OFFICE OF THE NEW YORK STATE COMPTROLLER

DIVISION OF LOCAL GOVERNMENT
& SCHOOL ACCOUNTABILITY

Elmira Heights Central School District

Financial Condition

Report of Examination

Period Covered:

July 1, 2010 — February 19, 2014

2014M-76

Thomas P. DiNapoli

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State of New York
Office of the State Comptroller

Division of Local Government
and School Accountability

September 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 Elmira Heights 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 Elmira Heights Central School District (District) is located in the Village of Elmira Heights, Chemung 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 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 Manager.

There are three schools in operation within the District, with approximately 1,100 students and 163 permanent employees. The District's budgeted appropriations for the 2013-14 fiscal year were approximately $20 million, which were funded primarily with State aid, real property taxes and grants. The District also maintains seven reserve funds which had a total balance of $2.6 million as of June 30, 2013.

As of June 30, 2012, the District was categorized as being in "moderate fiscal stress" in a report issued as part of the Comptroller's Fiscal Stress Monitoring System (FSMS), which evaluates local governments and school districts based on financial and environmental indicators to determine if these entities are in or nearing fiscal stress. 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 local government's or school district's inability to generate enough revenues within its current fiscal period to meet its expenditures (budget). Fiscal stress designations of FSMS are based solely upon year-end financial statements (ST-3) filed by the District.

Although District officials have improved the District's financial condition over the past two years by using fund balance to finance operations, they have almost depleted fund balance and will no longer have this remedy available for future fiscal years. If the District continues to rely on fund balance to finance operations, we expect its fiscal stress score to increase.

Objective

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

- Does the Board adopt realistic budgets, routinely monitor financial operations and take appropriate actions to maintain the District's financial stability?

Scope and Methodology

We examined the District's financial condition for the period July 1, 2010 through February 19, 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.

Comments of District Officials and Corrective Action

The results of our audit and recommendations have been discussed with District officials and their comments, which appear in Appendix A, have been considered in preparing this report. District officials generally agreed with our findings and recommendations and indicated they will take 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

A school district's financial condition affects its ability to provide educational services to its students. The Board, Superintendent and Business Manager are accountable to taxpayers for the use of a district's resources and are responsible for effective financial planning and management of a district's operations. Therefore, it is essential that officials develop structurally balanced budgets and manage fund balance responsibly and in accordance with statute. Fund balance is the difference between revenues and expenditures accumulated over time. An appropriation of fund balance is the use of unexpended resources from prior years to finance appropriations in the budget, which can be an effective means of reducing excess fund balance. However, when a board continuously appropriates fund balance, which results in a planned operating deficit[1] each year, it gradually depletes the surplus funds until there are none available to finance successive budgets. As a result, a board could be forced to increase revenues (such as property taxes) and/or decrease appropriations (which could potentially reduce services) to adopt structurally balanced budgets. Sound budgeting practices together with prudent fund balance management help ensure that sufficient funding will be available to sustain operations, address unexpected occurrences and accommodate long-term obligations or future expenditures.

While District officials have recently taken proactive measures to manage and improve the District's financial condition, their reliance on fund balance and reserves to finance planned operating deficits during the audit period has depleted available funds to dangerous levels. The District's total fund balance decreased over the past three years from \$5.1 million to \$4.0 million and is expected to continue to decline in the future. For 2013-14, District officials planned another operating deficit, budgeting \$600,000 in appropriated fund balance and \$384,560 from reserves as a funding source. We project that total fund balance will be \$3.2 million at the end of 2013-14 and the available moneys for funding operations will be exhausted by the end of 2014-15.

Over the last several years, District officials have developed reasonable budgets and controlled expenditures to offset a significant decline in State aid. The District has also eliminated positions,[2] changed

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[1] A planned operating deficit occurs when a board purposely adopts a budget in which expenditures are greater than anticipated revenues, with the difference to be funded with appropriated fund balance.

[2] Twelve positions were eliminated during the 2010-11 fiscal year and another four positions were eliminated during 2012-13.

health insurance plans and eliminated student programs and services from BOCES[3] (the Board of Cooperative Educational Services) to reduce expenditures. They continue to be proactive, planning to study consolidation with an adjacent district and working to reduce transportation costs by reducing bus routes. However, it is critical that, having stabilized the District's financial condition, District officials now discontinue relying on fund balance to pay for operations and instead adopt structurally balanced budgets that provide for recurring revenue sources to pay for recurring costs of operations.

General Fund Budget

The general fund is the District's main operating fund. The financial transactions for educational programs and other operating activities, including the maintenance of buildings and grounds, transportation and administration, are recorded in this fund. The general fund's financial condition depends on the Board's ability to develop realistic budgets, monitor the District's financial operations throughout the fiscal year and make budget modifications as needed.

In preparing the general fund budget, the Board is responsible for estimating what the District will spend and what it will receive in revenue (e.g., State aid), estimating how much fund balance will be available at fiscal year end and balancing the budget by determining the expected tax levy. Accurate estimates help ensure that the levy of real property taxes is no greater than necessary. Real Property Tax Law allows a district to retain a limited amount of fund balance (up to 4 percent of the ensuing year's budget) for unexpected events or cash flow. Fund balance in excess of that amount must be used to fund a portion of the next year's appropriations, thereby reducing the tax levy, or used to fund legally established reserves. It is important for recurring expenditures to be funded with recurring revenue, particularly when officials routinely rely on appropriating fund balance and reserves to the point of depletion.

During our audit period, District officials developed structurally balanced budgets based on realistic revenue and expenditure estimates and appropriated significant amounts of fund balance and reserves to finance annual operations. For example, to offset significant declines in State aid, the District appropriated $600,000 from unassigned fund balance and used excessive funds totaling $434,760 from the Employee Benefit Accrued Liability Reserve (EBALR) to finance budgeted appropriations in 2011-12. Further, in the 2012-13 fiscal year, District officials took steps that generated an additional $938,638 in revenue, bringing the billing in-house for excess cost aid (related to educational services for students with disabilities) and using

[3] The District has cut programs received through BOCES Cooperative Service Agreements (CoSers), such as summer school (except for seniors), career development counsel, online learning and distance learning programs.

existing staff to expedite the collection process. As a result, although $600,000 in fund balance was appropriated for 2012-13, nearly all of it[4] was not used. The additional money allowed the District to replenish the depleted fund balance up to the 4 percent allowed by statute. However, such results will be difficult to duplicate in the future because a portion of the revenues gained were a "one shot" source largely due to recapturing unbilled revenue from the previous year.[5]

For 2013-14, District officials continued their previous budgeting practices and planned another operating deficit, budgeting $600,000 in appropriated fund balance and $384,560 from reserves as funding sources. In August 2013, the Board voted to reduce the balance in the unemployment insurance reserve by $150,094 and the tax certiorari reserve by $199,329. The reduction and subsequent transfer of the unemployment insurance reserve money to unreserved fund balance was improper. District officials may only transfer "excess" amounts to certain other reserve funds and not to unreserved fund balance where its use would not be restricted.

We project that total fund balance will be $3.2 million at the end of 2013-14 (Figure 1), which includes almost $2 million in reserves.

Figure 1: Fund Balance – General Fund

	2010-11	2011-12	2012-13	2013-14 Projected
Beginning Fund Balance	$5,100,232	$5,036,405	$,3,989,823	$3,988,099
Less: Operating Deficit[a]	($63,827)	($1,046,582)	($1,724)	($777,210)
Ending Fund Balance	$5,036,405	$3,989,823	$3,988,099	$3,210,889
Less: Restricted Funds	$2,791,369	$3,337,242	$2,624,762	$1,997,646
Less: Unrestricted Funds Appropriated in Ensuing Year's Budget	$1,034,760[b]	$600,000	$600,000	$600,000
Unassigned Fund Balance	**$1,210,276**	**$52,581**	**$763,337**	**$613,243**

[a] Includes inter-fund transfers

[b] This balance included $434,760 used from the EBALR with OSC approval.

Although the District has been able to rely on unassigned funds and reserves to fund planned operating deficits, the amount of fund balance available to finance future operating costs is limited.

For the 2014-15 year, the District plans to appropriate another $600,000 of fund balance, leaving $613,000 available in unassigned fund balance to pay for any unexpected expenditures, which is

4 The District used $1,724 of the appropriated fund balance.

5 The related revenue was approximately $180,000 in 2011-12 while averaging in excess of $500,000 during the two previous years.

approximately $200,000 less than the amount allowed by statute. The amount of reserves the District plans to use in the adopted 2014-15 budget is about $266,000. Although the District is expected to have almost $2 million in reserves as of June 30, 2014, District officials may only expend moneys from these reserves as allowed by statute. Therefore, moneys in the capital ($808,165) and repair ($203,956) reserves cannot fund the next fiscal year's operating expenditures.

Although the District has a balance of $257,743 in its EBALR, there are no anticipated retirements for which benefits may be paid from this reserve. Because District officials improperly transferred $150,094 from the unemployment reserve to unassigned fund balance, this money must be returned or transferred to another reserve, which will leave the unemployment insurance reserve with an estimated balance of $175,094 at June 30, 2014. Since the District generally expends only $25,000 annually on unemployment claims, the District is limited to this amount as a funding source in the 2014-15 budget.

Due to the District's reliance on fund balance to fund planned operating deficits, the amount available to finance future operating costs is limited. District officials are continuing their proactive approach of monitoring the District's financial condition, decreasing transportation costs by reducing bus routes and participating in a study on the impact of consolidating with the Horseheads Central School District. However, it is imperative that, in addition to these efforts, District officials discontinue using fund balance to pay for operations.

Compensated Absences

Compensated absences are accrued liabilities used to account for expenditures chargeable to the current fiscal year but not due and payable until the following fiscal year. The compensated-absences account is a liability that represents the current portion of expected payments for unused leave to those employees who intend to leave District service within the fiscal year.

District officials recorded a liability for compensated absences of $138,000 as of June 30, 2013; however, no one entitled to these benefits had given the District notice of retirement within the next year. District officials also recorded $93,775 of this amount in the long-term liability portion in the EBLAR reserve, which lowered the reported fund balance available to fund operations. Therefore, the whole amount recorded as compensated absences is available to fund future operating expenditures.

Multiyear Financial Plan

Multiyear financial planning is a tool school districts can use to improve the budget development process. Planning on a multiyear basis enables District officials to identify developing revenue and expenditure trends, establish long-term priorities and goals and consider the impact of near-term budgeting decisions on future fiscal years. It also allows District officials to assess the merits of alternative approaches (such as appropriating fund balance or establishing and using reserves) to finance District operations. Multiyear financial planning can also help District officials project the future costs of employee salaries and benefits provided for in collective bargaining agreements. Any long-term financial plan must be monitored and updated on a continuing basis to provide a reliable framework for preparing budgets and to ensure that information used to guide decisions is current and accurate.

District officials formulated a four-year plan that took into consideration the recent trend of reductions in State aid and the impact of the New York State Property Tax Cap Law on revenue projections. The plan also addressed changes in anticipated expenditures and the availability of fund balance. However, the multiyear plan has not been updated since November 2012. The Business Manager told us she is in the process of updating the plan with actual numbers for the fiscal year 2012-13.

In response to anticipated deficits over the next several years, the District applied for and received a grant to study merging with another school district. District officials also told us that they are working to reduce bus runs as a cost-saving measure.

It is critical that the District continue to pursue cost reduction and revenue enhancement opportunities, as well as updating the long-term financial plan. We project that the use of fund balance and reserves to cover budget gaps, as in prior years, will not be available after the 2014-15 fiscal year. In addition, the FSMS offers online tools[6] that District officials can use as a resource for financial planning.

Recommendations

The Board and District officials should continue to monitor financial condition by:

1. Continuing to ensure that future budgets are structurally balanced, with recurring revenues for financing recurring expenditures rather than a continued reliance on appropriated fund balance and reserves.

2. Continuing to closely monitor financial operations and taking appropriate action to establish and maintain the District's financial stability.

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[6] http://www.osc.state.ny.us/localgov/fiscalmonitoring/tools.htm

3. Returning moneys improperly transferred from the unemployment insurance reserve and ensuring that future uses of reserve funds conform with statute.

4. Continuing to evaluate and explore ways to decrease expenditures and increase revenues.

5. Regularly updating a multiyear financial plan to provide a framework for future budgets and facilitate the District's management of financial operations.

APPENDIX A

RESPONSE FROM DISTRICT OFFICIALS

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

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September 2, 2014

Edward V. Grant, Jr., Chief Examiner
Office of the State Comptroller
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16 West Main Street, Suite 522
Rochester, New York 14614-1608

Dear Mr. Grant:

On behalf of the Elmira Heights Central School District I hereby acknowledge receipt of the Elmira Heights Central School District Financial Condition Report of Examination 2014M-76 for the period of July 1, 2010-February 19, 2014. This letter will serve as our official response.

It was a pleasure speaking with your staff on August 5th in regards to the exit interview. Elmira Heights Central School District recognizes and appreciates the work and effort the comptroller's office has put into examining our financial records for multiple years.

We were pleased there was recognition that we have been proactive in monitoring our financial conditions. We have implemented several strategies to deal with the effects of limited increases in State Aid and to mitigate the devastating impact on our financial condition since the implementation of the GEA. The Board of Education is committed in their continued efforts to monitor our financial condition and take appropriate steps to further diminish reliance on the use of fund balance.

The findings identified in your audit process will be reviewed and a more comprehensive corrective action plan will be developed to address the recommendations put forth by your office. You shall receive this document in the near future.

If you need additional information, please feel free to contact me at the number above.

Sincerely,

Mary Beth Fiore
Superintendent of Schools

Enter with high expectations – leave with confidence and pride.

APPENDIX B

AUDIT METHODOLOGY AND STANDARDS

Our overall goal was to assess the District's financial condition for the period July 1, 2010 through February 19, 2014. To accomplish the objective of our audit, we performed the following procedures:

- We interviewed officials to gain an understanding of the District's budgeting process.

- We reviewed the results of operations and analyzed changes in fund balance for the general fund for the period July 1, 2010 through June 30, 2013. To gain additional background information and perspective, we also reviewed financial data for reserves from fiscal years prior to those included in the audit scope period.

- We compared the adopted budgets to the modified budgets and actual operating results for the period July 1, 2010 through June 30, 2013 to determine if the budget assumptions were reasonable. We also reviewed the adopted budget for 2013-14 and reserve entries through February 19, 2014.

- We reviewed the appropriation of the District's reserves and fund balance for the period July 1, 2010 through June 30, 2013. We also reviewed the budgeted appropriations for 2013-14.

- We interviewed officials and obtained information regarding the District's efforts to implement cost savings opportunities.

- We reviewed the District's multiyear financial plan.

- We reviewed documentation related to the calculation of the District's property tax cap limit to determine if the District established a tax levy within the limits of the property tax cap.

- We tested the reliability of the accounting records by reviewing bank statement reconciliations and Board resolutions and compared them to the annual update document (AUD) data and certified financial statements.

- We reviewed general fund "other" assets and liabilities at June 30, 2013 to determine if they were properly accrued and capital projects closed, and to determine the availability of funds to offset future deficits.

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 objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

APPENDIX C

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