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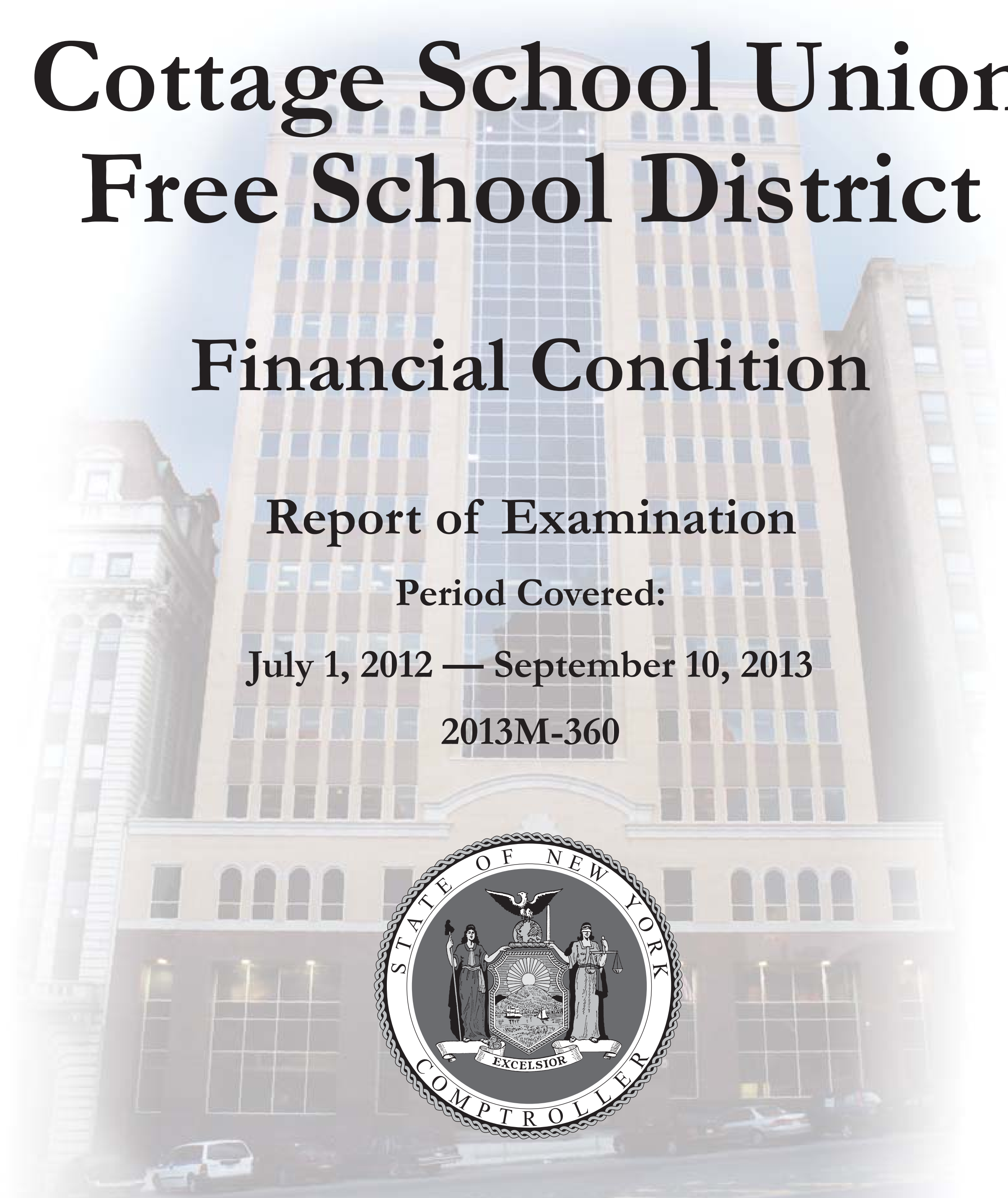
Mount Pleasant Cottage School Union Free School District



Financial Condition

Report of Examination

Period Covered:

July 1, 2012 — September 10, 2013

2013M-360

Thomas P. DiNapoli

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State of New York
Office of the State Comptroller

Division of Local Government
and School Accountability

March 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 Mount Pleasant Cottage School Union Free 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 Mount Pleasant Cottage School Union Free School District (District) is a special act school district located on the grounds of the Jewish Child Care Association's residential treatment center in Westchester County. The New York State Legislature created the District in 1971 to provide education to students from the residential treatment center as well as day students from neighboring districts. The District operates in accordance with the provisions of New York State's Education Law.

The District is governed by the Board of Education (Board), which normally comprises nine members. Seven members are appointed by the Jewish Child Care Association – the District's sponsoring agency – and two are appointed by the New York State Commissioner of Education. The Board is responsible for the District's general management and overall operation. The Superintendent of Schools (Superintendent) is the District's chief executive officer and is responsible, along with other administrative staff, for day-to-day District management under the Board's direction.

The Chief Financial Officer (CFO) is responsible for preparing the District's financial budget, with input from the Superintendent, and providing financial reports to the Board. The CFO also has assumed the role of billing for student tuition. Although the Board is primarily responsible for the effectiveness and proper functioning of internal controls, the Superintendent and department heads share this responsibility.

The District operates two schools. As of June 2013, the District had 157 employees and 328 registered students. The District's budgeted appropriations for the 2013 fiscal year were approximately $16.7 million, which were funded primarily by tuition charged to students' home school districts and/or sending agencies. The New York State Education Department (SED) Rate Setting Unit establishes, and the New York State Division of Budget (DOB) approves, the rates that the District may bill for student tuition.

Objective

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

- Do District officials adequately monitor the District's financial operations to ensure fiscal stability?

Scope and Methodology

We examined the District's financial condition for the period July 1, 2012 through September 10, 2013. We extended our scope back to the 2009 fiscal year to establish financial trends over the years.

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 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 recommendations and indicated they planned to initiate corrective action.

The Board has the responsibility to initiate corrective action. A written corrective action plan (CAP) that addresses the findings and recommendations in this report should be prepared and forwarded to our office within 90 days, 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. 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. We encourage the Board to make this plan 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 services on a continuing basis. A school district in good financial condition generally maintains adequate service levels during fiscal downturns and develops resources to meet future needs. Conversely, a school district in fiscal stress usually struggles to balance its budget, may suffer through disruptive service level declines, has limited resources to finance future needs and has minimal cash available to pay current liabilities as they become due. As a special act district, the District is not allowed to maintain a fund balance, which makes the timely collection of tuition and minimum accounts receivable crucial to its continued existence.

The District reported unexpended general fund deficits[1] for five consecutive years. The deficit was as high as $5.3 million in fiscal year 2008-09. However, the deficit started declining in the 2009-10 fiscal year when SED and DOB authorized tuition increases for the District. The District's enrollment has declined in recent years, which has adversely affected revenues. However, District officials have managed to decrease expenditures to offset the declines in revenues, which helped to relieve the deficit situation. We found that the District could improve its billing and collection procedures. As of June 30, 2013, the District had approximately $2.4 million in accounts receivable, of which $1.4 million had been outstanding for 30 days and $893,897 for 90 days or more. If the District is unable to collect these outstanding amounts, the District's financial condition will be negatively impacted.

Operating Results

To ensure financial stability, it is important that the District has sufficient revenues to fund its expenditures. When expenditures exceed revenues, operating deficits occur. Continued deficits will impact the District's ability to provide services to its students.

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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, committed, assigned and unassigned. 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).

The District's operating results have been slowly improving, but its financial condition remains fragile. As Table 1 shows, District officials have been able to decrease expenditures by $3.2 million, or 17 percent, from fiscal years 2008-09 through 2012-13. However, the District's revenues declined by 18 percent during this same time period. As a special act school district, the District's main source of revenue is tuition. The District received only a minimum amount of aid from the State, and the State sets the authorized rate at which the District may charge tuition. This places a limitation on the total revenue that the District can accumulate in a year.

Revenues have not increased because tuition rates have not changed since the 2009-10 fiscal year and enrollment has not been stable. Currently, the tuition rate is $1,122 per week for each student. Enrollment has declined from 341 to 303 students (11 percent) from fiscal years 2009-10 through 2012-13.

Table 1: Operating Results

Fiscal Year	2008-09	2009-10	2010-11[a]	2011-12	2012-13
Revenues	$16,170,989	$19,468,896	$20,314,295	$17,335,721	$16,187,161
Expenditures	$18,952,745	$18,318,013	$17,438,635	$16,678,833	$15,690,642
Operating Surplus (Deficit)	($2,781,756)	$1,150,883	$2,875,660	$656,888	$496,519

[a] The increase in revenue in 2010-2011 was due to a reconciliation and re-billing totaling $3,029,412

Although the District's operating results have been slowly improving, the District has operated with an unexpended general fund deficit from fiscal years 2008-09 through 2012-13. As Table 2 shows, at the end of fiscal year 2008-09, this deficit was approximately $5.3 million, but was reduced in each of the following four years; the District ended the 2012-13 fiscal year with a deficit of $171,427.

Table 2: Changes in Fund Deficit

Fiscal Year	2008-09	2009-10	2010-11	2011-12	2012-13
Beginning Fund Deficit	($2,569,622)	($5,351,379)	($4,200,494)	($1,324,834)	($667,946)
Ending Fund Deficit	($5,351,379)	($4,200,494)	($1,324,834)	($667,946)	($171,427)
Change in Fund Deficit	($2,781,757)	$1,150,885	$2,875,660	$656,888	$496,519

District officials reduced the deficit by prioritizing liabilities to be paid, maintaining expenditures at a level that correlated with enrollment and using one-time revenues that they received. The District received such one-time revenues when tuition rates were increased in the 2009-10 fiscal year and when it received additional payments from agencies after performing reconciliations.

Tuition Collection Process

In 2013, the District earned $16.2 million in revenue, of which tuition represented 99 percent. As such, to ensure financial stability, it is important that District officials have procedures in place for the timely collection of tuition.

District officials bill agencies for tuition on a monthly basis. The three largest agencies that the District bills for tuition are the Administration of Child Services (ACS), New York City Board of Education (BOE) and Westchester County (County). Specifically, on June 30, 2013, District officials billed ACS approximately $12.1 million, BOE $1.7 million and the County $700,000 for tuition for the 2012-13 school year.

Once ACS and BOE agree with their invoiced amounts, they pay through wire transfer. If there is a disagreement with the amount invoiced, such as length of stay for each student or missing child identification number, they will only pay the items that they agree with. District officials must then reconcile the invoiced amount with the payment and re-bill the agencies for the unpaid items. The other agencies and school districts pay by check. Therefore, District officials rely on the ACS and BOE payments to settle urgent liabilities such as payroll.

Because the CFO is responsible for billing these agencies and monitoring the accounts receivable in addition to his other duties, he does not immediately address the reconciliation of re-billed items and collection of accounts receivable. For example, the State approved an adjusted rate for the 2008-09 fiscal year on January 12, 2012. District officials sent an invoice dated October 4, 2012 for $463,160 to ACS and received payment on December 13, 2012. This nine-month delay in re-billing and 11-month delay in collection negatively impacted the District's cash flow.

The District's delays in re-billing have caused accounts receivable to grow and reduced cash flow. As Table 3 shows, accounts receivable reached their height of $4.7 million in the 2009-10 fiscal year. The most recent re-billing that District officials completed was in the 2010-11 fiscal year, which resulted in the collection of approximately $3 million. This decreased accounts receivable by $2.7 million, or 59 percent. However, because officials did not perform any subsequent re-billing, accounts receivable have since grown from $1.9 million in the 2010-11 fiscal year to $2.4 million in the 2012-13 fiscal year, or 26 percent.

Table 3: Accounts Receivable	
2008-09	$2,795,334
2009-10	$4,657,287
2010-11	$1,924,273
2011-12	$2,672,292
2012-13	$2,408,503

As of June 30, 2013, the District had approximately $2.4 million in accounts receivable, of which $1.4 million had been outstanding for 30 days and $893,897 had been outstanding for 90 days or more. Of the $1.4 million in "30 days" receivables, the three largest agencies owed $1.2 million. These agencies also owed $471,544 of the $893,897 in "90 days and over" receivables. The amounts in the "90 days and over" category are due to disputed bills, which means that these receivables might not be collectible. In fact, District officials deemed only 50 percent of the "90 days and over" receivables as collectible, which required aggressive collection procedures and additional reconciliation and verification to ensure that the original bills were accurate. If the District has to write off uncollectible accounts receivable, its financial condition will be adversely affected.

Recommendations

District officials should:

1. Closely monitor the fund deficit and continue to take action to eliminate the deficit,

2. Implement procedures that would enable more timely collection of outstanding tuition, and

3. Implement procedures to clear long outstanding receivables from the accounting records.

APPENDIX A

RESPONSE FROM DISTRICT OFFICIALS

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

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JAMES GAUDETTE
Superintendent of Schools

WALTER M. CALLAHAN
Chief Financial Officer

February 26, 2013

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

SUBJECT: DISTRICT RESPONSE-AUDIT 2013M-360; FINANCIAL CONDITION; 7/1/12 – 9/10/13

Dear Sir/Madam:

In regard to the above referenced audit, the District makes the following responses/observations.

The District agrees with the three (3) recommendations noted and will address each issue within the Corrective Action Plan (CAP) that will be published under separate cover.

However, the District does need to note (see Table 2 – Changes in Fund Balance) that even though the Fund Balance Deficit has been reduced significantly, continuing efforts to bring the Fund Balance to the point of a surplus position, will ultimately penalize the District.

Current methodology of rate calculation does not allow Special Act Districts to retain a Fund Balance. Should a special act district demonstrate fiscal prudence and generate an end of year Fund Balance surplus, subsequent rate reconciliations will calculate a lower rate that effectively eliminates any surplus.

Without Fund Balance surplus, a special act district finds itself in continual fiscal hardship unable to withstand downward shifts in student census, maintain staff continuity, or plan for any significant upgrades to the educational program or facilities.

An issue not referenced in the audit, but worth noting, is the fact that the district has been able to achieve the aforementioned level of fund balance deficit reduction while at the same time reducing its dependence on outside bank financing of operations from a high point of $6.7 million (2006-07 Fiscal Year) to the current level of $1.4 million. The District has been able to function without acquiring any new debt for the last several years.

The district does acknowledge the unhealthy level of outstanding receivables in the greater than 90 Day category and will take the necessary steps (outlined in forthcoming CAP) to return this key indicator to a more favorable status. On a positive note, Monthly tuition billing is billed in a timely manner and the overwhelming majority of this monthly billing is collected promptly.

In closing, a special act school district is forced to operate to a restrictive, counter-intuitive business model.

A Special Act District (1) does not set its own billing rate, (2) has no control over student census, (3) deals with a needy student population that is highly transient (student turnover within the year and from one year to the next is very high), (4) has no financial reserves to draw upon (no Fund Balance or financial institutions willing to lend to a school district that does not have the ability to levy taxes), (5) issues reconciling invoices, based on state-certified rate reconciliation process long after the original educational service was performed (a minimum of 2 years), (6) adheres to all state-mandated educational requirements (including new mandates such as Common Core requirements) for public education that impact the rising cost of personnel, facility, and program without any current financial resources to draw upon.

When all is said and done, this audit reflects this district's never ending struggle to get and stay financially healthy. This quest has never been easy and never will. Implementation of the recommendations listed in this audit, along with the continuation of the processes already in place, should help the district achieve the goal of financial stability in a very unstable environment.

At this time, the District would like to take this opportunity to thank the assigned auditors for their professional diligence and courtesies that were, at all times, on display.

If there are further questions in regard to this document or the audit, do hesitate to contact this writer at (914) 769-0456 Extension 203.

Sincerely,

James Gaudette

School Superintendent,
Mount Pleasant Cottage School District

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 reviewed Board minutes for the audit period of July 1, 2012 through September 10, 2013.
- We reviewed the District's policies and procedures for developing and reporting information relevant to financial and budgeting activities. This included obtaining information on the fiscal responsibilities of District officials.
- We interviewed Districts officials to determine what processes were in place and gain an understanding of the District's financial condition and budget process.
- We reviewed, analyzed and established trends of tuition collected and respective care days billed on a weekly basis by verifying rates and enrollments for the 2008-09 through 2012-13 school years.
- We reviewed the District's financial records and reports for all funds, including trial balances, balance sheets, budget reports, and statements of revenues and expenditures for the 2009-10 through 2012-2013 school years.
- We traced bank transfers from originating to destination banks.
- We verified tuition rates and revenue collected for the three largest sending institutions and traced paid invoices and respective rates to accounts receivable schedules. We examined approximately $7.5 million in tuition for the 2012-13 school year out of a total of $14.5 million that these institutions paid to the District. The total tuition that the District collected for the school year was approximately $16.7 million.

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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