



# Owego Apalachin Central School District

## Capital Project and Financial Condition

### Report of Examination

Period Covered:

July 1, 2012 — December 16, 2013

2014M-109



Thomas P. DiNapoli

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# State of New York Office of the State Comptroller

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## **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 Owego Apalachin Central School District, entitled Capital Project and 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*



## State of New York Office of the State Comptroller

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# EXECUTIVE SUMMARY

The Owego Apalachin Central School District (District) is located in the Towns of Candor, Newark Valley, Nichols, Tioga and Owego in Tioga County. The District is governed by the Board of Education (Board) which comprises seven elected members. The Board is responsible for the general management and control of the District's financial and educational affairs. The Superintendent of Schools (Superintendent) is the District's chief executive officer and is responsible, along with the Business Manager and other administrative staff, for the District's day-to-day management under the Board's direction. The District has outsourced recordkeeping and some budget oversight functions to the Centralized Business Office, operated by the Broome-Tioga Board of Cooperative Educational Services.

There are four schools in operation within the District, with approximately 2,200 students and 400 employees. The District's general fund budgeted appropriations for the 2013-14 fiscal year are \$42.4 million, which are funded primarily with State aid and real property taxes.

In September 2011, several of the District's facilities suffered flood damage as a result of Tropical Storm Lee. The Owego Elementary School was severely damaged. The Federal Emergency Management Agency (FEMA) has approved \$33.1 million in funding to date to replace this facility, and will determine the final award after project bids are finalized. The District is also awaiting approval from FEMA for funding for the replacement of the administrative and maintenance buildings. In addition, the District has received a number of other FEMA awards totaling nearly \$9 million to provide funding for cleanup and repairs of other District facilities, rental of temporary facilities and flood remediation.

The District has engaged various consultants to assist with its rebuilding process: an architectural and engineering firm for building design and development, a construction manager to manage the construction project as the District's agent, a municipal advisory firm for bond and cash flow planning, and a grant consultant to assist with FEMA grant management.

### **Scope and Objective**

The objective of our audit was to examine the District's financial activities for the period July 1, 2012 through December 16, 2013. We extended our scope back to the 2008-09 fiscal year and projected forward through June 30, 2014 to analyze budgeting practices, fund balance trends and reserve account balances. In addition, we extended our scope forward to February 11, 2014 for capital projects disbursement testing. Our audit addressed the following related questions:

- Did the Board properly plan and monitor the elementary school's capital project?

- Did the Board and District management develop reasonable budget estimates in the annual District budget?

### **Audit Results**

The Board, while properly planning for the project, does not have a process to effectively monitor the project's progress. As of the end of fieldwork, no one was preparing accurate and complete capital project financial reports for the Board. Instead, the Board is relying on the Superintendent's oral reports for information. It is imperative that District officials have the information necessary to properly monitor the project, as they do not have absolute assurance that the District will receive the final FEMA award amounts. As such, the District could be liable if project costs exceed the grant awards and other projected revenues.

The Board and District officials did not develop reasonable estimates for expenditures and use of fund balance in the annual District budget. While revenue estimates were generally close to the actual revenues received, expenditures for fiscal years 2008-09 through 2012-13 were consistently and significantly overestimated; the District spent nearly \$14.2 million less than budgeted (nearly 7 percent) during this time. In addition, although the District planned to use more than \$16 million in unexpended surplus funds<sup>1</sup> and reserves over the last five fiscal years, it actually used \$1.68 million (11 percent). The District, however, is facing considerable uncertainties regarding the final funding for the elementary school replacement, along with the funding for remaining flood recovery projects. If the District does not receive all of its anticipated funding, it may need to use unexpended surplus fund balance or reserve funds to fund these projects.

### **Comments of District Officials**

The results of our audit and recommendations have been discussed with District officials and their comments, which appear in Appendix B, have been considered in preparing this report. District officials disagreed with some of the findings in our report but indicated they would initiate corrective action. Appendix C includes our comments on issues District officials raised in their response.

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<sup>1</sup> The Governmental Accounting Standards Board (GASB) issued statement 54, which replaces the fund balance classifications of reserved and unreserved with new classifications: nonspendable, restricted and unrestricted (comprising committed, assigned and unassigned funds). The requirements of Statement 54 are effective for fiscal years ending June 30, 2011 and beyond. To ease comparability between fiscal years ending before and after the implementation of Statement 54, we will use the term "unexpended surplus funds" to refer to that portion of fund balance that was classified as unreserved, unappropriated (prior to Statement 54), and is now classified as unrestricted, minus appropriated fund balance, amounts reserved for insurance recovery and tax reduction, and encumbrances included in committed and assigned fund balance (post-Statement 54).

# Introduction

## Background

The Owego Apalachin Central School District (District) is located in the Towns of Candor, Newark Valley, Nichols, Tioga and Owego in Tioga County. The District is governed by the Board of Education (Board) which comprises seven elected members. The Board is responsible for the general management and control of the District's financial and educational affairs. The Superintendent of Schools (Superintendent) is the District's chief executive officer and is responsible, along with the District's Business Manager and other administrative staff, for the District's day-to-day management under the Board's direction. The District has outsourced certain Business Office functions, such as recordkeeping functions, to the Centralized Business Office (CBO). The CBO is operated by the Broome-Tioga Board of Cooperative Educational Services. District and CBO staff monitor the budget as a collaborative effort and the CBO provides District management with guidance during budget development.

There are four schools in operation within the District, with approximately 2,200 students and 400 employees. The District's general fund budgeted appropriations for the 2013-14 fiscal year are \$42.4 million, which are funded primarily with State aid and real property taxes.

In September 2011, several of the District's facilities suffered flood damage as a result of Tropical Storm Lee. The Owego Elementary School was severely damaged. The Federal Emergency Management Agency (FEMA) determined that the facility was eligible for replacement and has approved \$33.1 million in funding to date and will determine the final award after project bids are finalized. In addition, the District has received a number of other FEMA awards totaling nearly \$9 million to provide funding for cleanup and repairs of other District facilities, rental of temporary facilities and flood remediation. The District is also seeking approval from FEMA to replace the District's flood damaged administrative and maintenance buildings, but has not been able to reach an agreement with FEMA. The District has engaged various consultants to assist the District's rebuilding process: an architectural and engineering firm for building design and development, a construction manager to manage the construction project as the District's agent, a municipal advisory firm for bond and cash flow planning, and a grant consultant to assist with FEMA grant management.

**Objective**

The objective of our audit was to examine certain District financial activities. Our audit addressed the following related questions:

- Did the Board properly plan and monitor the elementary school's capital project?
- Did the Board and District management develop reasonable budget estimates in the annual District budget?

**Scope and Methodology**

We examined certain District financial activities for the period July 1, 2012 through December 16, 2013. We extended our scope back to the 2008-09 fiscal year and projected forward through June 30, 2014 to analyze budgeting practices, fund balance trends and reserve account balances. In addition, we extended our scope forward to February 11, 2014 for capital projects disbursement testing.

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 D 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 B, have been considered in preparing this report. District officials disagreed with some of the findings in our report but indicated they would initiate corrective action. Appendix C includes our comments on issues District officials raised in their 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 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.

## Capital Project

The Board is ultimately responsible for the oversight and management of the District's capital projects, but may hire consultants to provide assistance. Because of the significant resources involved in such projects, the Board should ensure that capital projects are properly planned and monitored. Education Law requires the District to use an architect or engineering firm to supervise the project to ensure that it is completed in compliance with project specifications. Adequate plans require the preparation of a budget and State Education Department (SED) approval of the capital project building plan and related State building aid. Districts also are required to obtain voter approval to authorize the issuance of debt and to use reserve fund moneys. Cash flow projections should be prepared and updated to ensure that sufficient cash is on hand to pay project expenditures. District officials should monitor capital project activities to ensure that projects are completed in the most cost effective manner and within the financial constraints established. If projects fall short of the District's expectations, it is the Board's responsibility to determine the reasons for those deviations, identify possible corrective action, and take the appropriate action to address any problems.

The Owego Elementary (OE) building had extensive flood damage from Tropical Storm Lee in September 2011. The demolition of the damaged OE building began in June 2013. Flood remediation work started in November 2013 on the same site as the original facility, and construction of a new building began in April 2014. The total replacement cost is estimated at \$72 million, funded primarily with disaster relief grants<sup>2</sup> and State aid. In October 2013, the Federal Emergency Management Agency (FEMA) informed the District that it would reimburse the District for the current design plans/proposal with certain exceptions<sup>3</sup> and that it would determine the final eligible costs upon receipt of the approved bid. The project's proposed spending plan is detailed in Appendix A.

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<sup>2</sup> The District has been awarded \$33 million in disaster relief grants from FEMA and the New York State Office of Emergency Management Services with stipulation that the amount will be adjusted when final construction bids are awarded. The \$60,234,279 amount reported in Appendix A is the District's estimate of the final award amount.

<sup>3</sup> FEMA has determined that the replacement building design includes enhancements that are not allowable for FEMA aid. These exceptions – an auditorium, geo-thermal heating system, three large group instruction spaces and added storage space – are estimated to cost \$11 million. District officials are funding these exceptions using reserve funds and State aid.



The District engaged various consultants to assist in the rebuilding process of this large project. The District hired an architectural and engineering firm (A&E) responsible for building design and development; a construction manager (CM) responsible for construction coordination, cost estimation and to provide project oversight; a grant consultant to assist with preparing and submitting claims and to maximize FEMA reimbursement; and a municipal advisory firm to provide cash flow and debt planning services. The District is also using the Broome–Tioga Board of Cooperative Educational Services Centralized Business Office (CBO) to maintain the District’s general ledger accounting system and provide monthly financial reports to the Board.

While the Board planned properly for the ongoing capital project, monitoring the project’s progress has been hampered by the lack of available complete information and/or the necessity to compile information from a variety of sources. As of the end of fieldwork, no one was preparing detailed financial reports to monitor the project’s progress against the plan developed by the Board and District administration.

The Board, with the assistance of District management, the A&E and the CM, prepared a proper project plan that included a proposed spending plan for each project category (see Appendix A), obtained the necessary SED and voter approvals, and have begun to seek competition for the project’s various phases. The District’s consultants also prepared project cash flow projections to ensure that sufficient cash would be available to meet the necessary obligations as the project progressed.

The Board, however, does not have a process to effectively monitor the project. Instead, the Board is relying on verbal reports from the Superintendent to provide it with information on the project status and does not receive any type of comprehensive financial report showing any amendments to the original plans and any progress made. In addition, as of the end of fieldwork, no one was accounting for the project’s resources in total. The District’s accounting system used by the CBO has been set up to track FEMA project awards and costs by the project number assigned by FEMA. However, as of the end of fieldwork, no one was recording transactions in this system properly. For example, the \$33.1 million total amount obligated to date by FEMA for the project was not recorded as a budgeted revenue and all of the planned expenditures were not recorded in this – or any – system.

Furthermore, actual expenditures as of the end of our fieldwork date for other FEMA projects were being recorded in this project’s account code, instead of the actual project they relate to, and were commingled

with the reconstruction project information. For example, we tested 20 capital project claims totaling \$1,218,427 that were paid from July 1, 2012 through February 11, 2014 and found that 14 of those claims, which totaled \$432,824, were not recorded in the proper project code. Therefore, the monthly capital fund budget to actual reports provided to the Superintendent and Business Manager from this accounting system were incomplete and inaccurate and did not provide an accurate financial picture of the reconstruction project.

In addition, both the CM and the FEMA consultant maintain their own separate project management and accounting system to track project costs. As of the end of fieldwork, District officials have not established any method of reconciliation between the District's accounting system and these other systems to ensure the financial information generated is complete and accurate. Additionally, the various consultants' reporting systems were not complete because they were waiting until all of the bids were formally accepted before updating the budgeted numbers and reporting on actual expenditures. Therefore, the consultants' systems also do not provide an accurate financial picture of the project's revenues and expenditures.

Board members told us that they believed the verbal reports from the Superintendent were keeping them well informed. However, when we explained that this practice failed to provide them with accurate reports detailing the project's financial activity, they agreed that receiving such reports would improve their knowledge and ability to monitor the project. Without timely, sufficient information showing the project's progress, no one can be sure that the project will be completed within the established cost limits and expected timelines.

The project's cost budget will not be finalized until after all construction bids are awarded. In addition, the final FEMA disaster fund award will not be certain until after FEMA has reviewed the final bid costs and determined their award estimates. Therefore, it is imperative that District officials closely monitor the project's proposed spending to actual performance, and ensure the project does not exceed the voter approved amount and that revenue sources are sufficient to cover final project costs. Even though District officials told us that cost overruns or significant deviations will be funded with increases in FEMA aid, they do not have absolute assurance from FEMA as to what the final amount of funds received will be at this time. Although the project has not had cost overruns as of the end of fieldwork, in the event that final project costs exceed the final award and other projected revenues, District officials will need to fund the shortfall.

**Recommendation**

1. The Board should closely monitor actual expenses to the proposed spending plan for the project's life to ensure it stays within the approved scope. To perform this monitoring, the Board should require that it be provided with complete and accurate financial reports relating to the project.

## Financial Condition

Effective financial management for a school district begins with the development of budget estimates for revenues and expenditures. A school district's financial condition is a factor in determining its ability to fund public educational services for students within the district. The Board and District officials are responsible for adopting annual budgets that contain realistic estimates of revenues, appropriations and use of fund balance. Estimates of expenditures (appropriations) should be based on known needs as well as historical trends. Similarly, revenue estimates should be based on known sources of revenue reflective of any identified trends. Fund balance is the surplus accumulated over time due to revenues exceeding expenditures. Fund balance can be used to finance operations and should not exceed 4 percent of the ensuing year's expenditures. Sound budgeting practices based on accurate estimates, coupled with prudent fund balance management, help ensure that sufficient funding will be available to sustain operations, address unexpected occurrences, and satisfy long-term obligations or future expenditures.

While revenue estimates were generally close to actual revenues received, the Board and District officials did not develop reasonable estimates for expenditures and use of fund balance in the annual District budget. For fiscal years 2008-09 through 2012-13, expenditures were consistently and significantly overestimated: the District spent nearly \$14.2 million (almost 7 percent) less than budgeted. The majority of this excess was related to employee health insurance (\$9.1 million) and instructional salaries (\$2.8 million). As indicated in Table 1, although the District budgeted to use approximately \$3.2 million on average of unexpended surplus funds<sup>4</sup> and reserves each year, or a total of more than \$16 million over the last five fiscal years, approximately \$1.68 million (11 percent) was actually used.<sup>5</sup> Furthermore, the District is

<sup>4</sup> The Governmental Accounting Standards Board (GASB) issued statement 54, which replaces the fund balance classifications of reserved and unreserved with new classifications: nonspendable, restricted and unrestricted (comprising committed, assigned and unassigned funds). The requirements of Statement 54 are effective for fiscal years ending June 30, 2011 and beyond. To ease comparability between fiscal years ending before and after the implementation of Statement 54, we will use the term "unexpended surplus funds" to refer to that portion of fund balance that was classified as unreserved, unappropriated (prior to Statement 54), and is now classified as unrestricted, minus appropriated fund balance, amounts reserved for insurance recovery and tax reduction, and encumbrances included in committed and assigned fund balance (post-Statement 54).

<sup>5</sup> Appropriated fund balance and reserves are only used in years in which a deficit occurs. The entire amount of the deficit is funded with a combination of restricted and unrestricted amounts depending on the District's balance in the respective accounts.

<sup>6</sup> The District's budget for 2013-14 planned the use of \$2,600,000 in appropriated

expected to end fiscal year 2013-14 with an operating deficit of \$3 million but had a budgeted deficit of almost \$3.5 million.<sup>6</sup> Therefore, the District will use slightly less than the amount appropriated.

	2008-09	2009-10	2010-11	2011-12	2012-13
Appropriated Fund Balance	\$2,400,000	\$2,400,000	\$3,850,000	\$2,600,000	\$2,600,000
Appropriated Reserves	\$337,207	\$310,000	\$0	\$661,255	\$932,559
<b>Total Amount Appropriated</b>	<b>\$2,737,207</b>	<b>\$2,710,000</b>	<b>\$3,850,000</b>	<b>\$3,261,255</b>	<b>\$3,532,559</b>
Operating Surplus/(Deficit)	\$691,020	\$629,922	(\$1,253,697)	(\$809,105)	(\$941,600)

District officials told us that they overestimated expenditures so that they would actually use only a portion of the budgeted appropriated fund balance. They did this to provide funds for cash flow purposes until they received real property taxes and State aid. District officials also discussed these deliberate overestimations during Board meetings and included this information on budget reports posted on the District's website.

Although the District's unappropriated fund balance was under the statutory 4 percent limit, the budgetary practice of appropriating fund balance that will not be used allowed the District's unexpended surplus fund balance<sup>7</sup> to increase to \$3.9 million at the end of the 2012-13 fiscal year, which equates to 9.2 percent of the ensuing year's expenditures.

	2008-09	2009-10	2010-11	2011-12	2012-13
<b>Total Unexpended Surplus Funds at Year End</b>	<b>\$1,620,656</b>	<b>\$1,361,232</b>	<b>\$1,628,321</b>	<b>\$1,565,217</b>	<b>\$1,314,100</b>
Ensuing Year's Budget	\$40,862,441	\$41,715,748	\$40,983,192	\$40,639,767	\$42,393,272
Reported Unexpended Surplus Funds as a Percentage of Ensuing Year's Budget	3.97%	3.26%	3.97%	3.85%	3.10%
Effective Unexpended Surplus Funds Resulting From Unused Appropriated Fund Balance	\$4,020,656	\$5,211,232	\$4,228,321	\$4,165,217	\$3,914,100
Effective Unexpended Surplus Funds as a Percentage of Ensuing Year's Budget	9.84%	12.49%	10.32%	10.25%	9.23%

fund balance and close to \$900,000 in reserves.

<sup>7</sup> When including the amount of appropriated fund balance and reserves that was projected not to be used in the 2013-14 fiscal year.

Even though the amount of effective unexpended surplus funds is substantial, the District is facing certain unknowns and restrictions. For example, the District is facing considerable uncertainties on the final funding for the elementary school reconstruction project, along with the funding for remaining flood recovery projects. Therefore, the District may need to use moneys from the reserve funds and unexpended surplus funds if anticipated funding falls short. Moreover, in fiscal year 2013-14, the District transferred \$1.5 million from the capital reserve to help fund the capital project discussed previously, and total reserves have decreased by approximately \$1.7 million from fiscal years 2008-09 through 2012-13. If additional moneys are needed, District officials are limited in the amount of real property taxes they can raise if they do not obtain voter approval.<sup>8</sup>

Finally, in January 2014, the District was categorized as “susceptible to fiscal stress” in a report issued as part of the Comptroller’s Fiscal Stress Monitoring System (FSMS). Fiscal stress designations of FSMS are based solely upon year-end financial statements (ST-3) filed by the District. We reviewed the factors used to calculate the District’s score and classify the District in this category. We determined that the District’s score was impacted by an interfund loan of \$3.745 million made from the general fund to the capital fund, which resulted in a low cash balance. This interfund loan was paid back in the next fiscal year once FEMA funds were received, which increased the general fund’s cash balance. Had this anticipated FEMA funding been received in the same fiscal year, the District’s overall fiscal stress score would have been lower.

## **Recommendations**

2. The Board and District officials should develop and adopt budgets that include estimates for expenditures based on contractual and historical data.
3. The Board should discontinue the practice of adopting budgets with the appropriation of unexpended surplus funds that will not be used.
4. District officials should develop a formal plan to use surplus fund balance while continuing to closely monitoring their fund balance levels.

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<sup>8</sup> In 2011, the State Legislature enacted a law establishing a property tax levy limit, generally referred to as the property tax cap. Under this legislation, the property tax levied annually generally cannot increase more than 2 percent, or the rate of inflation, whichever is lower, with some exceptions. School districts may override the tax levy limit by presenting the voters a budget that requires a tax levy that exceeds the statutory limit. However, that budget must be approved by 60 percent of the votes cast.

## APPENDIX A

### CAPITAL PROJECT PROPOSED SPENDING PLAN<sup>9</sup> FOR OWEGO ELEMENTARY SCHOOL RECONSTRUCTION

Table 3: Capital Project Proposed Spending Plan	
Estimated Project Funding	
Disaster relief grants (FEMA and NYSOEM)	\$60,234,279
Bond proceeds (to be repaid with State building aid)	\$9,400,000
Insurance proceeds	\$1,135,509
Transfer from the District's capital reserve	\$1,600,000
<b>Total Estimated Project Funding</b>	<b>\$72,369,788</b>
Estimated Project Costs	
Site development	\$5,822,000
General construction	\$27,394,000
HVAC, plumbing and electrical	\$26,576,745
Architectural and engineering	\$4,324,344
Construction management	\$3,434,124
Furniture and equipment	\$3,100,000
Administrative, legal and other costs	\$1,718,575
<b>Total Estimated Project Costs</b>	<b>\$72,369,788</b>

<sup>9</sup> This spending plan is taken from projections made early on in the planning phase for the capital project.

## **APPENDIX B**

### **RESPONSE FROM DISTRICT OFFICIALS**

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



# Owego Apalachin Central School District

5 Sheldon Guile Boulevard – Owego, New York 13827

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Board of Education  
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July 23, 2014

Office of the State Comptroller  
Binghamton Regional Office  
State Office Building, Suite 1702  
44 Hawley Street  
Binghamton, NY 13901

This correspondence is the official response from the Owego Apalachin Central School District Board of Education to the draft "Capital Project and Financial Condition – Report of Examination – July 1, 2012 through December 16, 2013."

The two areas encompassed in this audit - the District's capital project to rebuild Owego Elementary School after the disastrous flood of September, 2011, and the District's overall financial condition – have been at the heart of the Board's work for the past several years. Both areas have presented immense challenges to the Board and the District, and we have looked forward to an independent audit of our work and our results.

**Capital Project** - In approaching the capital project, the OSC auditor discussed that neither she nor her office had ever audited a FEMA-funded project, and looked forward to learning from our project. In our estimation, that inexperience led to considerable misunderstanding about the processes the District uses for managing the project. In particular, the auditor was dissatisfied with the fact that the District must keep financial records for two very different purposes: one, to prepare for the auditors from FEMA and the NYS Office of Emergency Management, along with the eventual audit from the U.S. Office of the Inspector General (OIG); and two, records appropriate for District management and accounting and submissions to the NY State Education Department for purposes of obtaining building aid.

See  
Note 1  
Page 19

See  
Note 2  
Page 19

The audit concludes that "no one was preparing detailed financial reports to monitor the project's progress against the plan developed by the Board and District administration," and that "no one was accounting for the project's resources in total." In fact, given that FEMA and the NYS Office of Emergency Management (NYSOEM) will be funding nearly 90% of the project, our efforts have focused primarily on the records necessary to obtain full reimbursement of our expenditures on the project, and to respond to the significant auditing we anticipate from those agencies in the future, plus a final audit from the OIG. If our record-keeping and accounting is not thorough and complete, we will not be reimbursed by FEMA/NYSOEM and our funding will be at risk from their audit process. Our consultant is an expert in the record-keeping necessary *for those purposes* and will continue to provide detailed financial reports as needed throughout the project as has been the practice from the inception of the project. To date, all of our records submitted to FEMA/NYSOEM have been complete and as a result all of our reimbursements have been forthcoming in a timely fashion.

See  
Note 3  
Page 19

The audit report reads as if no one is “minding the store” and that the project is proceeding without oversight. Nothing could be further from the truth. We would agree that detailed financial reports, *in the form the auditor would have liked to see them*, have not been routinely developed and presented to the Board of Education. However, to suggest that there is no fiscal oversight is deeply misleading.

The accounting that is typical for other district business and a typical capital project has not yet been reconciled with this FEMA-related accounting. That reconciliation is a complicated work in progress, but it has not been our main priority because of the absolute necessity of responding to FEMA, given the preponderance of FEMA/NYSOEM funding for this project.

The audit report asserts that our record-keeping systems are incomplete because all the bids for the project were not received and awarded at the time of the audit, and that “therefore . . . [we] do not [have] an accurate financial picture of the project’s revenues and expenditures.” Here again, an unfamiliarity with a FEMA/NYSOEM-funded project led to some substantial misunderstanding. Our commitment from FEMA/NYSOEM is to fund the project based on the actual costs, as represented by the awarded bids. FEMA assures us that they will revise their funding obligation to match the bid awards, *once they are known in their entirety*. In the meantime, they have obligated approximately half the total amount so that we could begin construction without further delay. As of this writing, we have received a verbal commitment for the remainder of the funds, and expect a formal written funding obligation from FEMA/NYSOEM in the very near future.

But without that final written commitment from FEMA/NYSOEM, it is impossible to develop a budget and a fully complete and “accurate financial picture of the project’s revenues and expenditures.” To be sure, we have detailed estimates of the likely costs, but our first round of bidding came in at substantial variance to the estimates. As the project proceeds, and all bids are in, the budget becomes more robust and complete.

This project is fundamentally different from a typical project, where you develop a budget and then live within it. In this project, FEMA/NYSOEM first agree to the scope of work, based on a review of the proposed design, and then proceed to reimburse the District for actual costs incurred, including change orders and cost overruns. Thus the budget can’t be known until all the bids are in. And then, during the FEMA audit process, costs previously reimbursed can be challenged and disallowed. Final funding is not provided until after closeout and a final FEMA audit. Finally, given the size of the project, the whole of the project will be scrutinized by the U.S. Inspector General.

We are confident that our project team is working diligently to mitigate any risks associated with funding and FEMA/OIG audits. The audit report seems to imply that, *because this project doesn’t fit neatly into the mold of typical capital projects*, it must not be adequately managed with proper oversight. The District contends that this is a seriously unfair characterization.

See  
Note 4  
Page 19

It has been nearly three years since the elementary school, and three other buildings in the District, were destroyed by the flooding of September 2011. During that period of extreme distress, we have marshalled every resource at our disposal to help our District recover to its pre-disaster condition. We are finally making excellent progress, but our school children and teachers will still be displaced from their school for another full year. In a perfect world, we might have designed other, more complete, accounting systems to track our recovery. As part of our corrective action plan going forward, we will work to improve upon and integrate the many systems we already have in place.

See  
Note 5  
Page 19

**Financial Condition** – The audit report takes issue with the District’s long-standing approach to using appropriated fund balance to manage cash flow. A school district’s fiscal year begins on July 1, as do its

new year's expenditures. Receipt of revenues, however, is delayed until September and October, when local property tax collection occurs and the first installment of state aid is received. This situation creates an issue with cash flow, *i.e.*, the District has necessary expenditures, but has no offsetting revenue coming in.

In this District, and in many other districts, the long-standing solution to this problem has been to use an appropriated fund balance as revenue to provide the necessary cash flow. The auditor notes that this process has been completely open and transparent. We identify approximately \$2.4 million in appropriated fund balance as revenue for the coming year, and then put an equivalent amount in the expense side of the budget (typically in the health insurance line) and make it clear that we will not spend that amount. We use these funds to manage cash flow during the initial part of the fiscal year, replacing them with other ordinary sources of revenue as it is received. At the end of the year, we again appropriate the unexpended funds for the same purpose the following year. A local taxpayer at a budget hearing where this was explained made the analogy that "it's like you're maintaining a balance in your checking account."

See  
Note 6  
Page 19

For the past several years, we have planned to reduce the amount of our "rolling" appropriated fund balance. Severe contractions in our state aid have slowed that plan somewhat, but for the 2013-14 and 2014-15 school years, we have steadily reduced the amount used in this fashion. Our goal is to reduce it to \$1.5 million, which we believe is an ample amount for this purpose.

The audit report chides us for this practice, and seriously misrepresents what has occurred. It states that we cumulatively overestimated our expenditures by \$14.2 million. In fact, after the district initially accumulated this fund balance many years ago, the same amount is used in the budget each year. **It does not accumulate.** In fact, during the period of the audit, our total reserves and fund balance have been drawn down by nearly \$7.5 million.

See  
Note 7  
Page 19

Every year, our district undergoes a thorough audit by an independent, external accounting firm. The result is always exemplary and this practice has never been flagged. Our bond ratings from Moody's and from Standard and Poor's are always very high, and they too do a thorough examination of our financial condition. We are not aware of any law or regulation that characterizes this action as an illegal practice. The auditor suggests that we could issue Revenue Anticipation Notes to handle the cash flow issues. While this is correct, it would cause the District to incur unnecessary debt and those additional borrowing costs would be borne by our taxpayers.

See  
Note 8  
Page 20

Each year, during our budget development process, the Board and Superintendent have extensive discussion about whether to continue this practice and how much to appropriate. In light of this audit report's critique, we will more critically assess the viability and appropriateness of this strategy during our next budget cycle.

Sincerely,

David Barton, President  
Board of Education

## APPENDIX C

### OSC COMMENTS ON THE DISTRICT'S RESPONSE

#### Note 1

Our audit focused on the planning and monitoring of the capital project, not the fact that the project was being largely funded by FEMA.

#### Note 2

Our audit concern is that the District's financial reporting system is not being used to properly account for capital project activity by project. The FEMA and NYS Office of Emergency Management records are merely subsidiary records that support what costs have been billed to these agencies. They do not constitute a reliable and complete record of all capital fund transactions.

#### Note 3

As of the conclusion of our fieldwork, the Board was not receiving any financial reports detailing the project's status.

#### Note 4

The audit does not question the management of the project, but rather the lack of financial reporting to assist in monitoring its progress.

#### Note 5

The District has an existing accounting system in place that could track the recovery. However, it was not being utilized to its fullest capabilities.

#### Note 6

We understand that the first two months of the fiscal year may include a substantial amount of the expenditures relating to materials and supplies and that the major expenditures for personal service costs are not incurred until the school year begins. The total expenditures for materials and supplies peaked at nearly \$1 million in fiscal year ended 2012. Total effective unreserved fund balance of \$4.2 million was more than four times that amount as of the end of the prior year.

#### Note 7

Our report shows that the District spent \$14.2 million less than the budgets presented to the voters during fiscal years ended 2009 through 2013. The District's budgets for fiscal years 2010 through 2013 included increases in the real property tax levy to finance these planned expenditures. These increases were not necessary.

Note 8

The independent, external auditors report on whether the District's presentation of its financial statements is fair and reasonable. Unless specifically engaged otherwise, their audit scope does not include an evaluation of the budgetary practice that would impact the taxpayers.

## APPENDIX D

### AUDIT METHODOLOGY AND STANDARDS

To accomplish our objectives, we interviewed appropriate District officials and consultants. We tested selected records and examined historical documents for the period July 1, 2012 through December 16, 2013. We extended our scope back to the 2008-09 fiscal year and projected forward through June 30, 2014 to analyze budgeting practices, fund balance trends and reserve account balances. Because construction on the capital project was just beginning, we extended our scope for reviewing construction claims to February 11, 2014. Our examination included the following:

- We interviewed District officials to gain an understanding of the budgeting process for the annual District budget, including their processes for monitoring and developing the budget and their procedures for monitoring capital projects.
- We reviewed pertinent documents available, including SED capital project filings, Board minutes, change orders, claims, bid awards and specifications contracts, FEMA grant award, and Board construction reports to gain an understanding of the project scope and planning.
- We evaluated the capital project projected spending plan by comparing the cost estimates to the actual bid awards and contracts and by comparing revenue estimates to available grant awards, insurance proceeds received, and voter authorized debt and reserve fund utilization.
- We evaluated the cash flow projection prepared for the capital project for reasonableness.
- We examined the request for proposal process used to obtain professional services for capital projects to determine if a qualified vendor was selected. We selected claims paid to the three main capital project consultants in February 2014, and compared the amount billed to the approved contract to determine if the amount paid was appropriate and in compliance with the agreement.
- We tested selected bid awards for compliance with competitive bidding requirements.
- We selected a random sample of 20 capital project claims totaling approximately \$1,218,000 to determine if the claims were properly authorized, supported and posted to the correct project code in the accounting system.
- We compared the adopted budgeted revenues in the annual District budget to actual revenues for the general fund for fiscal years 2008-09 through 2012-13 to determine if budget estimates were reasonable.
- We compared the adopted budgeted appropriations by functional area in the annual District budget to actual expenditures for the general fund for fiscal years 2008-09 through 2012-13 to determine if budget estimates were reasonable. For those functional areas that accounted for at least 75 percent of overbudgeted variances, we examined the budget line items to determine which line items accounted for the majority of the overestimated variances.

- We calculated the general fund's results of operation by comparing actual revenues to actual expenditures for fiscal years 2008-09 through 2012-13 and compared the results to the amount of appropriated fund balance to determine the amount of fund balance used.
- We projected the operating results for fiscal year 2013-14 by reviewing tentative actual expenditures through June 30, 2014.
- We reviewed and analyzed changes in reserve fund balances for fiscal years 2008-09 through 2012-13 and compared the amount of reserves used to the amounts appropriated.
- We reviewed the District's fiscal stress indicator calculation as of June 30, 2013 and recalculated the score after adjusting for the effect on cash for disaster grants receivables outstanding at year end.

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 E

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