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

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

Respectfully submitted,

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

The Schenectady City School District (District) is located in the City of Schenectady in Schenectady 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 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 Director of Business and Finance is the budget officer and is responsible for preparing the budget with the assistance of other District staff.

The District operates 19 schools with approximately 9,600 students and 1,700 employees. The District’s budgeted appropriations for the 2013-14 fiscal year were $159 million, which were funded primarily with State aid and real property taxes.

Fiscal stress is a judgment about the financial condition of an individual entity that must take into consideration the entity’s unique circumstances, but can be generally defined as a school district’s inability to generate sufficient revenues within a fiscal year to meet expenditures. The Office of the State Comptroller’s Fiscal Stress Monitoring System evaluates school districts, based on both financial and environmental indicators, to determine if school districts are in or nearing fiscal stress. The District has been classified as being in significant fiscal stress.

Objective

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

- Does the Board adopt realistic budgets that are structurally balanced and take appropriate actions to maintain the District’s fiscal stability?

Scope and Methodology

We examined the District’s financial records for the period July 1, 2011 through March 13, 2014.

We conducted our audit in accordance with generally accepted government auditing standards (GAGAS). More information on such standards and the methodology used in performing this audit is included in Appendix B of this report.
The results of our audit and recommendations have been discussed with District officials and their comments, which appear in Appendix A, have been considered in preparing this report. District officials generally agreed with our recommendations and indicated they planned to initiate corrective action.

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

Financial condition may be defined as a school district’s ability to balance recurring expenditure needs with recurring revenue sources, while providing desired educational services on a continuing basis. A school district in good financial condition can consistently generate sufficient revenues to finance anticipated expenditures and maintain sufficient cash flow to pay bills and other obligations when due without relying on short-term borrowing. Conversely, a school district in fiscal stress usually struggles to balance its budget, has limited resources to finance future needs and minimal cash available to pay current liabilities as they become due.

The Board and District officials are responsible for the financial planning and management necessary to maintain the District’s fiscal health. As such, an essential component of the Board’s and District officials’ duties and responsibilities is to make sound financial decisions to fund operations that are in the District’s and taxpayers’ best interests. This responsibility requires Board members and District officials to balance the level of educational services desired and expected from District residents with the ability and willingness of the residents to pay for such services. To maintain good fiscal health, it is essential that the Board adopt realistic and structurally balanced budgets, manage both fund balance and cash balance levels and identify and adjust to long-term challenges.

The Board-adopted 2011-12 through 2013-14 general fund budgets were not structurally balanced, because the Board routinely relied on significant amounts of appropriated fund balance to finance operations. The Board also did not adopt a policy establishing the level of unrestricted fund balance that should be maintained to prepare for any unanticipated expenditures or revenue shortfalls. As a result, for the 2011-12 and 2012-13 fiscal years, the general fund incurred operating deficits totaling more than $5.6 million and unrestricted fund balance declined by about 73 percent. In addition, the general fund’s cash level was deficient, resulting in District officials not having sufficient cash to pay District bills and other obligations when due. As a result, District officials annually issued short-term debt to finance operations in the form of a revenue anticipation notes (RANs), which are a temporary source of cash borrowing in anticipation of the pending collection or receipt of certain specific revenues other than real property taxes.

The District’s financial condition will likely decline further in the future if the Board continues to adopt budgets that are not structurally
balanced. Further, if actual revenues and expenditures for the 2013-14 fiscal year mirror the budget, the District will reduce the remaining fund balance to approximately $1.5 million as of June 30, 2014. If these trends continue, the District will incur fiscal instability that will negatively affect future District operations.

One of the key measures of a school district’s financial condition is its fund balance, which is the difference between revenues and expenditures accumulated over time. It is District officials’ responsibility to ensure that the level of fund balance maintained is sufficient to provide adequate cash flow, but not so excessive as to withhold funds that could be put to productive use. A continual decline in unrestricted fund balance indicates a deteriorating financial condition. To help District officials manage financial operations and ensure continued orderly school district operation, the Board should adopt a policy establishing an acceptable level of unrestricted fund balance\(^1\) to be maintained. When District officials follow such a policy during the annual budgeting process, the District is better prepared for unanticipated expenditures or revenues shortfalls.

While fund balance can be appropriated in the budget to help finance operations, consistently doing so – instead of planning to use recurring revenue sources – can deplete fund balance to levels that are not sufficient for unanticipated contingencies and current cash flow needs. A school district is considered to have a sound cash position when it routinely has sufficient cash to pay its bills and other obligations when due, without needing to rely on short-term borrowing. At a minimum, the district should have enough available cash to pay its bills, meet payroll and pay any other required disbursements for a 30- to 60-day period. When a fund does not have sufficient cash to meet its current obligations, school district officials are often forced to explore alternatives such as short-term borrowing.

Declining Fund Balance – The District’s total general fund balance decreased by more than $9 million or approximately 49 percent over the last two fiscal years, from more than $18.8 million at the start of the 2011-12 fiscal year to about $9.7 million at the end of the 2012-13 fiscal year. More importantly, unrestricted fund balance decreased by more than $4 million or approximately 73 percent over the last two fiscal years, from $5.68 million at the start of the 2011-12 fiscal year to about $1.51 million at the end of the 2012-13 fiscal year, which was nearly 1 percent of the 2013-14 general fund adopted appropriations. The substantial decline in fund balance was primarily the result of the Board appropriating significant amounts of fund balance as a

\(^{1}\) New York State Real Property Tax Law currently limits unrestricted fund balance to no more than 4 percent of the ensuing fiscal year’s budget.
financing source to support operations during the 2011-12 through 2013-14 fiscal years and a $3.5 million prior period adjustment.2

<table>
<thead>
<tr>
<th>Table 1: General Fund - Fund Balance</th>
<th>2011-12</th>
<th>2012-13</th>
</tr>
</thead>
<tbody>
<tr>
<td>Beginning Fund Balance</td>
<td>$18,806,665</td>
<td>$11,311,155</td>
</tr>
<tr>
<td>Operating Surplus/(Deficit)</td>
<td>($3,992,963)</td>
<td>($1,630,375)</td>
</tr>
<tr>
<td>Ending Fund Balance</td>
<td>$14,813,702</td>
<td>$9,680,780</td>
</tr>
<tr>
<td>Less: Restricted Fund Balance</td>
<td>$5,983,132</td>
<td>$5,786,424</td>
</tr>
<tr>
<td>Less: Assigned, Unappropriated Fund Balance</td>
<td>$294,169</td>
<td>$235,954</td>
</tr>
<tr>
<td>Less: Assigned, Appropriated Fund Balance</td>
<td>$3,175,000</td>
<td>$2,144,000</td>
</tr>
<tr>
<td>Unrestricted Fund Balance at Year-End</td>
<td>$5,361,401</td>
<td>$1,514,402</td>
</tr>
</tbody>
</table>

2 The prior period adjustment was made pursuant to the District’s external auditor finding that the District improperly recognized uncollected real property taxes enforced by the City of Schenectady as revenue in 2011-12, even though it was not expected to be collected within the first 120 days of the next fiscal year. This additional revenue shortfall occurred because of a change in when the City pays the District for uncollected taxes.

For the 2011-12 and 2012-13 fiscal years, the Board adopted general fund budgets that resulted in no significant budget variances between the total amounts budgeted and actual revenues and expenditures. However, the Board budgeted for planned operating deficits3 in each of these fiscal years by appropriating fund balance to help finance the 2011-12 and 2012-13 budgets. The amount of combined fund balance appropriated to fund operations for the 2011-12 through 2012-13 fiscal years totaled more than $9.325 million. As a result, the District experienced combined operating deficits totaling more than $9 million in the 2011-12 and 2012-13 fiscal years, which resulted in the decline in total unrestricted fund balance.

Additionally, the Board’s failure to adopt a fund balance policy that establishes the level of unrestricted fund balance to be maintained and over-relying on appropriated fund balance as a financing source from 2011-12 through 2012-13 contributed to the significant decrease in unrestricted fund balance. The depletion of unrestricted fund balance resulted in constraints on the District’s financial flexibility.

RANs – While short-term borrowing such as RANs may be used to alleviate temporary cash flow shortages, RANs should not be routinely relied upon to finance District operations. Additionally, unless a budgetary provision has been made to redeem the RANs, when the amount outstanding equals the amount of revenue yet to be collected, the remaining revenues collected must be set aside in a special bank account and dedicated to pay the RAN principal.

3 A planned operating deficit occurs when the Board adopts a budget in which estimated revenues are less than budget appropriations, with the difference to be funded with appropriated fund balance and/or reserves.
The District issued RANs for $19 million during both 2011-12 and 2012-13 and $15 million in 2013-14 to alleviate cash flow problems. Each fiscal year, subsequent RANs were reissued to pay off (redeem) the existing RANs at maturity. For example, the $19 million RAN issued in January 2013 and due to mature in January 2014 was partially redeemed with proceeds from the $15 million RAN issued in January 2014. As a result, the District incurred debt related expenditures for issuance fees and interest totaling more than $824,000 over the past three completed fiscal years ($339,569 in 2011-12, $290,500 in 2012-13 and $194,400 in 2013-14). Had District officials not issued RANs each year, the District would not have had sufficient cash to pay its bills and obligations, when due. For example, our review of District-prepared cash flow statements disclosed that, if RANs had not been issued, the general fund would have incurred cash deficits of $9.5 million as of February 28, 2013 and $4.1 million as of February 28, 2014.

While District officials decreased the total amount of RANs issued in 2013-14, there were not sufficient funding resources to include a budgetary provision to redeem the notes. Additionally, money was not set aside in a special bank account to pay the RANs’ principal. As a result, the District continued to issue successive RANs each year to pay off the existing RANs because insufficient cash was available to repay the notes’ principal. If District officials do not take action to improve the District’s cash-flow situation, its cash position could deteriorate further, resulting in continued cash-flow shortages and a likely reliance on increasing levels of short-term debt to finance operations.

2013-14 Budget – We reviewed the District’s adopted 2013-14 general fund budget, totaling about $159.3 million, to determine whether budget estimates were reasonable based on historical data, supporting source documentation and the actual results of operations through the end of our audit period, as well as whether the budget was structurally balanced. We found that the estimated revenues and budget appropriations overall were reasonable. However, the 2013-14 budget was not structurally balanced, because the Board again appropriated fund balance and reserves, totaling more than $2.1 million as a financing source to support operations. As a result, the District continued the budgetary practice of relying on fund balance as a means to finance recurring expenditures.

If actual revenues and expenditures for the 2013-14 fiscal year mirror the amounts budgeted, District officials will use all $2.1 million of appropriated fund balance and the District will have approximately $1.5 million of unrestricted fund balance remaining as of June 30, 2014. As a result, unlike in previous years, District officials had a minimal amount of fund balance to use as a financing source in the 2014-15 budget. The

\[4\] RANs were issued annually each January to alleviate cash flow problems until State aid was received in March.
Board therefore needed to find other revenue sources and increase the amount of real property taxes levied to maintain the District’s current level of services. Additionally in 2014-15, District officials eliminated about 56 full-time positions and realigned some programs.

2014-15 Budget – The District’s 2014-15 budget contains budget appropriations totaling about $164.3 million, which is $5 million more than the 2013-14 budget. District officials increased budget appropriations primarily because of increased costs for employee salaries and benefits. However, unlike in previous years, the District did not use fund balance as a funding source. District officials are funding this spending increase with approximately $5.6 million of additional State aid revenue and a 2.75 percent\(^5\) real property tax increase, which did not exceed the District’s tax levy limit.\(^6\)

We reviewed the 2014-15 general fund budget prior to voter approval to determine whether budget estimates were reasonable and supported. We analyzed the budget to identify significant revenues and appropriations. We also reviewed historic trends and other relevant information to determine whether these amounts were realistic. Based on information provided by District officials, we found that the District’s significant revenue estimates and appropriations appeared reasonable. However, District officials will need to closely monitor actual revenues and expenditures throughout the 2014-15 fiscal year to ensure that an operating deficit is not realized.

**Recommendations**

1. The Board should develop and adopt a fund balance policy establishing the amount of general fund unrestricted fund balance to be maintained within the legal limit.

2. The Board and District officials should develop a plan for the repayment of the RANs and for the long-term management of its cash flow requirements.

3. The Board should continue to adopt general fund budgets that include realistic estimates for revenues and expenditures and should ensure that future budgets are structurally balanced without relying on fund balance as a financing source.

\(^5\) The 2014-15 budget contained a real property tax levy of about $54.2 million, an increase of $1.3 million from 2013-14.

\(^6\) 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. Districts may override the tax levy limit by presenting to the voters a budget that requires a tax levy that exceeds the statutory limit. However, that budget must be approved by a 60 percent of the votes cast.
APPENDIX A

RESPONSE FROM DISTRICT OFFICIALS

The District officials’ response to this audit can be found on the following page.
August 21, 2014

Office of the State Comptroller
Division of Local Government & School Accountability
One Broad Street Plaza
Glens Falls, New York 12801


Dear [Name of recipient]:

Please accept this as the District’s response to the above referenced audit.

Recommendation 1
The District’s management is in agreement with the recommendation that the Board of Education should develop and adopt a fund balance policy. The District had reconvened its Finance Committee this past Spring and one purpose of the committee was to develop and make recommendations to the Board of Education concerning financial guidelines, including but not limited to, a fund balance policy. The expectation is for the committee, in conjunction with the District’s policy committee, to present a policy for the Board to act upon, no later than December 31, 2014.

Recommendation 2
The District’s management is in agreement that a plan needs to be developed to alleviate the District’s need to issue a Revenue Anticipation Note annually due to its cash flow requirements. The District’s management has already taken steps to reduce the amount of the borrowing and will continue its efforts towards this goal.

Recommendation 3
The District’s management is in agreement that the Board should continue to adopt general fund budgets that include realistic estimates for revenues and expenditures and further to ensure that future budgets are structurally balanced without relying on fund balance as a financing source. As noted, the 2014-15 budget did not include any fund balance appropriation. In addition, the District ended the 2013-14 budget with an unreserved, unrestricted fund balance of over four million dollars. The district had an operating surplus and did not need to use any of the $2.14 million fund balance.

Respectfully submitted,

Laurence T. Spring
Superintendent
APPENDIX B

AUDIT METHODOLOGY AND STANDARDS

Our overall goal was to assess the District’s financial condition and identify areas where the District could realize efficiencies and protect assets from loss or misuse. To accomplish this, our initial assessment included a comprehensive review of the District’s financial condition.

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

- We interviewed the Board President and other District officials to gain an understanding of the District’s financial management policies and procedures. This included inquiries about the District’s budgeting practices and the development of plans to maintain the District’s fiscal stability.

- We analyzed the District’s financial records for the general fund for fiscal years 2011-12 and 2012-13 to determine if the general fund’s financial condition declined. We also evaluated any factors contributing to the decline.

- We compared the adopted budgets for the general fund for fiscal years 2011-12 and 2012-13 with the actual results of operations to determine if the budgets were realistic and structurally balanced.

- We reviewed the District’s financial records for the period July 1, 2010 through March 13, 2014, and interviewed District officials to determine the type and amount of short-term debt that was issued and the reason the short-term debt was issued.

- We reviewed the adopted general fund budget for the 2013-14 fiscal year to determine whether the budgeted revenues and appropriations were reasonable based on historical data, supporting source documentation. We analyzed the actual results of operations through the end of our audit period to determine whether the budget was structurally balanced.

- We reviewed the proposed general fund budget for the 2014-15 fiscal year to determine whether the budgeted revenues and appropriations were reasonable based on historical data, supporting source documentation. We analyzed the actual results of operations through the end of our audit period to determine whether the budget was structurally balanced.

We conducted this performance audit in accordance with GAGAS. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.
APPENDIX C

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DIVISION OF LOCAL GOVERNMENT
AND SCHOOL ACCOUNTABILITY

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