Office of the New York State Comptroller

Division of Local Government
& School Accountability

Clinton Central School District

Financial Condition

Report of Examination

Period Covered:

July 1, 2008 — June 30, 2010

2011M-133

Thomas P. DiNapoli

Table of Contents

State of New York
Office of the State Comptroller

Division of Local Government
and School Accountability

October 2011

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 Clinton Central School District, entitled Financial Condition. This audit was conducted pursuant to Article V, Section 1 of the State Constitution and the State Comptroller's authority as set forth in Article 3 of the General Municipal Law.

This audit's results and recommendations are resources for district officials to use in effectively managing operations and in meeting the expectations of their constituents. If you have questions about this report, please feel free to contact the local regional office for your county, as listed at the end of this report.

Respectfully submitted,

Office of the State Comptroller
Division of Local Government
and School Accountability

Introduction

Background

The Clinton Central School District (District) is located in the Towns of Kirkland, Marshall, New Hartford, Paris, Vernon, Westmoreland and Whitestown in Oneida 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.

Until March 2010, a Director of Business managed the District's business affairs and oversaw the staff of the business office. After the Director resigned, the Board appointed the District Treasurer to assume the Director's business management duties. The Treasurer served in both capacities for the remainder of our audit period.

There are three schools in operation within the District, with approximately 1,450 students. The District's budgeted expenditures for the 2010-11 fiscal year were $23.1 million, which were funded primarily with State aid, real property taxes, and grants.

Our prior audit[1] of the District's financial condition and selected financial activities disclosed that the $0.7 million deficit fund balance reported for the general fund at the end of the 2005-06 fiscal year was significantly understated. Our report concluded that the District's June 30, 2006 balance sheet had excluded certain accruable liabilities and included an unrealizable receivable due from the capital project fund. As a result, the District's fund balance deficit actually totaled approximately $1.8 million. The audit also reported that budgetary status reports being provided to the Board were not adequate for monitoring and controlling expenditures.

Objective

The objective of our audit was to evaluate the District's financial condition and budgeting practices for the period July 1, 2008 to June 30, 2010. Our audit addressed the following related question:

- Does the Board adopt realistic budgets and take appropriate actions to maintain the District's financial stability?

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[1] "Clinton Central School District: Financial Condition and Controls Over Selected Financial Activities," Report No. 2007M-215, issued November 2007 for the period July 1, 2005– November 30, 2006.

Scope and Methodology

We examined the financial condition and budgeting practices of the Clinton Central School District for the period July 1, 2008 to June 30, 2010.

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 understood our recommendations and indicated they planned to submit a corrective action plan.

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.

Financial Condition

A school district's financial condition affects its ability to provide educational services to students. The responsibility for effective financial planning and management of the District rests with the Board, the Superintendent, and the Director of Business. A school district is considered to have sound financial health when it can consistently generate sufficient revenues to finance anticipated expenditures, and maintain sufficient cash flow to pay bills and other obligations when due, without relying on short-term borrowings. Conversely, districts with financial condition problems often must rely on short-term debt to finance operations and alleviate cash flow difficulties.

It is imperative for Board members to maintain a sound District financial condition and develop structurally balanced budgets that are based on accurate financial information, including available fund balance. Fund balance represents resources remaining from prior fiscal years that can be appropriated to finance the next year's budget. It is especially important that District officials maintain financial records that accurately depict the District's true financial condition, since management relies on this information to make business decisions and to develop budgets. Furthermore, voters need transparent financial information about the District's true financial condition to make informed decisions about the proposed annual budget.

District officials did not address a significant audit finding from our prior audit report concerning the inclusion of certain interfund receivables in general fund assets that produced a significant overstatement of the District's available fund balance. District officials continued to finance construction and legal costs associated with a capital project by recording improper interfund loans to the capital project fund. As a result, available fund balance was consistently overstated.

We found that the capital project fund did not have the financial resources to repay interfund loans totaling more than $1 million. Therefore, the District's true available operating fund balance is significantly less than the amount presented in its financial statements. We calculated that the reported fund balance of $1.5 million at June 30, 2010 was actually about $497,000.

Also, officials have annually issued revenue anticipation notes (RANs) to finance District operations. The District currently lacks the fiscal resources to properly comply with the statutory requirements for issuing RANs and still pay District bills.

Fund Balance

A key measure of the District's financial condition is its level of fund balance, which is the difference between revenues and expenditures accumulated over time. When maintained at reasonable levels, fund balance provides cash flow and can be used to help finance the next fiscal year's operations. Receivables or moneys that the District expects to collect such as loans, are assets and would increase the amount of available fund balance.

The Governmental Accounting Standards Board requires that if the repayment of a loan is not expected within a reasonable amount time, interfund balances should be reduced and the amount that is not expected to be repaid should be reported as a transfer from the fund that made the loan to the fund that received the loan. Financial statement errors resulting from misuse of facts that existed at the time the financial statements were prepared should be corrected with a prior-period adjustment.

District financial statements reported an ending fund balance of about $1.5 million for the general fund as of June 30, 2010. However, about $1 million of this reported fund balance is not available because general fund assets include an uncollectible receivable from the capital project fund. We reported this condition in our prior audit of the District during 2007. The District had experienced significant cost overruns related to a $22.6 million capital project for school renovations (capital project #1). These expenditures had been funded with cash from the general and the debt service funds and recorded as interfund loans[2] to the capital project fund. As of June 30, 2006, the capital project fund had a deficit of $683,024 with no source of revenue available to fund repayment of the interfund loans. We reported that the general fund would ultimately have to fund the capital project fund deficit and that the corresponding receivable in the general fund should not be considered a general fund asset. The removal of this asset from the general fund balance sheet would have increased the existing June 30, 2006 fund balance deficit by $683,024. Our report recommended that the Board ensure that the District's accounting records accurately state the District's financial position.[3]

Our current audit found that District officials did not change their financial reporting practices and continued to fund additional cost overruns and associated litigation costs from capital project #1 by

[2] A municipality can move resources from one fund to another in the form of a loan (interfund loan) which must be repaid by the close of the fiscal year in which it was made.

[3] Our report also identified $440,402 of liabilities that the District had failed to accrue on its balance sheet as of June 30, 2006. District officials corrected that reporting deficiency for subsequent years by properly recording the accrued liabilities.

recording additional interfund loan funds to the capital project fund. As of June 30, 2010, the capital project fund owed about $1 million for interfund loans attributable to unfunded capital project #1 costs. As the corresponding portion[4] of interfund loan receivables recorded on the general fund balance sheet is not available, it is misleading to report that amount among fund assets. Additionally, loans where there is no expectation of repayment are not loans, but transfers. Removal of the capital project #1 loan assets from the general fund would have decreased the reported fund balance of $1.5 million to a true available fund balance of only about $497,000 as of June 30, 2010.

The Superintendent and Treasurer/Business Manager told us that most of the additional expenditures for capital project #1 have been legal expenses to defend the District against a lawsuit by a project contractor who is claiming significant damages. Furthermore, this litigation is ongoing and the District may incur significant future legal costs related to capital project #1.

The following tables summarize interfund loan activity related to capital project #1 during the two year period we audited and the effect on the fund balance of the District's general fund.

Table 1: Capital Project Loan		
Loans to the Capital Project Fund For Unfunded Capital Project #1 Costs	**2009**	**2010**
Beginning Loan Balance	$1,147,619	$1,185,861
Current Year Project Expenditures	$38,242	$0
Interfund Transfers from General Fund	$0	($174,861)
Ending Loan Balance	$1,185,861	$1,011,000

Table 2: Fund Balance		
General Fund:	**2009**	**2010**
Beginning Fund Balance (deficit)	($151,960)	$810,760
Excess Operating Revenues Over Expenditures	$962,720	$1,057,606
Transfers to Capital Project Fund - Capital Project #1	$0	($174,861)
Transfers to Capital Project Fund - Other Projects	$0	($185,139)
Ending Fund Balance (deficit)	$810,760	$1,508,366
Less: Loans receivable from Capital Project #1	($1,185,861)	($1,011,000)
Adjusted Fund Balance (deficit)	($375,101)	$497,366

[4] District officials have also recorded loans from the general fund to the capital project fund to fund other capital projects. Those loans are expected to be repaid from grant funds and/or the proceeds from long term borrowing.

The District's financial reports misrepresent its financial condition by failing to clearly disclose the impact of capital project #1 cost overruns on the District's fund balance. Overstatement of general fund balance presents a misleading picture of the District's true financial condition. Also, the available fund balance in the general fund is an important component of the proposed budget that the District presents to voters. For example, in May 2010, District officials proposed and voters approved the use of $639,000 from fund balance to offset cost cuts or an increase in the District's property tax levy for the 2010-11 budget. That appropriation was about $141,000 more than the District's true available fund balance.

The Board President told us that the Board has an unwritten plan to eliminate the interfund loan balance related to capital project #1 over a ten year period by transferring surplus fund balance from the general fund to the capital project fund in ensuing year's budgets. Management's intention to eliminate the capital fund deficit is evidenced by the transfer of $174,861 from the general fund to the capital fund for 2009-10 year and budgeted transfers of $100,000 for 2010-11 and $50,000 for 2011-12.

RANs

Districts with financial condition problems often must rely on short-term borrowing to finance operations and alleviate cash flow difficulties. RANs represent a temporary source of cash borrowed in anticipation of the pending collection or receipt of specific revenues estimated in the annual budget, other than real property taxes. Local Finance Law requires that when the amount of outstanding RANs equals the amount of revenue yet to be collected, the remaining revenues collected must be set aside in a special bank account and dedicated to pay the principal on the notes. Setting aside dedicated revenues when they are collected ensures that legally restricted cash will be available to meet RAN payments when they become due. When used properly, RANs may be used to alleviate temporary cash-flow difficulties; however, RANs should not be overly relied on by a school district.

The District has been forced to rely on annual RAN borrowings not only to alleviate cash flow difficulties, but to finance operations. In June 2008, the District issued RANs totaling $4.7 million in anticipation of State aid revenue to be received during fiscal 2008-09. The District repaid those notes on June 18, 2009 and immediately issued new RANs totaling $4 million against State aid anticipated during the next year. That process was repeated on June 18, 2010 with the issuance of $4 million of RANs in anticipation of fiscal 2010-11 State aid. Our analysis of the District's cash position on June 18, 2010 found that without receipt of the $4 million from the new RAN, the District had less than $25,000 of operating cash available. Therefore, it appears unlikely the District could have financed its operations for the entire 2009-10 year had it properly set aside State aid receipts[5] in a special bank account to repay the RANs.

When the District is forced to rely on annual short-term borrowing to finance operations, it incurs interest and other issuance and administrative costs that could be avoided by more effective financial management. Interest expense for the RANs issued for the 2009-10 year was about $60,000.

Recommendations

1. District officials should make appropriate prior period adjustments to District financial records to eliminate the amount recorded as an interfund loan for capital project #1.

2. District officials should develop a formal plan to ensure that the District's accounting records accurately and transparently state the District's financial position and that District budgets generate sufficient resources to:

   - fund the payment of future litigation costs related to capital project #1.
   - decrease reliance on annual RAN borrowing to finance District operations.
   - comply with statutory requirements related to the repayment of RAN obligations.

3. The Board should monitor progress against the plan and take appropriate action to modify the District's financial management strategies based on actual performance and economic events.

[5] The Treasurer told us that all State aid had been received by the end of October 2009.

APPENDIX A

RESPONSE FROM DISTRICT OFFICIALS

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

CLINTON CENTRAL SCHOOL DISTRICT
75 Chenango Avenue
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Website: www.ccs.edu

Mr. Matthew Reilly
Superintendent of Schools

October 7, 2011

Rebecca Wilcox, Chief Examiner
Office of the State Comptroller
Division of Local Government Services
333 East Washington Street
Syracuse, NY 13202

Dear Ms. Wilcox:

I have reviewed on behalf of the District the draft report of examination for the financial condition of the Clinton Central School District for the period July 1, 2008 to June 30, 2010. I understand the objectives of the audit, the scope and methodology, and findings of this report. Furthermore, I understand the recommendations being made by the report and that the District has 90 days to submit a corrective action plan.

Sincerely,

Matthew Reilly
Superintendent of Schools

C: [redacted]

APPENDIX B

AUDIT METHODOLOGY AND STANDARDS

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 over financial condition, management oversight, 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. 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 objectives and scope by selecting for audit those areas most at risk. We selected financial condition for further audit testing.

To accomplish the objectives of our audit, our procedures included the following:

- We reviewed selected reports and other information provided to the Board for use monitoring the District's financial stability including monthly treasurer's reports and budget to actual reports for revenues and expenditures.
- We evaluated Board and District management procedures for developing and adopting annual school district budgets and for monitoring actual revenues and expenditures against the budget plan during the year.
- We analyzed the District's audited financial statements for the last three fiscal years and annual financial reports (ST-3 reports) submitted to the New York State Education Department for the last five fiscal years, to assess the District's financial performance and reported operating surpluses/deficits.
- We reviewed and assessed the treasurer's records of interfund loan activity.
- We analyzed District budgets against actual performance and assessed the causes of significant variances.
- We reviewed the District's proposed budget for the 2010-11 school years for reasonableness.
- We reviewed and evaluated the District's issuance and repayment of RANs.
- We analyzed the District's cash position at June 18, 2010 and at June 30, 2010.
- We evaluated the Board and District management plans to address ongoing lawsuits and potential future litigation costs and we obtained a representation letter from the District's attorney.

We conducted this 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 objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

APPENDIX C

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Steven J. Hancox, Deputy Comptroller
Nathaalie N. Carey, Assistant Comptroller

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