



Elmira City School District

Financial Management

Report of Examination

Period Covered:

July 1, 2006 — June 30, 2011

2011M-196



Thomas P. DiNapoli

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State of New York Office of the State Comptroller

Division of Local Government and School Accountability

March 2012

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 Elmira City 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 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 Elmira City School District (District) is located in the City and Town of Elmira, Chemung 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. The District had a turnover in the following positions: the School Superintendent started as an interim March 2009 and was appointed in September 2009, and the School Business Administrator started in July 2009, during our audit period.

There are 13 schools in operation within the District, with approximately 6,800 students. The District's operating expenditures for the 2010-11 fiscal year were \$116.4 million for the general fund, which were funded primarily with State aid, real property taxes, and grants.

Objective

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

- Did the Board effectively monitor and control the District's finances?

Scope and Methodology

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 a review of Board oversight and monitoring and evaluations of the following areas: financial oversight, cash receipts and disbursements, purchasing, payroll and personal services, and information technology. 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 area of financial management and, therefore, we assessed financial management for the period July 1, 2006 to June 30, 2011. We also reviewed the 2011-12 budget.

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 have begun to initiate 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 Management

The Board, Superintendent, and Business Manager are accountable to District taxpayers for the use of District resources, and are responsible for effectively planning and managing the District's financial operations. The Board and Superintendent are also responsible for ensuring that budgets are based on reasonable estimates of appropriations and revenues. Sound budgeting provides sufficient funding for needed operations and prudent fiscal management includes establishing reserves needed to address long-term obligations or planned future expenditures. It is also important for District officials to adopt policies governing the establishment, use and maintenance of reserve funds. After the Board has addressed those issues, any remaining fund balance, exclusive of that allowed by law to be retained to address cash flow and unexpected occurrences, should be used in a manner that benefits District taxpayers.

Due to significant reductions in Federal and State aid, the District exhausted its unrestricted fund balance during the 2010-11 fiscal year and ended the year with a deficit of \$629,700. We found that the District included more realistic estimates of revenues and appropriations in the 2011-12 budget than in prior years, and used some reserves to help fund operations. This should result in the fund balance being restored to a positive amount by the end of the 2011-12 fiscal year. We also found that at June 30, 2011, the District had \$2.9 million in excess reserve funds that can be used to help finance the District's operations and offset any unexpected fluctuations in revenues and expenditures.

Fund Balance

A key measure of the District's financial condition is its level of fund balance, which is the difference between revenues and expenditures accumulated over time. When maintained at reasonable levels, fund balance provides cash flow and can be used to help finance the next fiscal year's operations. The restricted portion of fund balance represents the amount that the District may use only for specific purposes. The unrestricted portion of fund balance is the amount that may be appropriated to fund programs in the next year's budget.

For the 2010-11 fiscal year, the District's estimated revenues exceeded actual by \$6.2 million. The majority of this difference (\$6.1 million) was associated with changes to State and Federal aid. In August 2010, the District was notified that current year basic State aid would be reduced by over \$1.12 million for building aid take backs, and the District estimated an additional \$925,000 for completed projects, resulting in a total decrease in aid of almost \$2 million. Additional

decreases in basic State aid (\$3.3 million), BOCES aid (\$2.1 million) and other aid (\$300,000) resulted in a further reduction of estimated revenues by \$5.7 million. Although this reduction was partly covered by Federal Aid that had not been budgeted (\$1.6 million), there was still a gap of \$6.1 million remaining. The District exhausted its unrestricted fund balance during the 2010-11 fiscal year and ended the year with a deficit of \$629,700.

For the 2011-12 budget, the District reduced budgeted revenue from 2010-11 by \$6.5 million, increased the tax levy by 5 percent (\$1.4 million) and decreased appropriations by \$5.1 million. The 2011-12 budget included the appropriation of \$1.2 million of non-existent fund balance as a financing source to offset the 2011-12 State aid reduction, which would result in an accumulated deficit of \$1.8 million.

However, the District Business Manager provided us with an estimated analysis of the District's budget versus actual activity and anticipated financial activity remaining for the 2011-12 year as of January 31, 2011. Revenue is estimated to come in \$553,000 over budget, and the District also now expects to spend \$2,135,000 less than they budgeted. This net positive budget variance of about \$2.7 million will eliminate the District's planned operating deficit of \$1.2 million and should result in a positive fund balance at the end of 2011-12.

Reserves

Reserve funds may be established by a district's board to provide financing for specific purposes, such as for capital projects and unemployment insurance payments. Reserves are established pursuant to statutes which determine how the reserves may be funded, expended, or discontinued. Generally, the amount of money school districts can maintain in reserves is not limited. However, it is important that districts maintain reserve balances that are reasonable. Therefore, it is important that boards adopt written policies that communicate the rationale for establishing reserve funds, objectives for each reserve established, optimal or targeted funding levels, and conditions under which the funds' assets will be used or replenished. Ideally, transfers to reserve funds should be included in the annual adopted budget. Making clear provisions to raise resources for reserve funds in the proposed budget will give voters and residents the opportunity to know a board's plan for funding reserves, which increases transparency. When conditions warrant, a board should reduce reserve funds to reasonable levels or liquidate and discontinue a reserve fund that is no longer needed or whose purpose has been achieved.

The Board has not adopted a reserve fund policy that provides any specific guidelines for the establishment or funding of reserves that address the Board's expectations or intent with respect to optimal

or targeted funding levels or conditions under which reserve funds will be used and replenished, except for the Capital Reserve. The District had seven general fund reserves totaling about \$3.2 million at June 30, 2011. We determined that three reserves, totaling almost \$2.9 million at June 30, 2011, were overfunded, unnecessary, or established for non-permissible purposes. The use of these funds will allow the District to maintain an additional margin of financial flexibility and the opportunity to offset any unrealized revenues, such as a reduction in State aid, or unexpected expenditures.

Table 1: Excess General Fund Reserve Balances		
Fund	June 30, 2010^(a)	June 30, 2011^(b)
Insurance Reserve	\$1,693,210	\$ 1,701,059
Workmen's Compensation Reserve	\$924,403	\$929,180
Unemployment Insurance Reserve	\$222,679	\$223,209
Total	\$2,840,292	\$2,853,448
^(a) Amounts represent total reserve fund balances.		
^(b) Amounts are from the District's independent audit report.		

Insurance Reserve Fund – This reserve was established under General Municipal Law (GML) on May 9, 1995 to fund certain uninsured losses, claims, actions, or judgments for which the District is authorized or required to maintain insurance. At June 30, 2010, the balance in this reserve was \$1,693,210. According to the District's independent auditor's report, this reserve increased to \$1,701,059 due to interest revenues with no expenditures for the year. Because the District has not used this reserve in the last five years, we question the necessity of this reserve. The Board can discontinue this reserve if it determines the reserve is unnecessary. Money from the discontinued reserve can be transferred only to another reserve as authorized by Education Law.¹

Workers' Compensation Reserve – This reserve was established under GML on May 9, 1995 for the payment of compensation benefits, medical and hospital expenses, and expenses of administering a self-insurance program. At June 30, 2010, the balance in this reserve was \$924,403. The District has not used the Workers' Compensation Reserve as a funding source in the last five years, so at June 30, 2011 the balance was \$929,180. Instead, the District budgets for these expenditures in the general fund and, therefore, has levied taxes to pay for them. Because the Board has not used this reserve to pay for workers' compensation costs and included a budget appropriation in the amount of \$683,554 in the 2011-12 budget, we question why the Board is continuing to hold a substantial balance

¹ Section 3651

in this reserve. We believe the Board can improve accountability for District finances by using funds from this reserve as a resource when preparing the District's annual budget. Alternately, the Board can discontinue this reserve and transfer the moneys to District operating funds or to another legal reserve, as authorized by GML.

Unemployment Insurance (UI) Reserve – This reserve was established under GML to reimburse the State Unemployment Insurance Fund (SUIF) for payments made to claimants. We found that District expenditures to the SUIF were \$239,519² for the five-year period ending June 30, 2011, or an average of approximately \$48,000 a year. However, the UI Reserve had a reported balance of \$223,209 at June 30, 2011, which was more than four times the average annual expenditures of the last five years.

Because the District budgets for these expenditures in the general fund and therefore levies taxes to fund them, we question why the Board is continuing to hold a substantial balance in this reserve. We believe the Board can improve accountability for District finances by using funds from this reserve as a funding source when preparing the District's annual budget. Alternately, the District can discontinue this reserve and transfer the moneys to District operating funds or to another legal reserve, as authorized by GML.

Recommendations

1. The Board should continue to closely monitor the District's 2011-12 budget by regularly determining if expected revenues are being achieved, if planned appropriations are being used as anticipated, and if moneys used from reserve funds are appropriate.
2. The Board should adopt a comprehensive reserve policy that clearly communicates to District taxpayers the purpose and intent for establishing each reserve fund, the manner in which the Board will fund and maintain each reserve fund, the optimal or targeted funding levels, and conditions under which each fund's assets will be used or replenished.
3. The Board should review all reserves and determine if the amounts reserved are necessary, reasonable and in compliance with statutory requirements. To the extent that they are not, transfers should be made to unrestricted fund balance, where allowed by law, or other reserves established and maintained in compliance with statutory directives.

² SUIF expenditures were \$62,834 for 2006-07, \$33,783 for 2007-08, \$40,118 for 2008-09, \$39,124 for 2009-10 and \$63,660 for 2010-11.

APPENDIX A

RESPONSE FROM DISTRICT OFFICIALS

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

March 22, 2012

Edward V. Grant
Chief Examiner Division of Local Government and School Accountability
Office of State Comptroller
The Powers Building, 16 W. Main Street, Suite 522
Rochester, NY 14614

Dear Mr. Grant:

The Elmira Board of Education wishes thank Comptroller DiNapoli and his staff for the Financial Management Report of Examination for our District and have started work on the recommendations.

Recommendations

1. The Board should continue to closely monitor the District's 2011-12 budget by regularly determining if the expected revenues are being achieved, if planned appropriations are being used as anticipated, and if money used from reserve funds is appropriate.

The School Business Administrator, treasurer and Audit Committee Chair have worked to provide the Board a financial snapshot that is easier to read to provide them with the necessary information to show the financial health of the district. This report is given at the second monthly meeting.

2. The Board should adopt a comprehensive reserve policy that clearly communicates to the District taxpayers the purpose and intent for establishing each reserve fund, the manner in which the Board will fund and maintain each reserve fund, the optimal or targeted funding levels, and conditions under which each fund's assets will be used or replenished.

The Board agrees that this is an important step in keeping the trust of the District's taxpayers. We will work with the policy committee on developing a corrective action plan for this recommendation.

School Board

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3. The Board should review all reserves and determine if the amounts reserved are necessary, reasonable and in compliance with statutory requirements. To the extent that they are not, transfers should be made to unrestricted fund balance, where allowed by law, or other reserves established and maintained in compliance with statutory directives.

The Board agrees that annual reviews should take place on all reserve funds and will direct the School Business Administrator and the Audit Committee to formalize a plan.

Sincerely,

A handwritten signature in blue ink that reads "Larry McGovern, Jr." with a stylized, cursive script.

Larry McGovern, Jr.

Elmira School Board President

APPENDIX B

AUDIT METHODOLOGY AND STANDARDS

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

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

After reviewing the information gathered during our initial assessment, we determined where weaknesses existed, and evaluated those weaknesses for the risk of potential fraud, theft and/or professional misconduct. 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 on the reported objective and scope by selecting for audit those areas most at risk. We selected financial management for further audit testing.

- We reviewed annual financial statements submitted to the State Education Department (SED), audited financial statements, and adopted budgets for the fiscal years ended June 30, 2007 through June 30, 2011 to analyze changes in fund balance, to analyze budget versus actual variance for revenue and expenditures, and to determine major revenue and expenditure activities. We compared State aid revenue reported from SED to budgeted State aid.
- We evaluated the appropriateness for the reserves currently in place and the level of fund balance remaining as unreserved and unappropriated in the general fund as of June 30 of each fiscal year 2006-07 through 2010-11.
- We obtained information from administrators to understand the District's plan and intent for the establishment and use of the reserve funds.
- We conducted an analysis of the District's current reserve funds to determine if the balances were appropriate.
- We analyzed the District's tax levy for the fiscal years 2006-07 through 2009-10 to confirm that the Board had chosen not to raise taxes.
- We reviewed the transfer of funds appropriated for capital projects from the general fund to the capital project fund.

- We reviewed the reported AUD for the 2010-11 year to determine the use of reserves and the ending general fund balances.
- We reviewed the adopted budget for 2011-12 to determine the extent that District officials intended to use reserves and appropriate unrestricted general fund balance.

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 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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