



New York Mills Union Free School District Financial Management

Report of Examination

Period Covered:

July 1, 2014 – November 30, 2015

2016M-107



Thomas P. DiNapoli

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State of New York Office of the State Comptroller

Division of Local Government and School Accountability

June 2016

Dear School District Officials:

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

Following is a report of our audit of the New York Mills Union Free School District, entitled Financial Management. This audit was conducted pursuant to Article V, Section 1 of the State Constitution and the State Comptroller's authority as set forth in Article 3 of the New York State General Municipal Law.

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

Respectfully submitted,

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

Introduction

Background

The New York Mills Union Free School District (District) is located in the Towns of Whitestown and New Hartford, Oneida County. The District is governed by the Board of Education (Board), which is composed of seven elected members. The Board is responsible for the general management and control of the District's financial and educational affairs. The Superintendent of Schools (Superintendent) is the District's chief executive officer and is responsible, along with other administrative staff, for the day-to-day management of the District under the Board's direction. The Business Official is mainly responsible for the District's finances and accounting records and reports.

The District operates one school with approximately 570 students and 100 employees. The District's budgeted appropriations for the 2015-16 fiscal year are approximately \$13.5 million, which are funded primarily with real property taxes and State aid.

Objective

The objective of our audit was to examine the District's financial management practices. Our audit addressed the following related question:

- Did the Board and District officials adequately manage the District's financial condition?

Scope and Methodology

We examined the District's financial management practices for the period July 1, 2014 through November 30, 2015. We expanded our scope back to the 2011-12 fiscal year for trend analysis.

We conducted our audit in accordance with generally accepted government auditing standards (GAGAS). More information on such standards and the methodology used in performing this audit are included in Appendix B of this report.

Comments of District Officials and Corrective Action

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

The Board has the responsibility to initiate corrective action. Pursuant to Section 35 of General Municipal Law, Section 2116-a (3)(c) of New York State Education Law and Section 170.12 of the Regulations of the Commissioner of Education, a written corrective

action plan (CAP) that addresses the findings and recommendations in this report must be prepared and provided to our office within 90 days, with a copy forwarded to the Commissioner of Education. To the extent practicable, implementation of the CAP must begin by the end of the next fiscal year. For more information on preparing and filing your CAP, please refer to our brochure, *Responding to an OSC Audit Report*, which you received with the draft audit report. The Board should make the CAP available for public review in the District Clerk's office.

Financial Management

The Board, Superintendent and Business Official are responsible for making sound financial decisions in the best interest of the District, the students they serve and District residents. The Board is responsible for adopting budgets that contain estimates of actual and necessary expenditures that are funded by planned realistic revenues. Fund balance represents resources remaining from prior fiscal years. A district may retain a portion of fund balance within the limits established by New York State Real Property Tax Law (RPTL). It also is important for District officials to develop a comprehensive multiyear financial plan to estimate the future costs of ongoing services.

The Board and District officials did not develop reasonable budgets or effectively manage the District's financial condition. The District appropriated an average of approximately \$1.4 million in fund balance annually, which was not needed to fund operations due to operating surpluses. District officials consistently overestimated expenditures by almost \$6.9 million (13.6 percent) over the last four fiscal years (2011-12 through 2014-15). These budgeting practices generated approximately \$1.5 million in operating surpluses over the same period. Further, the District improperly reported about \$1.3 million of unrestricted fund balance in the debt service fund and improperly encumbered \$100,000.

These practices allowed the District to appear that it was within the 4 percent statutory limit imposed on the level of unrestricted fund balance. However, when adding back unused appropriated fund balance, money that was improperly placed in the debt service fund and an erroneous encumbrance, the District's recalculated unrestricted fund balance was about 25 percent of the ensuing year's appropriations, exceeding the statutory limit from 2011-12 through 2015-16. As a result of these practices, District officials have levied real property taxes that were higher than necessary to fund District operations. Finally, District officials have not developed a multiyear financial plan.

Budgeting and Fund Balance

The Board and District management are responsible for accurately estimating revenues and appropriations in the District's annual budget. Accurate budget estimates help ensure that the real property tax levy is not greater than necessary. The estimation of fund balance is also an integral part of the budget process. RPTL currently limits unrestricted fund balance to no more than 4 percent of the ensuing fiscal year's budget.

We compared the District’s appropriations with actual results of operations for fiscal years 2011-12 through 2014-15 and found that the District overestimated appropriations by almost \$6.9 million (13.6 percent) over this time, as shown in Figure 1. Actual revenues were generally consistent with budgeted estimates over the same period.¹

| Fiscal Year | Appropriations | Expenditures | Difference | Percentage |
|--------------|---------------------|---------------------|--------------------|--------------|
| 2011-12 | \$12,242,865 | \$10,275,592 | \$1,967,273 | 16.1% |
| 2012-13 | \$12,555,038 | \$10,841,893 | \$1,713,145 | 13.6% |
| 2013-14 | \$12,898,455 | \$11,335,144 | \$1,563,311 | 12.1% |
| 2014-15 | \$13,150,675 | \$11,520,544 | \$1,630,131 | 12.4% |
| Total | \$50,847,033 | \$43,973,173 | \$6,873,860 | 13.6% |

The District has experienced a cumulative operating surplus of over \$1.5 million for the four-year period. District officials used the surpluses to partially fund a voter-approved \$1 million capital reserve. District officials told us that they overbudget for appropriations because of unexpected expenses, such as new special needs students, and they also do not know how much State aid they will receive from year-to-year. While it is prudent to have some provision for unanticipated expenditures, it can be done with maintaining ample fund balance, using reserves or adopting a conservative budget. Doing all three of these, and continuing to do them as fund balance and reserves are growing, results in the tax levy being higher than necessary.

As indicated in Figure 2, the District reported unrestricted fund balances that complied with the 4 percent statutory limitation during the four years reviewed. However, District officials used certain budgeting practices – including appropriating fund balance that was never used, inappropriately transferring general fund moneys to a debt service fund and overstating encumbrances – that made it appear the District had less unrestricted fund balance than it actually had.

¹ From 2011-12 through 2014-15, actual revenues, on average, exceeded budgeted estimates by about \$100,000 annually.

| Figure 2: Unrestricted Fund Balance at Year-End | | | | |
|---|----------------|----------------|----------------|----------------|
| | 2011-12 | 2012-13 | 2013-14 | 2014-15 |
| Total Beginning Fund Balance | \$3,069,996 | \$3,737,622 | \$4,142,289 | \$4,192,652 |
| Add: Operating Surplus | \$667,626 | \$404,667 | \$50,363 | \$409,449 |
| Total Ending Fund Balance | \$3,737,622 | \$4,142,289 | \$4,192,652 | \$4,602,101 |
| Less: Restricted Funds | \$1,741,768 | \$1,741,768 | \$2,292,147 | \$2,292,723 |
| Less: Encumbrances | \$125,338 | \$120,314 | \$160,478 | \$304,643 |
| Less: Appropriated Fund Balance for the Ensuing Year | \$1,375,000 | \$1,764,000 | \$1,214,000 | \$1,464,000 |
| Total Unrestricted Funds at Year-End | \$495,516 | \$516,207 | \$526,027 | \$540,735 |
| Ensuing Year's Budgeted Appropriations | \$12,555,038 | \$12,898,455 | \$13,150,675 | \$13,518,387 |
| Unrestricted Funds as Percentage of Ensuing Year's Budget | 3.9% | 4.0% | 4.0% | 4.0% |

Appropriated Fund Balance – The District appropriated an average of \$1.4 million in fund balance as a financing source in each of the annual budgets for 2011-12 through 2014-15 even though it maintained an operating surplus for each of the four years. As a result, it did not use any of this appropriated fund balance to fund operations.

Debt Service Fund – Debt service funds are used to account for and report the accumulation of resources that are restricted, committed or assigned to the payment of principal and interest on long-term debt. For example, a debt service fund must be established and maintained to account for the proceeds of a sale of a capital asset with outstanding debt, or if State or federal aid is received for a capital improvement for which there is outstanding debt. These funds should be used for debt service payments on that debt. In addition, if a district has residual bond proceeds or interest earned on bond proceeds upon completing a project, the money must be maintained in the debt service fund and used to pay debt service on any related obligations.

The District maintained a debt service fund with a balance of approximately \$1.3 million as of June 30, 2015. District officials have not identified which debt issues the money is associated with, nor has the Board appropriated it for existing debt service commitments. District officials told us that they moved general fund money to the debt service fund over a three-year period beginning in 2009 because they wanted to set aside money for future debt payments and other endeavors. They also told us that their external auditors told them that this was allowed. However, since the money is not restricted, committed or assigned to existing debt service obligations, it is unassigned and should have been reported in the general fund. In effect, District officials circumvented the statutory limit imposed on

the level of unrestricted fund balance by reporting this money in the debt service fund.

Erroneous Encumbrance – Encumbrances are commitments for payments related to unperformed contracts for goods or services. At the end of the fiscal year, a portion of the unreserved fund balance should be set aside for the payment of goods, materials and services that have been ordered but not received. In fiscal year 2014-15, the Treasurer improperly assigned \$100,000 of fund balance for an encumbrance that did not exist, which contributed to the appearance that the District was within the statutory limit. The Treasurer told us that this was a booking error. As a result, the District’s unrestricted fund balance was understated by \$100,000 in this year.

The unnecessary appropriation of fund balance, improper money in the debt service fund and erroneous encumbrance made it appear that the District’s unrestricted fund balance was within the 4 percent statutory limit. When these amounts were added back, the District’s recalculated unrestricted fund balance exceeded the statutory limit each year. It averaged approximately 25 percent of the ensuing year’s appropriations, as indicated in Figure 3. This is over six times the 4 percent statutory limit.

| Figure 3: Unused Fund Balance | | | | |
|--|----------------|----------------|----------------|--------------------------|
| | 2011-12 | 2012-13 | 2013-14 | 2014-15 |
| Total Unrestricted Funds at Year-End | \$495,516 | \$516,207 | \$526,027 | \$540,735 |
| Add: Appropriated Fund Balance Not Used to Fund Ensuing Year's Budget | \$1,375,000 | \$1,764,000 | \$1,214,000 | \$1,464,000 ^a |
| Add: Debt Service Fund | \$1,274,263 | \$1,274,263 | \$1,312,706 | \$1,314,404 |
| Add: Erroneous Encumbrance | | | | \$100,000 |
| Total Recalculated Unrestricted Funds | \$3,144,779 | \$3,554,470 | \$3,052,733 | \$3,419,139 |
| Recalculated Unrestricted Funds as a Percentage of Ensuing Year's Budget | 25.0% | 27.6% | 23.2% | 25.3% |

^a Anticipated amount unused based on past trends

The result of the District’s budgeting practices made it appear that the District needed to use fund balance to close projected budget gaps. However, the District’s budgets resulted in operating surpluses in all four years reviewed. We reviewed the District’s 2015-16 budget and determined that the District budgeted similarly as in previous years. Therefore, it is likely that the District will have an operating surplus and not need to use the almost \$1.5 million in appropriated fund balance.

By maintaining excessive or unnecessary fund balance, a result of ongoing budgeting practices that routinely generated operating surpluses, the Board and District officials have withheld significant funds from productive use and levied property taxes that were higher than necessary. These practices have decreased the transparency of the District's finances to its residents.

Multiyear Financial Plan

An effective multiyear plan projects operating and capital needs and financing sources over a three- to five-year period. Such plans allow District officials to identify developing revenue and expenditure trends, set long-term priorities and goals and avoid large fluctuations in tax rates. A multiyear financial plan can also help District officials to assess the effects and merits of alternative approaches to address financial issues, such as using unrestricted fund balance to finance operations. Long-term financial plans work in conjunction with Board-adopted policies and procedures to provide necessary guidance to employees on the financial priorities and goals set by District officials. Additionally, District officials should monitor and update long-term financial plans on an ongoing basis to ensure that their decisions are guided by the most accurate information available.

District officials have not developed a multiyear operational plan. District officials told us that they are working on a plan. It is important for the Board and District officials to develop an effective multiyear financial plan so they can better manage the use of the District's unrestricted fund balance and establish practical goals to ensure that such use is in the best interest of District residents.

Recommendations

The Board should:

1. Develop realistic estimates of expenditures and the use of fund balance in the annual budget.
2. Ensure that the amount of the District's unrestricted fund balance is in compliance with the limit established by RPTL.
3. Develop a plan to reduce the amount of unrestricted fund balance in a manner that benefits District residents. Such uses could include, but are not limited to, using surplus funds as a financing source, funding one-time expenditures, funding reserves to finance future capital needs or reducing property taxes.
4. Return money improperly residing in the debt service fund to the general fund.

5. Develop and adopt a multiyear financial plan for a three- to five- year period that addresses the District's use of fund balance and any economic or environmental factors.

The Business Official should:

6. Only report those encumbrances that remain outstanding at the end of the fiscal year.

APPENDIX A

RESPONSE FROM DISTRICT OFFICIALS

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



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New York Mills, NY 13417

Kathy S. Houghton
Superintendent of Schools

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May 24, 2016

Ms. Ann C. Singer
Chief Examiner
State Office Building, Suite 1702
44 Hawley Street
Binghamton, NY 13901-4417

Dear Ms. Singer;

Please accept this letter as notification that the New York Mills Union Free School district has received and reviewed the preliminary draft findings of the recent examination of our school district's financial management conducted by the New York State Comptroller's Office. We understand that the Report of Examination, 2016M-107, included the period between July 1, 2014 and November 30, 2015.

Based on the preliminary report, we have developed a Corrective Action Plan, which is enclosed. Please inform the district if additional information is required by the Division of Local Government and School Accountability.

Thank you.

Sincerely,

A handwritten signature in black ink that reads 'Kathy Houghton'. The signature is written in a cursive, flowing style.

Kathy Houghton
Superintendent of Schools

Enclosure

Plan of Corrective Action – New York Mills Union Free School District

Recommendation #1 – The Board should develop realistic estimates of expenditures and the use of fund balance in the annual budget

Response - We have historically carried and appropriated fund balance in order to offset any tax increase implications for our school district residents and we will continue to do so.

Recommendation #2 – Ensure that the amount of the District’s unrestricted fund balance is in compliance with the limit established by Real Property Tax Law (RPTL).

Response - The District will insure that our fund balance remains within the guidelines set forth by the New York State Comptroller’s Office.

Recommendation #3 – Develop a plan to reduce the amount of unrestricted fund balance in a manner that benefits District residents. Such uses could include, but are not limited to, using surplus funds as a financing source, funding one-time expenditures, funding reserves to finance future capital needs or reducing property taxes

Response - Before the Comptroller’s Audit began, the district was in the process of developing a plan for the systemic use of unrestricted fund balance in the manner that best benefits our district residents and our K-12 students.

Recommendation #4 – Return moneys improperly residing in the Debt Services Fund to the General Fund.

Response - The returning of monies in the Debt Service Fund was an integral component of the district’s planned use of unrestricted fund balance. Examples of this plan include our newly created Building Capital Reserve Fund and Transportation & Vehicle Reserve Fund, as well our plan to have no tax impact to taxpayers during the 2016-17 school year.

Recommendation #5 – Develop and adopt a multiyear financial plan for a three- to five-year period that addresses the District’s use of fund balance and economic or environmental factors.

Response - We have enlisted the assistance of Bernie P. Donegan Associates, our financial advisors for the development of a 3-5 year financial plan that addresses our use of fund balance and economic and environmental factors of the school district.

Plan of Corrective Action – New York Mills Union Free School District Cont’d

Recommendation #6 – The Business Official should only report those encumbrances that remain outstanding that the end of the fiscal year.

Response - The Board of Education initiated a Capital Outlay Project cycle, beginning with the 2015-16 school year. It is properly budgeted and accounted for per the New York State Education Department. All other encumbrances are reported in accordance with Generally Accepted Accounting Practices (GAAP) at the end of each fiscal year.

APPENDIX B

AUDIT METHODOLOGY AND STANDARDS

The objective of our audit was to examine the District's financial management for the period July 1, 2014 through November 30, 2015. We expanded our scope back to the 2011-12 fiscal year for trend analysis. To achieve our audit objective and obtain valid evidence, we performed the following procedures:

- We interviewed District officials and reviewed the Board meeting minutes, resolutions and policy manual to gain an understanding of the process and procedures over the District's financial management.
- We reviewed general fund results of operations for fiscal years 2012-13 through 2014-15.
- We analyzed the trend in total fund balance, including the use of appropriated fund balance, in the general fund for fiscal years 2011-12 through 2014-15. We compared the appropriated fund balance to the same year's operating results to determine if the appropriated fund balance was actually used.
- We calculated the unrestricted fund balance in the general fund as a percentage of the ensuing year's appropriations to determine if the District was within the statutory limitation during fiscal years 2011-12 through 2014-15.
- We compared the budgeted revenues and appropriations to the actual revenues and expenditures for the general fund for fiscal years 2011-12 through 2014-15 to determine if the District's budgets were reasonable.
- We reviewed the trend of real property tax rates, levies and assessments for fiscal years 2011-12 through 2015-16.

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

APPENDIX C

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