



Minisink Valley Central School District Internal Controls Over Budget Estimates

Report of Examination

Period Covered:

July 1, 2002 — June 30, 2008

2008M-221



Thomas P. DiNapoli

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State of New York Office of the State Comptroller

Division of Local Government and School Accountability

December 2008

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 Minisink Valley Central School District, entitled Internal Controls Over Budget Estimates. 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 Minisink Valley Central School District (District) is located in Orange County. The District is governed by the Board of Education (Board) which comprises nine elected members. The Board is responsible for the general management and control of the District's financial and educational affairs. The Superintendent of Schools (Superintendent) is the chief executive officer of the District and is responsible, along with other administrative staff, for the day-to-day management of the District under the direction of the Board.

There are five schools in operation within the District, with approximately 4,600 students and 650 employees. The District's budgeted expenditures for the 2007-08 fiscal year were \$78 million, which were funded primarily with State aid and real property taxes.

Objective

The objective of our audit was to evaluate the District's internal controls over its budget process. Our audit addressed the following related question:

- Are internal controls over budget estimates operating effectively to ensure that projections of the amount of fund balance to be used to reduce the tax levy are reasonable?

Scope and Methodology

We examined internal controls over the budget process of the District for the period July 1, 2002 through June 30, 2008.

Our overall goal was to assess the adequacy of the internal controls put in place by officials to safeguard District assets. To accomplish this, we performed an initial assessment of the internal controls so that we could design our audit to focus on those areas most at risk. Our initial assessment included evaluations of the following areas: financial oversight, cash receipts and disbursements, purchasing, and payroll and personal services. Based on that evaluation, we determined that controls appeared to be adequate and limited risk existed in most of the financial areas we reviewed. We did determine that risk existed in the budget process and, therefore, we examined internal controls over budgeting for the period July 1, 2002 to June 30, 2008.

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 C 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. Except as indicated in their response letter, District officials generally agreed with our audit findings and recommendations, and indicated they were taking corrective action. Appendix B contains our comment on an issue raised in the District's response.

The Board has the responsibility to initiate corrective action. Pursuant to Section 35 of the General Municipal Law, Section 2116-a (3)(c) of the Education Law, and Section 170.12 of the Regulations of the Commissioner of Education, a written corrective action plan (CAP) that addresses the findings and recommendations in this report must be prepared and forwarded to our office within 90 days. To the extent practicable, implementation of the CAP must begin by the end of the next fiscal year. For more information on preparing and filing your CAP, please refer to our brochure, *Responding to an OSC Audit Report*, which you received with the draft audit report. The Board should make the CAP available for public review in the District Clerk's office.

Budget Estimates

The responsibility for effective financial planning and management of the District rests with the Board, the Superintendent, and other officials including the Assistant Superintendent for Business, who reports financial information to the Board. The Board and District officials must ensure that budgets are prepared, adopted, and amended based on reasonable and accurate assessments of resources that can be used to fund appropriations. A school district's annual budget should include reasonable estimates of appropriations required to fund expenditures in the coming fiscal year. It should also include an estimate of fund balance at the end of the fiscal year. Accurate estimates prevent the levy of excessive, unnecessary real property taxes. We found the District overestimated expenditures to accumulate fund balance.

Salary Estimates

We analyzed appropriations and expenditures for the fiscal years beginning with the 2002-03 fiscal year through the 2007-08 fiscal year and found that District officials consistently overestimated appropriations for payroll and personal services and employee benefits. During this six-year period, appropriations for payroll and employee benefits exceeded expenditures by a total of \$31.1 million.

District officials begin preparation of the ensuing year's budget each October, and use the current year's budget to determine the ensuing year's budget without comparing budgeted estimates with actual revenues and expenditures. For example, the estimation for payroll expenditures is developed by taking the current year's budget and adding the increases required by employment contracts, new staff positions at the maximum rate and deducting payroll amounts for known retirees without analyzing prior year's payroll costs. This practice resulted in budgeted amounts exceeding actual expenditures by \$17.7 million during the audit period as depicted in the table below.

Overestimates of Budgeted Appropriations – Payroll and Personal Services			
Fiscal Year	Appropriations	Expenditures	Overestimated Appropriation
2002-03	\$29,823,932	\$26,841,655	\$2,982,277
2003-04	\$30,844,544	\$27,548,989	\$3,295,555
2004-05	\$31,958,497	\$28,898,842	\$3,059,655
2005-06	\$33,467,999	\$30,582,839	\$2,885,160
2006-07	\$34,979,972	\$32,604,236	\$2,375,736
2007-08	\$36,870,959	\$33,740,457	\$3,130,502
Total	\$197,945,903	\$180,217,018	\$17,728,885

The overestimation of payroll costs will continue because District officials use budgeted figures as the basis for ensuing year's budgets. If District officials compared budget versus actual costs, rather than only using budgeted costs as a basis, it would provide a clearer indication of the amount needed to create and fund the next year's proposed budget.

Employee Benefits Estimates

Employee benefits include health insurance premiums, as well as Social Security and retirement system contributions. The District receives estimates of the ensuing year's insurance premium changes (percentage increases) prior to budget preparation: employee salaries and contracts determine Social Security costs; the District also receives estimates for retirement system contributions for the upcoming fiscal year prior to budget adoption. District officials calculated employee benefits based on the current year's budget, even though the Board and District officials had most of the information necessary to prepare more reasonable estimates for employee benefits. As a result, District appropriations were overestimated by \$13.4 million throughout the audit period.

Overestimates of Budgeted Appropriations – Employee Benefits			
Fiscal Year	Appropriations	Expenditures	Overestimated Appropriation
2002-03	\$8,755,775	\$6,815,872	\$1,939,903
2003-04	\$10,420,679	\$8,007,234	\$2,413,445
2004-05	\$12,606,785	\$10,809,662	\$1,797,123
2005-06	\$14,150,116	\$12,153,686	\$1,996,430
2006-07	\$15,357,707	\$12,870,140	\$2,487,567
2007-08	\$15,831,182	\$13,062,486	\$2,768,696
Total	\$77,122,244	\$63,719,080	\$13,403,164

When appropriations are not properly budgeted and expenditures are overestimated in the annual budget, it can, as in this case, result in the District not using the fund balance appropriated to reduce the tax levy and instead lead to the accumulation of fund balance.

Fund Balance

An important aspect of budget preparation includes establishing a reasonable estimate of fund balance at the end of the fiscal year. There are two types of fund balance, reserved and unreserved. Unreserved fund balance is the amount that is uncommitted and is available for the reduction of real property taxes in the next fiscal year. The portion of the unreserved fund balance that the District retains, that can be used for cash flow purposes and unanticipated expenditures, is known as unappropriated fund balance. The amount of fund balance at the end of any given fiscal year has a direct impact on the amount of the

real property tax levy needed to fund the ensuing fiscal year's budget. Real Property Tax Law limits the unappropriated fund balance a school district can retain to no more than 4 percent of the next year's budget for the 2008-09 fiscal year.

Fiscal Year Ended	6/30/2003	6/30/2004	6/30/2005	6/30/2006	6/30/2007	6/30/2008
Appropriated Fund Balance	\$5,520,000	\$6,545,000	\$6,915,000	\$6,350,000	\$7,000,000	\$6,900,000
Unappropriated Fund Balance	\$1,113,722	\$1,218,848	\$1,317,019	\$1,397,918	\$1,700,859	\$2,521,033
Total Unreserved Fund Balance	\$6,663,722	\$7,763,848	\$8,232,019	\$7,747,918	\$8,700,859	\$9,421,033

The District's budgets indicated that fund balance was appropriated to reduce the amount of the real property tax levy in amounts ranging from \$5.5 to \$7 million. However, because of the consistent overestimates of salary and benefit costs, District financial results show that fund balance was actually used to fund District operations only in one year. In the 2005-06 fiscal year, District expenditures exceeded revenues by approximately \$832,000 resulting in the use of less than 15 percent of the \$6.35 million planned to be used. In each of the other years, District revenues actually exceeded expenditures and did not result in the use of the fund balance as proposed to District voters. Furthermore, tax increases between June 30, 2003 and June 30, 2008, ranged from 5 percent to 12 percent, annually.

District officials stated that the excess in fund balance is a "savings account" that has accrued over the course of years and reflects careful and conservative financial planning by the District's Board. The "savings" allows the District to account for the fluctuations in State aid year to year and unanticipated expenditures. However, the District's portrayal to voters that appropriated fund balance is being used to reduce the ensuing year's tax levy has not been accurate.

According to District officials, cash flow, unanticipated expenses, funding changes, bond ratings and impending changes in school district accounting are reasons for overestimating appropriations. In addition, the proposed budget is submitted prior to the end of the current year, and the final numbers for the current budget are not available to aid in the preparation of the next year's budget; therefore, District officials have opted to use the budgeted numbers and not actual. However, this practice gives the taxpayers the perception that the budget increased because of need. The District overestimates payroll and employee benefits to ensure that the fund balance continues to grow.

When appropriations are not properly budgeted and expenditures are overstated in the annual budget, it denies those voting on the budget a true estimate of the next year's operational costs. In addition, the inclusion of unrealistic budget estimates misleads the public about where District funds are expected to be spent and limits their ability to provide meaningful feedback during the budget adoption process. It also reduces the effectiveness of the annual budget as a tool to monitor and manage the District's financial affairs.

Recommendations

1. District officials should prepare accurate budget estimates based on prior years' experience, contracts, and available information.
2. The Board should develop a plan to reduce the unreserved fund balance in the general fund. If the Board believes it is necessary to accumulate money for future planned purposes, it should consider formally establishing authorized reserves.

APPENDIX A

RESPONSE FROM DISTRICT OFFICIALS

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

Minisink Valley Central School District

P.O. Box 217, Route 6
Slate Hill, NY 10973-0217

November 28, 2008

Christopher J. Ellis, Chief Examiner
Office of the State Comptroller
33 Airport Center Drive, Suite 103
New Windsor, NY 12553-4725

Re: Audit Response Letter and Corrective Action Plan

Dear Mr. Ellis:

On October 30, 2008, we received a copy of the Report of Examination of the New York State Office of the State Comptroller for the period covering July 1, 2002 through June 30, 2008 for the Minisink Valley Central School District. As outlined in the brochure, "Responding to an OSC Audit Report" and consistent with the exit meeting held between the New York State audit team and officials from the school district, we offer the following response.

The Minisink Valley Central School District acknowledges that the report states that an initial assessment of the district's internal controls, including financial oversight, cash receipts and disbursements, purchasing and personnel services, found that "controls appeared to be adequate and limited risk existed in most of the financial areas we reviewed."

We further acknowledge that the report states that the district "consistently overestimated appropriations for payroll and personnel services and employee benefits." We disagree with the characterization that "payroll and employee benefits exceeded expenditures by a total of \$31.1 million." In the auditor's report, the annual overestimated appropriations were totaled, when the appropriations were actually rolled over annually. Subsequent years' appropriations *include* the previous year's amount.

See Note 1 Page 12

Response to recommendations and corrective action plan:

1. *District officials should prepare accurate budget estimates based on prior years' experience, contracts, and available information.*

The district will prepare budget estimates based on prior year's experience, contracts and available information such that the unreserved, appropriated fund balance is reduced over a period of three or more years.

2. *The board should develop a plan to reduce the unreserved fund balance in the general fund. If the board believes it is necessary to accumulate money for future planned purposes, it should consider formally establishing authorized reserves.*

The board will encourage the New York State Legislature to establish a reserve for the district's projected GASB 45 liability. Until such time as appropriate reserve fund(s) for the district's future planned purposes become available, the board will take steps to reduce the unreserved, appropriated fund balance over a period of three or more years through continued budget management. In addition, the board will work toward fully funding the unreserved, unappropriated fund balance.

In summary, we would like to thank the audit team for their courtesy during the audit process. The Minisink Valley Central School District will continue to monitor both its appropriated and unappropriated fund balances.

Sincerely,



Dr. Martha Murray
Superintendent of Schools

C. Members of the Board of Education

APPENDIX B

OSC COMMENT ON DISTRICT OFFICIALS' RESPONSE

Note 1

Each year, District officials overestimated the costs of payroll and personal services and employee benefits. We included the chart in the report to highlight each year's total overestimation, and we totaled the amounts by which appropriations for these costs exceeded expenditures over the six-year period to give the reader an understanding of their significance. The cumulative total of overestimated appropriations for this period amounted to \$31.1 million.

APPENDIX C

AUDIT METHODOLOGY AND STANDARDS

Our overall goal was to assess the adequacy of the internal controls put in place by officials to safeguard District assets. To accomplish this, we performed an initial assessment of the internal controls so that we could design our audit to focus on those areas most at risk. Our initial assessment included evaluations of the following areas: financial oversight, cash receipts and disbursements, purchasing, and payroll and personal services.

During the initial assessment, we interviewed appropriate District officials, performed limited tests of transactions and reviewed pertinent documents, such as District policies and procedures manuals, Board minutes, and financial records and reports. In addition, we obtained information directly from the computerized financial databases and then analyzed it electronically using computer-assisted techniques. This approach provided us with additional information about the District's financial transactions as recorded in its databases. Further, we reviewed the District's internal controls and procedures over the computerized financial databases to help ensure that the information produced by such systems was reliable.

After reviewing the information gathered during our initial assessment, we determined where weaknesses existed, and evaluated those weaknesses for the risk of potential fraud, theft and/or professional misconduct. Based on that evaluation we determined that controls appeared to be adequate and limited risk existed in most of the financial areas we reviewed. We then decided upon the reported objectives and scope by selecting for audit those areas most at risk. We selected the District's budget process for further audit testing.

In order to accomplish the objectives of this audit, our procedures included the following:

- We reviewed District policies to determine who is responsible for creation of the District budget.
- We interviewed the president of the Board of Education, Superintendent of Schools and the Assistant Superintendent for Business along with other relevant employees to obtain and understanding of the internal controls in place at the District with regard to the budget process.
- We performed analysis of the District's revenues and expenditures for the period of July 1, 2002 to June 30, 2008. For each of these years, we compared budgeted figures to actual figures to determine where the District had overestimated the budget.
- We performed analysis of the districts fund balance for the period of July 1, 2002 to June 30, 2008. For each of these years, we determined the amounts of fund balance, reserved, unreserved and appropriated. We reviewed the board minutes to verify that the amounts appropriated were intended to reduce the ensuing year's tax levy.

- We performed analysis to determine how the District’s budget process affected the fund balance and the amounts to be appropriated to reduce the ensuing year’s real property tax levy.
- We reviewed budget work sheets and supporting documentation for those areas where the budget was overestimated to evaluate the assumptions used in creation of those estimates.
- We reviewed the budget process to determine if the process itself affected the reasonableness of budgeted figures.
- We interviewed the president of the Board of Education, Superintendent of Schools and the Assistant Superintendent for Business to obtain an understanding of the reasons for the overestimation of the budget.

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

APPENDIX D

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