



# Herkimer Central School District Financial Condition

## Report of Examination

Period Covered:

July 1, 2014 – October 31, 2015

2016M-68



Thomas P. DiNapoli

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# State of New York Office of the State Comptroller

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## **Division of Local Government and School Accountability**

May 2016

Dear School District Officials:

A top priority of the Office of the State Comptroller is to help school district officials manage their districts efficiently and effectively and, by so doing, provide accountability for tax dollars spent to support district operations. The Comptroller oversees the fiscal affairs of districts statewide, as well as districts' compliance with relevant statutes and observance of good business practices. This fiscal oversight is accomplished, in part, through our audits, which identify opportunities for improving district operations and Board of Education governance. Audits also can identify strategies to reduce district costs and to strengthen controls intended to safeguard district assets.

Following is a report of our audit of the Herkimer 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 Herkimer Central School District (District) is located in the Village of Herkimer, Herkimer County. The District is governed by the Board of Education (Board), which is composed of seven elected members. The Board President is the chief financial officer. 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. During our audit period, the District contracted with the Herkimer-Fulton-Hamilton-Otsego Board of Cooperative Educational Services (BOCES) for the business official position until July 1, 2015, when the Superintendent took over these responsibilities. The business official is responsible for preparing and presenting financial information to the Board.

The District has approximately 1,200 students and 180 employees. For the 2014-15 fiscal year, the District's operating budget was approximately \$22 million, funded primarily with State aid and real property taxes.

## Objective

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

- Did the Board adopt structurally balanced budgets and properly manage fund balance?

## Scope and Methodology

We examined the District's financial records for the period July 1, 2014 through October 31, 2015. We expanded our scope back to July 1, 2011 to analyze the District's fund balance, budgeting and financial trends.

We conducted our audit in accordance with generally accepted government auditing standards (GAGAS). More information on such standards and the methodology used in performing this audit are included in Appendix 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 planned to take 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 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 usually struggles to balance its budget, can suffer through disruptive service level declines and has limited resources to finance future needs. School district officials have a responsibility to taxpayers to ensure the prudent use of their money. To fulfill this responsibility, it is essential that school district officials are provided with accurate up-to-date accounting records in order to develop reasonable budgets and manage fund balance responsibly. District officials should also develop detailed multiyear plans to allow them to set long-term priorities and work toward those goals.

The Board did not adopt structurally balanced budgets or properly manage fund balance. The Board consistently adopted budgets that appropriated fund balance to finance operations without a clear understanding of the amount of fund balance available to appropriate. As a result, the total fund balance in the general fund declined by over \$1.5 million, or 70 percent, during the past four years. As of June 30, 2015, the District's unrestricted fund balance was \$143,946, or 0.6 percent of the ensuing year's appropriations

### **Budgeting and Use of Fund Balance**

The Board is responsible for making sound financial decisions that are in the best interest of the District, the students it serves and the taxpayers who fund the District's programs and operations. Sound budgeting practices based on accurate estimates derived from reliable, up-to-date accounting records, along with prudent fund balance management, help ensure that sufficient funding will be available to sustain operations, address unexpected expenditures and satisfy long-term obligations or future expenditures. Fund balance represents resources remaining from prior fiscal years. A district may retain a portion of fund balance but must do so within the limits established by New York State Real Property Tax Law.

Currently, the amount of fund balance that a school district can retain may not be more than 4 percent of the ensuing fiscal year's budget. The remaining fund balance can be used as a funding source for operations or to establish reserves for specific purposes. However, when a board appropriates fund balance, which results in a planned operating deficit,<sup>1</sup>

<sup>1</sup> A planned operating deficit occurs when a board intentionally adopts a budget in which appropriations exceed budgeted revenues with the difference to be made up by the appropriation of fund balance.

fund balance can be depleted until nothing is available to help finance successive budgets. Eventually, the board must either increase revenues (generally real property taxes) or decrease appropriations (services) to balance budgets. Therefore, officials should monitor available fund balance to ensure that it is not diminished below reasonable levels.

In recent years, the District has struggled with fiscal challenges, and the Board adopted budgets with planned operating deficits from 2011-12 through 2015-16. We compared the total amounts of budgeted to actual revenues and expenditures for fiscal years 2011-12 through 2014-15 and found that revenues and appropriations were reasonable. However, the Board relied on appropriated fund balance as a financing source in its last four annual budgets, which has resulted in reduction in the District's general fund balance.

**Figure 1: Unrestricted Fund Balance at Year-End**

	2011-12	2012-13	2013-14	2014-15
Total Beginning Fund Balance	\$2,162,114	\$1,678,600	\$1,774,818	\$1,168,705
Prior Period Adjustment	\$2	\$0	(\$18,949)	(\$215,231)
Add: Operating Surplus/(Deficit)	(\$483,516)	\$96,218	(\$587,164)	(\$306,313)
Total Ending Fund Balance	\$1,678,600	\$1,774,818	\$1,168,705	\$647,161
Less: Restricted Fund Balance (Reserves)	\$163,117	\$340,640	\$321,186	\$135,883
Less: Encumbrances	\$28,545	\$0	\$39,099	\$117,332
Less: Fund Balance Appropriated for Next Fiscal Year	\$800,000	\$615,000	\$815,000	\$250,000
Total Unrestricted Funds at Year-End	\$686,938	\$819,178	(\$6,580)	\$143,946
Ensuing Year's Budgeted Appropriations	\$20,151,875	\$20,736,480	\$21,744,965	\$22,450,000
Unrestricted Funds as Percentage of Ensuing Year's Budget	3.41%	3.95%	(0.03%)	0.64%

The Board's repeated, extensive use of fund balance to fill budget gaps resulted in the District's unrestricted funds declining to a deficit of \$6,580 at the end of 2013-14, which means the District appropriated more fund balance in the 2014-15 budget than it actually had available. Based on our discussions with District officials and review of available documents, the Board did not always receive accurate or timely fund balance estimates from the BOCES business official during the budget planning process, which may have contributed to the Board's overuse of fund balance as a financing source in the budgets.

For example, in May 2014, during the budget planning process for the 2014-15 fiscal year, the BOCES business official informed the Superintendent, who subsequently informed the Board, that the amount of fund balance estimated to be available at the end of 2013-14 was \$1,415,000. Based on this information, the Board appropriated



\$815,000, believing it left the District with approximately \$600,000 in unrestricted fund balance, or 2.8 percent of the 2014-15 year budgeted appropriations (\$21.7 million). However, the District's 2013-14 reported ending fund balance, less reserve funds, was actually about \$847,500, or \$567,500 (40 percent) less than projected.

The Superintendent took over the business official's duties on July 1, 2015. In October 2015, at the completion of the 2014-15 external audit, the District's auditor made District officials aware of a \$215,000 reduction in fund balance that stemmed from an error in 2011-12, in which a transfer from the general fund for a capital project was not properly recorded. Had this error been recognized at the end of the 2011-12 fiscal year, District officials would likely have appropriated less fund balance in the next four annual budgets.<sup>2</sup> This prior period adjustment, combined with the operating deficit in 2014-15, further depleted the District's already low fund balance.

Over the past four years, the District raised revenue by increasing property taxes within the constraints of the property tax cap limits.<sup>3</sup> In an effort to reduce reliance on fund balance, the Board proposed a 2015-16 budget that appropriated \$200,000 of fund balance and required a tax cap override. However, District residents did not approve this budget. As a result, the Board modified the budget to appropriate \$250,000, or 63 percent of its available fund balance to finance the 2015-16 budget in order to reduce the proposed tax levy. The modified budget was ultimately approved.

The Board's appropriation of \$565,000 less fund balance in the 2015-16 budget than in the prior year has contributed to the District's unrestricted funds increasing to \$143,945 at the end of 2014-15, or 0.64 percent of the 2015-16 budget. While this is an improvement from the prior year's deficit of \$6,580, this level of fund balance provides the District with a very limited financial cushion for managing unexpected events and maintaining cash flow.

## Long-Term Planning

Long-term financial planning can be a vital tool for school districts. It allows decision makers to set long-term priorities and work toward goals, rather than making choices based only on the needs of the moment. A plan can help residents and board members see

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<sup>2</sup> The Board appropriated a total of \$2.48 million in fund balance in the next four budgets.

<sup>3</sup> In 2011, the New York State Legislature enacted a law establishing a property tax levy limit, generally referred to as the property tax cap. Under this legislation, the property tax levied annually generally cannot increase more than 2 percent, or the rate of inflation, whichever is lower, with some exceptions. School districts may override the tax levy limit by presenting to the voters a budget that requires a tax levy that exceeds the statutory limit. However, the budget must be approved by 60 percent of the votes cast.



the effect of their fiscal decisions over time. They can then decide what program funding choices to make in advance, avoiding sudden tax increases or dramatic budget cuts. Long-term planning is critical when a school district is in fiscal stress.

According to District officials, they were aware of the fiscally difficult times they were facing during budget planning for the 2012-13 fiscal year. At the time, however, the Board was optimistic it would be successful in merging with two neighboring districts in a consolidation effort being studied. When District voters defeated the merger efforts, the Board was left without a long-term plan in place. Since that time, the District hired a consultant to assist with long-term planning.

The Board has also made cuts in personal services costs by eliminating the business official position, 10 teachers and four support personnel positions. In addition, sports programs have been reduced, along with some changes in contractual benefits. In an effort to generate greater revenue, the Board hired consultants to review expenditure-driven aids, such as special education and transportation. These actions proved to be insufficient to close the gap between revenues and expenditures in the 2015-16 budget; therefore, the Board proposed an increase in property taxes that required District residents to approve a tax cap override. When District residents did not approve the override, the Board was forced to make further cuts and increase their planned use of fund balance.

Early in the 2015-16 school year, the District contracted out transportation services and moved from using teacher aides to licensed teacher assistants. With these additional changes the Superintendent believes the District may end the year with a surplus, allowing them to begin to rebuild fund balance.

## **Recommendations**

The Board should:

1. Develop and adopt structurally balanced budgets that do not rely on one-shot revenues to finance recurring expenditures. During budget development, consider the amount of fund balance available to appropriate and work toward building a reasonable amount of unrestricted fund balance to address unanticipated needs.
2. Develop and implement a multiyear plan to provide a framework for future budgets and facilitate management of District operations. This plan should be updated annually.

## **APPENDIX A**

### **RESPONSE FROM DISTRICT OFFICIALS**

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

# HERKIMER CENTRAL SCHOOL DISTRICT

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801 West German Street  
Herkimer, New York 13350



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*Superintendent of Schools*  
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April 20, 2016

Rebecca Wilcox  
Chief Examiner  
Office of State Comptroller  
Syracuse Regional Office  
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## **RE: District Audit Response – Herkimer Central School (210601)**

Dear Ms. Wilcox:

The Board of Education and the Superintendent of Schools of the Herkimer CSD are in receipt of the draft copy of the Report of Examination on the Financial Condition of the district for the period from July 1, 2014 to October 31, 2015 and the recommendations contained therein. We would like to thank the staff from the Comptroller's office for their efficiency and professionalism throughout the audit process. Please allow this letter to serve as our response to the audit.

We have reviewed the findings in the draft audit report and have given significant consideration to the information in the report. As expected, the audit did not uncover any instances of fraud, or malfeasance with the School District Financial Management. Please be advised that we agree and accept the findings, conclusions and recommendations contained in this report.

While we agree with the findings in this report, we also must note that Herkimer CSD has been severely underfunded by New York State both through the GAP elimination assessment and grossly inadequate foundation aid along with the revenue restrictions placed on the

Rebecca Wilcox  
April 20, 2016  
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district through the tax levy limit legislation. In 2015-16 alone our district was nearly \$2.7 million dollars, about a third, underfunded in foundation aid and have had over \$20 million in foundation aid withheld from the district in the last seven (7) years. The district has reduced instructional positions, instructional support positions and administrative positions by more than 20% over that same time period. The district has been torn by its obligation to both provide a free appropriate public education to our children and the need to be fiscally prudent. That said, the district will develop a corrective action plan which will include less reliance on fund balance and developing a five year financial plan.

We would again like to thank the staff from the Comptroller's office for their efficiency and professionalism throughout the audit process.

Sincerely,

Robert J. Miller  
Superintendent of Schools

RJM/sj

## **APPENDIX B**

### **AUDIT METHODOLOGY AND STANDARDS**

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

- We interviewed District officials and reviewed the meeting minutes, resolutions and budget brochures to gain an understanding of the District's budget development, including the fund balance process.
- We reviewed the general fund's results of operations for the fiscal years 2012-13 through 2014-15, and we reviewed the 2015-16 budget.
- We compared the budgeted revenues and appropriations to the actual revenues and expenditures for the general fund for fiscal years 2011-12 through 2014-15. We also compared the 2015-16 budgeted revenues and appropriations to actual revenues and expenditures from fiscal years 2013-14<sup>4</sup> through 2014-15 to determine if District officials were budgeting reasonably.
- We analyzed the trend in total fund balance, including the use of appropriated fund balance, in the general fund for fiscal years 2011-12 through 2014-15. We also compared the unrestricted fund balance to the ensuing year's budgeted expenditures to determine if the District was within the statutory limitation during the same fiscal years.
- We reviewed the trend of real property tax rates, levies and assessments for the 2012-13 through 2015-16 fiscal years.

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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<sup>4</sup> The District changed its financial reporting system recently and was unable to generate financial detail for fiscal year 2012-13. At the end of our audit, the District was working to gain access to this program.

## **APPENDIX C**

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**AND SCHOOL ACCOUNTABILITY**

Andrew A. SanFilippo, Executive Deputy Comptroller  
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