.cox@pennmanor.net)

## A Performance Audit

### School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes

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#### Response to Recommendations for the Penn Manor School District

Noted: “we did not find any non-compliance with laws or regulations.”

1. Refrain from applying for referendum exceptions unless the district has utilized unspent funds in the General Fund’s commitments and/or assignments, Additionally, refrain from applying for referendum exceptions if the district has set aside specifically for the type of expenditure that is being requested prior to increasing taxes above the index.

Recommendation noted: The district has sought and used exceptions as allowed and approved four times since the inception of Act 1. The decision was not taken lightly and was discussed in public sessions by the Board of Directors as part of a multi-year approach to funding not only operational expenses, but anticipated operational expenses from the \$100 million 3-year phased high school renovation project. The Board passed the resolution not to exceed the index in all previous and subsequent budgets.

2. Pass a resolution during the preliminary budget to not increase taxes above the district’s index when budgetary needs can be met with existing available funds in the General Fund.

Recommendation noted: The resolution not to exceed the index has been passed by the Board of Directors in 14 of the 18 years since the inception of Act 1. The Board considers all tax increases carefully and publicly before any decision is made.

3. As a best practice, revise the General Fund policy to eliminate the restriction of maintaining excess surplus funds in the unassigned fund balance and to accommodate current practices regarding increasing taxes prior to reaching 6% of estimated expenditures.

Recommendation noted: Penn Manor maintains an unassigned fund balance for financial stability, cash flow, and for maintenance of the district's credit rating. The board will periodically consider policy revisions.

4. If the district has designations for funds that are not used within a few years as intended, the Board should consider the funds as unassigned fund balance in the General Fund.

Recommendation noted: Penn Manor discusses and commits a portion of its fund balance twice a year in public session. Commitments will continue to be based upon the best available information and will allow for flexibility as situations change.

5. Reconsider the practice of transferring surplus funds to the Capital Reserve Fund unless the funds were specifically budgeted for and disclosed to the taxpayers. Excess surplus funds should be maintained in the General Fund as unassigned fund balances for future operation costs to lessen the burden on taxpayers. This will ensure tax increases are appropriate and needed.

## **A Performance Audit**

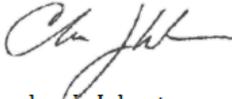
### **School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes**

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Recommendation noted: The Board of Directors of Penn Manor discusses interfund transfers during the budget process (planned transfers) and during the audit process (unplanned transfers). Unplanned transfers typically occur when expenditures come in significantly lower than budgeted for any number of reasons. The large unplanned transfer on fiscal year 2020-21 was directly related to extraordinary issues stemming from the Covid-19 pandemic.

We look forward to speaking with you during the exit conference to address our response. If you have any questions concerning this letter, please contact me.

Sincerely,



Christopher L. Johnston  
Chief Financial Officer  
Penn Manor School District

## A Performance Audit

### School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes

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#### **Auditor’s Conclusion to Penn Manor School District’s Response**

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The Penn Manor School District (Penn Manor) emphasizes its compliance with laws and regulations; states that the report should reference its \$100 million high school renovation project that is part of a multi-year strategy to increase the tax base for increased debt service payments; and generally agrees with our recommendations. Below we address areas we believe warrant further comment based on Penn Manor’s response.

#### **Recommendation 1**

Penn Manor responded that it used the referendum exceptions to increase the taxes above the index to pay for rising pension and special education costs while using the portion of the tax increase at or below the index to build millage capacity and raise funds for its \$100 million high school project. We acknowledge the importance of this construction project to the district and that some of the district’s actions during our audit period were taken on a one-time basis, but this recommendation should, nonetheless, be considered by the district.

As illustrated, the district’s General Fund balance ranged from \$18.5 million to \$20.7 million which should have negated the need to apply for \$1.5 million in referendum exceptions. However, we note that raising taxes at or below the index to increase the tax base for future planned increased debt service payments appears reasonable.

#### **Recommendation 2**

We are encouraged that Penn Manor has passed resolutions to not exceed the index since FYE June 30, 2020.

#### **Recommendation 3**

We are encouraged that Penn Manor periodically revises its policy provisions and recommend that the district eliminate the restriction of maintaining more than 8% when it has surplus funds.

#### **Recommendation 4**

Penn Manor responded that it reviews and commits a portion of its fund balance twice a year in public session and will continue to base the designations on available information to allow for flexibility. We agree that there are instances in which the district may need to retain funds for a future year based on a three- or five-year business plan; however, as illustrated in Table #2, the district had more than \$18.5 million of unspent committed funds for the entire four-year audit

## **A Performance Audit**

### **School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes**

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period. Had the district not designated the funds as committed, Penn Manor would have been over the PSC threshold and not permitted to increase taxes without a referendum vote.

#### **Recommendation 5**

We are encouraged that Penn Manor acknowledged having both planned and unplanned transfers and discusses such interfund transfers with the Board. However, we continue to recommend that the district consider operating surplus for future tax stabilization rather than non-budgeted transfers.

## A Performance Audit

### School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes

#### West Chester Area School District

West Chester Area School District’s (West Chester) revenues and expenditures ranged from \$238 million to \$269 million during the four FYE June 30, 2018, 2019, 2020, and 2021.<sup>125</sup> The following table summarizes West Chester’s information for referendum exceptions requested by fiscal year, the funds available in its General Fund at the beginning of each fiscal year (July 1), whether taxes were raised, and whether taxes were raised above the index.

**Table #1**

FYE June 30	Did the District Request a Referendum Exception? <sup>a/</sup>	Type of Exception Requested <sup>b/</sup>	Total Amount Approved	General Funds Available July 1 <sup>c/</sup>	Taxes were Raised	Taxes Were Raised Above the Index <sup>f/</sup>
2018	Yes	Pension Obligations and Special Education Costs <sup>d/</sup>	\$5,400,281	\$21,352,589	Yes	Yes
2019	Yes	Pension Obligations and Special Education Costs	\$3,229,145	\$24,421,441	Yes	Yes
2020	No	N/A	N/A	\$28,460,261	Yes	No
2021	No	N/A	N/A	\$43,883,151	No <sup>e/</sup>	No

<sup>a/</sup> - Based on PDE’s applicable year’s Report on Referendum Exceptions, the district did or did not request a referendum exception to raise taxes above the index.  
<sup>b/</sup> - Act 1 of 2006, as amended, provides four different types of referendum exceptions based on type of expenditure costs, see the *Introduction and Background* section of this report. See Taxpayer Relief Act, 53 P.S. § 6926.101 *et seq.*  
<sup>c/</sup> - The amount of funds available to West Chester at the beginning of the fiscal year; for instance, for the FYE June 30, 2018, the amount available for appropriation by the Board on July 1, 2017, was \$21,352,589.<sup>126</sup>  
<sup>d/</sup> - Pension obligations refer to the retirement contributions made by the school district to the Public School Employees’ Retirement System (PSERS).

<sup>125</sup> The range of revenues and expenditures is based on the final adopted General Fund budgets.

<sup>126</sup> The table includes funds committed and/or assigned in the General Fund that are available for use if the Board so directs. Also, the available funds listed have been unspent for several years and remain available for the Board to recommit and/or reassign for other types of expenditures.

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### School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes

<sup>e/</sup> - The district did not raise taxes but there was a mandatory tax rate rebalancing between West Chester's two counties (Chester County and Delaware County).

<sup>f/</sup> - Taxes were raised above the index within the approved PDE referendum exception.

N/A – Not applicable

*Sources: Produced by staff of the Department of the Auditor General based on information in the PDE's referendum reports and West Chester's audited financial statements for the FYE 2017, 2018, 2019, 2020, and 2021.*

Based on our audit procedures, we did not find non-compliance with law or regulations. However, we found the following issues regarding prudent stewardship of taxpayer funds:

- West Chester requested referendum exceptions and raised taxes above the index twice during the audit period despite having sufficient funds in its General Fund for anticipated annual expenditures.
- West Chester designates its General Fund as commitments and assignments, allowing it to increase taxes while retaining millions of dollars not used timely for designated purposes and while transferring millions to the Capital Reserves Fund.

The following two sections describe these results in more detail.

#### **West Chester requested referendum exceptions and raised taxes above the index twice during the audit period despite having sufficient funds in its General Fund for anticipated annual expenditures.**

West Chester applied for referendum exceptions to raise taxes above the index for the FYE June 30, 2018, and 2019. It used the approved referendum exceptions during the FYE June 30, 2018, and 2019, to increase taxes above the index for pension obligations and special education costs. When questioned, West Chester's Director of Business Affairs (Director) explained that the district's Board routinely applied for referendum exceptions if the preliminary budget indicated a need for the exceptions and if the pension and/or special education costs showed increases that were allowable for the referendum exceptions.

Based on Act 1 of 2006, as amended, Section 333(a)(1), an additional tax rate increase above the index may be requested if needed to balance the preliminary budget.<sup>127</sup> By requesting a referendum exception, the district is indicating that the tax increase above the index is needed

<sup>127</sup> Subsection (a)(1) of Section 333 (relating to public referendum requirements for increasing certain taxes) of the Taxpayer Relief Act. Please note at Subsection (a)(2) of the act states as follows: "(2) This section shall apply to each board of school directors beginning with any proposed tax increase that takes effect in the 2007-2008 fiscal year and each fiscal year thereafter." See 53 P.S. § 6926.333(a)(1)-(2).

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due to insufficient available funding. However, we found that West Chester had sufficient funding available to balance the budget, which negated the need to apply for referendum exceptions for the FYE June 30, 2018, and 2019, for the following reasons:

- West Chester had an average of \$15.4 million in its estimated ending unassigned fund balance listed on the preliminary budgets for the FYE June 30, 2018, and 2019. Therefore, West Chester did not need to apply for referendum exceptions and propose an increase in taxes above the index because the funds it had were sufficient to balance its preliminary budgets.<sup>128</sup>
- West Chester had an assignment for tax stabilization of \$5.5 million as of July 1, 2016 that increased to \$7.2 million during the FYE June 30, 2017, when West Chester applied for the referendum exceptions for FYE June 30, 2018. Therefore, West Chester did not need to apply for referendum exceptions for that fiscal year and increase taxes above the index for pension obligations and special education costs totaling \$5,400,281 as listed in Table #1 above, because the assignment was more than the requested amounts. This is also applicable to the district's referendum exceptions for the FYE June 30, 2019, because the assignment increased from \$7.2 million to \$11.3 million during FYE June 30, 2018, and was sufficient for the pension obligations and special education costs totaling \$3,229,145 as listed in Table #1 above.
- West Chester had sufficient funds committed specifically for the type of expenditures used for the referendum exception it sought. For example, the Board passed a resolution on October 24, 2016, to commit \$2.1 million and on October 23, 2017, to commit \$1.1 million of its General Fund balance for pension obligations during the FYE June 30, 2018 and 2019, respectively.<sup>129</sup> Therefore, West Chester did not need to apply for the referendum exception for pension costs totaling \$761,447 of the \$5,400,281 or \$33,330 of the \$3,229,145 for the FYE June 30, 2018 and 2019, respectively, as listed in Table #1 above, because the annual commitments were more than the requested pension amount.

Our results demonstrate that West Chester had sufficient funding and did not need to apply for referendum exceptions to meet its pension obligations and special education costs for the FYE June 30, 2018, and 2019. Additionally, the district presented preliminary budgets to the taxpayers and PDE that suggested the district had insufficient funds to balance its budget while it

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<sup>128</sup> While this calls into question the reason PDE approved the referendum exceptions, this is not an audit of PDE's procedures and processes.

<sup>129</sup> West Chester's Board approved resolutions for commitments and/or assignments after the fiscal year end, prior to the finalization of its audited financial statements. For instance, the October 23, 2017, resolution was committing and assigning funds for the FYE June 30, 2017, which are available for use in the FYE June 30, 2018.

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had millions of dollars available for anticipated expenditures. The process of applying for unnecessary referendum exceptions wasted time and resources for the district and PDE. Further, the tax increases above the index that occurred during the FYE June 30, 2018, and 2019, were not needed and the resulting funds were not spent for general operations in the respective fiscal years.<sup>130</sup> Therefore, the Board placed an unnecessary excess burden on district taxpayers. This excess tax burden was compounded in future years because the Board did not reverse the unneeded tax increases.

### **West Chester designates its General Fund as commitments and assignments allowing it to increase taxes while retaining millions of dollars not used timely for designated purposes and while transferring millions to the Capital Reserves Fund.**

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General Fund balances can be designated as committed, assigned, or unassigned.<sup>131</sup> The PSC **prohibits** districts from increasing taxes if its unassigned fund balance in the General Fund is **greater than 8%** of the next fiscal year's budgeted expenditures.<sup>132</sup> By reducing the unassigned fund balance every year to less than 8%, West Chester increased taxes during the FYE June 30, 2018, 2019, and 2020, even though it has sufficient funds for anticipated expenditures in its General Fund.

During our audit period, West Chester committed and assigned its available funds in the General Fund to several items, including, but not limited to, healthcare and tax stabilization, alternative education, enrollment growth, and technology. The following table illustrates West Chester's General Fund balances:

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<sup>130</sup> The operating surplus for each year led to an increase in the General Fund balance and funds being transferred that were in excess of the approved referendum exceptions.

<sup>131</sup> The General Fund classifications are described in more detail in the *Introduction and Background* section of this report.

<sup>132</sup> 24 P.S. § 6-688(a).

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### School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes

**Table #2**

FYE June 30				
General Fund - Fund Balances	2018	2019	2020	2021
Committed:				
Healthcare stabilization	\$ 4,159,909	\$ 4,159,909	\$ 4,159,909	\$ 4,159,909
Assigned:				
Tax stabilization	\$11,304,138	\$13,945,496	\$29,486,832	\$38,183,867
Gate Receipts	\$ 69,756	\$ 83,577	\$ 128,904	\$ 128,904
Alternative Education	\$ 676,000	\$ 1,000,000	\$ 1,000,000	\$ 2,000,000
Enrollment Growth	\$ -	\$ 2,500,000	\$ 3,500,000	\$ 4,500,000
Property Assessment Fluctuations	\$ -	\$ -	\$ -	\$ 1,000,000
Technology/Distance Learning	\$ -	\$ -	\$ -	\$ 500,000
Unassigned	\$13,047,547	\$14,431,188	\$14,267,415	\$15,861,417
<b>Total Committed, Assigned, and Unassigned Fund Balance</b>	<b>\$29,257,350</b>	<b>\$36,120,170</b>	<b>\$52,543,060</b>	<b>\$66,334,097</b>

Source: Produced by staff of the Department of the Auditor General based on information in West Chester's audited financial statements for the FYE June 30, 2018, 2019, 2020, and 2021.

Based on our audit procedures, we found:

- On an annual basis, prior to the completion of the audited financial statements for the prior period, in mid-fall, West Chester's Board formally approved resolutions to commit and/or assign funds in the General Fund for specific purposes.<sup>133</sup> As a result, West Chester did not comply with the applicable PDE requirements for commitments and assignments since the formal resolution determining the specific purposes of the funds to be committed are to be approved prior to the end of fiscal year even if the amounts are not yet determined.
- West Chester's policy states that if the General Fund's unassigned fund falls below 5%, the Board will pursue increasing revenues and/or decreasing expenditures. We found that in contradiction to the policy, West Chester raised taxes while having more than 5% as unassigned fund balance for the three FYE June 30, 2018, 2019, and 2020. When questioned, West Chester's Director indicated that the district does not use the 5% as a mandatory requirement to increase taxes and if the unassigned fund balance is "projected" to decrease below 5%, the district may take actions such as increasing taxes.

<sup>133</sup> PDE Accounting Bulletin #2010-01, effective fiscal year 2010-11, and thereafter, requires commitment classifications for specific purposes be the result of a formal action by the school's highest level of authority, which in this case is the Board. The PDE bulletin provides that the Board's approval to commit the funds be before the end of the fiscal year and the amounts can be determined after the fiscal year. Additionally, assignments of funds do not require formal action by the Board.

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- West Chester’s business office created preliminary and final budgets that were very conservative. Specifically, the final adopted budgets reported deficits while the district experienced actual surpluses. This is illustrated in the table below.

**Table #3**

FYE June 30				
Surplus (Deficit)	2018	2019	2020	2021
Final Adopted Budget	\$(5,646,042)	\$(6,628,745)	\$(9,214,436)	\$ (21,327,637)
Audited Financial Statements	\$ 3,126,195	\$ 6,962,436	\$16,586,662	\$ 13,697,043
Variance	\$ 8,772,237	\$13,591,181	\$25,801,098	\$ 35,024,680

*Source: Produced by staff of the Department of the Auditor General based on information in West Chester’s final adopted budgets and audited financial statements for the FYE June 30, 2018, 2019, 2020, and 2021.*

When questioned, West Chester’s Director stated that the district uses conservative projections based on historical trends and anticipated changes in district educational needs and personnel. However, we found that the district uses prior year budgets estimated ending fund balances to forecast the next fiscal year’s beginning fund balances rather than using actual audited figures. This has created budgets with compounding effects year after year as shown in the table above. While we realize budgets are estimates, the estimates should be reasonable and based on actual audited fund balances and current financial conditions, and not the prior year budgeted estimates.

- West Chester did not use the funds designated as commitments and assignments in any of the four years audited and the Board increased the assignments each year from \$7.8 million as of July 1, 2017, to \$46.3 million by the FYE June 30, 2021. The General Fund balance is from local, state, and federal sources and the funds are generally available to finance the current operations of the school district.<sup>134</sup> Maintaining the funds as commitments and assignments without timely using the funds for those intended purposes could give the appearance of circumventing the PSC threshold to raise taxes by classifying unassigned funds as commitments and/or assignments.

Based on our audit results, had West Chester retained the unspent commitments and assignments, as unassigned fund balance, it would have exceeded the PSC threshold and been unable to increase taxes during the FYE June 30, 2018, 2019, and 2020, without a referendum vote until the funds were spent for general operations. However, West Chester’s practice of designating funds as committed or assigned allows it to increase taxes while retaining millions of

<sup>134</sup> Manual of Accounting and Financial Reporting for Pennsylvania Local Educational Agencies (LEAs). Maintained by: PA Office of the Budget, Office of Comptroller Operations Central Agencies & School Finance Unit. Revised August 2016.

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dollars of unspent funds for several years in its General Fund. The Board should reconsider its practices to help lessen the tax burden on its taxpayers.

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#### **Recommendations for West Chester Area School District**

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While we did not find non-compliance with law or regulations, we offer the following recommendations to West Chester Area School District to improve stewardship of taxpayer funds:

1. Refrain from applying for referendum exceptions unless the district has utilized unspent funds in the General Fund's commitments and/or assignments. Additionally, refrain from applying for referendum exceptions if funds have been set aside specifically for the type of expenditure that is being requested prior to increasing taxes above the index.
2. Pass a resolution during the preliminary budget phase to not increase taxes above the district's index when budgetary needs can be met with existing available funds in the General Fund.
3. Comply with PDE procedures and formally approve the purpose of General Fund commitments and assignments prior to the applicable fiscal year-end, even if the amounts are to be determined at a later date.
4. If the district has designations for funds that are not used in the next fiscal year as intended, the Board should repurpose the funds or the funds should be considered as unassigned fund balance in the General Fund.
5. As a best business practice, prepare budgets based on actual audited fund balances and current financial conditions rather than prior year budget estimates to reflect a more accurate financial position.

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### School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes

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## West Chester Area School District's Response

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### WEST CHESTER AREA SCHOOL DISTRICT

*Educating and inspiring students to achieve their personal best*

Dr. Robert Sokolowski, Superintendent of Schools

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December 14, 2022

Timothy L. DeFoor  
Auditor General  
Department of Auditor General  
Commonwealth of Pennsylvania  
229 Finance Building  
Harrisburg PA 17120

**RE: West Chester Area School District  
Response to Confidential Draft Performance Audit Report (2022)**

Dear Auditor General DeFoor:

I am the Superintendent for the West Chester Area School District (“WCASD” or the “District”). Please accept this letter in response to the Pennsylvania Department of Auditor General’s (“DAG’s”) confidential draft of a Performance Audit Report of WCASD fiscal years ended (“FYE”) June 30, 2018, 2019, 2020, and 2021 (the “Report”). **The Report found that WCASD complied with all laws and regulations.** However, the DAG called into question certain other WCASD processes and procedures. WCASD believes that these issues result from a misunderstanding and/or mischaracterization of WCASD accounting and financial practices, and WCASD therefore disagrees with the Report.

#### **I. Background and Scope of Audit**

The DAG’s stated purpose in selecting WCASD as one of 12 school districts for an audit is that WCASD had not had its fiscal years audited by the DAG since June 30, 2017, and had a total balance for all fund types greater than \$60 million as of the FYE June 30, 2020 (as opposed to just the general fund balance), and WCASD proposed to raise local taxes using a PDE exception at least once during the four-year audit period. See Report, p. 4. The District notes in regard to the selection criteria that the DAG utilized Capital Fund balances that are restricted by the Pennsylvania Department of Education (“PDE”) and are only to be utilized for expenditures that are capital in nature. Therefore, they should not have been included in the selection criteria. When the Capital Fund balances are excluded for the relevant years, the District would not have fallen within the selection criteria for this audit.

The DAG’s specifically stated audit objectives are to:

1. “determine whether each of the selected districts appropriately used the referendum exception method to raise local school property taxes . . . .”; and<sup>1</sup>

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<sup>1</sup> DAG fails to state what definition or criteria it has utilized to determine if the referendum exception was “appropriate.” When, as here, the District complied with the law, followed PDE’s prescribed process for application for an exception for projected increase in costs in special education and pension, and received PDE’s approval, the District, without question, acted appropriately.

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## School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes

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2. “determin[e] if each district ensured that fund balances were properly designated and used for intended purposes.”

Report, p. 1.

### II. DAG Audit Findings for WCASD

The DAG concludes as follows in the Report as to WCASD:

**“Based on our audit procedures, we did not find non-compliance with law or regulations.”**

Report, p. 9 (emphasis added). WCASD agrees that it complied with all relevant laws and regulations.

Nevertheless, the DAG faults the District in two ways “regarding prudent stewardship of taxpayer funds”:

1. “West Chester requested referendum exceptions and raised taxes above the index **twice** during the audit period despite having sufficient funds in its General Fund for anticipated annual expenditures”; and
2. “West Chester designates its General Fund as commitments and assignments, allowing it to increase taxes while retaining millions of dollars not used timely for designated purposes and while transferring millions to the Capital Reserves Fund.”

Report, p. 9 (emphasis in original). The District objects to these findings and the characterizations of its practices as set forth below.

### III. WCASD’s Response to the Report

WCASD has long valued transparent and prudent financial and accounting practices. The DAG appears to recognize this by noting as its ultimate conclusion in its Report that the DAG “did not find non-compliance with law or regulations.” Report, pps. 9, 14. Indeed, WCASD has complied with the Pennsylvania Public School Code (the “School Code”), Act 1, PDE’s guidelines and accounting bulletins,<sup>2,3</sup> the applicable versions of PDE’s Manual of Accounting and Financial Reporting for Pennsylvania Local Educational Agencies (LEA)<sup>4</sup> and the

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<sup>2</sup> A copy of PDE Referendum Exception Guidelines for the 2020-2021 Fiscal Year Special Session for Act 1 of 2006 is available here: <http://web.archive.org/web/20201021010647/https://www.education.pa.gov/Documents/Teachers-Administrators/Property%20Tax%20Relief/ReferendumExceptions/Act%201%20Referendum%20Exception%20Guidelines.pdf>.

<sup>3</sup> A copy of PDE Accounting Bulletin 2010-01 is available here: <https://www.education.pa.gov/Documents/Teachers-Administrators/School%20Finances/Comptrollers%20Office/Accounting%20Bulletins/AccBull201001.pdf>.

<sup>4</sup> A copy of the manual last updated through October of 2022 is available here: <https://www.education.pa.gov/Documents/Teachers-Administrators/School%20Finances/Comptrollers%20Office/Manual%20of%20Accounting.pdf>.

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Governmental Accounting Standards Board. The District's budgeting process and timeline is entirely driven and constrained by law, policy, and guidance from the General Assembly and state agencies.

The District also believes it is important for the DAG to acknowledge and place its findings in the context of the District's, and all other school districts', obligation to comply with the processes and timelines referenced above. In its Report, the DAG fails to consider or acknowledge the time constraints under which school districts must determine whether to apply for an exception, in relation to the timing of final budget approval and the information then available to the District. The timing of the budget exception process is mandated by state law. School districts are required to make multiple decisions regarding the potential application for and/or use of a budget exception, with limited and constrained information. For example, a decision regarding whether to leave open the possibility of seeking a referendum exception must be made by the school board no later than January, when it only has five to six months of current revenue and expenditure data. See 53 P.S. §§ 6926.311(c), 6926(d)(1). Similarly, school districts are required to seek approval from PDE for referendum exceptions requiring their approval in February or early March, again when it only has limited information on current revenue and expenditure data. See 53 P.S. § 6926.333(j).

In all years, school districts must make determinations about their final budget and budget exceptions without any information regarding the Commonwealth's budget and any funding school districts may receive.<sup>5</sup> Depending on the trend shown in the budget modeling and projections in December and January, reserving the opportunity to potentially utilize an exception based on the then-current projected revenues and expenditures is the most fiscally prudent and conservative option available to school districts to protect their ability to continue to operate at then-current service levels for their taxpayers, residents, and students.

Furthermore, the District has consistently taken great effort to ensure that its budgeting process is transparent, open, and accessible to its taxpayers and residents as detailed at length in Section III(B)(4) herein. The issues called out by the DAG above are in many cases inaccurate and have the potential to damage WCASD's reputation in the eyes of its taxpayers. Thus, for the following reasons, WCASD continues to urge the DAG to modify the Report to more accurately reflect the audit's findings, and if it elects not to do so, provides this information as an attachment to the Report in the interest of providing clarity as to its disagreement with the DAG for WCASD residents and taxpayers, and to provide additional insight to the General Assembly and PDE.<sup>6</sup>

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<sup>5</sup> For the 2017-2018 school year, the Commonwealth's budget was approved without the Governor's signature and became law on July 11, 2017; for the 2018-2019 school year, the Commonwealth's budget was approved on June 22, 2018; for the 2019-2020 school year, the Commonwealth's budget was approved on June 28, 2019; and for the 2020-2021 school year, the Commonwealth's budget was approved on November 23, 2020. In all years, the District adopted its final budget prior to the Commonwealth's adoption of its budget. See <https://www.budget.pa.gov/Publications%20and%20Reports/CommonwealthBudget/Pages/PastBudgets2015-16To2006-07.aspx>. For two of the relevant years, the Commonwealth adopted its budget in the subsequent fiscal year and after the District was required by law to adopt its budget.

<sup>6</sup> In addition, WCASD notes that this audit was completed *via* the telephone and email, without a site visit or in-person interaction with the DAG auditors. WCASD therefore believes that this has resulted in some confusion as to WCASD procedures and protocols for its finances and accounting, as described further herein.

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#### A. The Table 1 Overview Is Inaccurate and Misleading.

The DAG includes as part of Table 1 a summary of the District’s budget and tax information for the relevant fiscal years. Under the heading “Funds Available,” the DAG has improperly included amounts the District’s Board of School Directors (the “Board”) had assigned and committed for specific purposes. Those funds were not in fact available for general purposes of operation. Therefore, Table 1 does not provide accurate information, as the DAG should have only included the unassigned amounts:

	<u>2018</u> Funds available <u>July 1, 2017</u>	<u>2019</u> Funds available <u>July 1, 2018</u>	<u>2020</u> Funds available <u>July 1, 2019</u>	<u>2021</u> Funds available <u>July 1, 2020</u>
<b>Committed</b>				
PSERS	1,117,000	-	-	-
<b>Total Committed</b>	<b>1,117,000</b>	<b>-</b>	<b>-</b>	<b>-</b>
<b>Assigned</b>				
Tax Stabilization	7,227,366	11,304,138	13,945,496	29,486,832
Gate Receipts	-	69,756	83,577	128,904
<b>Total Assigned</b>	<b>7,227,366</b>	<b>11,373,894</b>	<b>14,029,073</b>	<b>29,615,736</b>
<b>Unassigned</b>	<b>13,008,223</b>	<b>13,047,547</b>	<b>14,431,188</b>	<b>14,267,415</b>
<b>Totals</b>	<b><u>21,352,589</u></b>	<b><u>24,421,441</u></b>	<b><u>28,460,261</u></b>	<b><u>43,883,151</u></b>

Further, while the District does not dispute the “Total Amount Requested & Approved,” the District does not believe Table 1, as currently shown, provides full transparency to the public regarding exceptions that were applied for and received, as Table 1 fails to include the amount of the exception ultimately utilized by the District when it adopted its final budget. Table 1 should be revised to include this information as follows:

FYE <u>June 30</u>	<u>Total Amount Requested &amp; Approved</u>	<u>Total Amount of Exceptions Utilized</u>
2018	\$ 5,400,281	\$ 700,051
2019	\$ 3,229,145	\$ 798,084
2020	N/A	N/A
2021	N/A	N/A

Specifically, for the fiscal year ending June 30, 2018, the District ultimately utilized only \$700,051 (or approximately 13%) of the requested exception. For the fiscal year ending June 30, 2019, the District utilized \$798,084 (or approximately 25%). Failure to include this information is misleading to the public. For both

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years, through continued budget modeling and revisions, the District was able to minimize its utilization of the exceptions it received and decrease its impact on its taxpayers.

B. WCASD Properly Requested Referendum Exceptions for the FYE June 30, 2018, and 2019 in Compliance with Act 1 of 2006.

As the DAG acknowledges, the District, “applied for referendum exception if the preliminary budget indicated a need for the exceptions and if the pension and/or special education costs showed increases that were allowable for the referendum exception.” Report, p 9. As the DAG found, the District complied with all laws and regulations, much of this portion of the Report appears to be a difference in opinion between the DAG and the General Assembly in the adoption of enacted taxation procedures, PDE in its implementation of the exception process and the elected local officials regarding prudent stewardship of taxpayer funds. The DAG faults WCASD for having “sufficient” funds available, which in its opinion negated the need to apply for exceptions in two of the fiscal years in the audit. See Report, p. 9. The DAG does not identify what it means by “sufficient” in its Report. The District can only assume that “sufficient” refers to unassigned fund balances. The District does not agree this finding.

**1. WCASD’s Funds Were Not Sufficient to Balance Its Preliminary Budgets.**

At the outset, the DAG acknowledges that the District complied with all laws and regulations. Report, pps. 9, 14. The District utilized and followed the appropriate legal and PDE process to request a referendum exception for two of the school years during the audit period. As required by PDE, the District prepared a preliminary budget of revenues and expenditures. The projected increases in expenses for the categories of special education and Pennsylvania Public School Employees’ Retirement System (“PSERS”) along with the projected shortfall in revenue met the PDE criteria for filing for referendum exceptions. The District applied to PDE and, after PDE’s review, received approval from PDE on February 17, 2017, for the 2017-2018 school year and March 21, 2018, for the 2018-2019 school year. When as here, the District has complied with all requirements and received approval from the agency charged with making the determination of whether an exception is permitted, there is no question that the District’s actions were appropriate.

The DAG states in a footnote that since DAG believes WCASD had sufficient funds to balance its preliminary budgets, that “[w]hile this calls into question the reason PDE approved the referendum exceptions, this is not an audit of PDE’s procedures and processes.” Report, p. 9 n. 24. The DAG thus appears to question the legitimacy of PDE’s grant of the exceptions, which is well beyond the scope of the budgeting process of the District. WCASD respectfully suggests that if the DAG believes PDE’s processes for referendum exceptions are inappropriate, the correct remedy is not as it has done here to fault the WCASD for complying with them, but to do as it suggests and revisit them with PDE.<sup>7</sup>

Further, the School Code and PDE state that a school district may not seek to raise taxes if the unassigned ending fund balance is more than 8% of the operating budget. See 24 P.S. § 6-688(a). The \$15.4 million in

<sup>7</sup> PDE provides on its website a detailed explanation of referendum exceptions and the process of applying for one. See Pennsylvania Dep’t of Educ, Referendum Exceptions, COMMONWEALTH OF PENNSYLVANIA, available at: <https://www.education.pa.gov/Policy-Funding/PropertyTax/Pages/Referendum-Exceptions.aspx> (“PDE Referendum Reports”). On that same website, PDE provides reports on referendum exceptions, applied for and granted, dating back to 2007-2008. See PDE Referendum Reports.

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WCASD's unassigned fund balance represents 6.3% and 6.1% of budgeted operating expenses in 2018 and 2019, respectively, well below the required threshold. As a practice, WCASD does not utilize unassigned fund balance to balance an operational budget, as it is not a prudent financial practice. The District has been praised for this practice as part of Moody's rating agency issuance of an Aaa credit rating for WCASD. In each of the Moody's reports issued in October 2017, September 2018, August 2019, and August 2020, Moody's indicates that the District's credit strengths include: conservative budgeting practices and ample reserves. Moody's lists factors that could lead to a downgrade as budget imbalances resulting in draws on fund balance. In each report, Moody's' comments related to the rating outlook for WCASD: "The stable outlook is based on the district's history of conservative budget management and strong fiscal controls." WCASD is proud of the continued Aaa rating assigned by Moody's and recognizes that this excellent credit rating is saving WCASD taxpayers thousands of dollars annually in interest expenses.<sup>8</sup> Thus, the DAG's conclusion in this regard is a misunderstanding of a key facts.

#### **2. WCASD Appropriately Applied for Referendum Exceptions Given that Stabilization Amounts Had Not Been Fully Recognized.**

The DAG emphasizes that WCASD had assignments for tax stabilization that were higher than the corresponding pension obligations and special education costs for FYE ending June 30, 2017 and June 30, 2018. See Report, p. 10. This appears to be a misunderstanding on the part of DAG and a product of the required timeline for applying for exceptions.

The stabilization reserve of \$5.5 million at July 1, 2016, was utilized in its entirety to balance the 2016-17 budget as evidenced in the Final PDE 2028.<sup>9</sup> The stabilization reserve included in the preliminary budget for the 2017-18 school year was calculated based on year-to-date projections ended November 2016. At its December 19, 2016 public Board meeting, the Board had to approve publication of the intent to potentially obtain a budget exception to comply with the required advertising requirements. The preliminary budget was prepared and presented at the regular public January 23, 2017 Board meeting, with referendum requests submitted on February 1, 2017, consistent with the time requirements of state law. At that time, the projected stabilization for the 2017-2018 budget was \$2.9 million. The projected stabilization amount was included and utilized to balance the budget with the preliminary PDE 2028 form. The total \$7.2 million stabilization amount referenced by DAG was not fully recognized until after the close of the FYE June 30, 2017. However, a portion of the \$7.2 million that was recognized prior to the adoption of the final budget for FYE June 30, 2018 was used in its entirety to balance the 2017-18 budget, as evidenced in the final PDE 2028 and the budget adopted on May 24, 2017.

The same explanation holds true for the 2018-19 budget. The tax rate stabilization assignment is intended to ensure that current year savings are used as needed to offset the tax rate increases in the following years. After approving its public intent to potentially obtain a budget exception at its December 18, 2017 meeting, at its January 22, 2018 public Board meeting, the preliminary 2018-19 budget was adopted by the Board, and the projected stabilization amount was \$4.3 million. The projected stabilization amount was included

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<sup>8</sup> Copies of Moody's announcements are on file with the WCASD and available at Moody's publicly accessible website at: <https://www.moody.com/>.

<sup>9</sup> The fiscal year ending June 30, 2017 was not the subject of this audit.

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and utilized to balance the budget with the preliminary PDE 2028. The \$11.0 million<sup>10</sup> in anticipated savings for fiscal operation for the 2017-18 school year had not yet been recognized and, as such, was not available in totality for balancing the preliminary 2018-19 PDE 2028.

WCASD's procedure in light of the above is reasonable and justifies its application to PDE for referendum exceptions. Therefore, the Report regarding this allegation is in error.

#### **3. WCASD Did Not Have Sufficient Funds Committed for the Type of Expenditures Used for the Referendum Exception Sought.**

The DAG references the Board's passage of resolutions dated October 24, 2016, to commit \$2.1 million and the subsequent October 23, 2017 recommitment of the remaining \$1.1 million portion of the 2016 commitment of its General Fund balance for pension obligations during FYE June 30, 2018 and June 30, 2019, as a reason that WCASD did not need to apply for a referendum exception for requested pension amounts less than that figure.

WCASD did make this commitment and recommitment to the PSERS pension obligation. However, in accordance with state law, the commitments do not state in which fiscal year they will be utilized. The commitments were made for future PSERS obligations. The PDE referendum exception worksheet does not require assignments or commitments to be included in the calculations.<sup>11</sup> WCASD believes that it prudently reserved the right to utilize approved exceptions that it needed to balance its budget.

Even more significantly, WCASD utilized \$1.0 million of the \$2.1 million PSERS obligation to offset costs in the 2016-17 budget as evidenced in the PDE 2028.<sup>12</sup> In January of 2018, WCASD did apply for an exception to cover the increased costs of PSERS obligations. However, WCASD fully utilized the remaining \$1.1M commitment in its final approved budget and as a result of continuing budgeting after the exception application **did not in fact use the received exception to raise taxes for PSERS obligations**. The District's procedure in light of the above is reasonable, and therefore the District disagrees with the Report.

#### **4. WCASD Did Not Issue a Misleading Preliminary Budget to Taxpayers and PDE.**

In concluding its argument that WCASD did not need to apply for referendum exceptions for the FYE June 30, 2018 and 2019, the DAG implies that WCASD misled its taxpayers and PDE by presenting preliminary budgets that suggested WCASD had insufficient funds to balance its budget "while it had millions of dollars available for anticipated expenditures." Report, p. 10. The DAG fails to acknowledge those dollars were in commitments and assignments, not the unassigned fund balance. Further, the DAG contends that WCASD's referendum exception applications "wasted time and resources" for both it and PDE, and that the resulting tax increases were "not needed," thereby placing "an unnecessary excess burden on district taxpayers." Report, p. 10.

<sup>10</sup> There seems to be a suggestion on page 10 of the Report that the \$11M in the 2018-2019 budget was cumulative of the 2017-2018 year, that is, the \$7.2 million was not utilized as part of the 2017-2018 budget, which is in error and should be corrected.

<sup>11</sup> A sample copy of the 2021-2022 PDE Referendum Exception Worksheet is available at pages 19 through 24 here: <https://www.education.pa.gov/Documents/Teachers-Administrators/Property%20Tax%20Relief/ReferendumExceptions/2021-22%20Report%20on%20Referendum%20Exceptions.pdf>.

<sup>12</sup> The 2016-2017 budget year was not the subject of this audit.

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The District disagrees with this paragraph. This comment could be read to indicate that WCASD did not disclose unassigned, assigned, and committed fund balances in its preliminary and final budgets. That is wrong and misleading, particularly when, as here, the DAG requested no information during this audit regarding how the District communicates information regarding the budget to its taxpayers and residents.

The District has a Property & Finance Committee (“P&F”) that meets to discuss the budget forecasting and the budget eleven or twelve months of the year. The P&F agendas with the supporting documentation to be discussed at the committee meetings are posted in advance on District’s public website.<sup>13</sup> The P&F meetings are open to the public with an opportunity for public comment on agenda items at each meeting, and since Spring 2020 are also livestreamed and posted to YouTube for individuals who may not be able to attend in person.<sup>14</sup> Similarly, there is a P&F report and financial report at every regular monthly Board meeting.<sup>15</sup> As with the P&F committee, the Board agendas with supporting documentation to be discussed or acted upon are posted in advance on the District’s public website.<sup>16</sup> The Board meetings are open to the public with an opportunity for both agenda and nonagenda item public comment, and since Spring 2020, are also livestreamed and posted to YouTube. The District also posts its budgets, budget documents, audited financial statements, PDE 2028 General Fund Budgets, PDE 2057 Annual Financial Report, and Budget Forecast Models by Month on its public website.<sup>17</sup> The foregoing makes clear that WCASD has actively worked to be transparent with its residents and taxpayers and allow them to participate in the budget process.

Regarding the reference to PDE, the District complied with all laws and PDE procedures in applying for exceptions. PDE did in fact grant the exceptions, which indicates that PDE (the entity charged with that determination) found that it was appropriate and necessary. Importantly, in addition to the exceptions, the District submits its budget, not once, but *twice*, to PDE, which provides PDE with multiple opportunities to review and consider the District’s budgetary practices. Further, during all years relevant to this Report, the District’s independent auditors<sup>18</sup> have found:

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the West Chester Area School District, Exton, Pennsylvania, as of June 30, 2018 [June 30, 2019, June 30, 2020, and June 30, 2021], and the respective changes in financial position, and, where applicable, cash flows thereof, and the budgetary comparison statement of the general fund for the year

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<sup>13</sup> P&F agendas with supporting documentation relevant to the fiscal years between July 1, 2017 through and including June 30, 2021, are available at <https://www.wcasd.net/Domain/42>.

<sup>14</sup> P&F committee meetings and Board meetings during the relevant time period are available at <https://www.youtube.com/@WestChesterASD/streams>.

<sup>15</sup> There are 12 regular school board meeting each year.

<sup>16</sup> The Board agendas and meeting minutes with supporting documentation relevant to the fiscal years between July 1, 2017 through and including June 30, 2021 are available at <https://www.wcasd.net/Domain/49>.

<sup>17</sup> The budgets are available here: <https://www.wcasd.net/Page/6721>; all other information is available at <https://www.wcasd.net/Domain/25>.

<sup>18</sup> Auditor reports are available at <https://www.wcasd.net/Domain/25>.

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then ended in accordance with accounting principles generally accepted in the United States of America.

WCASD believes the paragraph at the bottom of Page 10 of the Report is wrong and misleading.

C. WCASD Properly Designated Its General Fund as Commitments and Assignments for FYE June 30, 2018, 2019, and 2020.

The DAG claims that WCASD designates its General Fund as commitments and assignments, “allowing it to increase taxes while retaining millions of dollars not used timely for designated purposes and while transferring millions to the Capital Reserves Fund.” Report, p. 9. This finding is misleading and is a mischaracterization of WCASD financial and accounting practices.

Except for the unassigned fund balance that the DAG averages at \$15.4 million or 6.0% of the average General Fund budget over the four-year audit period, all fund balances are committed or assigned and utilized for purposes as designated by the Board.

Further, as part of the budget process, WCASD budgets for transfers to the capital reserve fund to finance projects that are capital in nature. Amounts budgeted to be transferred are included in the WCASD operating budget and presented to the Board and the taxpayers at multiple public meetings. The process of transferring to the capital reserve fund allows WCASD to support the capital infrastructure without the need to borrow and incur additional expenses associated with debt. In further effort to be fully transparent with its residents and taxpayers, the unbudgeted transfer of debt service savings is recognized at the time of the debt refinance in a public meeting, and the actual transfer into the capital reserve fund is approved by the Board in a public meeting.<sup>19</sup>

The DAG also states erroneously that “[b]y reducing the unassigned fund balance every year to less than 8%, West Chester increased taxes during the FYE June 30, 2018, 2019, and 2020, even though it has sufficient funds for anticipated expenditures in its General Fund.” Report, p. 11. On the contrary, WCASD did not reduce its unassigned fund balance in *any* of the years of the four-year audit period. Rather, WCASD *increased* its unassigned fund balance in two of the years (2018-2019 and 2019-2020).

1. **WCASD Raised Taxes in Compliance with Its Policy Regarding the General Fund’s Unassigned Fund.**

The DAG claims that “West Chester’s Director indicated that the district does not use the 5% [limit on unassigned fund balance] as a mandatory requirement to increase taxes and if the unassigned fund balance is ‘projected’ to decrease below 5%, the district may take actions such as increasing taxes.” Report, p. 12. However, the intent of the Board policy<sup>20</sup> regarding the fund balance is to maintain an unassigned fund balance between 5% and 8% of the next year’s total operating expenditures. The policy does *not* restrict tax increases

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<sup>19</sup> See Board Meeting Minutes for October 23, 2017 and Board Meeting Minutes for October 25, 2021, available at <https://www.wcasd.net/Domain/49>.

<sup>20</sup> See Board Policy 620 available at: <http://go.boarddocs.com/pa/wche/Board.nsf/goto?open&id=9UZJZ24F8BE0>.

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to *only* instances when the unassigned fund balance is projected to go below 5%. It does however restrict tax increases if the unassigned fund balance is projected to go above 8%. As such, this statement is inaccurate.

#### 2. WCASD's Budgets Are Appropriately Conservative, and They Forecast the Next Fiscal Year's by Using Actual Expenditures and Revenue.

First, the DAG contends that "West Chester's business office created preliminary and final budgets that were very conservative." Report, p. 12. WCASD recognizes that it utilizes a conservative approach to budgeting but does not agree that the approach very conservative.<sup>21</sup>

Second, the DAG states that WCASD uses prior year budget estimated ending fund balances to forecast the next year's beginning fund balances rather than using actual audited figures. See Report, p. 12. There appears to be some confusion on WCASD's methodology on fiscal forecasting here.

WCASD utilizes the most up-to-date financial information available at the time of budget preparation. WCASD preliminary budgets are prepared in January and the final budgets are prepared and approved in May. The audited final statements for the prior fiscal year are not available during the time this budgeting process occurs. As a result, it would be impossible for the District to utilize the audited statements as the DAG suggests. All WCASD budgets are prepared with a conservative outlook on revenue and expense projections based on historical trends and anticipated changes in district educational needs. WCASD does not use prior year budgets as the tool for future budgets; rather, the District uses prior year actual expenditures and revenues as the basis. As such, the District disagrees with this suggestion by the DAG.

#### 3. WCASD Did Not Circumvent the School Code's 8% Threshold.

In the Report, the DAG states:

West Chester did not use the funds designated as commitments and assignments in any of the 4 years audited and the Board increased the assignments each year from \$7.8 million as of July 1, 2017 to \$46.3 million by the end of FYE June 30, 2021. . . . Maintaining the funds as commitments and assignments without timely using the funds for those intended purposes could give the appearance circumventing the PSC threshold to raise taxes by classifying unassigned funds as commitments and or assignments.

Report, p. 13.

The numbers referenced by the DAG are inaccurate and should be removed or updated to reflect the numbers in the table below. The DAG references assignments and commitments but only references assignment *numbers*. Also, the numbers referenced are taken from year-end balances from audited financial statements, as opposed to the adopted budget. As discussed herein at length, budgets are prepared well in advance of the close of the fiscal operations of the prior year and utilize financial data through April. The table below illustrates the beginning, ending, and use of assigned fund balances for each of the audit years based on the Board-approved budgets in May of each year.

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<sup>21</sup> WCASD notes that it must adopt a final budget before WCASD learns of how much money it will receive from the Commonwealth and must determine whether to apply for exceptions early in the prior fiscal year, as detailed herein.

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## School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes

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Assigned Fund Balance Analysis				
Fund Balance from PDE 2028				
	<u>2017-18</u>	<u>2018-19</u>	<u>2019-20</u>	<u>2020-21</u>
Beginning Assigned Fund Balance				
Stabilization	4,529,042	7,628,745	10,214,436	22,327,637
Alternative Education	-	500,000	676,000	1,000,000
Enrollment Growth			1,000,000	3,500,000
Athletics	89,487	79,324	69,756	83,577
Ending Assigned Fund Balance				
Stabilization	-	-	-	-
Alternative Education	-	500,000	676,000	1,000,000
Enrollment Growth		1,000,000	2,000,000	4,500,000
Athletics	89,487	79,324	69,756	83,577
Used to Balance Budget	<u>4,529,042</u>	<u>6,628,745</u>	<u>9,214,436</u>	<u>21,327,637</u>

This table clarifies that in all years during the audit period, **the District utilized the entirety of its stabilization assignments**. The assignment of tax stabilization is intended to be used in the subsequent year(s) after it is assigned. This amount comprises savings from prior years' operations, which is used to offset the budget deficiency in the following year. This amount grew substantially in 2020 and 2021 because of savings associated with COVID shutdowns and allowed for a 0% tax increase in 2020-21. The assignment will be used to reduce future tax increases in subsequent years.

#### D. The District Disagrees with DAG Recommendation Nos. 1, 2, 4 and 5.

While DAG did not find non-compliance with law or regulations, it still offers recommendations to the District. See Report, p. 13. The District disagrees with the need for Recommendation Nos. 1, 2, and 5, as they reflect the District's existing practices. For Recommendation No. 4, the District disagrees with the recommendation. As set forth in Section III(B)(3), assigned or committed funds do not have to be utilized within a specific time frame. Further use of the funds is the prerogative of the local elected officials. The District requests that this Response be included in its entirety in the final DAG Report.

#### IV. CONCLUSION

The DAG's draft Report has serious potential to damage the reputation and image of WCASD as a taxing authority due to the mischaracterizations and misunderstandings of WCASD's financial practices and procedures detailed above.

WCASD is charged with shepherding the finances and operations of its school system for the benefit of its taxpayers, constituents, and the community. In doing so, WCASD has consistently emphasized transparent and prudent financial and accounting practices. WCASD is a large and complex district serving high numbers of students, with infrastructure, educational, personnel, and operational costs to match. WCASD's conservative approach in budgeting is strictly a result of planning for a worst-case scenario, and WCASD does so each year *before* knowing how much it will receive from its revenues and the Commonwealth, or its ultimate actual expenditures for the prior year.

## A Performance Audit

### School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes

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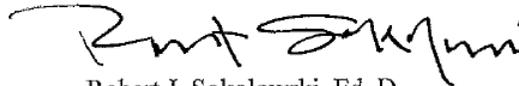
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Moreover, WCASD's application for referendum exceptions during the audit period was appropriate under Act 1. Indeed, the DAG itself found that WCASD complied with all laws or regulations. While the DAG may take issue with Act 1 itself, including PDE's process for approving referendum exceptions, (all of which WCASD has fully complied with), the determination of what WCASD, or any other school district, financially "needs" in terms of annual budgeting results solely from the individual and appropriate judgment of local school boards, which are empowered – and indeed are required – to make these decisions locally. If the DAG has qualms with what Act 1 has permitted WCASD – and myriad other school districts – to do, such complaints are better directed to the General Assembly.

WCASD complied with Act 1, and every other relevant law and regulation related to its financial and accounting practices during the audit period. WCASD provided honest and reasonable explanations for the decision making of its Board, P&F Committee, and other personnel. WCASD has further attempted to clarify any ambiguity in this letter response. WCASD hopes that this response aids the DAG in realizing what WCASD really is – a prudent steward of taxpayer funds.

Sincerely,



Robert J. Sokolowski, Ed. D.  
Superintendent  
West Chester Area School District

Enclosures

cc: John Scully, WCASD Business Manager  
Sue Tiernan, WCASD President of the Board of Directors  
Gary Bevilacqua, WCASD Chair of the Property & Finance Committee  
Unruh, Turner, Burke & Frees, WCASD Solicitor

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### School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes

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#### Auditor’s Conclusion to West Chester Area School District’s Response

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The West Chester Area School District (West Chester) emphasizes its compliance with laws and regulations, its belief that the Department of the Auditor General (Department) misunderstood or mischaracterized the district’s processes and procedures, and its disagreement with the report. West Chester’s response insists that the Department replace audited financial numbers with its budgeted estimates to show the true financial picture of the district. Below we will address the West Chester assertions in the order of its response that we believe warrant further comment.

West Chester responded that it should not have been included within this audit because it does not agree with the Department’s second selection criteria. We disagree and we clarified during our exit conference that the second criteria for selecting districts was based on total balance of all Fund types which included Capital Projects/Reserves Funds. These Funds include operating surplus transferred from the General Fund, as well as bond proceeds. West Chester along with six other districts fell into this criterion.

West Chester indicated that the Department’s report did not define or list criteria for what we utilized as criteria for what is “appropriate” in reference to a referendum exception. We disagree since the report clearly states that Act 1 of 2006, as amended, Section 333(a)(1), provides that an additional tax rate increase above the index may be requested if needed to balance the preliminary budget.<sup>135</sup> Therefore, if the district has funds available to balance the preliminary budget, it should not apply for a referendum exception. We specifically addressed in our report that West Chester had sufficient funds to balance its preliminary budget, and therefore, questionably requested to, and did, increase taxes above the index.

West Chester responded with a narration of the budget timeline, referendum exception process, the state budget approvals, potential damage to its reputation, and other items it feels are relevant to the reader which we include in this report verbatim. While all of West Chester’s comments and information was taken into consideration by the Department, it does not excuse the district from addressing the core issues we reported of having millions of dollars of funds available while requesting and utilizing referendum exceptions to increase taxes above the index, twice during the audit period.

West Chester stated that Table #1 of our report, which includes the referendum exceptions and funds available, is inaccurate and misleading because the Department included the assigned and committed funds as “funds available”. We disagree because, as described by the Pennsylvania

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<sup>135</sup> Subsection (a)(1) of Section 333 (relating to public referendum requirements for increasing certain taxes) of the Taxpayer Relief Act. Please note at Subsection (a)(2) of the act states as follows: “(2) This section shall apply to each board of school directors beginning with any proposed tax increase that takes effect in the 2007-2008 fiscal year and each fiscal year thereafter.” See 53 P.S. § 6926.333(a)(1)-(2).

## **A Performance Audit**

### **School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes**

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Department of Education (PDE), the assigned and committed funds are unrestricted and available for appropriation as directed by the Board of Directors (Board). While the Board does have the authority to commit and assign the funds, the Board also has the authority to change its mind to decommit or reassign those same funds to prioritize the funds as needed for current operations.

West Chester stated that to provide full transparency, the Department's table should also list the amount of the referendum exceptions actually utilized. This information is included in our report within West Chester's response. While we agree the district did not increase its taxes to the full extent of the approved referendum exception, it did use the referendum exception and increase taxes above the index twice during the audit period.

West Chester indicated that the Department's report does not identify what is meant by sufficient funds in the report and assumes that sufficient funds only refers to unassigned fund balances. We disagree with West Chester's assertion and assumption since Table #1 of our report noted that available funds included committed, assigned, and unassigned fund balances and included a footnote that the Board had funds available to recommit and/or reassign.

West Chester stated that its funds were not sufficient to balance its preliminary budget, its referendum exceptions were appropriate, in accordance with law, and approved by PDE, while having ample reserves to maintain a high bond credit rating. Again, the district is not addressing the actual issue we raised in our report. The Department acknowledged legal compliance and the approval by PDE for the referendum exceptions; however, West Chester's preliminary budgets did not consider the funds the district had at its disposal to balance the budget.

West Chester asserted that it was appropriate to apply for the referendum exceptions because its assignment for tax stabilization was not yet recognized. West Chester asserted that the \$5.5 million of unused funds assigned for tax stabilization in one year is not yet recognized as available to use in the next year's budget. Therefore, West Chester does not include these funds to balance the following fiscal year's budget. While we acknowledge this could be true based on West Chester's budgeting practices, we believe most districts know or should know by mid-year whether such fund reserves will be utilized based on revenues districts received by that time period.

West Chester stated that it did not have funds committed for the type of expenditure in which it applied for a referendum exception. West Chester later stated, however, that it had committed funds for pension obligations, but it was not required to include these fund commitments on the PDE referendum exception application form. While we agree no noncompliance was noted, we believe this is a clear loophole in the referendum exception process that we will include in our *Overall Summary and Recommendations* section to this report in order to bring to the attention to the PDE and the Pennsylvania General Assembly.

## **A Performance Audit**

### **School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes**

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West Chester asserted that its preliminary budget was not misleading to taxpayers or to PDE. Again, the district acknowledged that while it had the funds available, these funds were committed or assigned and should not be considered. We disagree with West Chester's assertion that designating funds as approved by the Board, it does not make these funds unavailable for other purposes when needed.

West Chester stated that the Department did not request information relating to what the district communicates to its taxpayers and residents. We disagree and we did request and review the district's budgets, presentations, and treasurer's reports presented as they were presented to its Board and the public. West Chester further noted that it has exhaustive documents on the district's website. We do not disagree, however, West Chester is not addressing the real issue we brought to its attention regarding the availability of the committed, assigned, and unassigned funds to balance its preliminary budgets to alleviate increasing taxes on the taxpayers.

West Chester further stated that the following statements in our report are misleading that the district:

- Had sufficient funding and did not need to apply for referendum exceptions for FYE June 30, 2018 and 2019.
- Presented misleading preliminary budgets.
- Wasted time and resources of the district and PDE.
- Placed an unnecessary excess burden on district taxpayers.

We disagree and reiterate that these conclusions are supported by the details we address in our report and information from the West Chester's audited financial statements.

West Chester again stated that the Department is mischaracterizing its financial practices in regard to committing and assigning its General Fund to maintain an unassigned fund balance below the PSC threshold which allows the district the ability to increase taxes annually. West Chester noted its compliance with policy and suggested that while its budgets are conservative and estimated for the worst case scenario, they are not overly conservative. West Chester further asserted that its adopted budgets are more in line with its financial condition than its audited financial statements. We disagree in that we report information based on actual audited financial statements and not estimates as included in West Chester's budgets. For instance, West Chester's budgets included personnel salaries and benefits for more than 90 positions that were not filled which contributed to surpluses included on the audited statements. These surplus funds should be considered for the following year. While utilizing the audited financial statements allows us to have the benefit of hindsight with our evaluation and conclusions, we believe the information we reported and the recommendations made to West Chester are valuable to help improve its practices.

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Additionally, West Chester stated that the tax stabilization assignment of \$38.2 million as of FYE June 30, 2021, was from substantial savings associated with reduced costs during the COVID pandemic. Although we agree the district had a slight decrease in expenditures of \$4 million when comparing the FYE June 30, 2019, to FYE June 30, 2020, West Chester's local revenue increased \$20 million during our four-year audit period primarily from increases to local taxes. In reviewing West Chester's audited financial statements, these increases in local taxes appear to more substantially contribute to its operating surpluses.

#### **Recommendations 1, 2, and 5:**

West Chester stated that it disagrees with the need for recommendations 1, 2, and 5 that relate to referendum exceptions and budgeting practices because the district already does what we recommend with its existing practices. We, however, disagree based on the information as presented in our report and believe West Chester should reconsider our recommendations.

#### **Recommendation 3:**

We are encouraged that the district plans to address this recommendation.

#### **Recommendation 4:**

West Chester stated that it disagrees with this recommendation because assigned or committed funds do not need to be utilized within a specific time frame and the use of funds is the prerogative of the local elected school board. While we agree there is no specified time frame to use assigned and committed funds, we still believe that if these funds are not used within the current or next fiscal year, consideration should be made to repurpose the funds or include as unassigned funds in the General Fund.

West Chester concluded in its response that our audit report could seriously damage its reputation and its image due to the mischaracterizations and misunderstandings of West Chester's practices and procedures. We, however, reiterate that our reported results for West Chester are based on the district's detailed records, including but not limited to, its budgets and annual audited financial statements. While no edits are deemed necessary and our conclusions and recommendations remain as stated, West Chester's response is included in our audit report verbatim.

## A Performance Audit

### School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes

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#### Appendix A

#### Objectives, Scope, Methodology, and Data Reliability

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The Department of the Auditor General (Department) conducted this performance audit pursuant to the following mandates:

- Article VIII, Section 10 of the Constitution of the Commonwealth of Pennsylvania, which authorizes the Department to audit all or any of the schools receiving a state appropriation “**as far as may be necessary to satisfy the department** that the money received was expended or is being expended for no purpose other than that for which is was paid.”
- Sections 402 and 403 of The Fiscal Code, 72 P.S. §§ 402 and 403.<sup>136</sup>

We conducted this audit in accordance with generally accepted *Government Auditing Standards*, issued by the Comptroller General of the United States. 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.<sup>137</sup> We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Refer to the *Introduction and Background* section of this report for how the 12 school districts included in our audit were selected.

## Objectives

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Our performance audit objectives were as follows:

1. Determine whether each of the selected districts appropriately used the Pennsylvania Department of Education referendum exception method to raise local school property taxes (taxes).<sup>138</sup>

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<sup>136</sup> See 72 P.S. §§ 402 and 403 and Pa. Const. art. VIII, Sec. 10. (Emphasis added.) The authority to conduct performance audits derives from the 2004 Pennsylvania Commonwealth Court decision in *Dep’t of the Aud. Gen. v. State Emp. Ret. Sys.*, citing the prior case in the matter, which plainly concluded that the Auditor General (and his Department) under Article VIII, Section 10 of the constitution and Section 402 and Section 403 of the Fiscal Code **has the authority to conduct performance audits** of, among others, a public agency (such as a school district) receiving state funds at his discretion. See 860 A.2d 206, 214 (pa. Cmwth. 2004) amending the prior decision in *Dep’t of the Aud. Gen. v. State Emp. Ret. Sys.*, 836 A.2d 1053, 1069-1070 (Pa. Cmwth. 2003). (Emphases added.)

<sup>137</sup> U.S. Government Accountability Office. *Government Auditing Standards*. 2018 Revision. Technical Update April 2021.

<sup>138</sup> See the Taxpayer Relief Act, 53 P.S. § 6926.333(f) and (n) (pertaining to the four school district referendum exceptions under Act 1 of 2006, as amended by Act 25 of 2011) and the PDE [Referendum Exceptions \(pa.gov\)](#).

## A Performance Audit

### School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes

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2. Determine if each district ensured that fund balances were properly designated and used for intended purposes.<sup>139</sup>

With regard to the financial aspects of the objectives, we did not conduct our own financial statement audit of each district. Instead, we reviewed the annual financial statement audit reports and findings of the independent CPA firms that audited the districts' financial statements for the four-year audit period. This review was completed to determine if additional procedures needed to be performed to rely on the information and the amounts in the financial statements, and to determine if there were any documented issues with internal controls.

We also conducted procedures to determine whether the districts had prior audit findings and recommendations from prior Department reports related to our objectives. One district, Lower Merion School District, had a prior limited procedures engagement report issued October 2017 related to this audit that had recommendations. Based on the status of the recommendations of that report, we incorporated any remaining issues in our current audit results (see the Lower Merion School District audit results).

### Scope

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This performance audit covered the period July 1, 2017, through June 30, 2021. We reviewed the financial audit reports and other documentation for the fiscal years ended (FYE) June 30, 2018, 2019, 2020, and 2021.

District management is responsible for establishing and maintaining effective internal controls to provide reasonable assurance of compliance with applicable laws, regulations, and administrative policies and procedures. In conducting our audit, we obtained an understanding of the districts' internal controls, including information system controls.

*Standards for Internal Control in the Federal Government* (also known as and hereafter referred to as the Green Book), issued by the Comptroller General of the United States, provides a framework for management to establish and maintain an effective internal control system.<sup>140</sup> We used the framework included in the Green Book when assessing the districts' internal control systems.

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<sup>139</sup> See the Public School Code, 24 P.S. §§ 6-687 and 6-688.

<sup>140</sup> Even though the Green Book was written for the federal government, it explicitly states that it may also be adopted by state, local, and quasi-government entities, as well as not-for-profit organizations, as a framework for establishing and maintaining an effective internal control system.

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### School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes

The Green Book’s standards are organized into five components of internal control. In an effective system of internal control, these five components work together in an integrated manner to help an entity achieve its objectives. The five components contain 17 related principles, listed in the table below, which are the requirements an entity should follow in establishing an effective system of internal control.

We determined all the internal control components are significant to the audit objectives. The table below represents a summary of the level of the internal control assessment for effectiveness of design (**D**); implementation (**I**); and/or operating effectiveness (**OE**) that we performed for each principle; or an indication that reliance was placed on the internal control work performed by the school districts’ external auditors and no further assessment was done (**R**); along with a conclusion regarding whether issues were found with the principles, and if those issues are included in the report.<sup>141</sup>

Component		Principle	Level of Assessment	Objective	Conclusion
Control Environment	1	The oversight body and management should demonstrate a commitment to integrity and ethical values.	R	1, 2	No issues noted
	2	The oversight body should oversee the entity’s internal control system.	R	1, 2	No issues noted
	3	Management should establish an organizational structure, assign responsibility, and delegate authority to achieve the entity’s objectives.	R	1, 2	No issues noted
	4	Management should demonstrate a commitment to recruit, develop, and retain competent individuals.	R	1, 2	No issues noted

<sup>141</sup> The Green Book, Sections OV3.05 and 3.06, states the following regarding the level of assessment of internal controls. Evaluating the design of internal control includes determining if controls individually and in combination with other controls are capable of achieving an objective and addressing related risks. Evaluating implementation includes determining if the control exists and if the entity has placed the control into operation. Evaluating operating effectiveness includes determining if controls were applied at relevant times during the audit period, the consistency with which they were applied, and by whom or by what means they were applied.

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	5	Management should evaluate performance and hold individuals accountable for their internal control responsibilities.	R	1, 2	No issues noted
Risk Assessment	6	Management should define objectives clearly to enable the identification of risks and define risk tolerances.	R	1, 2	No issues noted
	7	Management should identify, analyze, and respond to risks related to achieving the defined objectives.	R	1, 2	No issues noted
	8	Management should consider the potential for fraud when identifying, analyzing, and responding to risks.	R D	1, 2	No issues noted
	9	Management should identify, analyze, and respond to significant changes that could impact the internal control system.	R	1, 2	No issues noted
Control Activities	10	Management should design control activities to achieve objectives and respond to risks.	R D, I, OE	1, 2	See each districts' report
	11	Management should design the entity's information system and related control activities to achieve objectives and respond to risks.	R	1, 2	No issues noted
	12	Management should implement control activities through policies.	R D, I	1, 2	No issues noted
Information and Communication	13	Management should use quality information to achieve the entity's objectives.	R	1, 2	No issues noted
	14	Management should internally communicate the necessary quality information to achieve the entity's objectives.	R D, I	1, 2	See each districts' report
	15	Management should externally communicate the necessary quality information to achieve the entity's objectives.	R D, I	1, 2	See each districts' report

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Monitoring	16	Management should establish and operate monitoring activities to monitor the internal control system and evaluate results.	R	1, 2	No issues noted
	17	Management should remediate identified internal control deficiencies on a timely basis.	R	1, 2	No issues noted

*Government Auditing Standards* require that we consider information system controls “...to obtain sufficient, appropriate evidence to support the audit findings and conclusions.”<sup>142</sup> This process further involves determining whether the data that supports the audit objectives is reliable. In addition, Publication GAO-20-283G, *Assessing Data Reliability*, provides guidance for evaluating data using various tests of sufficiency and appropriateness when the data are integral to the audit objective(s).<sup>143</sup> See our assessment in the *Data Reliability* section that follows.

Our procedures to assess the design, implementation, and/or operating effectiveness accordingly are discussed in the *Methodology* section that follows. Deficiencies in internal controls we identified during the conduct of our audit and determined to be significant within the context of our audit objectives are summarized in the conclusion section below and described in detail within the respective audit sections in this report. See table above for description of each of the principle numbers included in the conclusions below.

#### Conclusion for Objective 1 and 2:

While our review of the internal control work performed by the school districts’ CPA firms did not find any issues relevant to our objectives, our assessment of the school districts’ design of controls found issues regarding Principles 10, 14, and 15. This included the following issues with requests for referendum exceptions and the General Fund: (1) districts requested referendum exceptions to increase taxes above the index despite having adequate funds in the General Fund for annual expenditures; and (2) districts increased taxes despite having sufficient funds in the General Fund or while transferring unbudgeted funds. These issues are described in general in the *Overall Summary and Recommendations* section of this report and in detail for each district in the (audit results) sections.

<sup>142</sup> U.S. Government Accountability Office. *Government Auditing Standards*. 2018 Revision. Technical Update April 2021. Paragraph 8.59 through 8.67.

<sup>143</sup> U.S. Government Accountability Office. *Assessing Data Reliability*. December 2019.

## **A Performance Audit**

### **School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes**

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#### **Methodology**

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To address our audit objectives, we performed the following procedures:

##### Overall Procedures:

- Reviewed information from the school districts’ websites and the Pennsylvania Department of Education’s website regarding school district finances, General Fund - fund balances, and budget processes to assist in the development of the audit objectives.
- Reviewed the needs of potential users of the audit report and the significant effects on the students, faculty, and taxpayers of the school districts.
- Identified those charged with governance and communicated an overview of the objectives, scope, methodology, and timing of the performance audit.
- Reviewed the following laws, regulations, guidance, and written policies and procedures applicable to the school district’s referendum exception requests and fund balances: [Principle 12]
  - Various sections of the Public School Code of 1949
  - The Taxpayer Relief Act, as amended by Act 25 of 2011
  - PDE Property Tax Referendum Exception Guidelines
  - PDE Consolidated Financial Reporting System – General Fund Budget General User Manual
  - PDE Manual of Accounting and Financial Reporting
  - PA Office of the Budget’s Chart of Accounts for PA Local Education Agencies
  - Various PDE Accounting Bulletins
- Designed audit procedures to provide reasonable assurance of detecting significant violations of law, regulations, policies, etc. in the context of our audit objectives. [Principle 12]
- Obtained an understanding of school districts’ internal controls and assessed the design, implementation, and/or operating effectiveness of such internal controls to the extent necessary to address the audit objectives.

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- Evaluated the significance of identified internal control deficiencies within the context of our audit objectives.
- Considered illegal acts, fraud, and abuse throughout the audit process.
- Conducted fraud/abuse, audit risk, and control risk brainstorming meetings to highlight high risk areas and to be aware of situations in which fraud and control weaknesses may exist.
- Assessed significance and audit risk within the context of the audit objectives and applied these assessments to establish the scope and methodology for addressing the audit objectives.
- Designed the audit procedures to obtain sufficient, appropriate evidence that provided a reasonable basis for findings and conclusions based on the audit objectives and to reduce audit risk to an acceptably low level.
- Planned and performed audit procedures and test work based on ongoing risk assessments to obtain sufficient and appropriate evidence to adequately support our audit objectives.
- Provided appropriate and sufficient staff and other resources to perform the audit.
- Prepared a written audit plan for the audit and updated the plan, as necessary, to reflect any significant changes to the plan made during the audit.
- Reviewed the school districts' annual audited financial reports for the FYE June 30, 2018, 2019, 2020, and 2021, to determine what, if any, reportable weaknesses were found regarding internal controls to ensure we could rely on the CPA firms' financial audit reports.
- Verified the school districts' CPA firms' individuals who conducted the audits were independent of the school district and qualified to perform the audits.
- We reviewed the CPA firms financial audit reports, peer reviews, and internal control assessments to rely on the financial accounts of the school districts for this performance audit. [All Principles]

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- Surveyed each district regarding its understanding and/or knowledge of fraud, significant internal control weaknesses, potential fraud, or noncompliance. [Principle 8]
- To address the Status of Prior Audit Findings related to the performance audit objectives, we performed the following procedures:
  - Reviewed each school districts' prior Department's audit report and respective findings to determine any impact related to our current audit objectives.
  - If the findings or observations related to the current audit objectives, inquired of the applicable school district, Lower Merion School District, for the status of the prior audit reports recommendations.

#### Objective 1:

- Reviewed applicable Board of Directors' meeting minutes for the FYE June 30, 2018, 2019, 2020, and 2021, for the following: [Principle 10]
  - Approval of tax increases, if applicable.
  - Approval of the preliminary budgets or resolutions to not increase taxes above the index.
  - Approval of the annual final adopted General Fund budgets due June 30 for the next fiscal year.
  - Budget and financial presentations to the Board of Directors and the public for transparency and understanding of the financial condition of the district.
  - Approval of the audited financial statements.
- Interviewed and corresponded with school district management in order to:
  - Gain an understanding of the data and information used to prepare preliminary budgets and applications for referendum exceptions.
  - Gain an understanding of the school districts' process to request referendum exceptions.
- Verified the School Districts met timeline requirements to apply for referendum exceptions and approve annual General Fund budgets:
  - Verified the applicable deadlines were met for the resolution to not increase taxes above the index or for the adoption of the preliminary budget to request a referendum exception.

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### School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes

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- If a referendum exception was requested, verified the school district made the preliminary budget available for public inspection 20 days prior to the adoption and public notice 10 days prior to adoption.
- Verified all proposed budgets were: [Principles 10, 12, 14, and 15]
  - prepared 30 days prior to adoption,
  - made available for public inspection 20 days prior to the adoption,
  - provided public notice 10 days prior to adoption, and
  - approved by June 30 of the applicable year.
- Determined what fiscal year(s) and which type of referendum exception(s) the districts requested and were approved for to raise property tax above the index.
- Confirmed the districts needed the funds for the purpose requested. For instance, if the district was requesting a referendum exception for pension obligations, was the increase in the expenditure from the prior fiscal year more than the funds set aside for pension obligations as commitments or assignments or if there were sufficient funds in the unassigned fund balance in the General Fund.
- Determined if the school districts used the approved referendum exceptions to raise the taxes above the index.
- Verified increased taxes above the index were at or lower than the PDE approved rates.
- Verified the School District's Unassigned Fund Balance listed on the final adopted General Fund budget was less than 8% of estimated budgeted expenditures for the applicable year in which taxes are being increased.
- Compared preliminary budgets, final adopted budgets, and actual financial statement to ensure the budget practices were reasonable.
- Reviewed budgeted transfers from the final adopted budgets versus actual transferred funds according to the audited financial statements from the General Fund to other Governmental Funds to trace surplus funds.
  - Interviewed and corresponded with school district management to obtain explanations for variances or discrepancies between documents.

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#### Objective 2:

- Obtained and reviewed the School Districts’ policies for designating funds in the General Fund from “unassigned” to committed or assigned.
  - Verified approvals and appropriate Board resolutions were used to designate funds as committed. [Principle 10]
  - Determined if the School Districts’ policies for unassigned fund balance in the General Fund were limiting the unassigned fund balance to less than the PSC threshold to raise taxes by designating funds. [Principle 12]
  - Interviewed and corresponded with school district management to gain an understanding of the data and information regarding fund balances and why the district commits or assigns funds.
- Determined whether the assigned and committed General Fund balances were designated and used in the next fiscal year or within a reasonable time period or repurposed.
- Reviewed general bond debt increases and decreases based on capital projects plans to determine if debt increased with corresponding projects.
- Reviewed investment policy and treasury reports to ensure the district had policies and procedures in place for investing funds and to ensure that the district was reporting information to its Board. [Principles 12 and 14]
- Obtained the School Districts’ capital projects plan and reviewed capital project funds in the General Fund, Capital Projects Fund, and/or Capital Reserves Fund to confirm surplus funds transferred from the General Fund to the other Funds were for capital projects.
- Reviewed the purpose of having funds for capital improvements in different Governmental Funds to determine the origin of the funds, such as operating surplus funds, bond proceeds, or special tax revenue.
- Reviewed transfers from the General Fund to other Governmental Funds to determine if the interfund transfers were planned and recorded in the General Fund budget for transparency. [Principles 14 and 15]

## A Performance Audit

### School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes

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#### Data Reliability

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*Government Auditing Standards* requires us to assess the sufficiency and appropriateness of computer-processed information that we used to support our findings, conclusions, and recommendations. The assessment of the sufficiency and appropriateness of computer-processed information includes considerations regarding the completeness and accuracy of the data for the intended purposes.<sup>144</sup>

In performing this audit, we used financial data provided in the school districts' annual audited financial statements and in the school districts' preliminary and final adopted General Fund budgets. The school districts contract with independent CPA firms to conduct annual audits of their financial statements. We reviewed the CPA firms financial audit reports, peer reviews, and internal control assessments to rely on the financial accounts of the school districts for this performance audit.

During our audit, we performed the following procedures related to the work of the CPA firms and determined the scope, quality, and timing of the audit work performed by the CPA firms to place reliance on the financial records of the school districts:

- Confirmed that the external auditors of the CPA firms were independent and qualified to conduct the financial audits of the school districts.
- Verified the audits were conducted in accordance with GAGAS.
- Obtained a copy of the firms' most recent peer review results and found the CPA firms received a rating of pass during their last peer review.
- Reviewed the independent auditor's assessments of internal controls for the fiscal year ended June 30, 2021, for each district, with the exception of three school districts.<sup>145</sup>
- Reviewed any reported deficiencies or management letter comments for impact on our performance objectives.

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<sup>144</sup> U.S. Government Accountability Office. *Government Auditing Standards*. 2018 Revisions. Technical Update April 2021. Paragraph 8.98.

<sup>145</sup> Three school districts had CPA firms that would not provide the internal control assessment work papers. For these three districts, we ensured there were no deficiencies, weaknesses, or findings in the audit reports that would have an impact on our audit objectives.

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- Noted that the independent auditors presented an unmodified opinion on the financial statements for the applicable fiscal years audited.

In addition to reviewing the CPA firms financial audit reports, we also obtained the related annual General Fund adopted budgets for the corresponding fiscal years and performed comparisons to the financial statements to determine if there were any substantial fluctuations in amounts budgeted versus actual. We did not identify any unusual items that warranted further procedures to be performed. Additionally, nothing came to our attention that was significant in the context of our audit objectives that warranted the extension of our audit procedures to encompass additional testing of the financial records of the school district for this performance audit.

To perform this audit, we also used data provided in the Pennsylvania Department of Education's annual Reports on Referendum Exceptions for the four-year audit period. The school districts submit preliminary General Fund budgets to support the application for referendum exceptions. PDE approves referendum exception applications submitted by the districts and reports the information annually on a Report on Referendum Exceptions. To rely on the PDE reports, we traced the preliminary budget information and millage increase requested to the respective PDE report. We also, ensured that the five districts that actually increased taxes above the index did so within the PDE referendum exceptions approved.

Based on the above procedures, we found no limitations with using the data for our intended purposes. In accordance with *Government Auditing Standards*, we concluded that the school districts' financial data and PDE reports on Referendum Exceptions, for the period July 1, 2017, through June 30, 2021, to be sufficiently reliable regarding completeness and accuracy for the purposes of this engagement.

## A Performance Audit

### School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes

<b>Appendix B</b>	Approved Referendum Exceptions, Funds Available, and Tax Increases Imposed
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The following table illustrates the funds available at the beginning of each fiscal year for the 12 school districts (district) reviewed as part of this audit, the approved referendum exception(s) amounts, whether the district raised taxes, and whether the district used the approved referendum exception(s) to raise taxes above the index.

Funds Available vs. Referendum Exception Approved					
School District	Fiscal Year Ended June 30,	Funds Available July 1 <sup>a/</sup>	Referendum Exception Approved <sup>b/</sup>	Taxes were Raised <sup>c/</sup>	Taxes Were Raised Above the Index <sup>d/</sup>
Abington	2018	\$40,757,021	\$ 602,578	Yes	Yes
	2019	\$42,134,221	\$ 1,087,186	No	No
	2020	\$42,810,865	N/A <sup>e/</sup>	No	No
	2021	\$38,405,249	\$ 903,197	No	No
Bethlehem	2018	\$30,483,175	\$ 3,359,702	Yes	No
	2019	\$33,667,787	\$ 2,362,390	Yes	No
	2020	\$39,366,308	\$ 844,619	No <sup>f/</sup>	No
	2021	\$38,311,403	\$ 1,851,517	No <sup>f/</sup>	No
Canon-McMillan	2018	\$ 2,880,628	N/A	Yes	No
	2019	\$ 4,471,432	N/A	Yes	No
	2020	\$ 6,144,419	\$ 190,294	Yes	No
	2021	\$ 9,441,843	N/A	Yes	No
Hempfield	2018	\$14,467,647	\$ 476,600	Yes	No
	2019	\$13,856,242	\$ 998,428	Yes	No
	2020	\$14,726,602	\$ 1,017,836	Yes	No
	2021	\$18,008,899	\$ 1,286,361	No	No
Lancaster	2018	\$29,036,399	N/A	Yes	No
	2019	\$28,761,156	N/A	Yes	No
	2020	\$29,995,393	N/A	Yes	No
	2021	\$30,390,245	\$ 1,724,337	Yes	No
Lower Merion	2018	\$50,516,884	\$ 2,805,325	Yes	No
	2019	\$50,371,038	N/A	Yes	No
	2020	\$20,226,200	N/A	Yes	No
	2021	\$20,483,767	N/A	Yes	No

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Neshaminy	2018	\$34,260,871	\$ 3,678,504	<b>Yes</b>	No
	2019	\$34,226,092	\$ 753,576	<b>Yes</b>	No
	2020	\$42,440,162	\$ 32,260	<b>Yes</b>	No
	2021	\$47,970,291	N/A	<b>Yes</b>	No
North Allegheny	2018	\$17,108,861	\$ 1,013,515	No	No
	2019	\$16,781,453	\$ 131,265	<b>Yes</b>	<b>Yes</b>
	2020	\$14,207,259	\$ 1,562,375	<b>Yes</b>	<b>Yes</b>
	2021	\$18,897,001	\$ 2,754,419	No	No
North Penn	2018	\$37,750,278	N/A	<b>Yes</b>	No
	2019	\$37,533,955	\$ 1,781,977	<b>Yes</b>	<b>Yes</b>
	2020	\$38,070,589	\$ 1,453,237	<b>Yes</b>	No
	2021	\$34,913,910	\$ 1,541,260	<b>Yes</b>	No
Northampton	2018	\$15,033,939	\$ 614,624	<b>Yes</b>	No
	2019	\$12,482,717	\$ 943,250	<b>Yes</b>	No
	2020	\$10,367,092	\$ 810,284	<b>Yes</b>	No
	2021	\$10,073,366	\$ 2,230,103	No	No
Penn Manor	2018	\$16,664,260	\$ 452,356	<b>Yes</b>	<b>Yes</b>
	2019	\$18,531,100	\$ 771,389	<b>Yes</b>	<b>Yes</b>
	2020	\$19,290,382	\$ 320,381	<b>Yes</b>	<b>Yes</b>
	2021	\$20,218,950	N/A	No	No
West Chester	2018	\$21,352,589	\$ 5,400,281	<b>Yes</b>	<b>Yes</b>
	2019	\$24,421,441	\$ 3,229,145	<b>Yes</b>	<b>Yes</b>
	2020	\$28,460,261	N/A	<b>Yes</b>	No
	2021	\$43,883,151	N/A	No <sup>f/</sup>	No

<sup>a/</sup> - The amount of funds available to the applicable district at the beginning of the fiscal year; for instance, for the fiscal year ended (FYE) June 30, 2018, the amount available for appropriation by the Board on July 1, 2017.<sup>146</sup>

<sup>b/</sup> - Referendum exceptions requested included special education costs and/or pension obligations which refer to the retirement contributions made by the school district to the Public School Employees' Retirement System (PSERS).

<sup>c/</sup> - Were taxes raised at or below the index?

<sup>d/</sup> - Were taxes raised above the index by using an approved referendum exception to raise taxes above the index? If the district raised taxes above the index, we verified the amount was within the approved referendum exception.

<sup>e/</sup> - Abington's preliminary budget did not require an increase above the index and therefore, no type of referendum exception was requested.

<sup>f/</sup> - The district did not raise taxes but there was a mandatory tax rate rebalancing between two counties.

N/A – Not applicable

*Sources: Produced by staff of the Department of the Auditor General based on information in the PDE's referendum reports and each district's audited financial statements for the FYE 2017, 2018, 2019, 2020, and 2021.*

<sup>146</sup> The table includes funds committed and/or assigned in the General Fund that are available for use if the board so directs. Also, the available funds listed have been unspent for several years and remain available for the board to recommit and/or reassign for other types of expenditures.

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### School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes

#### Appendix C

#### Unassigned versus Unrestricted Fund Balance Analysis

The following table illustrates the school districts (districts) estimated ending “unassigned” fund balance (unreserved, undesignated funds) as a percentage of estimated expenditures for the applicable fiscal year. Each of the 12 districts could have raised taxes every year based on the current Public School Code (PSC) requirements. The green highlight indicates the year the respective district actually raised taxes. Collectively, over the four-year audit period, the 12 districts raised taxes 37 times.

	FYE June 30			
	2018	2019	2020	2021
Abington	0%	0%	0%	0%
Bethlehem	4%	6%	5%	4%
Canon-McMillan	4%	2%	4%	4%
Hempfield	5%	6%	6%	7%
Lancaster	8%	8%	8%	7%
Lower Merion	5%	6%	7%	0%
Neshaminy	7%	7%	7%	7%
North Allegheny	8%	8%	8%	7%
North Penn	8%	8%	5%	3%
Northampton	6%	7%	5%	5%
Penn Manor	6%	6%	4%	3%
West Chester	6%	6%	6%	6%
Highlight – Raised taxes below, at, or above the index, see more detailed information in <i>Appendix B</i> .				

*Source: Produced by staff of the Department of the Auditor General based on information in each school district's final adopted budgets for the FYE 2018, 2019, 2020, and 2021.*

For comparison, the next table illustrates the school districts and the estimated ending “unrestricted” fund balance as a percentage of estimated expenditures for the applicable fiscal year. Unrestricted funds include unassigned funds as well as committed and assigned funds. The green highlight indicates districts which would have still been able to increase taxes if the PSC threshold is revised from using unassigned fund balance to unrestricted fund balance with the same 8% threshold.

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### School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes

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	FYE 2018	FYE 2019	FYE 2020	FYE 2021
Abington	14%	14%	15%	12%
Bethlehem	10%	11%	11%	12%
Canon-McMillan	10%	4%	6%	6%
Hempfield	7%	10%	9%	10%
Lancaster	9%	11%	11%	7%
Lower Merion	19%	13%	14%	13%
Neshaminy	15%	16%	18%	22%
North Allegheny	13%	12%	11%	10%
North Penn	15%	14%	12%	10%
Northampton	8%	8%	6%	5%
Penn Manor	15%	17%	16%	13%
West Chester	8%	8%	9%	10%
Highlight – The districts that would have still met the 8% threshold with using unassigned, committed, and assigned fund balances as a percentage of expenditures.				

*Source: Produced by staff of the Department of the Auditor General based on information in each school district's final adopted budgets for the FYE 2018, 2019, 2020, and 2021.*

If the threshold requirement was revised to using unrestricted funds rather than using unassigned funds, collectively only 5 of the 12 districts would have been able to raise taxes a total of 11 times during the same four-year period without a voter referendum.

## A Performance Audit

### School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes

#### Appendix D

#### Budgeted Transfers versus Actual Transfers

The following table provides the amount budgeted to be transferred from the General Fund to other Capital Funds versus the actual amounts collectively transferred during the four-year period FYE June 30, 2018, 2019, 2020, and 2021, for the 12 school districts (districts) reviewed for this audit.

	Budgeted Transfers	Actual Transfers <sup>a/</sup>	Over/(Under) Budget
Abington	\$ 6,874,448	\$ 11,522,448	\$ 4,648,000
Bethlehem	\$ 148,000	\$ 14,750,000	\$ 14,602,000
Canon-McMillan	\$ 439,650	\$ 20,203,291	\$ 19,763,641
Hempfield	\$ 15,115,489	\$ 13,146,698	\$ (1,968,791)
Lancaster	\$ -	\$ 4,000,000	\$ 4,000,000
Lower Merion	\$ 28,949,522	\$ 65,434,164	\$ 36,484,642
Neshaminy	\$ 5,914,598	\$ 5,348,083	\$ (566,515)
North Allegheny	\$ 2,765,200	\$ 10,597,200	\$ 7,832,000
North Penn	\$ 2,233,417	\$ 14,729,897	\$ 12,496,480
Northampton	\$ 103,018	\$ -	\$ (103,018)
Penn Manor	\$ 9,163,573	\$ 12,512,861	\$ 3,349,288
West Chester	\$ 21,710,327	\$ 23,478,241	\$ 1,767,914
<b>Totals</b>	<b>\$ 93,417,242</b>	<b>\$ 195,722,883</b>	<b>\$ 102,305,641</b>

<sup>a/</sup> - We did not include transfers to trust Funds or debt service Funds.

Source: Produced by staff of the Department of the Auditor General based on information in each school district's final adopted budgets and audited financial statements for the FYE 2018, 2019, 2020, and 2021.

Collectively, the 12 districts transferred from their General Fund to other Capital Funds \$102 million more than what was budgeted during our four-year audit period. Of the 12 districts, 4 districts transferred more than \$10 million over their respective district's budgets.

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#### Appendix E

#### Definitions

The following definitions are summarized from the Manual of Accounting and Financial Reporting for Pennsylvania Local Educational Agencies, maintained by the Pennsylvania Office of the Budget, Office of Comptroller Operations Central Agencies and School Finance Unit, unless otherwise noted.<sup>147</sup>

**Inflationary Index (index)** – The Pennsylvania Department of Education (PDE) sets an inflation index each September that caps a district’s allowable increase of local school property taxes (taxes) for the following fiscal year. The only methods of increasing taxes above the index is to either apply for a referendum exception provided by Act 1 or obtain approval from voters by placing a referendum question on the ballot in the election preceding the fiscal year.<sup>148</sup>

**Preliminary Budget** – A budget for the General Fund prepared by the end of January prior to the applicable fiscal year and used to apply for a referendum exception when an increase in taxes above the index is needed to balance the budget.<sup>149</sup>

**Final Adopted Budget** – The annual budget of the General Fund, required by law and approved by the district’s Board of Directors (Board) by June 30<sup>th</sup> of each year for the following fiscal year beginning July 1.

**Operating Surplus** – When the current fiscal year operating revenues exceed expenditures. The General Fund balance increases due to an operating surplus.<sup>150</sup>

**Operating Deficit** – When the current fiscal year operating revenues are less than expenditures. The General Fund balance decreases due to an operating deficit.<sup>151</sup>

**Governmental Funds** – Funds the district uses for reporting sources, uses, and balances. Generally, governmental-type funds include, but are not limited to, the General Fund, Special Revenue Funds, Capital Projects Funds, Debt Service Funds. Governmental Funds do not include Proprietary Funds, Enterprise Funds, Internal Service Funds, Trust Funds, or Fiduciary Funds.

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<sup>147</sup> Manual of Accounting and Financial Reporting for Pennsylvania Local Educational Agencies (LEAs). Maintained by: PA Office of the Budget, Office of Comptroller Operations Central Agencies & School Finance Unit. Revised August 2016.

<sup>148</sup> PDE’s Taxpayer Relief Act Report on Referendum Exceptions For School Year 2020-2021, dated April 2020.

<sup>149</sup> Ibid.

<sup>150</sup> For simplicity purposes, this explanation of operating surplus does not include results from intergovernmental fund transfers or other financing sources and uses.

<sup>151</sup> Ibid.

## A Performance Audit

### School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes

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**General Fund** – The Governmental Fund used to account for the district’s financial resources and expenditures for operations of the district.

**General Fund Balance Designations:**<sup>152</sup>

**Non-spendable** – Amounts in the General Fund that cannot be spent because they are not in a cash form or because the funds are legally or contractually required to be maintained, e.g., inventory.

**Restricted** – Amounts set aside for a specific purpose imposed by law or external parties, such as creditors or grantors.

**Committed** – Amounts set aside for specific purposes approved by formal action of the Board of Directors of a district. Once committed, it takes the same type of formal action to de-commit the funds for a different purpose.

**Assigned** – Amounts set aside for a specific purpose that are not restricted or committed. The assignment of funds and the un-assignment of the funds does not require formal approval of the district’s Board of Directors unless required by district’s policy.

**Unassigned** – Amounts that are spendable that are not categorized in the above designations.

**Unreserved, undesignated** – Portion of the fund balance which is appropriable for expenditure or not legally or otherwise segregated for a specific or tentative future use, projected for the close of the school year for which a school district’s budget was adopted and held in the General Fund accounts of the school district.<sup>153</sup>

**Unrestricted** – Includes committed, assigned, and unassigned fund balances that are available for appropriation.<sup>154</sup>

**Capital Funds** – Funds within the Governmental Fund that are used to account for capital projects. Districts use different titles and purposes, such as, Capital Reserve Funds, Capital Projects Funds, Technology Funds, and Construction Fund.

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<sup>152</sup> Pennsylvania Department of Education (PDE) accounting bulletins and the Governmental Accounting Standards Board (GASB) Statement #54 – Fund Balance Reporting and Governmental Fund Type Definitions.

<sup>153</sup> See 24 P.S. § 6-688(c).

<sup>154</sup> Pennsylvania Department of Education (PDE) accounting bulletins and the Governmental Accounting Standards Board (GASB) Statement #54 – Fund Balance Reporting and Governmental Fund Type Definitions.

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#### Appendix F

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## A Performance Audit

### School Districts – General Fund Balances Applying for Referendum Exceptions, Designating Funds, and Increasing Taxes

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**A Performance Audit**

**School Districts – General Fund Balances  
Applying for Referendum Exceptions, Designating Funds, and  
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