



DeRuyter Central School District Financial Condition

Report of Examination

Period Covered:

July 1, 2012 — December 31, 2014

2015M-119



Thomas P. DiNapoli

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State of New York Office of the State Comptroller

Division of Local Government and School Accountability

August 2015

Dear School District Officials:

A top priority of the Office of the State Comptroller is to help school district officials manage district resources 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 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 DeRuyter 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 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 DeRuyter Central School District (District) is located in the Towns of Cazenovia, DeRuyter, Georgetown and Nelson in Madison County; the Towns of Lincklaen and Otselic in Chenango County; the Town of Cuyler in Cortland County; and the Town of Fabius in Onondaga County. The Board is responsible for the general management and control of the District's financial and educational affairs. The Superintendent 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 Business Administrator and the Treasurer are mainly responsible for the District's finances and accounting records and reports.

The District operates one building for kindergarten through grade 12. As of December 31, 2014, the District had approximately 105 employees and 430 students. The District's budgeted appropriations for the 2014-15 fiscal year were approximately \$10 million, which were funded primarily with real property taxes and State aid.

Objective

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

- Did the Board adopt structurally balanced budgets and properly plan for and use reserve funds?

Scope and Methodology

We examined the District's financial condition for the period July 1, 2012 through December 31, 2014. We extended our scope period back to July 1, 2009 for financial trend analysis.

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. Unless otherwise indicated in this report, samples for testing were selected based on professional judgment, as it was not the intent to project the results onto the entire population. Where applicable, information is presented concerning the value or size of the relevant population and the sample selected for examination.

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 take corrective action.

The Board has the responsibility to initiate corrective action. Pursuant to Section 35 of the General Municipal Law (GML), Section 2116-a (3)(c) of the New York State Education Law (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. 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 is a primary factor in determining its ability to continue providing public educational services for students in the district. The Board, Superintendent and Business Administrator are accountable to taxpayers for the use of District resources and are responsible for the effective management of District operations and financial planning. It is essential that officials develop reasonable budgets and manage fund balance responsibly and in accordance with statute. Sound budgeting practices coupled with prudent fund balance management can help ensure that sufficient funding will be available to sustain operations, address unexpected occurrences and satisfy long-term obligations or future expenditures. A best practice for managing fund balance would be for the Board to adopt a fund balance policy that would establish what is considered an adequate level of unrestricted fund balance¹ and how to maintain that level. Reserve funds should be used in accordance with their statutory provisions.

The Board and District officials have appropriated a significant amount of fund balance for the District's budget over the past few years. For example, over the past three fiscal years² the Board appropriated \$675,000, \$525,000 and \$376,626, respectively, in its adopted budgets. The Board has not adopted a fund balance policy establishing the level of unrestricted fund balance to maintain. As a result, the general fund balance has declined approximately \$1.2 million, or 64 percent, over the past four years. Furthermore, the District has used general fund money to help subsidize the school lunch fund operations over the past several years, and at the end of the 2013-14 fiscal year, the school lunch fund owed the general fund nearly \$44,000, which is likely uncollectible. Lastly, the Board did not use \$250,000 in the insurance reserve for authorized and intended purposes during our audit period, and it has not included a provision in the 2014-15 budget to make a required repayment of about \$35,000 to the repair reserve to replenish it after moneys were used for emergency expenditures.

General Fund

It is essential that the Board adopts structurally balanced budgets in which recurring revenues finance recurring expenditures and reasonable levels of fund balance are maintained. An appropriation of fund balance is the use of unexpended resources from prior years to finance budget appropriations and is considered a nonrecurring

¹ New York State Real Property Tax Law (Real Property Tax Law) allows a school district to maintain up to 4 percent of the ensuing year's budget as unrestricted fund balance.

² 2012-13, 2013-14 and 2014-15

or “one shot” financing source. An appropriation of fund balance is an acceptable and reasonable practice when a school district has accumulated an adequate level of unrestricted fund balance. However, continued use of fund balance when a school district has recurring annual operating deficits³ will eventually cause depletion of fund balance, causing the district to ultimately go into a deficit position. Maintaining a reasonable level of unrestricted fund balance, while staying within the statutory limits for school districts,⁴ is an essential component of good financial management. If the amount retained is too low, the District may not have a sufficient financial cushion for unanticipated costs. Adopting a fund balance policy, which addresses the appropriate level of unrestricted fund balance to be maintained from year-to-year, is a best practice that provides the Board with guidelines to use during the budget process.

The District’s general fund had four consecutive years of planned operating deficits, as indicated by the Board’s appropriation of fund balance each year. Figure 1 illustrates the Board’s appropriation of fund balance and how this practice contributed to the general fund’s declining fund balance. The District’s reported fund balance has declined approximately \$1.2 million or 64 percent from the beginning of 2010-11 to the end of 2013-14.

Figure 1: General Fund Operating Results

	2010-11	2011-12	2012-13	2013-14
Beginning Fund Balance	\$1,886,844	\$1,719,519	\$1,371,582	\$1,015,969
Prior Period Adjustment		\$2	\$220,585	
Plus: Operating Surplus/(Deficit)	(\$167,325)	(\$347,939)	(\$576,198)	(\$339,993)
Ending Fund Balance	\$1,719,519	\$1,371,582	\$1,015,969	\$675,976
Less: Restricted Fund Balance	(\$615,381)	(\$346,955)	(\$233,308) ^a	(\$106,667) ^b
Available Fund Balance for Appropriation	\$1,104,138	\$1,024,627	\$782,661	\$569,309
Less: Appropriated Fund Balance for Next Year	(\$650,426)	(\$675,000)	(\$525,000)	(\$376,626)
Unrestricted Ending Fund Balance	\$453,712	\$349,627	\$257,661	\$192,683
Ensuing Years Appropriations	\$9,552,149	\$9,766,892	\$9,949,095	\$10,016,241
Unrestricted Fund Balance as a Percentage of Next Year’s Appropriations	4.7%	3.6%	2.6%	1.9%

^a Includes encumbrances of \$190,122
^b Includes encumbrances of \$63,481

³ Operating deficits occur when actual expenditures in a given year exceed actual revenues. An operating deficit can be planned for and financed by appropriating fund balance.

⁴ Real Property Tax Law limits the amount of “unexpended surplus” that may be legally retained by Districts to 4 percent of the ensuing year’s budget. Funds properly retained under other sections of law (e.g., reserve funds established under GML or Education law) are excluded from the 4 percent limitation.

The Business Administrator, Board President and Superintendent told us that the District has appropriated fund balance in its budgets to avoid raising taxes and comply with the property tax levy limit. They told us that the Board has tried to reduce the amount of fund balance that is appropriated in the budget to become less reliant on it while trying to make budget cuts where appropriate. The Business Administrator has also developed a long-term operational plan which, although not formally adopted by the Board, is discussed with the Board. This plan shows the Board's desire to keep the property tax levy increase to 2 percent or less. However, the plan did not show how the District could do this while maintaining a reasonable unrestricted fund balance level. Instead, the long-term operational plan used appropriated fund balance to bridge the gap between appropriations and estimated revenues with no regard for the actual amount of fund balance that would be available. If the long-term operational plan incorporated a reasonable unrestricted fund balance to be retained each year, the plan would have been clear that the appropriation of fund balance projected was not realistic or sustainable.

As noted previously, continually relying on fund balance to make up the difference between the required appropriations and other forms of revenue will eventually deplete fund balance resulting in fiscal stress. Consequently, the District will need to replace fund balance as a financing source with recurring revenues or cut costs to balance future budgets, or both. If District officials determine it is necessary to increase real property taxes, they may need to seek voter approval to adopt a budget that requires a tax levy in excess of the amount allowed by the property tax cap statute.⁵

Interfund Activity

School districts sometimes temporarily advance moneys held in one fund to another fund. Such interfund advances are made to address short-term cash flow needs of a fund. However, repayment of the borrowed cash should be made as soon as moneys are available, but no later than the close of the fiscal year in which the advance was made. The Governmental Accounting Standards Board has stated that, if repayment of a loan is not expected within a reasonable amount time, interfund balances should be reduced and the amount that is not expected to be repaid should be reported as a transfer from the fund that made the loan to the fund that received the loan.

At the end of the 2013-14 year, the general fund's reported interfund receivables were \$1,030,088, which included money due from the school lunch, special aid and capital projects funds. The general fund also had \$775,696 in interfund payables due to most of these same funds. After offsetting these interfund receivables with the interfund

⁵ In order to override the property tax levy limit, that budget must be approved by 60 percent of the votes cast.

payables, the general fund had a net interfund receivable of \$254,392 composed of \$152,207 due from the special aid fund, \$58,333 due from the capital projects fund and \$43,852 due from the school lunch fund.

We analyzed the financial position of each fund that owed the general fund money as of June 30, 2014 and determined that, of the net receivable above, the amount owed by the school lunch fund is likely uncollectible. The school lunch fund had a deficit fund balance of \$31,700 as of June 30, 2014. Therefore, it did not have funds available to repay the advance.⁶ In addition to the interfund advance from the general fund to the school lunch fund, for the 2014-15 year, the Board included an additional \$103,000 in its general fund budgeted appropriations to subsidize the school lunch fund operations. The Business Administrator informed us that, over the past three years prior to 2014-15, the District paid from \$80,000 to \$100,000 out of the general fund for the cost of the cook's salary and all of the cafeteria employees' benefits. In 2014-15, the District began charging these costs directly to the school lunch fund and budgeting an interfund transfer from the general fund to subsidize the school lunch fund. While this accounting change will help improve the transparency of the school lunch fund's financial position, the school lunch fund is still not expected to generate sufficient revenues in 2014-15 to repay the interfund advance.

Because the school lunch fund will not likely have sufficient cash available to repay the interfund loans in the near future, District officials may need to transfer moneys from the general fund to the school lunch fund in order to pay off the loan balance, which could further deplete the general fund.

Use of Reserves

District officials can legally set aside, or reserve, portions of fund balance to finance certain future costs for a specified purpose. The use of reserve funds is considered prudent fiscal management. Each statute that authorizes a reserve fund sets forth a particular underlying purpose for the fund, how the reserve is funded and, generally, if no longer needed, how it may be terminated. The Board should be actively involved in creating, using and terminating reserve funds.

GML authorizes the governing board of school districts to establish an insurance reserve to fund certain uninsured losses, claims, actions or judgments for which a district is authorized or required to purchase or maintain insurance. In order to use insurance reserve funds for other than these purposes, the governing board would have to make a determination that the funds were no longer needed for these purposes

⁶ The school lunch fund also reported fund balance deficits in prior years of \$10,100 in 2010-11, \$8,300 in 2011-12 and \$33,700 in 2012-13.

and there were no liabilities incurred or accrued against the funds. Then, upon certification by the chief fiscal officer and the district's attorney, the funds could be transferred to another reserve and expended from there. The funds must be transferred to the designated reserve prior to expending them for other than insurance purposes.

GML also authorizes the governing boards of school districts to establish a repair reserve to pay for certain repairs to capital improvements and equipment. Except in emergency situations, district officials must provide public notice and hold a public hearing before making expenditures from a repair reserve fund. In an emergency, money in a repair reserve fund may be expended without first giving notice and without holding a public hearing upon a board vote with two-thirds approval. However, at least one-half of the expenditure must be repaid to the fund in the next fiscal year and the balance repaid by the end of the fiscal year after that. These statutes also allow the school boards to transfer unexpended balances⁷ in both these reserves to certain other reserves. At June 30, 2012, the District reported an insurance reserve with a balance of \$250,000 and a repair reserve with a balance of \$69,689.

In June 2013, the District's architects determined that a leach field had failed and needed to be replaced. The Board adopted a resolution declaring an emergency situation, estimating the maximum cost of the replacement to be \$300,000, to be financed by \$69,689 from the repair reserve, \$100,000 from the insurance reserve and a budget transfer of \$130,311.⁸ Although the Board's resolution indicated its desire to use insurance reserve fund money to help finance this project, we found no evidence that the Board took any action to transfer the money from the insurance reserve into the repair reserve to help pay for the leach field replacement. The replacement was completed in July and August 2013 at a total cost of \$249,119.⁹ In addition to spending the insurance reserve funds on the leach field, the District transferred

⁷ Money may be transferred from an insurance reserve to another reserve only if the district determines that the fund is no longer needed and only to the extent that the money in the fund exceeds a sum sufficient to pay all liabilities incurred or accrued against the fund.

⁸ Although not part of the scope of this audit, we note that repair reserve funds may be used only for repairs of capital improvements or equipment, which are of a type not recurring annually or more frequently (GML Section 6-d[3][a]). Repair reserve fund money may not be expended for capital improvements. The Board resolution of June 13, 2013 refers to the leach field project as a "total replacement." In general, completely replacing a facility would constitute a capital improvement, not a repair (see, e.g., OSC Opinions Numbers 88-51 and 88-50). In the future, the District should ensure that repair reserve fund money is expended only for repairs as described in GML Section 6-d.

⁹ The project cost less than initially estimated. The District used the \$69,689 balance in the repair reserve and \$100,000 from the insurance reserve and \$79,430 was transferred from other appropriations.

the remaining \$150,000 in the insurance reserve to unrestricted fund balance in the general fund. According to the Business Officer, this transfer was made so the funds would be available for appropriation in the budget for the 2013-14 fiscal year.

The use of the insurance reserve funds for the leach field project and the transfer to unrestricted fund balance were improper because the money was not used for the authorized and intended purpose of the reserve or transferred to other authorized reserves, in accordance with statutory provisions. Furthermore, the District's 2014-15 budget does not contain any provisions for the repayment of \$34,845 (one half of \$69,689) to the repair reserve. We found no evidence of repayment through the end of our audit period.¹⁰

The statute governing repair reserve funds expressly states that Board members are the reserve fund's trustees and are subject to all of the duties and responsibilities imposed by law. We believe the Board has similar responsibilities with respect to insurance reserve funds. Therefore, the Board and other District officials should ensure that they use reserve funds for authorized and intended purposes and adhere to all legal requirements when transferring unneeded balances to other reserves and repaying reserves.

The Board should:

Recommendations

1. Develop and adopt a fund balance policy that establishes an adequate amount of unrestricted fund balance to be maintained, within the legal limit, to meet the District's needs and provide sufficient cash flow.
2. Develop and regularly update a realistic multiyear financial plan to provide a framework for future budgets and facilitate the District's management of financial operations.
3. Develop and adopt structurally balanced budgets that do not rely on one-shot revenues, such as appropriations of fund balance, to finance recurring expenditures.
4. Ensure that reserve funds are used for the authorized and intended purposes in compliance with applicable laws.
5. Repay the repair reserve for the moneys expended for the

¹⁰ Had the Board acted by resolution to transfer the unneeded \$100,000 in the insurance reserve to the repair reserve and then made a total expenditure from the repair reserve of \$169,689, the District would have been required to repay \$84,844 to the repair reserve by June 30, 2015 and the remaining half by June 30, 2016.

emergency leach field project, as required by law.

6. Develop a plan for the school lunch fund to pay back the outstanding interfund loans from the general fund or, if it determines the interfund loans cannot be repaid, transfer funds from the general fund to the school lunch fund to reduce the loans.

APPENDIX A

RESPONSE FROM DISTRICT OFFICIALS

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



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Superintendent

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Brittanie Gibbons
Director of
Special Education

James Southard
Business Administrator

August 6, 2015

Rebecca Wilcox, Chief Examiner
Office of the State Comptroller
State Office Building, Room 409
333 East Washington Street
Syracuse, New York 13202-1428

Ms. Wilcox:

This letter is the response to the initial draft of audit report 2015M-119 from July 23, 2015. We are pleased to note that the audit found no fraud or misappropriation of funds. The issues that have been identified will be addressed in a corrective action plan that will be considered and approved by the board of education shortly after the official release of the report.

As far as the core of the report, we have known and communicated that we were drawing down the reserves and fund balances over the years to address the wider economic situation that has made life difficult for school districts across the state. We also had a significant emergency issue, mentioned in the report, which impacted our financial condition. The positive outcome of our work is that, during the 2015-16 school year, we have projected that we will use no fund balance or reserves for continuing expenses (assuming all the Federal Grant funds continue at approximately the same level as previous years). This provides a positive base from which to work at reinvigorating the unencumbered unallocated fund balance to a reasonable level that will be determined by the board of education.

We want to thank your auditor and audit supervisor for their work during this process.

Charles Walters, Superintendent

C: Fred Lawrence, President, Board of Education
Jim Southard, Business Administrator
Sandy Welsh, District Clerk
Amanda Graham, Treasurer

DeRuyter Central School = District Committed to Success

Board of Education: Fred Lawrence, President; Amy Sperat, Vice President; Members - Brandi Compton, Dean Hathaway, Bradley Mierke

APPENDIX B

AUDIT METHODOLOGY AND STANDARDS

Our overall goal was to assess the District's financial condition for the period July 1, 2012 through December 31, 2014. To achieve our financial condition objective and obtain valid audit evidence, we performed the following audit procedures:

- We reviewed and analyzed the District's financial records and reports for all funds, including annual budgets, annual reports, bank statements, budget status reports and general ledgers.
- We interviewed District officials to determine whether they have identified the cause of the District's fiscal stress.
- We gained an understanding of the budget process and information provided to the Board at budget time.
- We interviewed Board members to determine if they understand the Business Administrator's long-term capital plan regarding how the District should address its declining fund balance.
- We determined whether interfund transfers were allowed and authorized by statute and were supported, and if interfund loans/advances were in balance and properly classified, recorded and reported.
- We verified if the accounts payable balances at the end of the 2014 fiscal year were valid, including searching for unrecorded liabilities that may have existed at the end of the fiscal year.
- We verified if the receivable balances at the end of the 2014 fiscal year were valid and collectible in a timely manner to meet current District needs.
- We reviewed the documentation for the emergency leach field replacement project to determine whether reserves were used appropriately to fund the project.

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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