



Port Jervis City School District Financial Condition

Report of Examination

Period Covered:

July 1, 2014 – June 30, 2016

2016M-319



Thomas P. DiNapoli

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State of New York Office of the State Comptroller

Division of Local Government and School Accountability

November 2016

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 Port Jervis 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 New York State 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 Port Jervis City School District (District) is located in the City of Port Jervis, Orange County. The District serves students from Orange and Sullivan Counties who reside in the City of Port Jervis and the Towns of Deer Park, Mount Hope, Mamakating and Forestburg. The District is governed by the Board of Education (Board), which is composed of nine 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 operates four schools with approximately 2,500 students and 437 employees. The District's budgeted appropriations for the 2015-16 fiscal year were \$65 million, which were funded primarily with State aid and real property taxes.

Objective

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

- Did the Board and District officials ensure that fund balance and reserves were maintained at reasonable levels and in accordance with statutory requirements?

Scope and Methodology

We examined the District's financial condition for the period July 1, 2014 through June 30, 2016. We extended our audit scope period back to July 1, 2011 to evaluate financial trends.

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 certain findings in our report. Appendix B includes our comments on issues raised in the District's response.

The Board has the responsibility to initiate corrective action. Pursuant to Section 35 of General Municipal Law, Section 2116-a (3)(c) of New York State 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

The Board is responsible for making sound financial decisions that are in the best interests of the District, the students it serves and the residents who fund the District's programs and operations. Prudent fund balance management, along with use of reserves, helps ensure that sufficient funding will be available to sustain operations, address unexpected expenses and satisfy long-term obligations or future expenditures. Fund balance represents resources remaining from prior fiscal years.

A district may retain a portion of fund balance but must do so within the limits established by New York State Real Property Tax Law (RPTL). Currently, the amount of fund balance that a school district can retain may not exceed 4 percent of the ensuing fiscal year's budget. Reserve funds provide a mechanism for legally saving money to finance all or part of future infrastructure, equipment and other requirements. There should be a clear purpose or intent for reserve funds that aligns with statutory authorizations. Combining a reasonable level of unrestricted fund balance with specific legally established reserve funds provides resources for both unanticipated events and other identified or planned needs.

Over the five-year period 2011-12 through 2015-16, the District's reported unrestricted fund balance ranged from 12 to 17 percent of the ensuing year's budget. Although the Board appropriated fund balance annually to fund operations, it was not used because annual budgets resulted in operating surpluses. In addition, the District's tax certiorari reserve was overfunded by \$793,000 and the workers' compensation reserve was not used to fund expenditures totaling approximately \$1.5 million. When overfunded reserve amounts were added back into unrestricted fund balance, the recalculated unrestricted fund balance exceeded the statutory limit by 13.9 to 24.6 percentage points over the five-year period.

Fund Balance

School districts may retain a portion of fund balance at year-end for cash flow purposes or to fund unexpected expenditures. RPTL currently limits unrestricted fund balance to no more than 4 percent of the ensuing fiscal year's budget. Any amounts in excess of the statutory limit should be used to lower real property taxes, increase or establish necessary reserves for specific purposes, pay down debt or pay for one-time expenditures.

The District's unrestricted fund balance ranged from 12 to 17 percent of the ensuing year's budget between 2011-12 and 2015-16. The

Board appropriated fund balance annually during this period to fund operations; however, due to operating surpluses in four of the five years, the appropriated fund balance was not used. In addition, the Board used operating surplus funds to make unbudgeted transfers totaling approximately \$5.4 million to the capital projects fund during the last five completed fiscal years. Furthermore, the District's tax certiorari reserve was overfunded as of June 30, 2016 by \$793,265.

When the unused appropriated fund balance, unbudgeted capital fund transfers and excess tax certiorari reserve funds are added back, the District's recalculated unrestricted fund balance ranged from 17.9 to 28.6 percent of the ensuing year's budget, exceeding the 4 percent statutory limit.

Figure 1: Recalculated Unrestricted Fund Balance

	2011-12	2012-13	2013-14	2014-15	2015-16
Total Unrestricted Fund Balance at Year-End	\$7,260,626	\$10,870,549	\$12,329,598	\$14,367,429	\$16,358,545
Add: Appropriated Fund Balance Not Used to Fund Ensuing Year's Budget	\$1,375,000	\$1,270,350	\$1,325,000	\$1,050,000	\$1,050,000 ^a
Add: Excessive Tax Certiorari Reserve					\$793,265 ^b
Add: Year-End Unbudgeted Transfers to Capital Projects Fund	\$2,234,923	\$188,699	\$712,831	\$941,116	\$1,345,011
Total Recalculated Unrestricted Fund Balance	\$10,870,549	\$12,329,598	\$14,367,429	\$16,358,545	\$19,546,821
Recalculated Unrestricted Fund Balance as a Percentage of Ensuing Year's Budget	17.9%	19.8%	22.5%	24.9%	28.6%

^a Unused appropriated fund balance can be calculated only after a year is complete. It appears, from preliminary analysis of year-end data, that appropriated fund balance for 2016-17 will not be needed prior to any unbudgeted transfers.

^b This is a cumulative amount that was reserved over several years.

The District's surpluses were caused by overestimating expenditures in each of the five years, such as instructional (by \$5.5 million) and employee benefits (by \$3.6 million), for a total of approximately \$9.1 million (3 percent). District officials should be able to accurately estimate these expenditures because they are based on contractual amounts.

Had the Board adopted more realistic budgets and used appropriated fund balance to finance operations as planned, it could have reduced the tax levy and accumulated less fund balance. In 2015-16, the Board again appropriated about \$1 million of fund balance for use in the 2016-17 fiscal year. If this amount is not used, the District's unrestricted fund balance will continue to exceed the statutory limit. This will contribute to real property taxes being higher than necessary to fund the District's operations.

Reserves

Reserve funds are established to provide resources for an intended future use. When the Board establishes reserve funds for specific purposes, it is important that it develop a plan for funding the reserves and for determining how much should be accumulated and how and when the funds will be used to finance related costs. Such a plan should guide the Board in accumulating and using reserve funds and would help inform District residents about how resources will be used. In addition, the Board should review the District's reserves at least annually and fund them through budgeted appropriations that are voted on by District residents. This will help ensure the amounts reserved are necessary and transparent to District residents.

The District had four reserves totaling approximately \$10.8 million at the end of the 2015-16 fiscal year: compensated absences (\$5.7 million), workers' compensation (\$2.9 million), capital reserve (\$1.3 million) and tax certiorari (\$980,000). Although the District does have a reserve policy, it does not state how each reserve will be funded, when reserves will be used or how much will be maintained in each reserve.

Funding of Reserves – From fiscal years 2011-12 through 2015-16, the Board transferred \$5.4 million directly to the capital projects fund at year-end, rather than funding the capital reserve through budgeted appropriations. When provisions for funding reserves are not in the budget, District residents are not given an opportunity to know the Board's plan for funding reserves.

Use of Reserves — Three of the four reserves appear to be used for their intended purposes. However, the workers' compensation reserve is not being used for its intended purpose. As of June 30, 2016, the workers' compensation reserve had a balance of \$2.9 million. While this balance appears reasonable, instead of using this reserve to pay workers' compensation costs, the Board includes appropriations for estimated expenditures in the budget. From 2011-12 through 2015-16, the District incurred workers' compensation expenditures of \$1.5 million. The reserve has had no activity except for interest of \$21,800 earned during this time. The Board should balance the desirability of accumulating reserves for future needs with the obligation to make sure residents are not overburdened by these practices.

Funding Levels of Reserves – As of June 30, 2016, the tax certiorari reserve had a balance of approximately \$984,000 and was overfunded by approximately \$793,000. The District's tax certiorari cases on file showed a total potential liability of approximately \$191,000. We reviewed the claims that the District settled during the last two fiscal years and found the amount the District calculated was reasonable for possible settlements. However, the reserve balance was \$793,000

more than the potential liability. Pursuant to Education Law, funds that are not expended or that will not be reasonably required to pay any such judgment or claim must be returned to the general fund.

Recommendations

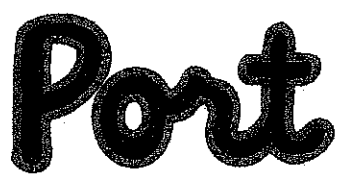
The Board should:

1. Use surplus fund balance as a financing source for:
 - Funding one-time expenditures;
 - Funding needed reserves; and
 - Reducing property taxes.
2. Adopt budgets that represent the District's actual needs and discontinue the practice of adopting budgets that appropriate fund balance that will not be used to fund operations. Budgets also should include any transfers to the capital projects fund.
3. Establish reserve fund policies that identify a clear intent or plan regarding the purpose, use and replenishment of funds, when appropriate.
4. Review reserves to determine if the amounts reserved are justified, necessary and reasonable. To the extent that they are not, reserves should be properly reduced.
5. Budget for funding and use of reserves in a manner that is allowable and transparent to District residents.

APPENDIX A

RESPONSE FROM DISTRICT OFFICIALS

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



Port Jervis

CITY SCHOOL DISTRICT

Thomas M. Bongiovi
Superintendent of Schools
9 Thompson Street, P.O. Box 1104
Port Jervis, New York 12771
Phone (845) 858-3100
Fax (845) 856-1885

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October 13, 2016

New York State Education Department
Office of Audit Services, Room 524EB
89 Washington Avenue
Albany, NY 12234

Re: 2016M-319

Dear Sir or Madam:

The Board of Education has reviewed the Port Jervis City School District Financial Condition- Report of Examination for the July 1, 2014 through June 30, 2016 period of operations.

The Board of Education notes that the report represents an examination of exceptions and does not report actions the district has taken to reduce fund balance and establish reserves that support fiscally responsible decision-making. The Board of Education remains committed to providing sound educational opportunities for students and staff while providing a fiscally sound financial environment in which to make decisions.

In May 2016, the Board of Education presented and the taxpayers approved a ten million dollar Capital Reserve. The reserve was established to provide funds to address the aging Middle School. The board has engaged in discussions on funding of the Capital Reserve. The members anticipate taking action on funding the reserve in 2016-2017.

See
Note 1
Page 11

Annually, the board reviews budget to actual results and adjusts future budgets as is appropriate. The report references expenditures only. In the past several years, despite using the adopted state budget, state aid received has exceeded the adopted state budget. Expenditures, budget to actual, are closely monitored and bidding practices followed to ensure the most efficient use of taxpayer funds. A budget consists of revenue and expenditures and should not be analyzed using only one measure. Fund balance growth has steadily decreased over the past several years because the Board of Education has taken appropriate budget action.

See
Note 2
Page 11

The Board of Education reviews reserve balances annually. The Workers' Compensation Reserve has not increased, aside from interest earned, in more than five years. The district is self-insured for Workers' Compensation and the reserve is supported by actuarial calculations.

The Tax Certiorari Reserve is recalculated annually and supported by historical data and pending litigation. For the past several years, the reserve has decreased.

See
Note 3
Page 11

In Figure 1, the total add-backs of “unbudgeted transfers to Capital Fund” equals \$5,422,580. These transfers were approved uses of fund balance, either through voter approved referenda or legal board resolution. In all instances, the voters through vote or public board comment had a voice in the use of fund balance. Inclusion of these funds, overstates the opening unrestricted fund balance dollars and impacts the percentages. The Board of Education acknowledges the auditors’ recommendation that journal entries be entered that would reduce the Total Unrestricted Fund Balance at Year End and not be included in operating budget activity.

See
Note 4
Page 11

See
Note 5
Page 11

In summary, the Board of Education thanks the State Comptroller’s office for the professionalism of the auditors and the audit recommendations. The Board of Education will continue to fund one-time expenditures with excess fund balance, fund reserves as is appropriate and necessary to ensure fiscal responsibility and develop and present budgets that address the educational needs of the students.

Respectfully submitted,

Deborah Lasch
President of the Board of Education

APPENDIX B

OSC'S COMMENTS ON THE DISTRICT'S RESPONSE

Note 1

Although District residents approved a \$10 million capital reserve, the Board has not yet funded the reserve. This reserve has no bearing on the unrestricted fund balance that exceeded the statutory limit by 13.9 to 24.6 percentage points.

Note 2

We reviewed budgeted revenues and appropriations over the past five years and compared them to actual results. We found the District's surpluses were caused by overestimating appropriations that District officials should have been able to more accurately estimate.

Note 3

Based on historical data and pending litigation, the District's projected liability is about \$191,000. The tax certiorari reserve currently has a balance of \$984,000, which is over \$793,000 or more than twice the District's potential liability.

Note 4

The Board did not fund reserves through budgeted appropriations voted on by District residents. Instead, the Board funded reserves annually via transfers of operating surpluses, which diminishes transparency.

Note 5

We did not recommend that journal entries be used to reduce unrestricted fund balance. We recommended that the Board use surplus funds for funding one-time expenditures, funding needed reserves or reducing property taxes.

APPENDIX C

AUDIT METHODOLOGY AND STANDARDS

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

- We interviewed District officials to gain an understanding of the processes and procedures in place over the District's budgeting.
- We tested the accounting records' reliability by comparing them to the annual financial report filed with the Office of the State Comptroller, the District's independently audited financial statements and trial balances.
- We analyzed the general fund's trend in total and restricted fund balances, including the use of appropriated fund balance for fiscal years 2011-12 through 2015-16. We also compared the unrestricted fund balance to the ensuing year's budgeted appropriations to determine the fund balance availability for future years.
- We recalculated the District's unrestricted fund balance using unused appropriated fund balance, overfunded tax certiorari reserve and unbudgeted interfund transfers to the capital projects fund.
- We tested a sample of outstanding tax certiorari claims to determine if the calculated amount of open claims was reasonable.
- We reviewed the District's fund balance policy.
- We reviewed budget-to-actual reports to determine operating surpluses or deficits.
- We reviewed the general fund results of operations and analyzed changes in fund balance for the period July 1, 2011 through June 30, 2016.
- We reviewed monthly financial reports provided to the Board.
- We reviewed Board minutes to verify the approved budget amounts.
- We reviewed reserve fund records and the balances maintained for reasonableness.

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.

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