



Mount Morris Central School District Financial Condition

Report of Examination

Period Covered:

July 1, 2012 – September 3, 2014

2014M-328



Thomas P. DiNapoli

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State of New York Office of the State Comptroller

Division of Local Government and School Accountability

June 2015

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 Morris 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 Mount Morris Central School District (District) is located in the Village of Mount Morris and the Towns of Mount Morris, West Sparta, Leicester and Groveland in Livingston County. The District is governed by the Board of Education (Board) which comprises seven 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 chief executive officer of the District and is responsible, along with other administrative staff, for the day-to-day management of the District under the direction of the Board. The Business Administrator is responsible for accounting for the District's finances, maintaining accounting records and preparing financial reports. The current Business Administrator began employment with the District at the start of the 2013-14 fiscal year, working with a budget she did not help develop. The former Superintendent resigned as of July 31, 2014 after three years at the District; the Board appointed an interim Superintendent effective August 1, 2014 and appointed a new Superintendent effective February 1, 2015.

The District operates one central building with an enrollment of approximately 525 students. The District's budget for the 2014-15 fiscal year totals \$13.9 million and is funded primarily with State aid and real property taxes.

Objective

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

- Did the Board and District officials adequately manage the District's financial condition?

Scope and Methodology

We examined the District's financial condition for the period July 1, 2012 through September 3, 2014. We expanded our scope back to fiscal year 2011-12 to review fund balance, budgeting and tax levy 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 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 generally agreed with our recommendations and indicated they have begun, and will continue, 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 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

Financial condition may be defined as a school district's ability to balance recurring expenditure needs with recurring revenue sources, while providing desired educational services on a continuing basis. The Board and District officials are responsible for the financial planning and management necessary to maintain the District's financial condition. The general fund's¹ financial condition depends on the Board's ability to develop realistic and structurally balanced budgets, monitor their effective implementation and manage fund balance responsibly and in accordance with statute. In preparing a realistic budget, the Board and District officials should develop revenue and expenditure estimates based on prior years' operating results, past expenditure trends, anticipated future needs and available information related to projected changes in significant revenues or expenditures.

Another key component of budgeting is an accurate estimate of the amount of fund balance that will be available at year-end. Fund balance represents the differences between revenues and expenditures accumulated from prior years. The Board may retain up to 4 percent² of the ensuing year's appropriations as unassigned fund balance³ to serve as a financial cushion for unexpected events and maintaining cash flow. Prudent fiscal management also includes establishing reserves to set aside a portion of fund balance (referred to as restricted fund balance) to address long-term obligations or planned future expenditures.⁴ An appropriation of fund balance is the use of unexpended resources from prior years to finance appropriations in the budget and reduce the necessary tax levy as well as any excess unexpended funds. The Board may also appropriate a portion of its reserves to finance expenditures in the budget that are directly related to the reserves' statutory purposes. However, when the Board continuously appropriates and uses fund balance, which results in a planned operating deficit⁵ each year, it gradually depletes the surplus funds and reserves until there are none available to finance successive

¹ The general fund is the District's main operating fund, used to account for the financial transactions for educational programs and other operating activities, including the maintenance of buildings and grounds, transportation and administration.

² Per New York State Real Property Tax Law

³ This is the remaining portion that is not restricted (reserved).

⁴ The Board should fund reserves at appropriate levels and use them as intended for planned expenditures, in accordance with related statutes.

⁵ A planned operating deficit occurs when a board purposely adopts a budget in which appropriations are greater than anticipated revenues, with the difference to be funded with appropriated fund balance.

budgets. As a result, the Board could be forced to increase revenues (such as property taxes) and/or decrease appropriations (which could potentially reduce services) to adopt structurally balanced budgets. Sound budgeting practices together with prudent fund balance management help ensure that sufficient funding will be available to sustain operations, address unexpected occurrences and accommodate long-term obligations or future expenditures.

The District has not consistently generated sufficient revenues to finance recurring expenditures. District officials have instead relied on the use of fund balance and reserves to close budget gaps, which has negatively affected the District's financial position. The District reported a general fund operating deficit of \$824,815 and zero unassigned fund balance as of June 30, 2013, after the appropriation of \$820,187 for the 2013-14 budget. The District incurred an even greater operating deficit in 2013-14 of \$1,060,295. While nearly 80 percent of these operating deficits were planned through fund balance appropriations, they significantly reduced total fund balance. The repeated use of fund balance to close budget gaps instead of making necessary amendments to revenue or expenditure estimates quickly caused the fund's financial condition to deteriorate and, if continued, will lead to fiscal stress.

The Board's adopted budgets did not include realistic estimates for revenues, expenditures and the amount of fund balance that would be available and used. Specifically, the Board significantly overestimated appropriations in 2011-12 for BOCES⁶ and contractual services. This significant variance helped to offset the significant revenue shortfall in 2011-12 that was due in part to an overestimate of State aid of approximately \$268,000. However, expenditures more closely met appropriations in 2012-13 and 2013-14, resulting in smaller variances that could no longer cover revenue shortfalls including an additional \$305,000 State aid shortfall in 2012-13. As shown in Figure 1, operating deficits occurred in 2012-13 and 2013-14 in excess of the planned operating deficits, resulting in the use of the appropriated fund balance and additional fund balance of almost \$395,000 to fund expenditures.

⁶ Board of Cooperative Educational Services

Figure 1: General Fund – Budget Variances and Fund Balance				
	FY 2011-12	FY 2012-13	FY 2013-14	Totals
Budgeted Revenues	\$11,998,277	\$12,181,905	\$12,500,447	\$36,680,629
Actual Revenues	\$11,499,258	\$11,914,941	\$12,518,838	\$35,933,037
Under/(Over) Estimated Revenues	(\$499,019)	(\$266,964)	\$18,391	(\$747,592)
Appropriations	\$12,593,277	\$12,852,092	\$13,320,634	\$38,766,003
Actual Expenditures	\$11,513,889	\$12,739,756	\$13,579,133	\$37,832,778
Over/(Under) Estimated Expenditures	\$1,079,388	\$112,336	(\$258,499)	\$933,225
Total Budget Variance	\$580,369	(\$154,628)	(\$240,108)	\$185,633
Beginning Total Fund Balance	\$5,451,295	\$5,436,664	\$4,611,845	\$15,499,804
Operating Surplus (Deficit)	(\$14,631)	(\$824,815)	(\$1,060,295)	(\$1,899,741)
Appropriated Fund Balance	\$595,000	\$670,187	\$820,187	\$2,085,374
Unplanned Operating Deficit	N/A	(\$154,628)	(\$240,108)	(\$394,736)
Year-End Total Fund Balance	\$5,436,664	\$4,611,849	\$3,551,550	
Unassigned Fund Balance	\$314,032	\$0	\$554,046	

The District's total general fund balance decreased by almost \$1.9 million, or approximately 35 percent, over the last two fiscal years, from over \$5.4 million at the beginning of 2012-13 to about \$3.6 million at the end of 2013-14. More importantly, reported unassigned fund balance – the portion of fund balance that can be used for cash flow and unanticipated expenditures – decreased to zero as of June 30, 2013. The substantial decline in fund balance was primarily the result of the Board appropriating and using significant amounts of fund balance as a financing source to support operations during 2012-13 and 2013-14. For example, the District appropriated fund balance totaling \$820,187 in the 2013-14 budget, including \$450,000 from three specified reserves.⁷ However, because the Board and Superintendent did not adequately explain or monitor the implementation of the approved budget plan, the new business administrator and the external auditor covered the amount not available in unrestricted fund balance by moving nearly \$400,000 from the unemployment insurance and retirement contribution reserves,⁸ as part of the 2012-13 year-end adjustments. This included \$160,544 from the unemployment insurance reserve that was not used for applicable unemployment insurance expenses and should be repaid to the reserve.⁹

⁷ \$50,000 from the unemployment insurance reserve, \$100,000 from the retirement contribution reserve and \$300,000 from the employee benefit accrued liability reserve (EBALR) after the District contacted the Office of the State Comptroller (OSC) in early 2013, which certified an excess of \$418,381 in the EBALR as of June 30, 2012.

⁸ \$224,350 from the unemployment insurance reserve and \$175,110 from the retirement contribution reserve.

⁹ The \$224,350 transfer from the unemployment insurance reserve exceeded the benefits paid to claimants in 2012-13 (\$63,806) by \$160,544.

During the last four years,¹⁰ the Board increased real property taxes by 9 percent and has remained within the tax levy cap since its inception in 2012-13.¹¹ Although District officials were able to restore the unassigned fund balance to \$554,046 at the end of 2013-14, they did so through extensive use of reserves¹² to fund operations and the reallocation of fund balance among the unrestricted and reserved/restricted components. Furthermore, after taking into account the repayment that District officials should make to the unemployment insurance reserve, the unassigned fund balance would be reduced to \$393,502. The need to rely so heavily on reserves to fund operations and report a positive unassigned fund balance increases the chance of again errantly using reserve funds for inappropriate expenses.

In the 2014-15 adopted budget, District officials planned for another \$665,000 operating deficit by appropriating \$380,000 of unrestricted fund balance and an additional \$285,000 from reserves.¹³ Although they increased the property tax levy by 4 percent¹⁴ (\$149,446), they also increased State aid¹⁵ estimates by 5 percent (\$435,138) – despite having fallen significantly short of State aid estimates in prior years. They also increased total appropriations by \$530,559. Based on these continued trends, the general fund will likely incur another operating deficit and additional reductions to both reserved and unrestricted fund balance. The necessary repayment to the unemployment insurance reserve and the planned use of fund balance and reserves during 2014-15 will essentially exhaust the District’s unassigned fund balance and further reduce reserve balances, leaving little margin for variance in the District’s actual financial results.

We reviewed the District’s interim 2014-15 budget status report as of April 2015 along with the business administrator’s projections,¹⁶ which further indicated that past financial trends will likely continue through year-end. However, the District will likely have a smaller

¹⁰ From 2011-12 through the current 2014-15 year

¹¹ Chapter 97 of the Laws of 2011 established a tax levy limit on all school districts beginning in the 2012-13 fiscal year and precludes a school district from adopting a budget that requires a tax levy that exceeds the prior year’s tax levy by more than 2 percent or the rate of inflation, whichever is less, and certain exclusions permitted by law, without the approval of 60 percent of district voters.

¹² The District used a total of \$1,195,691 from reserves during 2013-14 (\$875,000 from the capital reserve for voter-approved projects, \$58,500 from the repair reserve and \$262,191 from the EBALR reserve.)

¹³ District officials took proper action to ensure that their intentions related to the use of restricted and unrestricted fund balance were adequately reflected in the 2014-15 budget and the 2013-14 annual financial report.

¹⁴ Although this increase exceeds 2 percent, the District remained within constraints of the tax cap calculation.

¹⁵ Includes basic formula, excess cost, lottery and BOCES aid

¹⁶ Obtained at our exit conference on April 27, 2015

operating deficit and smaller than planned reductions in fund balance and reserves.¹⁷ Continued reliance on fund balance and reserves to balance future budgets – without significant adjustments to revenue or expenditure estimates – will exhaust available fund balance and reserves and lead to fiscal stress.

Recommendations

The Board and District officials should:

1. Continue to develop and adopt budgets that include realistic estimates for revenues, expenditures and available fund balance, based on all information available at that current time including historical data.
2. Carefully review and amend budgeting practices to avoid over-reliance on the appropriation of fund balance and reserves to balance future budgets.
3. More closely monitor the implementation of the adopted budget and its progress, against operating results, throughout the year and address any significant variances in a timely manner.
4. Ensure that expenditures and transfers from reserve funds are carefully scrutinized, budgeted for in advance (when possible) and made in accordance with General Municipal Law and Board authorizations.
5. Return moneys improperly transferred from the unemployment insurance reserve fund.

¹⁷ While District officials no longer anticipate needing to use the \$185,000 appropriated from the retirement contribution and unemployment insurance reserves or the \$380,000 appropriated fund balance, they did request OSC certification to use approximately \$108,000 from the EBALR for the current year.

APPENDIX A

RESPONSE FROM DISTRICT OFFICIALS

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



Mount Morris Central School

30 Bonadonna Avenue Mount Morris, New York 14510

May 15, 2015

Mr. Edward V. Grant Jr., Chief Examiner
Office of the State Comptroller
The Powers Building
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Rochester, New York 14614-1608

Unit Name: Mount Morris Central School District
Audit Report Title: Financial Condition
Audit Report Number: 2014M-328

Dear Mr. Grant,

On behalf of the Board of Education and Administration of the Mount Morris Central School District I would like to thank you and your staff for the guidance provided as a result of this audit. We have reviewed the draft report issued by your office and submit the following response to the audit recommendations. In addition please consider this as the district's corrective action plan.

1. Continue to develop and adopt budgets that include realistic estimates for revenues, expenditures and available fund balance, based on all information available at that current time including historical data.

In 2013 the district was notified of a significant (\$236,220) reduction in building aid resulting from the recalculation of the bond percent on capital project dating back to 2001. This was the primary factor that contributed to the unfavorable revenue (\$266,964) earned in 2012-2013. This building aid adjustment was factored into the district's revenue budget for 2013-2014. Actual district revenue in 2013-2014 was favorable to budgeted revenue by \$18,391.

In 2012-2013 expenditures were favorable to budgeted appropriations. In 2013-2014 budget adjustments were made reflecting May 2013 voter authorization directing the district to use \$250,000 of capital reserve for the purchase of technology resources. In December 2013 a voter approved capital project (\$4,000,000 total project) authorized an additional \$625,000 of capital reserve, to cover the local share of the project. In

addition, the use of \$60,000 of repair reserve was approved by the board to address safety concerns on the district's track and to provide repairs to significant deficiencies in the district's HVAC system. These adjustments increased district appropriations to \$14,225,634. With these adjustments considered, actual expenditures were favorable to the authorized appropriations.

The district has and continues to develop its budget in light of both its short and long range fiscal capacity. Revenue estimates are reviewed and adjusted by the Business Administrator prior to the development of the District's budget to increase accuracy and minimize variance; District administrative staff are an integral part of budget development and have been charged with control of and accountability for operational budgets. Administrative staff have been provided real-time access to the accounts for which they are responsible to facilitate their management of these resources. These actions will result decrease budget to actual variance.

2. Carefully review and amend budgeting practices to avoid over-reliance on the appropriation of fund balance and reserves to balance future budgets.

Since 2010 the district has lost over \$2.2 Million in state aid due to the GEA. To fill the gap the district has applied fund balance and reserves as a revenue source conscious of the finite nature of these funding sources. In addition, in that same time frame the district has been underfunded by over \$10 Million in foundation aid.

Restoration of the GEA has allowed the district to reduce its use of fund balance and reserves in the 2015-2016 budget by \$75,000.

Full funding of the foundation aid will allow the district to further reduce if not eliminate the use of reserves.

It is the intention of the District's Board of Education to continue to reduce its reliance on reserves and fund balance in future budgets.

3. More closely monitor the implementation of the adopted budget and its progress, against operating results, throughout the year and address any significant variance in a timely manner.

The district fully agrees that monitoring district operating results throughout the year is essential. Since 2013-2014 in order to have accurate estimates of its expenditures, the district has implemented a spending freeze effective February first of each year. Staff are required to identify and encumber funds for all anticipated expenditures. Only emergency expenditures are authorized after the freeze takes effect.

4. Ensure that expenditures and transfers from reserve fund are carefully scrutinized, budgeted for in advance when possible and made in accordance GML and Board authorizations.

Reserve transfers are specifically identified in the revenue budget adopted by the Board of Education. All transfers will be Board authorized and will fully comply with GML.

5. Return money improperly transferred from the unemployment insurance reserve fund.

The district recognizes that it needs to correct the transfer from the unemployment reserve fund, however we would categorize this transfer as having been done incorrectly rather than improperly. The Business Administrator will work with the District's legal counsel and external auditors to correct the transfer of these funds.

Regards,

Gregory Bump
Superintendent, Mount Morris Central School District

APPENDIX B

AUDIT METHODOLOGY AND STANDARDS

Our overall goal was to assess the Board's management of the District's financial condition.

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

- We interviewed District officials to gain an understanding of the processes and procedures for financial management.
- We analyzed the District's general fund financial records for 2011-12 through 2013-14 to determine if and why the general fund's financial condition had declined. We also evaluated factors contributing to the decline. This included an analysis of fund balance.
- We reviewed the District's audited financial statements for 2011-12 through 2013-14 and documented unexpended surplus funds, reserve funds, revenues and expenditures.
- We performed an analysis of reserve funds for 2011-12 through 2013-14 to determine funding, use and compliance with General Municipal Law.
- We compared the adopted general fund budgets for 2011-12 through 2013-14 with the actual results of operations to determine if the budgets were realistic and structurally balanced.
- We reviewed the proposed general fund budget for 2014-15 to determine whether the budgeted revenues and appropriations were reasonable and if fund balance trends would continue.
- We reviewed revenue and appropriation status reports and performed an analysis of State aid variances for 2011-12 through 2013-14.
- We tested the reliability of the audited financial statements by reviewing bank statements, bank deposits and cash receipts.
- We reviewed the real property tax warrants, receipts and levy increases. We also reviewed the District's tax cap filing for 2014-15.
- We compared unexpended surplus funds to the ensuing year's appropriations to determine if the District was within the statutory limit.
- We reviewed Board minutes, resolutions and other documentation to determine if reserve funds were created, funded and expended properly; if liabilities were properly recorded; and if transfers were appropriate.

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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