



Chenango Forks Central School District Financial Condition

Report of Examination

Period Covered:

July 1, 2012 — February 26, 2014

2014M-98



Thomas P. DiNapoli

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State of New York Office of the State Comptroller

Division of Local Government and School Accountability

August 2014

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 Chenango Forks Central School District, entitled Financial Condition. This audit was conducted pursuant to Article V, Section 1 of the State Constitution and the State Comptroller's Authority as set forth in Article 3 of the General Municipal Law.

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

Respectfully submitted,

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

Introduction

Background

The Chenango Forks Central School District (District) is located in the Towns of Barker, Chenango, Fenton, Maine and Triangle in Broome County and the Town of Greene in Chenango County. The District is governed by the Board of Education (Board) which comprises five 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 District's day-to-day management under the Board's direction. District officials have outsourced financial operations, including certain budget development processes to the Central Business Office (CBO), which is operated by the Broome-Tioga Board of Cooperative Educational Services (BOCES).

The District operates four schools with approximately 1,600 students and 225 employees. The District's budgeted appropriations for the 2013-14 fiscal year are \$30.5 million, which are funded primarily with State aid and real property taxes.

Objective

The objective of our audit was to evaluate the District's financial condition. Our audit addressed the following related question:

- Did District officials take appropriate action to maintain the District's financial stability?

Scope and Methodology

We examined the District's financial records for the period July 1, 2012 through February 26, 2014. To analyze the District's historical and projected fund balance, budgeting and financial trends, we extended our audit scope period back to July 1, 2008 and projected forward through June 30, 2014.

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 is 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 take corrective action.

The Board has the responsibility to initiate corrective action. Pursuant to Section 35 of the General Municipal Law, Section 2116-a (3)(c) of the Education Law and Section 170.12 of the Regulations of the Commissioner of Education, a written corrective action plan (CAP) that addresses the findings and recommendations in this report must be prepared and 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 Condition

District officials are responsible for a district's financial stability, which can be accomplished, in part, by minimizing costs and maximizing revenues, where possible. A district's financial stability can also be improved by carefully appropriating fund balance, as necessary, and closely monitoring revenue, expenditure and fund balance levels. The Board and Superintendent are responsible for adopting budgets, which include reasonable estimates of actual and necessary expenditures that are funded by planned, realistic and available revenues based on contractual and historical data. District officials are also responsible for determining the amount of fund balance available to appropriate for the next year's budget to finance District operations. Any remaining fund balance, exclusive of the amount allowed by law¹ to be retained to address cash flow and unexpected occurrences, should not continually be relied upon to finance District operations.

The Board and District administrative staff initiated some significant steps to reduce expenditures and maintain financial stability beginning in the 2010-11 fiscal year. However, the Board-adopted budgets for the 2010-11, 2011-12 and 2012-13 fiscal years were not structurally balanced to include recurring revenues to finance recurring expenditures. Additionally, officials used more than \$1 million of fund balance to finance District operations over this three-year period. The District also lost other revenue sources from 2010-11 through 2012-13. Even though the District currently has fund balance, if these trends continue it could result in diminished fund balance levels in the future.

Structurally Balanced Budgets – The Board did not adopt structurally balanced budgets for the 2011-12, 2012-13 and 2013-14 fiscal years. Instead, recurring expenditures were funded with one-time revenues such as fund balance and interfund transfers. District officials used more than \$1 million of fund balance to finance operations in these years.² Additionally, the 2011-12, 2012-13 and 2013-14 budgets included a \$450,000 general fund interfund transfer as estimated revenue each year to pay for a portion of the District's outstanding debt. However, the District will have funds available to continue this type of transfer for just a few more years based on current funding

¹ Real Property Tax Law limits the amount of unexpended surplus funds that can be legally retained by District officials to no more than 4 percent of the next fiscal year's budget.

² The District incurred operating deficits of \$444,716 in 2010-11, \$59,911 in 2011-12 and \$580,293 in 2012-13.

levels and the debt issued will be outstanding for several more years.³ Additionally, the amount of fund balance available to appropriate is decreasing,⁴ therefore District officials will need to find other funding sources to pay for these recurring expenditures.

Budget Estimates – Furthermore, the Board did not adopt realistic budgets with revenue and expenditure estimates based on prior years’ operating results, past expenditure trends, anticipated future needs and available information from outside sources. While from 2010-11 through 2012-13 the District’s actual revenues were in line with budgeted amounts, expenditures were significantly overestimated each year. As a result, actual combined expenditures were approximately \$5.2 million less than the amounts budgeted in these years. According to the Business Official, the expenditure variances were caused primarily by conservative estimates of health insurance costs based on rising premiums.⁵

However, by not developing realistic estimates, the adopted budgets’ usefulness as a management tool is greatly diminished. When actual expenditures are consistently below the planned amounts, because the plan is faulty, the ability to monitor and control those expenditures is hampered at best, and not possible, at worst.⁶

Decreasing Revenues – From 2010-11 through 2012-13, District revenues dropped at a faster rate than expenditures, which poses an additional risk to the District’s financial stability. As a result, officials used appropriated fund balance to finance recurring District operations. The revenue decrease was primarily the result of State aid cuts totaling more than \$513,000 as well as an \$800,000 lapse of a Federal aid program. This contributed to three consecutive years of operational deficits aggregating to almost \$1.1 million and a corresponding drop in fund balance that is not reserved⁷ over this same period.

³ The District’s three outstanding bonds have final maturity dates ranging from 2015 through 2021.

⁴ The District’s 2014-15 budget appropriated less fund balance than the prior year (\$1.615 million of appropriated fund balance in 2014-15 versus \$1.815 million in 2013-14).

⁵ The actual increases in premiums were lower than premium increases budgeted, which contributed to the expenditure variance. Also, the District’s 2014-15 budget included a decrease in total expenditures of about \$700,000.

⁶ The 2013-14 fiscal year ended with an operating surplus of approximately \$729,000.

⁷ For comparative purposes due to GASB 54 changes effective for fiscal years ending June 30, 2011 and beyond, the reserve for encumbrances is included in the unreserved fund balance.

Cost Saving Initiatives – The Board President told us that they wanted to keep the real property tax increase relatively low and therefore explored various cost savings and revenue enhancement opportunities. During the 2013-14 fiscal year, District officials made a concerted effort to closely monitor financial operations and initiated measures to decrease District expenditures. From July 1, 2010 through June 30, 2012, total expenditures decreased by more than \$1.9 million. This reduction was driven primarily by reductions in expenditures related to salaries and BOCES services. However, in 2012-13 total expenditures increased by \$1.1 million because of increases in personal service costs (4 percent) and BOCES costs (11 percent). District officials took the following steps to reduce expenditures to offset the effects of reduced State aid and to adopt balanced budgets without significant increases in real property tax levies:

- District officials used advance refunding⁸ for three outstanding bonds, which will result in saving approximately \$1.3 million over the life of these bonds.
- District officials significantly reduced the workforce by approximately 60 employees, or 22 percent of the total staff. As a result, District expenditures for personal services dropped by about \$1.7 million from 2008-09 through 2012-13 fiscal years. However, even with the staff cuts, employee benefit costs continued to increase because the District is required to provide health insurance to retired staff in accordance with contractual agreements.
- District officials began using BOCES to provide business services during the 2013-14 fiscal year, resulting in annual savings of at least \$16,500 per year.
- The Superintendent told us he implemented a spending freeze during the 2013-14 fiscal year to further save the District money.

Although the District is currently financially stable, relying on one-time revenues combined with decreasing revenues and increasing employee benefit expenditures led to a decrease in total fund balance. Therefore, District officials may need to find other funding sources for necessary expenditures in future budgets. Additionally, District officials may be challenged to identify other options for enhancing

⁸ New bonds are issued to repay an outstanding bond issue. The interest and principal repayments on these bonds are then used to repay the old issue prior to its maturity date. The District's three outstanding bonds have maturity dates in fiscal years 2014-15, 2017-18 and 2020-21.

revenues and cutting costs as they work to limit the amount of real property taxes that can be raised.⁹

Recommendations

1. The Board should adopt budgets that are:
 - Structurally balanced with recurring expenditures funded by recurring revenues and
 - Consistent with the District's actual revenues and expenditures.
2. District officials should closely monitor the level of unrestricted fund balance and reduce reliance on fund balance as a financing source, while continuing to evaluate and explore ways to reduce expenditures and increase revenues.

⁹ By law, the District's real property taxes levied annually generally cannot increase more than 2 percent, or the rate of inflation, whichever is lower, with some exceptions. Districts may override the tax levy limit by presenting the voters with a budget that exceeds the statutory limit. However, that budget must be approved by 60 percent of District voters.

APPENDIX A

RESPONSE FROM DISTRICT OFFICIALS

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



1 Gordon Drive, Binghamton, NY 13901

Lloyd "Joe" Peck, Ed.D.
Superintendent of Schools
Phone (607-648-7543)
Fax (607-648-7560)

Memo

To: Office of the State Comptroller

From: Lloyd L. Peck, Ed.D., Superintendent of Schools

A handwritten signature in blue ink, appearing to read "L. Peck", is written over the "From:" line.

Date: July 31, 2014

RE: New York State Comptroller's Audit

The Chenango Forks Central School District received and reviewed the New York State Comptroller's Audit. Please accept this letter as the District and Board of Education's official response.

The report recommends that the Board should adopt budgets that are structurally balanced and consistent with actual expenditures while reducing the District's reliance on fund balance as a financing source. The District is committed to, through budgetary practices and strategic planning, sustaining its education program for its students while balancing the fiscal resources of the District.

During the audit period covered by this report, the District experienced extraordinary fiscal challenges with the reduction of state aid through the Gap Elimination Adjustment. There have been increased regulatory requirements, unfunded mandates, and unanticipated cost increases. As a result, the District relied on the use of fund balance and one-time revenues to make ends meet. At the same time, the District faced stagnant tax revenue with the imposition of the Property Tax Cap regulations. The District's task of providing a quality education while insuring fiscal fidelity was a daunting one.

The District has implemented several strategies as it continues to focus on long-range stability and the protection of educational programming. In 2013-14, this included establishing and enforcing a spending freeze. As a result, the Districts projected operating surplus this year. For 2014-15, the district adopted a zero based budget technique whereby expenditures are held at zero and expenditure lines were reviewed to eliminate and/or adjust any unnecessary expenditures. Lastly, the District employed cost saving strategies such as energy performance contracts and the use of alternative energy sources to reduce costs, yielding projected savings of in excess of \$60,000 annually.

Furthermore, the use of appropriated fund balance has been reduced and the plan is to continue to decrease the reliance on fund balance in the future, provided this can be accomplished with little or no impact to programs. For 2014-15, the District taxpayers supported the proposed

budget, which included increasing taxes by the maximum amount under the tax cap provisions. The Board of Education recognized the need to raise revenues as much as possible to bring the budget in balance. The District also eliminated the use of the interfund transfers acknowledging limited availability of this source of revenue in the future.

In conclusion, the District administration and Board of Education will continue to work to improve the fiscal management of the Chenango Forks School District. We thank the Comptroller's Office for their report and intend to implement a corrective action plan upon receipt of the final report.

A handwritten signature in blue ink, followed by the text "ED.D." in a smaller font.

APPENDIX B

AUDIT METHODOLOGY AND STANDARDS

The objective of our audit was to assess the District's financial condition. To accomplish our audit objective and obtain valid evidence, our procedures included the following:

- We interviewed District officials to gain an understanding of the budget process.
- We obtained employee counts and cost savings analyses, including an analysis of savings achieved by moving business services to the CBO as prepared by District officials and evaluated for accuracy and reasonableness to determine cost savings implemented by District officials.
- We obtained debt schedules to calculate interest costs saved from refunded bonds.
- We obtained and reviewed the consolidation study to identify cost savings options considered by District officials.
- We compared revenues and expenditures to budgeted revenues and appropriations. We also calculated results of operations and compared to appropriated fund balance.

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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