Office of the New York State Comptroller

Division of Local Government
& School Accountability

Charlotte Valley Central School District

Financial Condition

Report of Examination

Period Covered:

July 1, 2011 — May 14, 2013

2013M-232

Thomas P. DiNapoli

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State of New York
Office of the State Comptroller

Division of Local Government
and School Accountability

December 2013

Dear 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 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 operations and Board of Education governance. Audits also can identify strategies to reduce costs and to strengthen controls intended to safeguard district assets.

Following is a report of our audit of the Charlotte Valley Central 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

Introduction

Background

The Charlotte Valley Central School District (District) is located in seven towns within Delaware, Otsego and Schoharie Counties. The District is governed by the Board of Education (Board) which comprises five elected members. The Board is responsible for the general management and control of the District's financial and educational affairs including budget development. They are also responsible for monitoring and controlling the budget throughout the year. The Superintendent of Schools (Superintendent) is the chief executive officer of the District and is responsible, along with other administrative staff, for the day-to-day management of the District under the direction of the Board. Responsibilities relating to the District's finances and accounting records and reports are largely those of the Business Office, which consists of the Treasurer and the Business Manager (who is also the Deputy Treasurer). The Board president is the Chief Financial Officer.

The District has one school in operation with approximately 390 students and 85 staff. The District's general fund budgeted expenditures for the 2012-13 fiscal year were approximately $8.6 million, which were funded primarily with State aid, real property taxes and grants.

Objective

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

- Did District officials effectively manage District finances?

Scope and Methodology

We examined the financial records of the District for the period July 1, 2011 through May 14, 2013. We extended our scope to include the fiscal years ending 2007-08 to 2011 to determine the District's financial trends. We also reviewed the tax rates, levies and assessments for the same period.

We conducted our audit in accordance with generally accepted government auditing standards (GAGAS). More information on such standards and the methodology used in performing this audit are included in Appendix C of this report.

Comments of District Officials and Corrective Action

The results of our audit and recommendations have been discussed with District officials and their comments, which appear in Appendix A, have been considered in preparing this report. District officials disagreed with the findings and recommendations in our report. Appendix B includes our comment on the issues raised in the District's response letter.

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

Effective financial management for a school district begins with the development of budget estimates for revenues and expenditures. Estimates of expenditures (i.e., 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. The surplus accumulated over time by District operations (i.e., fund balance) due to revenues exceeding expenditures, can also be used to finance operations. However, school districts are required to use any available fund balance above 4 percent to reduce the ensuing year's tax levy. School districts may also establish various legal reserves wherein surplus money may be transferred to finance certain future expenditures (as defined by each reserve). In addition, the Board can assign the Superintendent the responsibility for monitoring actual District operations in comparison to the adopted budget following up on variances, and reporting such findings to the Board. The Board can then further assign to the Superintendent the authority to either amend the budget, within limits, or modify operations accordingly.

District officials believed they were effectively managing the District's finances. However, the Superintendent and the Board did not develop reasonable budget estimates. For fiscal years ending 2007-08 through 2011-12, the Board adopted budgets that over-estimated expenditures by over $2 million, with over-estimating the students with disabilities account comprising almost 68 percent of that variance. The District's revenue estimates were under-estimated by nearly $723,000 for the same time period. These estimates ranged from as little as $9,000 in 2010-11 to $269,000 in 2011-12.

Table 1: Budget to Actual Revenues and Expenditures in the General Fund

	2007-08	2008-09	2009-10	2010-11	2011-12	Total
Appropriations	$7,366,612	$7,713,968	$7,982,878	$8,371,676	$8,394,181	$39,829,315
Actual Expenditures	$7,439,393	$7,019,783	$7,265,144	$8,056,483	$8,044,346	$37,825,149
Variance	($72,781)	$694,185	$717,734	$315,193	$349,835	$2,004,166
Estimated Revenues	$7,241,612	$7,513,968	$7,532,878	$7,881,676	$7,662,181	$37,832,315
Actual Revenues	$7,293,485	$7,671,360	$7,768,578	$7,890,936	$7,930,892	$38,555,251
Variance	($51,873)	($157,392)	($235,700)	($9,260)	($268,711)	($722,936)
Results of Operations	($145,908)	$651,577	$503,434	($165,547)	($113,454)	$730,102

The Board's adopted budgets also included appropriating fund balance totaling more than $2 million during the 2007-08 to 2011-12 fiscal years. However, only $420,000 of this fund balance was actually needed due to the operating surpluses in 2008-09 and 2009-10 (totaling $1,155,011). This resulted in the unexpended surplus fund balance[1] to be more than the 4 percent statutory limit, at 10.61 percent in 2007-08, 5.11 percent in 2008-09, 12.04 percent in 2009-10 and 4.05 percent in 2011-12. However, for the 2010-11 year, the fund balance was under the threshold at 3.95 percent.[2]

To reduce the unexpended surplus fund balance and bring it closer to the 4 percent limit, District officials made unplanned transfers to the District's reserves. For fiscal years ending 2007-08 through 2011-12, the accounts were overfunded. At the end of fiscal year 2011-12, five reserves had increased by more than $800,000, totaling approximately $1.6 million.[3] At fiscal year ending 2011-12, the balances in the tax certiorari, unemployment insurance and compensated absences reserves appeared to be unreasonable for their intended purposes.

- The tax certiorari reserve had a reported balance of $532,704. However, District officials did not have any support for anticipated claims from property owners. This balance is around 20 percent of the real property tax levy average for the last five years.

- The retirement contribution reserve has a balance of $579,260 which, based on actual average expenses for the past five years of $85,978, would allow the District to cover future expenses for almost seven years without any need for additional funding.

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[1] 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, less any amounts appropriated for the ensuing year's budget (after Statement 54).

[2] After our fieldwork was completed, the District filed its 2012-13 annual report with our office. These numbers show the District was under the threshold at 3.90 percent for the 2012-13 year.

[3] The 2012-13 annual report numbers show a decrease in total reserves by more than $300,000. However, we did not perform any audit work in relation to this decrease.

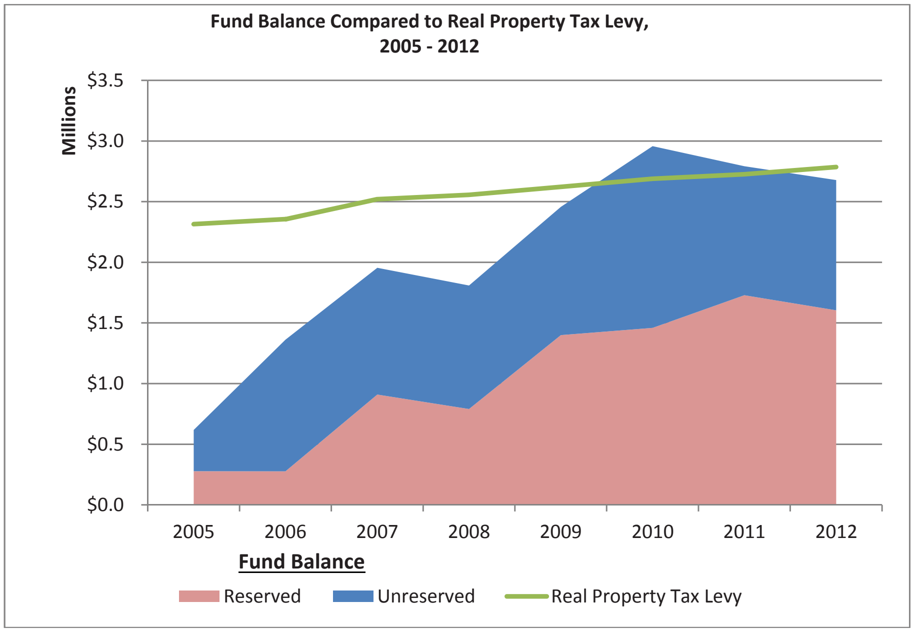
- The unemployment insurance reserve has a balance of $201,577 which, based on actual average expenses for the past five years of $17,107, would allow the District to cover future expenses for almost 12 years without the need for additional funding.

Finally, the Board has given authority to the Superintendent to monitor the District's financial operations and to make budget transfers when deemed necessary. However the Board has not set any limitations to these transfers (as stated in the Superintendent's contract) and are only notified of these modifications after they are executed. Although the Board receives various financial reports that depict the financial condition of the District, this is subsequent to the changes, and essentially limits the effectiveness of any input that the Board may have.

The Superintendent and Business Manager believe that they are budgeting very conservatively by overestimating expenditures and appropriating more fund balance to finance those overestimations because of the potentially unpredictable nature of educating students with special needs as well as fluctuations in State aid. The Superintendent exampled the significant financial impact that one family with five special-needs children had on a neighboring district when that district had not been prepared for such an increase in expenditures. Because this happened so close to his District, he believes there is a chance it could happen to them and he wants to be prepared to take care of those students to the best of their ability. Further, according to the annual financial reports for districts located in the adjacent four counties, 10 school districts reported an increase in total special education expenditures that exceeded 40 percent from the respective prior year between 1997 and 2012. The highest annual change of those districts was $400,000; just less than 15 percent of Charlotte Valley's total reserves and fund balance available as of the fiscal year ended 2012. Additionally, State aid estimates are made available well in advance of a district needing to adopt a budget.

Regarding the reserve balances, the Business Manager told us that the District's attorney suggested they keep approximately 5 percent of the current and previous three years' tax levy in the tax certiorari reserve for a rolling four-year period in anticipation for any tax certiorari proceedings. Therefore, based on this calculation, the June 30, 2012 balance of $532,704 includes approximately 5 percent from fiscal years ending 2009 through 2012.

The retirement contribution and unemployment insurance reserves are also overfunded. Although real property tax levies only increased by minimal amounts over a five-year period, it may have been unnecessary to have raised them at all considering the significant increases in total fund balance funded by surpluses generated by District operations:



Based on audited financial information reported by the District, during the 2012-13 fiscal year, the District had budgeted the use of $710,000 in fund balance, but only needed to use a little more than $400,000. Therefore, appropriating more fund balance than needed continued to occur during the 2012-2013 fiscal year as well. The budget for the 2013-14 fiscal year also included appropriated fund balance of $632,000, and based on past trends, the full amount may not be needed.

The unnecessary reservation of funds and appropriation of fund balance that is not needed causes available fund balance to be artificially lower. As a result, the Board and District officials have withheld significant funds from productive use (e.g., establishing a capital reserve to plan for future projects) and have not adequately reflected the financial condition of the District to the taxpayers.

Recommendations

1. The Board should adopt realistic budgets that are consistent with the District's actual revenues and expenditures.

2. Per New York Codes, Rules and Regulations (NYCRR), the Board should set limitations on the amount of transfers the Superintendent can make without prior approval.

3. The Board should review all reserve balances and determine if the amounts reserved are necessary, reasonable and in compliance with statutory requirements. To the extent that they are not, transfers should be made to unrestricted fund balance (where allowed by law) or other reserves established and maintained in compliance with statutory directives. If these transfers cause the unrestricted fund balance to exceed the statutory limit, then the Board should develop a plan to reduce the amount of fund balance in a manner that benefits District taxpayers.

APPENDIX A

RESPONSE FROM DISTRICT OFFICIALS

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

CHARLOTTE VALLEY CENTRAL SCHOOL

15611 State Highway 23 • Davenport, New York 13750

Phone (607) 278-5511 Fax (607) 278-5900

December 3, 2013

Mr. H. Todd Eames
Chief Examiner
State Office Building, Suite 1702
44 Hawley Street
Binghamton, NY 13901-4417

Dear Mr. Eames:

Please accept this letter as the official response from the Charlotte Valley Central School (CVCS) District regarding the "Draft Audit Report" covering the period from July 1, 2011 to May 14, 2013. We, the Board of Education (BOE), the business manager and myself, have thoroughly reviewed the report and the related findings and recommendations.

To begin, the Charlotte Valley Central School District strives to maintain a budget that works to serve both the best interests of:

- The District's taxpayers with respect to maximizing resources while minimizing costs and
- Our students, who must continuously acquire new skills to be competitive in a rapidly evolving, future economy.

Our District, and to a greater or lesser degree all districts statewide, are currently being forced to facilitate unprecedented change in instructional methodologies and teacher performance concurrent with experiencing similarly unprecedented fiscal stress. Though both of our respective organizations play a role in coping with the aforementioned issues, we fundamentally have different perspectives. School districts deal with the problems from the point of view of 20 feet and must anticipate possible actions. Your office deals with the problems from the point of view of 20,000 feet. Further you have the benefit of reviewing, after the fact, actual occurrences. Whether you are willing to concede to these points or not, they exist and the net difference is the crux of our divergent perspectives.

Clearly, in your original draft audit response, your opinions regarding our collective management of district finances were, to put it mildly, critical and blunt. Subsequent to our post-audit discussions, your office was willing to make some language concessions in the draft audit report. Thus I will measure the tone of this response accordingly. In the end, however, we will not likely agree regarding the fiscal management philosophy that CVCS needs to implement in order to remain solvent as we reshape instruction, management and fiscal practices in the current era of tumultuous change.

At stake will be our District's relative ability to survive. That need is a local priority. At CVCS, we will adhere to all applicable rules laws and regulations. We may not, however, similarly respond to recommendations that do not have the force of law. Should we choose to make those distinctions, it will be done with informed legal opinion.

It is our position, as recognized District officials, that we have been managing the district finances in a conservative manner. We budget conservatively in order to ensure that we can maintain the financial stability the district needs for the long-term. We reserve funds as necessary, while maintaining the unassigned fund balance within the prescribed limits.

In your report you cited that the district did not "develop reasonable budget estimates." Your comments go on to reference that our budgets overestimate expenditures and underestimate revenues. As a District, we do not agree with the analysis as indicated above. Budgeting is estimating. We anticipate expenses and revenues for the next school year; but, the process is not an exact science. Certainly, your office can appreciate the need to "error on the side of caution." That need is essential to the point of being axiomatic. This is especially pertinent in the wake of the State's imposition of the "Gap Elimination Adjustment" and the "Tax Cap." Thus, our District believes it has been justified in

See Note 1 Page 13

adding as much flexibility in its budgeting and spending practices as is practically possible. We endeavor to prepare, to the best of our ability, for circumstances that are beyond our control.

Expenditures, obviously, are not the only variable. Frequently, revenues are a source of planning frustration. Often, they are not paid to the District within the fiscal year for which the funds were budgeted. Further, there are revenues that the district receives throughout any given year that are not known to the district at the time of budgeting. Absent information that is concrete, such revenues are not included in our budget development.

Separately, regarding CVCS revenue issues specifically, are the storied "500 pound gorillas in the room" in the form of the "Gap Elimination Adjustment" (GEA) and the "Tax Cap" (TC). No matter which way CVCS finances are examined, the GAP has forced the District to consume its reserves to the point that we have depleted our reserves by approximately 1.5 million dollars over the last four years. At the current rate of spending, the District is facing insolvency at the end of 2016-17. This reality, clearly, has been atypical with respect to historic State aid to public schools and is further compounded by the extra imposition of the TC which effectively makes local growth more difficult. Hence, given enhanced limitations on State aid coupled with a law that impedes local growth, both have compounded to create an extremely impaired budgeting environment. Any average person might look at such a scenario and conclude that there could be conspiracy to pressure Districts such as CVCS into virtual or actual bankruptcy.

In the end, the CVCS Board of Education has reviewed the balances within the various reserves as of June 30, 2013 and has already made the adjustments that they deemed necessary. As indicated in the report, the District has maintained an unassigned fund balance around the 4% limit since the 2010-2011, school year.

We conclude by expressing our thanks to the NYS Comptroller's Office for its feedback as to the status of the financial condition of our District. We will certainly consider the recommendations made in this audit relative to making future corrective actions in our management of District finances.

Yours truly,

Mark. R. Dupra
Superintendent

APPENDIX B

OSC COMMENT ON THE DISTRICT'S RESPONSE

Note 1

As indicated in the report and discussed at the exit meeting, budget estimates should be based on historical trends. We reported on this issue because the District incurred consistent variances between budget vs. actual results for a five-year period.[4]

[4] See Table 1.

APPENDIX C

AUDIT METHODOLOGY AND STANDARDS

To accomplish our audit objective, we interviewed appropriate District officials and employees, tested selected records and examined pertinent documents. Our procedures included the following:

- We interviewed District officials to gain an understanding of the District's budget development process and to determine what reports are prepared and provided to the Board for monitoring the budget.
- We compared the adopted budget estimates for revenues and appropriations to actual performance.
- We reviewed the District's financial information and documented the trends in results of operations for the General, Cafeteria and Capital Project funds for fiscal years ending 2007-08 to 2011-12.
- We analyzed the trend in fund balance, reserves and appropriated fund balance for all funds over the last five fiscal years (2007-08 to 2011-12) using the reported ST-3 data.
- We reviewed the reserve accounts to determine if the funding and use of reserve funds were properly authorized and planned for. We also discussed with District officials if there were any plans for future projects and the use of reserves for those projects.
- We reviewed the trend of the property tax rates, levies and assessments for the 2007-08 to 2011-12 fiscal years.

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

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