

OFFICE OF THE NEW YORK STATE COMPTROLLER



DIVISION OF LOCAL GOVERNMENT
& SCHOOL ACCOUNTABILITY

Fallsburg Central School District

Financial Condition

Report of Examination

Period Covered:

July 1, 2011 — October 2, 2013

2014M-33



Thomas P. DiNapoli

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State of New York

Office of the State Comptroller

Division of Local Government and School Accountability

June 2014

Dear 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 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 Fallsburg 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 Fallsburg Central School District (District) is located in the Towns of Fallsburg, Mamakating and Thompson in Sullivan County and the Town of Wawarsing in Ulster County. The District is governed by the Board of Education (Board) which comprises 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 (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 Manager assists the Superintendent in preparing the annual budget and prepares the monthly and year-end financial reports.

The District operates two schools, with approximately 1,490 students and 250 employees. The District's budgeted appropriations for the 2013-14 fiscal year are approximately \$37 million, funded primarily with State aid, real property taxes and grants.

Objective

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

- Did the Board adopt reasonable budgets and, when appropriate, use fund balance to lessen the burden of District taxpayers?

Scope and Methodology

We examined the District's financial condition for the period of July 1, 2011 through October 2, 2013. We extended our audit period to July 1, 2010 to examine financial information to better able us to provide a more comprehensive understanding of the District's financial position.

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 agreed with our recommendations and indicated they planned to initiate 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 this plan available for public review in the District Clerk's office.

Financial Condition

A school district's financial condition is a factor in determining its ability to provide educational services to its students. The Board and Superintendent along with the Business Manager are responsible for accurate and effective financial planning along with making sound financial decisions in the best interests of the District, the students it serves and the taxpayers who fund its programs and operations. To fulfill this responsibility, it is essential that officials use sound budgeting practices based on accurate estimates and manage fund balance to ensure that sufficient funding will be available to sustain operations, address unexpected occurrences and satisfy long-term obligations or future expenditures while acting in accordance with statute.¹

Accurate historic and current information should be used to ensure that budgeted appropriations are not overestimated and that fund balance assigned as a funding source is actually used in the next fiscal year to cover expenditures. Unreasonable budgetary practices or lack of information about actual budget performance can mislead District taxpayers and can significantly impact the District's year-end unrestricted funds and financial condition.

The Board and District officials did not always develop reasonable budgets or use unrestricted funds to benefit District taxpayers. Over the last three years, the District appropriated \$941,081 more in unrestricted funds than needed because the District also generated approximately \$3.7 million in operating surpluses prior to making a \$4.4 million unbudgeted transfer to the capital fund in 2012-13. This negated any benefit the appropriation of fund balance would have in reducing fund balance or the property tax levy. The operating surpluses were mainly caused by District officials consistently overestimating expenditures by a total of \$3.8 million from the 2010-11 to 2012-13 fiscal years.²

Budgeting and Use of Fund Balance

Fund balance represents the cumulative residual resources from prior fiscal years that can be used to lower property taxes for the ensuing fiscal year. A District may retain unrestricted funds, as allowed by law up to 4 percent, to address cash flow and unexpected occurrences,

¹ Real Property Tax Law limits the amount of unrestricted surplus funds that can be legally retained by District officials to no more than 4 percent of the next fiscal year's budgeted appropriations.

² Our analysis of budget-to-actual performance only included the last three completed fiscal years. A change to the District's software did not allow us to obtain information for detailed analysis for years prior to 2010-11.

and can set aside and reserve reasonable portions of fund balance to finance future costs for a variety of specified objects or purposes. Budgetary estimates of expenditures (i.e., appropriations) should be based on known needs as well as historical trends. Similarly, revenue estimates should be based on known sources of revenue reflective of any identified trends.

District officials adopted budgets that included plans to use fund balance at an average rate of more than \$1.9 million annually between 2010-11 and 2012-13. Instead, the District's general fund used \$681,659³ even though the 2012-2013 fiscal year incurred a loss of over \$4.8 million due largely to an unbudgeted transfer of \$4.4 million to the capital fund. Without this transfer, the operating surplus would have been approximately \$3.7 million. In addition, the real property tax levy increased more than \$304,000 during the last three fiscal years.

District officials told us that they were aware that they exceeded the legal limit of 4 percent and included the use of fund balance to attempt to reduce the unrestricted funds. Yet, the total unrestricted funds averaged 20 percent over the last three fiscal years, or an effective average of 24 percent for the same period when considering the unused appropriated fund balance.

Table 1: Unrestricted Funds at Fiscal Year End

	2010-11	2011-12	2012-13
Beginning Fund Balance	\$6,995,341	\$9,657,602	\$11,300,749
Plus: Operating Surplus/(Loss)	\$2,524,958	\$1,644,427	(\$4,851,044)
Unrestricted Fund Balance - subtotal	\$9,520,299	\$11,302,030	\$6,449,705
Less: Appropriated Fund Balance	\$2,392,125	\$1,503,561	\$1,500,000
Less: Transfers to/(from) Reserves	(\$137,306)	\$1,282	\$493,566
Total Unrestricted Funds at Year End	\$7,265,480	\$9,797,187	\$4,456,139
Ensuing Year's Budget	\$35,543,247	\$35,543,247	\$36,648,130
Reported Unrestricted Fund Balance as a % of Ensuing Year's Budget	20%	28%	12%
Effective Unrestricted Funds Resulting From Unused Appropriated Fund Balance	\$9,657,605	\$11,300,748	\$4,456,138
Effective Unrestricted Funds as a Percentage of Ensuing Year's Budget	27%	32%	12%

During this time period, District budgets overestimated expenditures by nearly \$3.8 million, in aggregate.

³ Typically operating surpluses would equal the change in fund balance during the same period of time. Accounting adjustments made at the conclusion of a fiscal year can cause the calculated surpluses to differ from the changes in fund balance. The District's accounting records had one such entry during our audit period.

Table 2: Overestimated Appropriations

Fiscal Year	Budgeted Appropriations	Actual Expenditures	Difference
2010-11	\$35,579,068	\$31,839,695	\$3,739,373
2011-12	\$35,543,247	\$32,360,016	\$3,183,231
2012-13	\$35,543,247	\$38,671,876 ^a	(\$3,128,629)
Totals	\$106,665,562	\$102,871,587	\$3,793,975
3-year average	\$35,555,187	\$34,290,529	

^a2012-13 included an unbudgeted transfer of approximately \$4.4 million to the capital fund.

These overestimated expenditures were primarily in the categories of contractual⁴ (\$3.7 million), personnel services⁵ (\$2.8 million) and employee benefits⁶ (\$1.75 million). In fact, the aggregate surplus from 2010-11 to 2012-13 for employee benefits represented nearly 23 percent of the total employee benefits expenditures for the 2013 fiscal year. While contractual expenditures may be difficult to estimate, estimates for personal service costs are easily attained as they are based on employment contracts.

Budget Format

School districts, at a minimum, are required to present comparisons of the proposed budget estimates to the previous year's adopted budget. Additionally, information should be provided to the voters regarding the amount of the unrestricted portion of fund balance to be used when determining the amount of the school tax levy. The District's budget was approved each year by a majority of the District's voters and the Board and administration did present to the public the financial information required by law.

District officials begin their budget process with a rollover of the previous year's budget. This rollover budget is produced from a combination of the information from the District's accounting software and the Business Manager's worksheets. It includes known increases for salaries or other obligations and provides the starting point for budget development. District officials did not include historical information or the prior budget year's performance in the budget document. The lack of actual prior year's results also contributed to overestimated appropriations, as indicated in Table 2.

The Board and District officials have withheld significant funds from productive use, levied taxes that were higher than necessary and compromised the transparency of District finances to the taxpayers.

⁴ Includes expenditures for contracts, materials and supplies, tuition, textbooks and BOCES services

⁵ Includes teacher salaries, substitute salaries, instructional salaries and noninstructional salaries

⁶ Includes retirement contributions, social security, workers' compensation and health insurance

For example, when the District voters approved a capital project in the 2012-13 fiscal year they were told that there would be no additional costs to taxpayers when, in fact, the taxpayers had already been impacted through budget practices and surpluses generated since at least 2010-11 that resulted in tax levy increases without demonstrating any realistic need.

Recommendations

1. The Board and District officials should only appropriate the amount of surplus funds that will actually be needed in the next year's budget and develop appropriation estimates that are realistic and based upon all information available at the time the budget is developed.
2. The Board should develop a plan to reduce the true amount of fund balance in a manner that benefits District taxpayers. Such uses could include, but are not limited to:
 - Reducing real property taxes,
 - Increasing other necessary reserves,
 - Paying off debt and
 - Financing one-time expenses.
3. District officials should provide appropriate transparency through the budget process. If District officials continue to intentionally collect taxes in excess of what is necessary for financing current operations in an effort to accumulate funds for future use, those funds should be set aside in appropriate and duly established reserves.

APPENDIX A

RESPONSE FROM DISTRICT OFFICIALS

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

FALLSBURG CENTRAL SCHOOL DISTRICT

Ivan Katz, Ed. D., Superintendent of Schools

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May 22, 2014

Mr. Andrew A. SanFilippo
Executive Deputy
Office of State and Local Government
110 State Street
Albany, NY 12236

Dear Mr. SanFilippo:

The Fallsburg Central School District Board of Education and Administration submit this letter as its official response and corrective action plan for the recent examination of the District's Financial Condition. The Board of Education and the Administration agree with the findings in the report.

The report recommends the Board and District officials should only appropriate the amount of surplus funds that will actually be needed in the next year's budget and develop appropriate estimates that are realistic and based upon all information available at the time the budget is developed. The District is committed to, through budgetary practices and strategic planning, sustaining its educational program for its students while balancing the fiscal resources of the District. Those resources include accumulated fund balance, reserve funds, and the capacity of the district's taxpayers. The district agrees that it is important to develop realistic budget plans that accurately project the amount of surplus needed to be appropriated.

The report further recommends the Board develop a plan to reduce the true amount of fund balance in a manner that benefits the District's taxpayers. The Board and District officials have developed a strategic multi-year plan which will reduce the amount of fund balance by appropriating a portion of the available fund balance to reduce the amount property taxes need to be levied. Also, the district has used \$4,350,000 in fund balance to pay for the unreimbursed balance of a building project which has allowed the district to pay for \$11,000,000 in building repairs and upgrades without the need to levy additional property taxes.

Finally, the report recommends that District officials should provide appropriate transparency though the budget process with public disclosure and, if the district collects taxes in excess of what is necessary for financing current operations, those funds should be set aside in appropriate

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and duly established reserves. The Board and District officials hold several public budget workshops, a budget hearing, and send out to each address in the school district budget information in an effort to inform the public. District officials will continue to refine the processes used in projecting revenues and expenditures so that the necessary amount to taxes will be levied. Any excess funds will be used to reduce subsequent years' tax levies, increasing approved and established reserves, and financing one-time expenses.

The Fallsburg Central School District would like to thank the audit team from your office for their diligent work in examining the District's financial condition and the helpful suggestions they provided to us to improve our operations.

Sincerely,

 Joseph Collura
President
Board of Education

APPENDIX B

AUDIT METHODOLOGY AND STANDARDS

Our overall goal was to evaluate the District's financial condition. To accomplish our audit objective and obtain valid and relevant audit evidence, we performed the following procedures:

- We interviewed District officials to gain an understanding of the process followed when developing the general fund budget, including which documents are used in the budget development process and who prepares and provides the documents, and in determining how much fund balance is going to be used.
- We reviewed Board minutes and newsletters for our audit period to determine what types of information are provided to the public regarding the budget and any proposed capital projects to be approved by the voters.
- We calculated the differences between budgeted and actual revenues and expenditures in total and by budgetary line items to determine the accuracy of the general fund budgets for fiscal years 2010-11 through 2012-13.
- We calculated the difference between the 2013-14 adopted budget and the 2012-13 actual results of operations in total and by budgetary line items to determine if the 2013-14 general fund budget is reasonable.
- We calculated the results of operations for the last three completed fiscal years (2010-11 through 2012-13) to determine if the District ended with an operational surplus or deficit. We compared those results to budgeted fund balance appropriations to determine if the use of budgeted fund balance was realized.
- We calculated the increase or decrease of unrestricted funds for the last three completed fiscal years to determine if restricted fund balance increased or decreased from year-to-year.
- We calculated the general fund restricted fund balance as a percentage of ensuing years' budgeted appropriations for the last three completed fiscal years to determine if fund balance was over or under the statutory 4 percent limitation.
- We reviewed District tax information for the last three completed fiscal years and compared tax rates from year to year to determine if rates have increased or decreased.
- We reviewed available documentation regarding the District's voter-approved 2012-13 capital project to determine what voters were told regarding the financing of the project and when they were told.

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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