



Highland Central School District Financial Condition

Report of Examination

Period Covered:

July 1, 2010 — June 30, 2013

2013M-358



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 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 Highland 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 Highland Central School District (District) is located in the Towns of Esopus, Lloyd, Marlborough, New Paltz and Plattekill in Ulster County. The District operates three schools, and has 1,860 students and 415 employees. The District's budgeted appropriations for the 2013-14 fiscal year were approximately \$38.5 million, which were funded primarily with real property taxes and State aid.

The Board of Education (Board) is the legislative body responsible for managing District operations, including establishing internal controls over financial operations and maintaining sound financial condition. The Superintendent of Schools (Superintendent) serves as the chief executive officer and is responsible, along with other administrative staff, for the day-to-day District management under the Board's direction. Although the Board is primarily responsible for the effectiveness and proper functioning of internal controls, the Superintendent and department heads share this responsibility. The business administrator is responsible for compiling budget estimates and, along with the Superintendent, preparing the preliminary budget. During our audit period, the District had three business administrators.

Objective

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

- Does the Board adopt realistic budgets that are structurally balanced?

Scope and Methodology

We examined the District's financial condition for the period July 1, 2010 through June 30, 2013.

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 findings 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. 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 may struggle to balance its budget, may experience disruptive service level declines, may have limited resources to finance future needs, and may experience cash flow difficulties. School district officials have a responsibility to taxpayers to ensure that their tax burden is not greater than necessary. To fulfill this responsibility, it is essential that officials develop reasonable budgets and manage fund balance responsibly. School district officials should develop detailed multiyear plans to allow them to set long-term priorities and work toward goals, rather than making choices based only on the needs of the moment.

Starting in fiscal year 2010-11, the District's school lunch fund incurred a \$14,000 deficit fund balance; this deficit has since increased to almost \$287,000 at the end of the 2012-13 fiscal year. The general fund's unrestricted unappropriated funds also dropped 77 percent, from approximately \$1.5 million at the beginning of the 2010-11 fiscal year to \$353,000 at the end of the 2011-12 fiscal year. These declines occurred because the Board consistently overestimated revenues in the budget. During the last three completed fiscal years, the District's revenues fell short by an average of \$740,000 in the general fund and \$100,000 in the school lunch fund. We also found that the Board has not developed a current multiyear financial plan or capital plan to complement the budget development process. By developing such plans, District officials will have a roadmap to help manage future District costs and resources.

Fund Balance

A key measure of the District's financial condition is its level of fund balance, which is the difference between revenues and expenditures accumulated over time. When maintained at reasonable levels, fund balance provides cash flow and can be used to help finance the next fiscal year's operations. The restricted portion of fund balance represents the amount that the District may use only for specific purposes. The unrestricted portion of fund balance is the amount that may be appropriated to fund programs in the next year's budget.

To assist in managing financial operations and ensuring orderly operations, the District should maintain a reasonable level of unrestricted unappropriated fund balance as a financial cushion for unanticipated expenditures and/or revenue shortfalls. Maintaining a

reasonable level of unrestricted unappropriated fund balance is a key element of effective long-term financial planning.

Annual operating results are a measure of the District’s recent financial operations and its financial strength. Multiple years of operating deficits are an indication that the District’s budget is not structurally balanced – that its current revenues are not sufficient to support current expenditures. It is sound practice for the Board to adopt budgets that are based on realistic estimates of revenues and expenditures so that fund balance can be maintained at healthy levels.

General Fund —The District ended the 2012-13 fiscal year with an operating surplus of \$524,000. This surplus was the result of District officials’ improved budgeting practices which generated more revenues due mainly to an increase in real property taxes. For the 2010-11 and 2011-12 fiscal years, the District had incurred planned operating deficits¹ of approximately \$547,000 and \$430,000, respectively, which reduced the general fund’s unrestricted unappropriated fund balance by approximately 57 percent. These planned operating deficits resulted from the District’s appropriation of \$900,000 of fund balance each year. As a result of these planned operating deficits, the District’s unrestricted unappropriated funds were almost depleted by the end of the 2011-12 fiscal year.

| Table 1: General Fund Results of Operations | | | |
|--|--------------------|--------------------|--------------------|
| | FY 2010-11 | FY 2011-12 | FY 2012-13 |
| Beginning Fund Balance | \$2,844,657 | \$2,514,240 | \$2,230,102 |
| Total Revenues | \$34,596,503 | \$34,763,165 | \$35,802,948 |
| Total Expenditures | \$35,143,277 | \$35,193,126 | \$35,278,700 |
| Operating Surplus or (Deficit) | (\$546,774) | (\$429,961) | \$524,248 |
| Net Transfers | \$216,357 | \$145,822 | \$99,941 |
| Total Surplus or (Deficit) | (\$330,417) | (\$284,138) | \$624,189 |
| Total Year-End Fund Balance | \$2,514,240 | \$2,230,102 | \$2,854,291 |
| Appropriated Fund Balance | \$900,000 | \$900,000 | \$900,000 |

To ensure that the District’s financial condition continues to improve, we encourage District officials to consistently adopt structurally-balanced general fund budgets with realistic revenue estimates.

School Lunch Fund — During the three-year period ended June 30, 2013, the school lunch fund’s annual operating deficits averaged more than \$120,000. These deficits were caused by prior business administrators consistently overbudgeting revenues in this fund, mainly revenue from sales of meals. As a result of the operating

¹ A planned operating deficit occurs when fund balance is intentionally used as a budgetary financing source.

deficits, the school lunch fund's year-end fund balance decreased from a positive balance of \$82,640 on July 1, 2010 to a deficit balance of \$278,832 on June 30, 2013. Consequently, the school lunch fund must rely on the general fund to subsidize its operations. At fiscal year-end 2012-13, the school lunch fund owed the general fund \$476,878 for advances made to the school lunch fund to sustain its operations.

Table 2: School Lunch Fund Balance

| | FY 2010-11 | FY 2011-12 | FY 2012-13 |
|------------------------------------|-------------------|--------------------|--------------------|
| Beginning Fund Balance | \$82,640 | (\$13,626) | (\$140,616) |
| Total Revenues & Transfers | \$891,756 | \$878,089 | \$911,633 |
| Total Expenditures | \$988,022 | \$1,005,079 | \$1,049,849 |
| Surplus or (Deficit) | (\$96,266) | (\$126,990) | (\$138,216) |
| Total Year-End Fund Balance | (\$13,626) | (\$140,616) | (\$278,832) |

If the District continues to adopt school lunch fund budgets that are not based on realistic revenue estimates, or are not structurally balanced, this fund's financial condition will likely further deteriorate. In addition, its continued reliance on the general fund to subsidize operations will negatively affect the general fund's financial condition.

Budgeting

The Board is responsible for preparing and presenting the District's budget to the public for vote. In preparing the budget, the Board must estimate District revenues and how much surplus fund balance, if any, will be available to help fund the ensuing year's operations. The Board must then determine the tax levy. Accurate estimates are essential to ensure that the levy of real property taxes is not greater than necessary. After the budget is adopted, and until the tax levy is determined, certain information such as updated estimates of State aid and the actual amount of available fund balance becomes available. This information should be used to more accurately budget for expected revenues and the amount of appropriated fund balance used to reduce the tax levy.

We compared the District's budgeted revenues for the general and school lunch funds with actual results of operations for the fiscal years 2010-11 through 2012-13 and found that the District consistently overestimated revenues for these funds over the three-year period. No one specific revenue line item in the general fund budget was overestimated from year-to-year; District officials generally overestimated revenues across the board. District officials primarily overestimated the Sales of Reimbursable Meals budget line in the school lunch fund each year, even though there was information, including the number of students who were eligible for these types of meals, for officials to base their estimates on. Had they used this information, they would have been able to budget more accurately.

| Fund | | FY 2010-11 | FY 2011-12 | FY 2012-13 | Average |
|------------------------------|----------|----------------------|----------------------|--------------------|--------------------|
| General | Budgeted | \$35,827,312 | \$36,065,168 | \$36,164,108 | \$36,018,863 |
| | Actual | \$34,846,503 | \$34,963,165 | \$36,027,354 | \$35,279,007 |
| | Variance | (\$980,809) | (\$1,102,003) | (\$136,754) | (\$739,856) |
| School Lunch | Budgeted | \$939,500 | \$1,028,800 | \$1,012,585 | \$993,628 |
| | Actual | \$891,756 | \$878,089 | \$911,633 | \$893,826 |
| | Variance | (\$47,744) | (\$150,711) | (\$100,952) | (\$99,802) |
| Total Budget Variance | | (\$1,028,553) | (\$1,252,714) | (\$237,706) | (\$839,658) |

We also reviewed the amounts budgeted for the 2013-14 fiscal year and, although the amounts budgeted for the general fund appear reasonable, the school lunch fund budget appears to be high. The District has budgeted over \$1.1 million in revenues for this fund, which includes \$259,600 for reimbursable meals, \$385,000 for other cafeteria sales and a \$100,000 transfer from the general fund. However, as shown in Table 2, this fund has not received revenues exceeding \$912,000 in any of the prior three fiscal years. The overestimation occurred because the Board has not adopted a formal budget process. Instead, each of the three business administrators employed by the District during our audit period was permitted to use his or her own methods when developing the budget. As a result, there was no consistency in budget development from year-to-year. These revenue shortfalls have led to a decline in the District's financial condition.

Multiyear Financial Planning

Multiyear financial planning is a tool school districts can use to improve the budget development process. Planning on a multiyear basis will enable 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 using unrestricted unappropriated funds or establishing and using reserves) to finance its operations. Any long-term financial plan should 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.

The Board has not yet developed a multiyear financial plan. District officials stated this occurred because the prior business administrators did not have the requisite knowledge to prepare such plans. Had such a plan been in place, it would have been a useful tool for the Board to use to address budgeting deficiencies and the dependence on appropriating fund balance, a non-recurring revenue, to fund ongoing District operations.

Recommendations

1. The Board should develop a realistic plan to accumulate fund balance, within the legal limit, so that the District is prepared for unexpected expenses or revenue shortfalls.
2. The Board should work to reduce the deficit in the school lunch fund.
3. The Board should adopt a formal budget process detailing how District officials should prepare the budget and monitor the process to ensure it is followed.
4. The Board should adopt structurally balanced budgets that are based on reasonable revenue and expenditure estimates.
5. District officials should develop, and the Board should implement, a multiyear financial plan to provide a framework for future budgets and facilitate management of the District's financial operations. They should update the plan annually.

APPENDIX A

RESPONSE FROM DISTRICT OFFICIALS

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

HIGHLAND CENTRAL SCHOOL DISTRICT

Deborah A. Haab
Superintendent of Schools

February 24, 2014

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

To Whom It May Concern:

It was a pleasure speaking with your staff on February 11th in regards to the exit interview. Highland Central School District recognizes the effort taken to comprehensively examine multiple years of financial records and appreciates the determination undertaken to accurately document areas for improvement.

The findings identified will be reviewed and a corrective action plan to address these areas for improvement will be developed and forwarded to your attention in the near future.

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

Sincerely,

Deborah A. Haab
Superintendent of Schools

Alan Barone
President, Board of Education

Cc:



Home of the Huskies
320 Pancake Hollow Road, Highland, New York 12528 Phone: (845) 691-1012 Fax: (845) 691-1039 e-mail: highland-K12.org

APPENDIX B

AUDIT METHODOLOGY AND STANDARDS

The Office of the State Comptroller's Fiscal Stress Monitoring System evaluates school districts based on financial and environmental indicators. These indicators are calculated using the local government's annual update document² and information from the United States Census Bureau, New York State Department of Labor and the New York State Education Department, among other sources. The District has demonstrated signs of fiscal stress in several areas. Due in part to these fiscal stress indicators, we selected the District for audit.

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 the District's internal controls and procedures over the computerized financial databases to help ensure that the information produced by such systems was reliable.
- We interviewed District officials to determine what processes were in place and gained an understanding of the District's financial situation and budget.
- We analyzed audited financial reports and three years of data filed with the Office of the State Comptroller to evaluate fund balance trends.
- We reviewed and analyzed the District's financial records and reports for the general and school lunch funds, including balance sheets, adopted budgets, budget reports, and statements of revenues and expenditures.
- We compared budgeted-to-actual revenues and expenditures for the three-year period and investigated significant variances.

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.

² Required to be submitted annually by the District to the Office of the State Comptroller

APPENDIX C

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