



Chester Union Free School District Financial Management and Board Oversight

Report of Examination

Period Covered:

July 1, 2014 – September 29, 2015

2016M-95



Thomas P. DiNapoli

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State of New York Office of the State Comptroller

Division of Local Government and School Accountability

July 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 Chester Union Free School District, entitled Financial Management and Board Oversight. 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*



State of New York Office of the State Comptroller

EXECUTIVE SUMMARY

The Chester Union Free School District (District) is governed by the Board of Education (Board), which is composed of 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.

The District Treasurer (Treasurer) is responsible for maintaining custody of all District assets, signing checks, posting transactions and preparing financial reports and statements. Under the Business Official title, the Treasurer serves as the financial and business assistant to the Superintendent. The Business Official's duties also include preparing the budget, supervising all financial functions and serving as the purchasing agent.

Scope and Objective

The objective of our audit was to assess the Board's oversight of the District's financial operations for the period July 1, 2014 through September 29, 2015. Our audit addressed the following related questions:

- Did District officials ensure budget estimates were reasonable and fund balance was maintained in accordance with statutory requirements?
- Did the Board provide sufficient oversight of financial operations?

Audit Results

District officials did not maintain the District's fund balance in accordance with statutory requirements.¹ The Board adopted budgets with overestimated appropriations which resulted in operating surpluses. In addition, District officials appropriated between \$800,000 and \$1 million of fund balance for the fiscal years 2010-11 through 2014-15 that was not used, fund balance was in excess of the 4 percent statutory limit and as high as 13.5 percent of the ensuing year's appropriations in 2014-15. District officials did not use the excess fund balance to reduce real property taxes or other appropriate purposes, and need to improve the transparency of the budget process.

¹ A district may retain a portion of fund balance but must do so within the limits established by New York State Real Property Tax Law. Currently, the amount of fund balance that a school district can retain may not be more than 4 percent of the ensuing fiscal year's budget.

The Board also did not adequately segregate financial duties. The Treasurer, as the Business Official, the purchasing agent and the financial software administrator, has control over the entire financial process. As a result, there is an increased risk that errors or irregularities could occur and remain undetected.

The Board also did not ensure that claims were adequately audited and the claims auditor did not report directly to the Board or prepare a written report of audit findings. Our testing of 30 claims showed that neither contracts nor quotes were documented,² not all claims had department head approval, and original invoices and receiving documentation were not always attached. As a result, there is an increased risk of duplicate or inappropriate payments, payments for services not rendered or goods not received or being overcharged for goods and services. In addition, the Treasurer did not always wait for the warrant to be certified before paying the claims. We found that 38 canceled checks totaling almost \$1.3 million for the 50 claims tested cleared the bank before the corresponding warrant was certified, which increases the risk that errors or irregularities could occur and not be detected.

Finally, the District's audit committee was not functioning as intended. The Board also did not establish an internal audit function and external audit services were not solicited at least every five years, as required by law. As a result, the effectiveness of District's internal control system is reduced and District residents cannot be assured that external audit services were procured in the most prudent and economical manner.

Comments of District Officials

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 disagreed with our findings and recommendations. Appendix B includes our comments on issues raised in the District's response.

² The District requires three verbal quotes for purchases totaling \$1,501 to \$4,000 and three written quotes for purchases totaling \$4,001 to \$20,000.

Introduction

Background

The Chester Union Free School District (District) is located in the Town of Chester, Orange County. The District is governed by the Board of Education (Board), which is composed of 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.

The District Treasurer (Treasurer) is responsible for maintaining custody of all District assets, signing checks, posting transactions and preparing financial reports and statements. Under the Business Official title, the Treasurer also serves as the financial and business assistant to the Superintendent. The Business Official's duties also include preparing the budget, supervising all financial functions and serving as the purchasing agent.

The District operates two schools with approximately 1,070 students and 150 employees. The District's budgeted appropriations for the 2015-16 fiscal year are approximately \$25 million, which are funded primarily with State aid and real property taxes.

Objective

The objective of our audit was to evaluate the Board's oversight of the District's financial operations. Our audit addressed the following related questions:

- Did District officials ensure budget estimates were reasonable and fund balance was maintained in accordance with statutory requirements?
- Did the Board provide sufficient oversight of financial operations?

Scope and Methodology

We examined the District's general fund financial records for the period July 1, 2014 through September 29, 2015. We extended our scope period back to July 1, 2010 to examine the District's fund balance and assess budgeting practices to provide additional information for perspective and background. We also assessed the Board's oversight of financial activities, claims auditing, asset maintenance, the audit committee and the internal and external audit functions.

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. Unless otherwise indicated in this report, samples for testing were selected based on professional judgment, as it was not the intent to project the results onto the entire population. Where applicable, information is presented concerning the value and/or size of the relevant population and the sample selected for examination.

**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 disagreed with our findings and recommendations. Appendix B includes our comments on issues raised in the District's response.

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 is responsible for making sound financial decisions that are in the best interest of the District, the students it serves and the residents who fund the District's programs and operations. Sound budgeting practices based on accurate estimates, along with prudent fund balance management, help ensure that sufficient funding will be available to sustain operations, address unexpected expenditures and satisfy long-term obligations or future expenditures. Accurate budget estimates also help ensure that the real property tax levy is not greater than necessary.

Fund balance represents resources remaining from prior fiscal years. School districts may retain a portion of fund balance at year end for cash flow purposes or to fund unexpected expenditures but must do so within the limits established by New York State Real Property Tax Law (RPTL). Currently, the amount of fund balance that a school district can retain may not be more than 4 percent of the ensuing fiscal year's budget. Any excess amounts should be used to lower real property taxes, increase necessary reserves, pay for one-time expenditures, pay down debt or establish reserves for specific purposes.

From fiscal years 2011-12 through 2014-15, District officials adopted budgets that resulted in operating surpluses. In addition, District officials also appropriated between \$800,000 and \$1 million of fund balance each year that was not used, resulting in an unrestricted fund balance of almost \$3.4 million as of June 30, 2015, or 13.5 percent of the ensuing year's appropriations.

Budgeting Practices

District officials are responsible for preparing and the Board is responsible for adopting reasonable budgets based on historical or known trends for appropriations and revenues. It is essential that District officials use the most current and accurate information to ensure that budgeted appropriations are reasonable.

We reviewed the District's general fund budget for 2010-11 through 2014-15 and found that District officials overestimated expenditures during that period by a total of \$7.5 million (6 percent), as shown in Figure 1. District officials could have more accurately estimated appropriations by using available financial information, such as actual prior-year costs, when preparing the budget.

Figure 1: Overestimated Expenditures

	2010-11	2011-12	2012-13	2013-14	2014-15	Total
Appropriations	\$22,883,043	\$22,574,902	\$23,113,467	\$23,693,542	\$25,131,492	\$117,396,446
Actual Expenditures	\$21,258,200	\$21,141,631	\$21,183,755	\$22,760,692	\$23,553,745	\$109,898,023
Overestimated Expenditures	\$1,624,843	\$1,433,271	\$1,929,712	\$932,850	\$1,577,747	\$7,498,423
Percentage	7%	6%	8%	4%	6%	6%

As a result, the Board adopted inflated budgets each year, which led to excessive fund balance levels and possibly resulted in lost opportunities to reduce tax levies. The Board believes that the inflated budget appropriations, its annual appropriation of fund balance and its planned transfers of funds to offset capital project costs and fund reserves will ultimately reduce future debt.

Fund Balance

The District may retain a portion of fund balance but must do so within the limits established by RPTL. The amount of unrestricted fund balance that the District can retain may not be more than 4 percent of the ensuing year’s budgeted appropriations. The District may use the remaining resources to fund the next year’s budget or to establish necessary reserves for a specific purpose.

The Board did not ensure that fund balance remained within the statutory limit allowed by law. The District’s unrestricted fund balance ranged from 4.9 percent in 2010-11 to 9.9 percent as of June 30, 2015. The Board adopted budgets from fiscal years 2010-11 through 2014-15 that included overestimated appropriations totaling \$7.5 million and an annual average of \$900,000 of appropriated fund balance that was not used to fund operations. As a result, District officials have not used fund balance in a manner that benefits residents and is transparent in the budgeting process. The 2015-16 adopted budget continues the trend of appropriating fund balance and also includes a 1.52 percent tax levy increase, as well as a 2.66 percent increase in appropriations. The District will likely incur another surplus in 2015-16, resulting in unused appropriated fund balance and the continued accumulation of excessive fund balance levels.

In 2010-11 the District appropriated over \$1.1 million of fund balance but used about half, \$552,579. From fiscal years 2011-12 through 2014-15, District officials adopted budgets with appropriation estimates that resulted in operating surpluses each year. They also appropriated between \$800,000 and \$1 million of fund balance each year that was not used because of the operating surpluses (Figure 2).

Figure 2: Unrestricted Fund Balance at Year-End

	2010-11	2011-12	2012-13	2013-14	2014-15
Total Beginning Fund Balance	\$3,790,772	\$3,238,193	\$4,142,367	\$4,783,158	\$5,427,090
Prior Period Adjustment to Beginning Fund Balance	\$0	\$189,333	(\$8)	\$272,140	(\$6)
Add: Operating Surplus/(Deficit)	(\$552,579)	\$714,841	\$640,799	\$371,792	\$615,561
Total Ending Fund Balance	\$3,238,193	\$4,142,367	\$4,783,158	\$5,427,090	\$6,042,645
Less: Restricted Funds	\$952,819	\$1,117,373	\$1,485,958	\$2,151,437	\$2,151,453
Less: Encumbrances	\$278,539	\$152,046	\$0	\$520,957	\$512,087
Less: Appropriated Fund Balance for the Ensuing Year	\$900,000	\$800,000	\$1,046,462	\$900,000	\$900,000
Total Unrestricted Funds at Year-End	\$1,106,835	\$2,072,948	\$2,250,738	\$1,854,696	\$2,479,105
Ensuing Year's Budgeted Appropriations	\$22,574,902	\$23,113,467	\$23,693,542	\$24,085,149	\$25,024,626
Unrestricted Funds as a Percentage of the Ensuing Year's Budget	4.9%	9%	9.5%	7.7%	9.9%

We recalculated the District's unassigned fund balance for the fiscal years 2010-11 through 2014-15 including the unused appropriated fund balance. The District's actual unrestricted fund balance exceeded the statutory limit each year, ranging from 8.9 percent to 13.9 percent of the ensuing year's appropriations (Figure 3).

Figure 3: Unused Fund Balance

	2010-11	2011-12	2012-13	2013-14	2014-15
Total Unrestricted Funds at Year-End	\$1,106,835	\$2,072,948	\$2,250,738	\$1,854,696	\$2,479,105
Add: Appropriated Fund Balance Not Used to Fund Ensuing Year's Budget	\$900,000	\$800,000	\$1,046,462	\$900,000	\$900,000
Total Recalculated Unrestricted Funds	\$2,006,835	\$2,872,948	\$3,297,200	\$2,754,696	\$3,379,105
Recalculated Unrestricted Funds as Percentage of Ensuing Year's Budget	8.9%	12.4%	13.9%	11.4%	13.5%

District officials stated that they plan to use the excess fund balance for capital projects and to fund reserves. Had District officials adopted more realistic appropriation estimates and used appropriated fund balance to finance operations, they could have accumulated less fund balance and possibly reduced the tax levy. The practice of adopting unrealistic estimates for appropriations and appropriating fund balance that will not be used to finance operations diminishes the transparency of the budget process.

Recommendations

District officials should:

1. Develop realistic estimates of appropriations and the use of fund balance in the annual budget.

2. Ensure that the amount of unrestricted fund balance is in compliance with the statutory limit and reduce the amount of surplus fund balance in a manner that benefits District residents. Such uses could include, but are not limited to:

- Paying off debt;
- Financing one-time expenditures;
- Funding appropriate reserves; and
- Reducing property taxes.

Board Oversight

The Board is responsible for managing and overseeing the District's financial operations and safeguarding its resources. These duties include establishing a system of internal controls to provide reasonable assurance that District resources are properly safeguarded. The Board must adequately segregate incompatible financial duties and/or review and monitor the work performed by those whose financial duties are incompatible. The Board is also responsible for adopting and enforcing a policy to ensure assets are protected from loss and asset records are current and accurate.

The Board did not adequately segregate financial duties because all financial responsibilities were assigned to one individual. In addition, the Board did not adequately oversee the claims audit process to ensure that claims were sufficiently audited and findings reported. The Board also did not ensure that the audit committee functioned as intended, did not establish an internal audit function and it has not issued a request for proposals (RFP) for the annual external audit since 2007. Lastly, the Board did not ensure that the Treasurer conducted annual inventories or that sufficient asset records were maintained for all District assets.

Segregation of Duties

Segregation of incompatible duties is an internal control practice that reduces the risk that errors or irregularities will occur and not be detected. When it is neither practical nor cost-effective to segregate responsibilities, compensating controls, such as increased oversight, can reduce the risk of errors or irregularities.

The Board did not adequately segregate financial duties. The Treasurer is also the District's Business Official and purchasing agent as well as the administrator of the District's financial software. Consequently, the Treasurer performed all financial duties, in addition to administering the accounting software, with little oversight or any other compensating controls. The Treasurer has the ability to complete a transaction from start to finish, after which he is responsible for recording and reconciling transactions and preparing all financial reports. As the Business Official, his duties include preparing the budget and supervising financial reporting, purchasing and accounting. The lack of segregation of duties resulted in an increased risk that the Treasurer could misappropriate District assets or make errors that could go undetected.

Claims Auditing

The Board annually appoints a claims auditor during its reorganization meeting. The claims auditor's duties include reporting directly to the Board on the audit of claims results and certifying that each claim listed on the warrant was audited and payment was authorized. The Board adopted a policy for the claims auditor's appointment and duties, which required the auditor to examine all claim forms for the availability of funds within the appropriate budget codes and adequacy of evidence to support the District's expenditure. The policy also states that valid claims against the District shall be paid by the Treasurer only upon the approval of the claims auditor. Best practice requires the claims auditor to verify that claims are mathematically correct, do not include previous charges or sales tax and are in agreement with the purchase order or contract amount.

Although the claims that we reviewed were authorized, valid and for legal District purposes, the claims auditor did not verify that sufficient funds were available in the appropriation code. The claims auditor also did not verify claims were mathematically accurate, contained department approval, supported by sufficient documentation or that rates charged were in accordance with contracts or quotations. The District requires three verbal quotes for purchases totaling \$1,501 to \$4,000 and three written quotes for purchases totaling \$4,001 to \$20,000.

In addition, the claims auditor did not report directly to the Board and did not prepare a written report of audit findings. Instead, the claims auditor would circle and tick off claims on the warrant as an indication that claims were questioned. She considered the certified warrant as her report to the Board. Questionable claims were communicated to the accounts payable clerk by a phone call or email or by attaching a note to the claim packet.

We tested 30 randomly selected claims totaling \$612,569 to determine whether claims paid were for a valid purpose, approved by the department head, mathematically correct and contained sufficient documentation to support the claim, including original invoice and receiving documentation. We also reviewed the claims to determine if there were discrepancies between the requisition, purchase order and invoice. Our testing identified the following discrepancies:

- Nineteen claims totaling \$401,865 did not have documented quotes or contract terms attached.
- Five claims totaling \$3,443 did not contain evidence of department head approval and one of the five claims totaling \$1,213 was not sufficiently itemized or supported by a contract.

- Nine claims totaling \$3,142 did not have receiving documentation.
- Four claims totaling \$1,931 did not have the original invoices attached.

The claims auditor was not provided contracts, Board minutes or quotes to verify the agreed-upon contract rates. Instead, she relied on the Treasurer to check and approve claims prior to her audit. The claims auditor verified that the payments matched invoices and other attached documentation in the claim packet. The claims audit consisted of comparing check stubs to the attached claims voucher, verifying that invoices were attached, sales tax was not included in the payment and that claims were approved and initialed by the Treasurer. However, the claims packets did not indicate that the auditor checked the claim's mathematical accuracy.

In addition, the claims auditor did not verify that adequate funds were available in the appropriation code because she did not have access to the financial software and she was not provided with budget-to-actual expenditure reports, or other reports, to verify availability of funds. As a result, for the 2014-15 fiscal year, 15 budget lines were over expended by \$272,309.

The District also paid claims prior to the claims auditor certification of the warrants. We reviewed 50 judgmentally selected canceled checks totaling \$1,788,635 and compared the date the check cleared the bank to the date the warrant was certified. We found that 38 of the 50, or 76 percent, of the canceled checks tested, totaling \$1,272,393, cleared the bank before the corresponding warrant was certified. The claims auditor explained that warrants are not certified until all claims listed are approved. Unapproved claims are generally voided and may be included on the next warrant after all questions are resolved. To avoid the late payment of claims, checks may be mailed before the warrant is certified.

When warrants are not certified before checks are released, controls over the District's disbursements are weakened and this provides opportunities for errors or irregularities to occur. Without an effective claims audit process, the District has an increased risk that it could make duplicate payments or inappropriate payments to ineligible parties for improper purchases, pay for services not rendered or goods not received or be overcharged for goods and services.

Audit Committee

The Board is responsible for the District's overall fiscal management and is required to establish systems and processes that provide for transparency and accountability in the conduct of District business and provide for adequate oversight. Key to providing adequate oversight of District operations is the establishment and functioning of an audit committee. The primary role of the audit committee is to assist the Board in its oversight role to ensure financial accountability. The internal audit function should assist the Board in ensuring that necessary controls are in place and risks are minimized. The internal auditor should report directly to the Board.

In accordance with the law and regulations, school districts are required to establish an audit committee no later than January 1, 2006 as a committee of the Board; either as an advisory committee, or as a committee of the whole. The audit committee should consist of at least three members, who serve without compensation. School district employees are prohibited from serving on the audit committee.

The Board created an audit/finance committee (Committee) and adopted a charter (Charter) in 2007. The Charter requires the Committee to include two Board members and up to four community members. It also requires that the Committee assist in oversight of the internal audit function, assess and report to the Board on the Charter's adequacy at least annually and oversee the (RFP) process used to solicit quotations for the District's external audit. The Committee did not comply with the Charter requirements and did not function as intended.

The Committee did not:

- Exclude current District employees as members, such as the Superintendent and Business Official.
- Ensure that high-risk areas and key control activities were periodically evaluated and tested through an internal audit function.
- Hold regularly scheduled meetings, at least three times a year.
- Prepare minutes of their meetings and provide them annually to the Board.
- Review the adequacy of the Charter at least annually or maintain a copy of the Charter.

- Oversee the competitive RFP process used to solicit quotations for the annual external audit. The District has not solicited quotes for the external audit since 2007.

The Committee was not functioning as intended. Therefore, the District's internal control system is not effective as it could be because the Committee did not meet its requirements. In addition, District residents cannot be assured that external audit services are procured in the most prudent and economical manner.

Asset Records

The District's records indicate that it has about \$23 million in assets. The Treasurer is responsible for accounting for fixed assets by making arrangements for the annual inventory and maintaining property records for each asset costing \$5,000 or more.

The Board did not ensure that the Treasurer made arrangements for the annual inventories and maintained sufficient asset records for all District assets. Physical inventories were performed solely by the Food Service and Information Technology Departments, who maintained their own inventory records. Detailed property records were not maintained for each asset costing \$5,000 or more. The only asset record provided by the Treasurer was the depreciation expense report. This is not adequate as a property record because it does not contain accurate acquisition dates, descriptions of assets, location of assets, disposition information or identify the responsible official.

The July 30, 2014, and August 12, 2015 Board minutes included evidence that the Board approved asset disposals. However, the lists of disposed assets were not detailed. For example, the August 12, 2015 Board minutes included a description in the disposal listing that read "multiple assorted copiers, printers, PCs/servers." In addition, because the District had umbrella insurance coverage, the insurance company did not require an appraisal of all covered assets or annual updates of assets purchased or disposed of. As a result, the District does not have accurate records to substantiate the actual value of its assets, which increased the risk of loss.

Recommendations

The Board should:

3. Segregate financial duties, or if segregating duties is not practical, implement compensating controls.
4. Provide the claim auditor with procedures, a checklist and report format to perform a proper audit of claims.
5. Ensure the claims auditor reports directly to the Board.

6. Ensure that the claims auditor is able to verify the availability of funds as well as contract terms and quoted rates.
7. Ensure claims are not paid prior to warrant certification approving payment.
8. Ensure the Committee complies with its Charter's membership requirements, meets regularly, records its minutes and reports to the Board at least annually.
9. Establish an internal audit function to assess and test risk periodically.
10. Ensure that the District actively solicits quotes for the annual audit using the RFP process at least every five years.
11. Ensure that the Treasurer arranges for an annual asset inventory and maintains sufficient and accurate inventory and asset records.

APPENDIX A

RESPONSE FROM DISTRICT OFFICIALS

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

The District's response letter refers to an attachment that supports the response letter. Because the District's response letter provides sufficient detail of its actions, we did not include the attachment in Appendix A.

CHESTER UNION FREE SCHOOL DISTRICT

64 Hambletonian Avenue
Chester, New York 10918
Phone (845) 469-9184 Fax (845) 469-2377

June 3, 2016

New York State Office of State Comptroller
Division of Local Government and School Accountability
Newburgh Regional Office
Tenneh Blamah, Chief Examiner
33 Airport Center Drive, Suite 103
New Windsor, NY 12553-4725

I am writing to you in response to your draft Report of Examination for the covered period of July 1, 2014 – Sept. 29, 2015 (2016M-95).

There are two primary findings and recommendations expressed in the report: Financial Management and Board Oversight. I will attempt to address them each fully and in order. These items are also identified in the Scope and Objective contained in the Executive Summary.

Financial Management

Your report noted that “the Board is responsible for making sound financial decisions that are in the best interest of the District, the students it serves and the residents who fund the District’s programs and operations.” In contrast to a number of your “findings” I contest that the Chester Union Free School District Board of Education and Management has done exactly that.

- **Budgeting Practices**

You have noted that district officials “overestimated expenditures” when preparing operating budgets. That observation is far easier to make after the year is over. Managements estimates would be far more accurate if they have the luxury of preparing a budget for the year that just ended rather than having to know and account for shifting regular and special education program needs, tuition charges that are often adjusted years after the services are rendered, utility and repair needs throughout the year.

Your report draws a conclusion that the District’s budgeting practice “possibly resulted in lost opportunities to reduce tax levies” but you fail to note that it also possibly saved the District from significant financial stress, as measured by your own Fiscal Stress Monitoring System in which Chester’s score of 0% indicated “No Fiscal Designation.

See
Note 1
Page 21

See
Note 2
Page 21

By presenting a strong fiscal profile to the rating agencies the District was able to increase its bond rating (to Moody's A rating), the higher bond rating lowered our long-term capital bond rate saving the District's taxpayers annually more than \$500,000. In addition our rate is lower than that paid by the State Dormitory Authority which is the rate used to calculate our capital aid. By exercising its fiduciary responsibilities to the taxpayers the District has not only reduced cost associated with borrowing but maximized the aid received from the capital borrowing. Furthermore, the 2016 Moody's Annual Comment on Chester UFSD they note under Management and Governance: "Surplus operating margins are a component of strong financial management. Favorably, on average, Chester UFSD's were positive over the past several years, even while the tax base generally contracted"

See
Note 3
Page 21

- Fund Balance

Your presentation of "Unused Fund Balance" is inflammatory and in no way recognized or supported by generally accepted governmental auditing standards (GAGAS) that you claim this report conforms to. You again conclude that we could have "possibly reduced the tax levy". This is pure conjecture on your part. The conclusions you have drawn in this report shows that you have let your judgment and opinion cloud what should be a report of facts.

See
Note 4
Page 21

See
Note 5
Page 21

The fund balance acts as a buffer to help the district stabilize the tax rate and reduce the cost of borrowing. The fund balance has been consistently monitored and maintained to ensure and to enhance the District's fiscal integrity and maximize the benefits to the taxpayers of Chester.

See
Note 6
Page 21

Districts with a smaller than average residential tax base experience higher interest rates for both short and long term borrowings. Our fund balance has reduced the need to issue short term borrowing and saved the District's taxpayers thousands of dollars in interest.

See
Note 3
Page 21

The fund balance allows the District to react to changing student demographics. The cost of a high-needs student in a small district such as Chester is the same cost as in a larger district that can retain a much larger fund balance. Because we have exercised our fiduciary responsibilities the Chester UFSD can move forward in these fiscally trying times with lower cost and maintain a stable tax rate.

See
Note 6
Page 21

In addressing your recommendations, the Chester Board of Education appropriated excess Fund Balance to address long-term capital project funding to reduce the future cost of debt service. The minutes and resolution, of the October 13, 2016, was provided to you during your field work and a copy has been attached for your consideration.

See
Note 7
Page 21

Board Oversight

Your report points to segregation of duties, claims auditing, audit committee and asset records as examples of insufficient Board of Education oversight.

- Segregation of Duties

This has been brought to the Board's attention through the external audit function. The conclusion you reached in your report is that the treasurer could misappropriate District assets yet you offer no findings that support this conclusion.

See
Note 8
Page 22

- Claims Auditing

While the claims auditor reports directly to the Board, she will prepare a more formal report indicating the claims reviewed, any issues that were resolved prior to the mailing of payments and to note any unresolved issues that have been encountered.

See
Note 9
Page 22

Your report notes discrepancies in randomly selected claims tested during your field work. These discrepancies were not discussed with District management prior to June 3, 2016 so I have no way to discuss or dispute this finding. Your report also notes a review of 50 "judgmentally selected" checks. As you noted in your report, certain time-sensitive payments are released after the claims audit process, by e-mail confirmation, but prior to the sign off of the complete warrant. This process will be addressed to avoid occurrences in the future.

See
Note 10
Page 22

- Audit Committee

The Chester Board of Education will reevaluate the Charter of the audit committee and update the membership and roll of the committee. The committee is active and functions as intended but did not have sufficient non-board participation as you have noted. We will continue to reach out to the community for interested members.

The committee will be issuing an RFP for the annual audit function this year and on a more regular basis.

As per Commissioners Regulation (2116-b(2); 8 NYCRR 170.12 (c)(3)), school districts that employ less than eight teachers, had less than \$5 million in general fund expenditures or fewer than 1500 enrolled students in the previous school year are exempt from maintaining an internal audit function, provided that they certify to the commissioner of education they meet the exemption requirements. The certification of exemption was presented to you during the three months engagement in the district. It is unclear why this would be one of your recommendations if the Chester Union Free School District is exempt for the internal audit function.

See
Note 11
Page 22

- Asset Records

Your report references individual assets that were disposed of. As was discussed during your fieldwork, the disposed of assets were included with the general contractor capital construction contract and could not be itemized and tracked. We do account for all current and future assets purchases according to our capitalization policy, consistent with GASB 34.

See
Note 12
Page 22

Other Items of Concern

In response to your draft Report of Examination for the covered period of July 1, 2014 – September 29, 2015 (2016M-95) I would ask that the above clarification(s) be considered when crafting your final report.

As well, please note the following technical corrections:

Scope and Objective p.4 – the scope outlined in the Executive Summary was never communicated to District officials prior to the engagement or during the months of field work. Having known the focus of your review would have helped us schedule appropriate staff and prepare documents required for your review.

See
Note 13
Page 22

Appendix B Audit Methodology and Standards lists only the testing you conducted that resulted in a finding for this report. You did not include:

Exhaustive Payroll Testing

Employees Retirement System Reporting

BOCES Custodial Contract

Fuel Purchasing

Tax Cap Compliance

Real Property Tax Refunds

External Audit Reports

Collective Bargaining Agreements and Employee Handbooks

And a review of our Official Newspaper that included threats of action from your Office of Council.

See
Note 14
Page 22

See
Note 15
Page 22

Respectfully Submitted,

Frank Sambets, Board of Education President

APPENDIX B

OSC COMMENTS ON THE DISTRICT'S RESPONSE

Note 1

While some variance between budgeted and actual expenditures is expected, total District expenditures were consistently overestimated, ranging from \$932,000 to \$1.9 million, or an average of 6 percent, for the five-year period.

Note 2

The District's budgeting practices contributed to increasing fund balance that was already above the statutory limit. The District does not need to exceed the statutory limit to avoid being in fiscal stress.

Note 3

We acknowledge that operating surpluses and excess fund balance reduces the cost and need for borrowing. However, school districts are not permitted by law to retain more than 4 percent of the ensuing year's budget.

Note 4

GAGAS state that effect identifies the outcome or consequences of the condition and may be used to demonstrate the need for corrective action in response to identified problems or relevant risks. The District reported fund balance in excess of the statutory limit and District officials did not use the fund balance appropriated in the last four years. The recalculation of unrestricted fund balance shows the effect of these two conditions.

Note 5

All conclusions in this report are based on the data collected from the District and analyzed during the audit.

Note 6

New York State Real Property Tax Law currently limits the amount of fund balance that a school district can retain to no more than 4 percent of the ensuing fiscal year's budget.

Note 7

The October 2015 action taken by the Board was subsequent to our audit scope period. In addition, the financial condition analysis in our report covered July 1, 2010 through June 30, 2015. Therefore, the District's use of fund balance in October 2015 was subsequent to our analysis.

Note 8

Although we did not identify any misappropriation of funds during our audit, when an individual has the ability to complete a transaction from start to finish, after which he is responsible for recording and reconciling transactions and preparing all financial reports, there is an increased risk that misappropriation or misuse could occur.

Note 9

District officials did not provide any evidence that the claims auditor reports directly to the Board to discuss findings.

Note 10

Lists of all claims requested for review were provided to the Treasurer during the audit process and a second list of claims was sent on June 3, 2016.

Note 11

Although the District is not required to have an internal audit function, it was recommended as an internal control due to the lack of segregation of duties within the District office.

Note 12

By including these assets with the general contractor capital construction contract, the District does not have accurate records to substantiate the actual value of its assets when some of the assets are disposed of.

Note 13

The scope of July 1, 2014 to September 29, 2015 was communicated at the entrance conference. In addition, once the objectives were determined, officials were notified of the areas to be audited and the extended scope was explained.

Note 14

The methodology included in this report covers work performed during the audit stage of the engagement. The testing noted by the District in their response is work that was performed during the risk assessment portion of our audit. In addition, some of the items listed were reviewed, but no testing was performed.

Note 15

The auditors are not aware of any threats of action and also verified that no communication took place between District officials and our legal counsel.

APPENDIX C

AUDIT METHODOLOGY AND STANDARDS

To achieve our audit objective and obtain valid evidence, we performed the following procedures:

- We interviewed the Board President and District officials to obtain an understanding of the Board's oversight of financial management.
- We reviewed Board minutes for Board actions and procedures relating to budgeting and financial management.
- We reviewed Board policies and regulations pertaining to the Business Official, Treasurer and claims auditor duties.
- We compared the District's budgeted appropriations and estimated revenues with the actual results of operations from 2010-11 through 2014-15.
- We reviewed budget-to-actual status reports and analyzed budget estimates to determine if available balances were excessive (over \$100,000) and if budget lines were over expended as of March 31 and June 30, 2015.
- We determined the total amount of unrestricted fund balance maintained by the District from 2010-11 through 2014-15.
- We reviewed and analyzed the District's fund balances to ensure they complied with applicable statutes and to determine if the balances were reasonable from 2010-11 through 2014-15.
- We judgmentally selected 50 claims totaling almost \$1.8 million from the list of disbursements for the audit period based on unusual names or amounts paid for purchases, professional services and reimbursements. We compared the date the corresponding warrant was certified to the date the check cleared the bank from canceled check images to calculate the number of days it took the check to clear the bank before or after the warrant's certification. Similarly, we also compared the date of the warrant to the certification date for timeliness of certification.
- We reviewed the Charter and Five-Point Plan to determine if the Committee was functioning as intended.
- We randomly selected 30 claims packets to determine if the audit of claims was adequate. We tested whether each claim was for a valid District purpose, had departmental approval, contained sufficient documentation (including the original invoice, receiving documentation, quotes or bids), were mathematically correct and did not include sales tax.

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 D

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