Chenango Valley Central School District

Financial Condition and Internal Controls Over Selected Financial Activities

Report of Examination

Period Covered:
July 1, 2007 — December 22, 2008

2009M-190

Thomas P. DiNapoli
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Division of Local Government and School Accountability

December 2009

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 Chenango Valley Central School District, entitled Financial Condition and Internal Controls Over Selected Financial Activities. 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
The Chenango Valley Central School District (District) is located in Broome County and lies within the Towns of Chenango, Colesville, Dickinson, Fenton, and Kirkwood. 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 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 former Business Official was responsible for overseeing business operations and acting as purchasing agent. In March 2008, the Business Official retired and the Board contracted with an interim Business Official. In July 2009, the former Superintendent retired and the Board appointed the current Superintendent.

On January 1, 2009, the Board entered into a contract with the Broome Tioga Board of Cooperative Education Services (BOCES) for central business office (CBO) operations. The CBO is now responsible for the daily financial operations, processing for payroll, purchasing, cash disbursements and claims auditing. The CBO is also working with District officials to re-establish fund balance and manage finances so that the issuance of a deficit bond and associated repayment are met in accordance with the authorizing legislation.

**Scope and Objective**

The objective of our audit was to examine internal controls over selected financial activities to ensure that District assets were properly safeguarded for the period July 1, 2007 to December 22, 2008. Our audit addressed the following related questions:

- Did the Board effectively monitor and control District finances?
- Has the Board adopted realistic budgets and utilized long-term planning to identify and manage future operating requirements?
- Did the Board appoint a claims auditor in accordance with New York State Education Department regulations?

We expanded our scope to include the period June 30, 2003 through June 30, 2009 to review the District’s financial condition. We also expanded our testing to review the audit of claims for the period January 1, 2009 through June 30, 2009.
Audit Results

District management failed to set the proper “tone at the top,” which can have a negative impact on employees’ attitudes and decisions, and contributed to the District’s financial decline. The Board has failed to take or require corrective action based on audit findings and failed to provide proper guidance to District officials to carry out their duties. The former Business Official and former Superintendent failed to maintain accurate and complete accounting records. These factors contributed to the District’s financial problems and provided taxpayers with little assurance that the District’s financial operations were properly controlled.

The Board has not effectively monitored and controlled District finances or adopted realistic budgets, which resulted in an accumulated general fund deficit of $3.5 million as of June 30, 2008. The $3.5 million deficit was 12 percent of the $28.9 million general fund budget for the 2007-08 fiscal year. As a result, District officials obtained approval from the State Legislature and issued $3.5 million in deficit financing bonds. We also found the Board did not have procedures to plan for long-term operational needs, which may contribute to more financial problems in the future. In 2009, the District contracted with the CBO, who created the District’s first long-term plan to address the deficit.

The deficit financing and certain operational changes have allowed the District to complete the 2008-09 fiscal year with a surplus from operations. This improvement is due in large part to the deficit bond financing. However, even without the bond financing, revenues still exceeded expenditures by approximately $3.4 million. As of June 30, 2009, the District has an unreserved fund balance of $1.2 million for the fiscal year ending 2009 and has properly established four reserves totaling $2.1 million. In order for the District to continue to improve its financial condition, it is imperative that the Board strictly monitor revenues and expenditures to ensure that sufficient resources are available to meet future obligations.

The Board appointed an employee of BOCES as the District’s claims auditor. This is against the New York State Education Department’s (SED) guidance on interpreting regulations, which states that it may not be appropriate for a BOCES to provide claims auditing services to its component districts, since most of these districts would have material and significant contract payments to that BOCES. In addition, the Board appointed a second BOCES employee to serve as the District’s deputy claims auditor; however, there is no provision to permit the Board to appoint more than one claims auditor. We did not find any material deficiencies with the audit of District claims.

Comments of District Officials

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 already initiated, or plan to initiate, corrective action.
Introduction

Background

The Chenango Valley Central School District (District) is located in Broome County and lies within the Towns of Chenango, Colesville, Dickinson, Fenton, and Kirkwood. 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 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 former Business Official was responsible for overseeing business operations and acting as purchasing agent. In March 2008, the Business Official retired and the Board contracted with an interim Business Official. In July 2009, the former Superintendent retired and the Board appointed the current Superintendent.

On January 1, 2009, the Board entered into a contract with the Broome Tioga Board of Cooperative Education Services (BOCES) for central business office (CBO) operations. This contract is an agreement between the parties to allow the CBO to provide all financial operations, including accounting, estimating, analyzing, and reporting of the District financial performance. The CBO is now responsible for the daily financial operations, processing for payroll, purchasing, cash disbursements and claims auditing. This includes employing personnel with the knowledge and experience to ensure that District operations are performed within the confines of adopted budgets and in the best interests of the District taxpayers. The CBO is also working with District officials to re-establish fund balance and manage finances so that the deficit bond issue and associated repayment are handled in accordance with the authorizing legislation.

There are four schools and a transportation facility in operation within the District, with approximately 1,900 students and 300 employees. The District’s budgeted expenditures for the 2008-09 fiscal year were approximately $31.4 million, funded primarily with State aid, real property taxes and grants.

The Board failed to plan, monitor, and control District finances. As a result of the Board’s inaction, the general fund’s and school lunch fund’s financial conditions deteriorated to a significant deficit. Because of these deficits, the Board had to request authority to issue indebtedness to liquidate the deficit. The New York State Legislature enacted legislation for the District to issue $3,500,000 in bonds dated April 15, 2009. Final maturity occurs in 2019. This legislation also requires the Comptroller’s Office to examine the District’s annual
budget for the period the bonds are outstanding and review financial reports quarterly. Our report of the District’s 2008-09 budget was issued on April 23, 2008.

Objective

The objective of our audit was to examine internal controls over selected financial activities to ensure that District assets were properly safeguarded for the period July 1, 2007 to December 22, 2008. Our audit addressed the following related questions:

- Did the Board effectively monitor and control District finances?
- Has the Board adopted realistic budgets and utilized long-term planning to identify and manage future operating requirements?
- Did the Board appoint a claims auditor in accordance with New York State Education Department regulations?

Scope and Methodology

We examined internal controls over selected financial activities for the period July 1, 2007 to December 22, 2008. We expanded our scope to include the period June 30, 2003 through June 30, 2009 to review the District’s financial condition. We also expanded our testing to review the audit of claims for the period January 1, 2009 through June 30, 2009.

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 have already initiated, or plan 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 the CAP available for public review in the District Clerk’s office.
Management Responsibilities

The Board is responsible for the overall financial management of the District, including setting policies and objectives over financial operations and maintaining sound financial condition. The Superintendent and department heads share the responsibility for ensuring that internal controls are adequate and working properly to provide reasonable assurance that the District meets its financial goals and fiduciary responsibilities.\(^1\) A fundamental part of these controls is setting a proper “tone at the top,” which requires the Board to demonstrate a concern for good management and to follow appropriate procedures such as taking corrective action based on audit findings. Without adequate internal controls, taxpayers have little assurance that financial operations are properly controlled. The Board is also responsible for employing competent personnel who possess sufficient accounting and financial expertise to prepare accurate and timely reports and budgets.

The Board did not monitor and control District finances. The Board did not take or require corrective action based on audit findings, monitor financial operations, or provide proper guidance to District officials to carry out their duties. The Board’s inaction significantly contributed to the District’s deteriorating financial condition, as discussed later in this report. Business Office operations and the internal controls meant to monitor operations were not operating effectively, and the Board did not insist that the former Superintendent and former Business Official correct any deficiencies. As a result, the District ultimately had to seek deficit financing to sustain District operations.

**Board Response to Audits**

The District’s severe control weaknesses over financial operations have limited the Board’s ability to monitor and control financial operations, contributed to the District’s financial stress, and could allow accounting errors and/or fraud to occur and remain undetected and uncorrected. Although the Board was aware of the District’s severe financial weaknesses through annual audit reports and management letters prepared by the District’s independent public accountant (IPA), the Board, former Superintendent and former Business Official failed to take sufficient corrective action. The District’s IPA reported internal control deficiencies for all aspects of the District’s business operations.

\(^1\) Internal control procedures include establishing authorization to execute transactions, properly design records, secure assets and records, segregate duties, perform periodic reconciliations and verifications, and prepare suitable financial reports.
over the last two years. More importantly, the IPA reported a deficit fund balance for the last four years and expenditures in excess of appropriations for the last three years.

The significant control issues reported by the IPA in its 2006-07 and 2007-08 management letters included: “we do not believe that the current District management has the capability to prepare financial statements under GAAP.” These findings were red flags that the Board should have investigated. The Board would have found past segregation of duties and control weaknesses in purchasing, payroll, and disbursements that helped contribute to over-expenditures and the District’s declining financial condition.

Following up on audit findings and instituting corrective action is an important part of the Board’s oversight responsibility. In failing to fulfill its responsibility, the Board has set a bad example for District employees, established a poor tone at the top, and forgone the opportunity to correct budgetary and accounting deficiencies that were contributing to the District’s deteriorating financial condition. Timely and decisive responses to the IPA’s findings could have prevented or mitigated the financial stress that the District experienced. Our audit found similar control deficiencies in all of the District’s business operations prior to the District contracting with the Central Business Office (CBO) in January 2009. The CBO’s control procedures greatly improved the controls over District business operations.

Board members have a responsibility to serve the community and protect the public interest. They are responsible for the District’s fiscal management, have a fiduciary responsibility for District assets, finances and investments, and must exercise good faith, due diligence, care and caution. While we recognize that the Board is not elected to run day-to-day operations and must rely on professionals for this purpose, the Board needs to guide District management, hold the Superintendent and Business Official accountable for operations and proper service to the public, and ensure that the District complies with applicable rules, regulations, and laws.

The Board members did not exercise due diligence when carrying out their responsibilities. For example, the New York State Education Department Commissioner’s Regulations allow the Board to authorize the Superintendent to make budgetary transfers, but require the Board to set limits on the amount that can be transferred without Board approval. Although the Board authorized the former Superintendent

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2 For the school years 2006-07 and 2007-08
3 From 2004-05 through 2007-08
4 Generally Accepted Accounting Principles
to approve budget transfers, it did not establish dollar limits until the 2008-09 year, and did not review or approve budget transfers that the former Superintendent made prior to 2008-09. Further, District officials did not present budget transfers to the Board prior to the 2008-09 fiscal year. The majority of these transfers occurred late in the year after the District had exceeded its available appropriations. For example, of the $2.3 million transferred during fiscal year 2007-08, the District transferred $1.2 million in May 2008, one month before the fiscal year ended. Because the Board did not set limits or oversee budgetary transfers, it could not be assured that they were valid and made for proper District purposes.

In addition, several Board members told us that District officials never presented them with any budgetary reports and they had no idea that the District was experiencing deficits. However, the budget status reports5 were part of the Board meeting materials for every meeting starting in October and continuing through the year-end for at least the last two years (2006-07 and 2007-08). The Board did not review and take action when presented with budget status reports as required. If the Board members were reviewing the reports, they would have been alerted to the substantial over-expenditures that were occurring.

The Board also adopted an investment policy, which, among other objectives, requires a reasonable rate of return on the District’s investment. The Board did not monitor this policy and ensure that the former Business Official sought the best return on the deposit of District funds. During the period July 2007 through June 2008, we reviewed seven accounts the District held with local banks and found that they were not maximizing interest. Collectively, these accounts earned approximately $18,000 in interest. We estimated that the District could have earned as much as $178,000 more in interest if the Board required the former Business Official to obtain the best possible yield on District investments.

This lack of oversight resulted in a weak control environment and severe fiscal stress. The Board’s failure to monitor financial operations and adopt policies and procedures to provide guidance to District officials significantly contributed to the District’s pattern of deteriorating financial condition.

The Business Official has the primary responsibility to prepare and maintain accurate accounting records, with sufficient oversight from

Accounting Records

5 The budget status reports show the budgeted amount compared with the actual to date for revenues and expenditures.
6 Our analysis used the Federal Reserve six-month CD rate, a money market rate earned by a similar entity, and a public funds commercial money market rate.
the Superintendent. These records are the basis for many financial decisions and provide the Board and other entities with a financial snapshot of the District’s fiscal performance. Inaccurate or incomplete records can hide financial decline and do not provide a mechanism for the Board to make sound financial decisions that influence the District’s future fiscal health.

The former Business Official and former Superintendent failed to maintain accurate and complete accounting records. At the conclusion of the IPA audits for fiscal years ending June 30, 2007 and June 30, 2008, District officials made journal entries to adjust the various errors in the accounting records based on the IPA recommendations. These entries ranged from minor corrections of revenue and expenditures to significant adjustments to revenues and fund balance. Because these entries often happened in September or October of the following school year, budgets for the current year were already prepared using figures that were not representative of the true financial picture. Below are examples of such entries.

- An entry dated June 2007 decreased the balance in the general fund State Aid Receivable account over $1 million. According to entry details, the purpose was to remove unrealized State aid that the former Business Official anticipated receiving. This significant decrease in revenue negatively affected operations, helped to contribute to the operating deficit for the year, and further decreased fund balance.

- A second entry dated June 2007 decreased the balance in the general fund Due from Other Governments Fund account by $272,845. The purpose was to remove unrealized revenue that the former Business Official anticipated receiving for the District’s incarcerated youth program. As part of this entry, beginning fund balance was decreased $97,648 and the 2006-07 revenue was decreased $126,747. The remaining amounts of the entry adjusted expenditures and accounts payable. This entry also increased the operating deficit for the year.

These two corrections show that during the 2007-08 budget preparation, revenue and fund balance projections for the 2006-07 school year were incorrect and materially over-inflated. Revenue projections were overstated by approximately $960,000 and fund balance was about $330,000 less than reported. As a result, District officials could not make informed financial decisions when using these inaccurate records to prepare the budget.

In May 2008, the Board contracted with an interim Business Official to handle oversight of the business operations following the former
Business Official’s retirement. This interim Business Official worked with the District up until the transition to the CBO in January 2009. During his time with the District, he corrected accounting record errors and provided the Board with accurate financial reports. The interim Business Official initiated over 130 journal entries from May 2008 to June 2008 to correct previous errors. The interim Business Official’s work resulted in the IPA making only one general fund adjustment for the year ending June 30, 2008. We reviewed the accounting records maintained by the CBO and found them to be complete and accurate.

Recommendations

1. The Board should address all findings and recommendations issued by the internal auditor and the District’s IPA.

2. The Board should ensure that District funds held in bank accounts earn the best yields available and require that the Business Official periodically seek rate quotes from surrounding banks to determine that funds held in accounts will provide the most interest revenue.

3. The Board should review financial and budgetary information throughout the year and use this information to monitor the District’s financial activity.
Financial Condition

A school district’s financial condition has an impact on its ability to provide educational services to students within the district. Districts in good financial condition collect sufficient revenues to pay short-term bills and meet the current portion of long-term obligations while funding current programs. To this end, the Board should establish the District’s financial objectives and plans to meet those objectives, while the Superintendent and Business Official execute those plans and manage the day-to-day operations. The Treasurer also plays a role in the District’s financial management by reporting financial information to the Board. The Board, with input from District management, must make sure that budgets are prepared, adopted and amended based upon reasonable and accurate assessments of resources to fund appropriations. The Board must also make sure that policies, procedures and competent personnel are in place to ensure financial information is correct and reported in a timely manner. Education Law provides that total budget appropriations, as approved by the voters, may not be over-expended.

The Board did not adopt realistic budgets nor develop a long-term financial plan. As a result, the District’s general fund’s and school lunch fund’s financial conditions have diminished greatly in recent years, and the District needed to request the authority to issue debt to meet current financial obligations from the State Legislature in 2008. The State Legislature authorized the District to issue indebtedness to liquidate the deficit, and the District issued $3,500,000 in bonds dated April 15, 2009. The final bond payments occur in 2019. Over the life of the bond, the District is required to pay $826,511 in interest expenses.

The general fund’s financial condition and cash flow deficiencies were the result of the Board’s failure to demand that District officials prepare accurate and reliable financial information, its poor decisions in developing and adopting the annual operating budgets, as well as poor or no controls over spending. The Board did not monitor and oversee the District’s financial condition; instead, the Board completely relied on the former Superintendent and former Business Official to handle the District’s finances. These individuals did not prepare and maintain accurate and realistic financial records. As a result, the Board adopted budgets that continually underestimated expenditures, which exhausted the general fund’s fund balance. In addition, the Board had not developed a comprehensive, multi-year

\footnote{Chapter 260 of the Laws of 2008}
operational plan, nor did it have any other procedures in place to address the District’s long-term financial needs.

Operating Deficits and Fund Balance

It is important that District officials adopt realistic budgets based on reliable data, such as historical costs and available contract and State aid information, and that they regularly monitor actual results of operations for each fund throughout the year. The annual budget is a plan, subject to modifications when appropriate, that provides District officials with the information necessary to control District spending and ensure revenue projections are being met during the year. Based on past trends, current observations, and future expectations, District officials should revise budgetary estimates to ensure the District does not expend moneys beyond the level of appropriations approved by the voters.

An important aspect of budget preparation includes a reasonable estimate of fund balance at the end of the fiscal year. Fund balance is the cumulative difference between revenues and expenditures. There are two types of fund balance, reserved and unreserved. Reserved fund balance represents moneys that the District has set aside and may only use for specific purposes and, therefore, is not available for the District to use for general purposes. Unreserved fund balance is the amount of fund balance that is uncommitted. The portion of the unreserved fund balance that is used to help finance the next year’s budget is known as appropriated fund balance. The remainder of the unreserved fund balance is unappropriated. Any unappropriated fund balance remains available for cash flow purposes and to offset unexpected occurrences such as emergency repairs, cost and demand fluctuations in essential commodities, or unanticipated shortfalls in estimated revenues.

An operating deficit occurs when expenditures exceed revenues. An operating deficit can be planned for and financed by appropriating fund balance. An unplanned deficit can also occur due to over-expending appropriations, under-estimating appropriations, over-estimating revenues, not receiving budgeted revenues, or a combination thereof.

The Board did not effectively monitor the District’s financial operations or ensure that the District did not exceed its approved expenditures. As stated previously, the former Business Official and former Superintendent failed to maintain accurate and complete accounting records, and the Board failed to demand that they do so. District officials made journal entries to adjust the various errors in the accounting records based on the independent public accountant (IPA) recommendations. Because these entries often happened in September or October of the following school year, District officials had already prepared budgets for the current year using figures that
were not representative of the true financial picture. As a result, the Board adopted inaccurate budgets, and the general fund’s unreserved fund balance deteriorated from a surplus balance of more than $1.5 million during 2003-04 to a deficit of $3.5 million as of June 30, 2008. The $3.5 million deficit was 12 percent of the $28.9 million general fund budget for the 2007-08 fiscal year. The following table illustrates the deterioration of fund balance:

| General Fund Balance at June 30 as reported by Independent Public Accountants |
|---------------------------------|-----------------|--------|--------|--------|--------|
| Reserved Fund Balance           | $41,865         | $2,273  | $1,255  | $28,847 | $1,543  |
| Unreserved Fund Balance         |                |         |         |         |         |
| Appropriated                    | $0              | $800,000 | $0      | $0      | $0      |
| Unappropriated                  | $1,514,291      | ($389,006) | ($600,490) | ($3,072,564) | ($3,573,612) |
| Total Fund Balance              | $1,556,156      | $413,267* | ($599,235) | ($3,043,717)** | ($3,572,069) |

* The changes in fund balance also include prior period adjustments.  
** Significant decline in fund balance due in large part to adjusting entries made at year-end at the IPA’s recommendation. See Management Responsibilities finding for further explanation.

The primary cause of this significant decline in fund balance was several years of operating deficits resulting from adopting inaccurate budgets. For the fiscal years 2003-04 through 2007-08, the District incurred aggregate operating deficits totaling over $4.2 million in the general fund.

Although the Board had planned for one of these operating deficits by appropriating $800,000 as a financing source in the 2005-06 adopted budget, there was only $400,000 available to appropriate. The Board incorrectly over-appropriated fund balance because the accounting records used when preparing the budget were inaccurate and made it appear that there was fund balance available to appropriate. Subsequent adjustments, based on the IPA’s recommendations, showed that fund balance was not available for appropriation. In addition, the actual operating deficit exceeded what the Board planned by nearly $200,000 for the 2005-06 year. The unplanned operating deficits occurred because District officials failed to prepare and adopt realistic budgets based on past performance and known future liabilities (e.g., approved contractual salary increases for employees). In addition, the budgets exceeded the amount approved by taxpayer vote. A chart detailing revenue and expenditure variances for the past three fiscal years is shown on the next page.
**Budget Figures From Independent Audit Reports for General Fund***

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<td>($946,349)</td>
<td>($314,168)</td>
<td>($815,280)</td>
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* The District could not provide information for the 2003-04 or 2004-05 fiscal years.
** Improperly included proceeds from a budget anticipation note that was corrected in the subsequent year.
***Difference in revenues due in large part to adjusting entries made at year-end.

See Management Responsibilities finding for further explanation.

District officials failed to prepare budgets that responded to clear and obvious trends. For example:

- Estimates for 2007-08 instructional expenditures totaled $13.7 million, which included teachers’ salaries. The 2007-08 budget reflected a change of less than 1 percent from the prior year actual, although the employment contract for teachers included a 4 percent salary increase for 2007-08. Even though this contract was not formally adopted until July 2007, an increase in salaries should have been anticipated based on history. Thus, the Board’s adopted budget did not provide for the reasonably expected salary increases when preparing the 2007-08 budget, and teachers’ salaries were over-expended by approximately $1 million in that year.

- The District estimated special education services in 2007-08 to be $2.3 million. However, this was 20 percent less than the actual cost of $2.7 million in 2007-08. Even though District officials had past results of operations that would have allowed them to more accurately estimate special education costs, they did not use them, and consistently under-budgeted these costs by 18 to 22 percent (an average of nearly $440,000 each year for the last three years). In addition, the Special Education Director told us that she had provided the former Business Official with her budget estimates for the Special Education Department each year. The former Business Official did not use these estimates when preparing the budget, and consistently appropriated less than what the Director requested to fund these services.
In addition, District officials did not design and implement a system of controls to ensure that they kept expenditures within adopted budgets. During fiscal years ended June 30, 2006 to June 30, 2008, expenditures in the general fund exceeded budgeted amounts in all three years. District officials ignored the financial software controls meant to prevent over-expenditures. The former accounts payable clerk told us that she ignored the warnings because that was how “it always was.” Further, the Board-appointed purchasing agent (former Business Official) either approved these purchase orders that exceeded their appropriations or did not approve them at all because employees made the purchases without submitting purchase orders to him for his approval.

The Board’s failure to demand that District officials prepare realistic cost estimates and control expenditures significantly contributed to the deficits in the general fund. Further, over-expending budget appropriations is in violation of Education Law.

Cash Flow

An essential component of effective financial management is ensuring that sufficient cash resources are available to pay obligations as they come due. To ensure that cash is available as needed, districts should develop cash flow projections to help identify potential cash deficiencies. When a district does not have sufficient cash to meet its current obligations, it may issue short-term debt to fulfill cash obligations.

The District’s exhaustion of the general fund’s positive fund balance resulted in insufficient cash flow to pay bills as they came due without issuing debt. We compared the general fund’s current assets (cash and other assets readily convertible to cash) to current liabilities (amounts due and payable within the fiscal year) at fiscal year end, and found that the general fund has not been cash solvent since the 2003-04 fiscal year.

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<tbody>
<tr>
<td>Current Assets</td>
<td>$4,012,829</td>
<td>$2,276,639</td>
<td>$1,827,442</td>
<td>$1,662,472</td>
<td>$3,922,565</td>
</tr>
<tr>
<td>Current Liabilities</td>
<td>$3,369,699</td>
<td>$2,682,957</td>
<td>$4,743,523</td>
<td>$5,385,722</td>
<td>$7,923,970</td>
</tr>
<tr>
<td>Current Ratio*</td>
<td>1.19</td>
<td>0.85</td>
<td>0.39</td>
<td>0.31</td>
<td>0.50</td>
</tr>
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*The current ratio is measure of how solvent or available an entity’s cash is. A value of one or greater means that current cash can cover current liabilities as they come due. A value of less then one means that current liabilities cannot be met with the current cash available.
As a result, the District used the issuance of revenue anticipation notes (RANs)\(^8\) near the end of each fiscal year since 2004 to provide sufficient cash flow to finance District operations.

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<tbody>
<tr>
<td>RAN</td>
<td>$1,500,000</td>
<td>$2,500,000</td>
<td>$3,900,000</td>
<td>$4,500,000</td>
<td>$7,500,000</td>
</tr>
</tbody>
</table>

Although it is not uncommon to issue RANs,\(^9\) the increasing reliance on RANs to meet District financial obligations is an early indication of fiscal concerns. At some point, the need to issue an increasing amount of debt reaches a critical level and the continued operating deficit becomes more than a temporary concern. Because the District reached that point, the District needed to request the authority from the State Legislature in 2008 to issue debt to meet current financial obligations. The State Legislature authorized\(^10\) the District to issue indebtedness to liquidate the deficit, and the District issued $3,500,000 in bonds dated April 15, 2009. The final bond payments occur in 2019. Over the life of the bond, the District is required to pay $826,511 in interest expenses.

Soon after the departure of the former Business Official, the former Superintendent contacted the Business Official of a neighboring district for assistance in developing the budget estimates for the 2008-09 fiscal year. In addition, the Office of the State Comptroller conducted a budget review of the 2008-09 figures and determined that the estimates were reasonable. The District then contracted with an interim Business Official and the Central Business Office (CBO) beginning January 2009 to provide better controls and monitoring of the District’s business operations. All of these were positive steps towards improving District financial operations and the District’s financial condition. This improvement is due in large part to the deficit bond financing. However, even without the bond financing, revenues still exceeded expenditures by approximately $3.4 million. As of June 30, 2009, the District has an unreserved fund balance of $1.2 million for the fiscal year ending 2009 and has properly established four reserves totaling $2.1 million. To continue to improve its financial condition, it is imperative that the District closely monitor its business operations and ensure that it develops realistic budgets and then monitors operations to stay within its budget.

\(^8\) RANs represent a temporary source of cash borrowed against the pending collection of certain specific revenues estimated in the annual budget and must be issued within two weeks of the commencement of the fiscal year to which the estimates apply.

\(^9\) A school district’s fiscal year starts two months prior to its ability to begin collecting taxes and up to four months before it collects the full tax levy. Thus, for cash flow purposes, it is common for school districts to issue RANs to bridge these months.

\(^10\) Chapter 260 of the Laws of 2008
School Lunch Fund — As with any fund that generates revenues and incurs expenses, it is important to prepare a budget for the school lunch fund and monitor its financial operations to ensure its solvency. As of June 30, 2008, the District reported the school lunch fund’s deficit at approximately $183,000. Also, the District has reported negative total fund balances in the school lunch fund since the 2003-04 fiscal year. Furthermore, as reported in our report of the District’s 2008-09 budget, the District had not prepared a budget for the school lunch fund. Similar to the general fund, prior to the business operations shift to the CBO, the District engaged in little planning and reporting for the school lunch operation. The former Business Official manually recorded the lunch fund’s monthly activities and did not record the information in the accounting system until year-end. The school lunch director told us that she maintained monthly records and provided them to the former Business Official, but she was unsure if he did anything with the information. The Board minutes did not indicate the lunch fund’s performance. It appears that the cash disbursement schedules were the only cafeteria-related information provided to the Board. The CBO now maintains the school lunch financial records and provides the Board with reports such as a monthly operating statement and details of the number and types of meals served. For future years, the District is planning an inter-fund transfer of $40,000 per year from the general fund to address school lunch fund operations. As with the general fund, it is imperative that the District continue to monitor the school lunch fund’s financial operations to ensure that it remains solvent.

Long-Term Planning

Multi-year financial planning is a critical tool and is particularly important for districts that are financially stressed. Projecting operations several years into the future helps to identify structural imbalances between revenues and expenditures, allows officials to set long-term priorities and goals, provides a basis for assessing the impact and merits of alternative approaches to address financial problems, and helps to level the rate of tax increases and avoid sudden and severe cost-cutting measures. A long-term financial plan should be monitored and updated to ensure that decisions are guided by the most accurate information available.

Prior to 2009, the Board had not prepared a plan for long-term operational needs. This lack of long-term planning limited the Board’s ability to assess the effects of fixed costs such as labor contracts or debt payments and inflationary costs such as health insurance and energy, and did not allow the Board to budget in the most prudent and economical manner. In 2009, the CBO developed a long-term financial plan for the District to improve its financial condition. It is important for the Board to monitor and update this plan as needed to ensure that the District’s financial condition improves.
**Recommendations**

4. District officials should demand current and reliable financial information for use in monitoring District finances and preparing budgets.

5. The Board should continue to adopt budgets that accurately estimate revenues, expenditures and available fund balance and then monitor actual activity against the budget throughout the year.

6. The Board should continuously monitor the District’s long-term plan to prevent the future recurrence of deficit fund balances and cash flow deficiencies.
Claims Auditor

Conducting a proper audit of claims before the District pays them is an integral part of any internal control system. Education Law (Law) requires the Board to audit each claim voucher before authorizing payment. Alternatively, the Board can appoint a claims auditor to perform this important function. The claims auditor assumes all of the Board’s powers and duties for approving or disapproving claims against the District. The claims auditor must determine whether each claim is properly authorized and accurate, whether the purchase represents a valid District expense for goods or services, and whether the goods or services were actually received. The Board may delegate the claims audit function by using inter-municipal cooperative agreements, shared services to the extent authorized by Law, or independent contractors. However, State Education Department guidance on interpreting regulations states that it may not be appropriate for a Board Of Cooperative Education Services (BOCES) to provide claims auditing services to its component districts because the District could have material and significant contract payments\textsuperscript{11} to that BOCES. Further, there is no provision in Law that permits the Board to appoint more than one claims auditor.

At the December 17, 2008 Board meeting, the Board appointed an employee of BOCES Central Business Office (CBO) as the District’s claims auditor. The Board also appointed a second BOCES CBO employee to serve as the District’s deputy claims auditor. The Board’s appointment of a BOCES CBO employee as claims auditor was contrary to the SED guidance, because the District had material and significant contract payments ($2.5 million) to the BOCES for the 2008-09 fiscal year. Having an employee of the BOCES as claims auditor puts that person in the position of having to approve payments to his or her employer and is a poor control. In addition, there is no authority in Law to appoint a deputy claims auditor.

Because the Board’s appointment of its claims auditor did not meet SED regulations, we reviewed three claims for supplemental services totaling $870,871 that were payable to BOCES from the 2008-09 fiscal year to ensure that BOCES provided adequate documentation to support the amount billed to the District and verify that the claims auditor performed a thorough review of each claim. We found no material discrepancies with the claims we reviewed. However,\textsuperscript{11} Contract payments include all payments paid to a BOCES for goods and services provided to the District, which, if significant or material, may impair the claims auditor’s independence and result in a conflict of interest.
because the District made material and significant contract payments to BOCES and the Board appointed a deputy claims auditor contrary to SED regulations, there remains an increased risk that the claims auditor’s independence may be impaired because she approves her employer’s claims.

**Recommendation**

7. Board members should audit District claims themselves or appoint a claims auditor who is independent of vendors that submit claims to the District.
APPENDIX A
RESPONSE FROM DISTRICT OFFICIALS

The District officials’ response to this audit can be found on the following pages.
Mr. Patrick Carbone  
Chief School Examiner  
Division of Local Government and School Accountability

December 14, 2009

Dear Mr. Carbone,

The Chenango Valley Board of Education thanks the Office of the State Comptroller for a comprehensive audit of the District’s finances from July 1, 2007 to December 22, 2008. As stated in the report the district had been and was in a condition of fiscal distress that culminated in a very factual Independent Public Accountants report to the Board of Education in October of 2007 regarding the 06-07 and previous school years. Although the body of OSC Audit is generally correct, the BOE respectfully disagrees with some of the conclusions, but also accepts responsibility for various deficiencies as noted. It should be further noted that although the BOE was slow to initially realize the cause of the continued deterioration of the district finances, once it became evident to us in October 2007, the BOE took immediate and decisive action to correct the financial and management deficiencies.

Our first order of response is to state that the IPA Audit for the 08-09 school year states: “that no material deficiency have been reported and that of the 13 issues identified in the previous year’s audit, 12 have been fully corrected or implemented.” The one remaining item regarding Capital Projects is being corrected in the current year, upon the completion of the District’s Excel Capital Project. Additionally, no new deficiencies or weaknesses have been reported.

The district views the strength of the current IPA Audit as resolving our past fiscal issues and setting the stage for continued best management practices of the district’s finances. The conclusions of the IPA 08-09 Audit, except for the issue of Claims Auditing, show that all the recommendations of the OSC Audit have been corrected and the BOE has implemented new management practices and/or is in the process of such, in order to deliver better quality, easily understood financial reports, and review of the monthly and yearly budgetary/accounting systems of the district. The issue of the Claims Auditor has been a statewide problem due to the existing laws and the New York State Legislature is working on new standards to resolve this issue.

In regards to the OSC audit, it may appear that the BOE was not aware of the fiscal operations of the district. This opinion is somewhat disingenuous. The BOE asked questions regarding fund balances, increased future budgeting (to account for shortfalls in BOCES programs and other areas), budgeted amounts for potential contractual or negotiated raises, reasons of the RAN, and many other pertinent financial questions. These questions never resulted in receiving any fiscal information that would suggest, to the BOE, in any way the extent of deficiencies which the OSC Audit uncovered. The BOE takes responsibility for relying on good faith and trust in the former district management. It should be further noted, the OSC Audit cites the failure of the former business official and former superintendent to provide accurate and complete accounting information to the BOE. Due to this situation, the BOE could not properly evaluate the budget development or even monitor the district finances due to over stated revenues and inappropriately funded budget lines among other problems.
The Chenango Valley BOE takes the following responsibility.

1. The BOE should have demanded a written plan of action from the former business manager and former superintendent starting in October of 2005 when a deficit was first revealed to the BOE.
2. Following July 2006 when the former district management stated that the deficit situation had not improved, in spite of their oral representation that it was under control during the previous year, the BOE should have contracted with independent accounting consultants for an outside opinion.
3. When the former district management reported that the deficit had grown to $990,000 in June of 07, the BOE should have demanded a written response from the former superintendent and former business manager to explain why their deficit reduction plan had grossly failed.
4. In consideration of items 1 thru 3, the BOE should have addressed the financial management of the district at an earlier time in the district’s fiscal crisis.

We would also like to point out that following October, 2007, and in the timeline of the OSC Audit, the BOE initiated a Fiscal Oversight Committee. The BOE used outside advisors and consultants to review the financial situation at CV. The Committee reported to the BOE at each meeting from December, 2007 through June, 2008 and entered the Committee reports into the BOE meeting minutes. The BOE reasoned that the business management required a complete overhaul and ultimately hired the BOCES Central Business Office to handle all day-to-day business functions for the district. We employed a highly competent interim business manager to bridge the transition. The BOE directed the former superintendent to approach the local state legislators to obtain a 3.5 million dollar deficit bond.

In this process, both our consultants and the OSC reviewed and adjusted the current 07-08 budget to accurately reflect our true expenses. This all factored into the recovery of the district’s finances. We would also like to point out that the District developed a Financial Corrective Plan of Action and submitted it to the OSC on July 16, 2008 in support of the Deficit Financing conditions. Virtually all the objectives of this plan have been met.

The district continues to employ the CBO and through this relationship obtains comprehensive, timely, and accurate accounting information that allows the BOE to make fiscally responsible decisions. The district currently has a strong fund balance, has established a number of reserves accounts, and continues to refine and accurately monitor the current and future budgets. Also, in June, 2009, the CBO provided a comprehensive 3-year budget plan/projection that the district is using for future planning. This will be updated yearly. Separately, the BOE is reviewing our board practices to assure each member fully understands the monthly budget reports and has access to all pertinent information.

The district will provide the OSC with a written plan of corrective action in the required timeline.

In consideration of the IPA 08-09 Audit and the current fund balance projections, the Chenango Valley BOE is pleased to report that the district is in a solid financial position. The District looks forward to demonstrating the effectiveness of our new financial management systems and the positive end results to the OSC and to the CV District.

Sincerely,

James W. Penwell
President of the Chenango Valley BOE
Our overall goal was to assess the adequacy of the internal controls put in place by officials to safeguard District assets. To accomplish this, we performed an initial assessment of the internal controls so that we could design our audit to focus on those areas most at risk. Our initial assessment included evaluations of the following areas: financial oversight, cash receipts and disbursements, purchasing, payroll and personal services, and information technology.

During the initial assessment, we interviewed appropriate District officials, performed limited tests of transactions and reviewed pertinent documents such as District policies and procedures manuals, Board minutes and financial records and reports. In addition, we obtained information directly from the computerized financial databases and then analyzed it electronically using computer-assisted techniques. This approach provided us with additional information about the District’s financial transactions as recorded in its databases. Further, 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.

After reviewing the information gathered during our initial assessment, we determined where weaknesses existed, and evaluated those weaknesses for the risk of potential fraud, theft and/or professional misconduct. We then decided upon the reported objective and scope by selecting for audit the areas most at risk. We selected management oversight, financial condition, and claims auditor for further audit testing.

- We analyzed District bank accounts and calculated potential interest revenues based on rates we obtained from third parties to determine if the District maximized interest earnings.
- We interviewed Board members, both past and present, to gain an understanding of the deficit and determine what these members felt to be the cause of the District’s financial decline.
- We interviewed the former Business Official to determine what he felt caused the District’s financial decline and to determine his involvement with budget preparation and financial monitoring.
- We reviewed Board minutes and the corresponding supporting details for discussion of financial issues. We also reviewed the supporting documentation to determine if the Board received necessary financial information.
- We analyzed financial data that the District submitted to SED and the IPA financial statements for the last five fiscal years to determine operating surpluses/deficits.
- We compared budget to actual financial data to determine the over-expenditure of budgeted amounts for the period 2005-06 through 2007-08.
• We reviewed Board minutes to determine whether transfers were properly authorized, and accumulated transfer amount and information.

• We reviewed resolutions authorizing revenue anticipation notes and compiled their amounts.

• We reviewed three claims totaling $870,871 paid to BOCES during the 2008-09 fiscal year to verify that they were adequately supported and were properly audited and approved for payment.

We conducted our performance audit in accordance with generally accepted government auditing standards (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 objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.
APPENDIX C

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