



***Cold Spring Harbor
Central School District
Internal Audit Report on
Fund Balance Management***

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OVERVIEW

Based upon our interviews and observations, we have provided an overview of the District's governance and planning procedures as follows:

The Cold Spring Harbor Central School District is governed by the Board of Education ("the Board") which is comprised of seven elected members. The Board has the responsibility for the general management and control of the District's financial and educational affairs and the Superintendent along with administrative staff is responsible for the day to day operations of the District. The Board also has the responsibility for establishing a good solid internal control environment which includes adopting effective policies and procedures to guide the overall direction of the District. Additionally, the Board should ensure that audit recommendations are reviewed and that the appropriate corrective action plan is implemented.

A school district's financial condition determines its ability to fund and provide public educational services for students within a district. The Board and management are responsible for effective financial planning and management of District operations. A school district should ensure the budget is prepared, adopted and amended based on reasonable estimates of appropriations and revenues. It is imperative for a school district to follow sound business practices when developing a budget and utilize the best estimates available at the time the budget is adopted. A school district also has the responsibility to taxpayers to estimate realistic expenditures to prevent real property taxes from rising to greater levels than necessary to sustain operations.

The District has four schools in operation within the District, The District's budgeted expenditures for the 2014-2015 fiscal year was \$62,773,201 and is funded primarily by real property taxes, State aid, grants, rental of real property, interest income and local revenues.

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GOVERNANCE

During our review of the Board policy manual, we noted that the District has adopted the following policies that relate to the governance and planning processes:

Budget Planning

The District's *Budget Planning* policy, No. 6110, establishes that the Superintendent and the Business Official shall be responsible for the preparation of the budget which includes developing a budget calendar that shall be approved by the Board. It is the official document that describes the education objectives for students and should provide adequate accounting for program expenditures with consideration of the financial needs of program developments within the financial limitations of the District.

Budget Planning Regulation

The District's *Budget Planning Regulation*, No. 6110R, describes the elements of the budget calendar to include the dates and times when the various budget areas will be reviewed by central administration and by the Board. Additionally the regulation outlines the information that should be evaluated during the budget planning process.

Budget Hearing

The District's *Budget Hearing* policy, No. 6120, establishes that the Board will hold an annual budget hearing, in accordance with law, to present to District residents a detailed written statement regarding the District's estimated expenditures and revenue for the upcoming school year prior to the budget vote. The budget hearing will be held not less than seven nor more than 14 days prior to the Annual District Meeting and Election or Special District Meeting at which the budget vote will occur. The District Clerk shall mail a *School Budget Notice* to all qualified voters of the District after the date of the Budget Hearing, but no later than six days prior to the Annual Meeting and Election or Special District Meeting at which a school budget vote will occur.

Budget Adoption

The District's *Budget Adoption* policy, No. 6130, states the Board may modify the recommended budget of the Superintendent prior to its submission to District voters. Final authorization of the proposed budget is dependent upon voter approval unless a contingency budget is adopted by the Board. If the original proposed budget is not approved by the voters, the Board may resubmit the original proposed budget or a revised budget for voter approval or individual propositions may be placed before District voters, at a special meeting held on the third Tuesday of June. The District budget for any school year, or any part of such budget, or any proposition involving the expenditure of money shall not be submitted for a vote to the qualified District voters more than twice. The District adopted budget then becomes the basis for establishing the District's tax levy.

Administration of the Budget

The District's *Administration of the Budget* policy, No. 6140, establishes that the Superintendent will ensure that District employees are familiar with their program budget and guide to operate efficiently and economically. Under the direction of the Superintendent, the Assistant Superintendent for Business shall maintain such accounting records as required by New York State Uniform System of Accounts for School Districts.

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Budget Transfer Policy

The District's *Budget Transfers* policy, No. 6150, states the Superintendent is authorized to make budget transfers between line item accounts in the general fund, so long as the transfer for any one item does not exceed \$10,000. All transfers in excess of \$10,000 will require prior Board approval. Additionally, the policy further states that the Superintendent will a budget transfer report to the Board on a monthly basis.

Fund Balance Policy

The District's *Fund Balance* policy, No. 6610, establishes that fund balance measures the available financial resources. Additionally, the policy describes fund balance into classifications such as non-spendable, restricted, committed, assigned and unassigned fund balance.

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BUDGET DEVELOPMENT

Based upon our interviews and observations, we noted the procedures for budget development to be as follows:

Each school district has a budget officer who works with other District administrators to develop the final budget document. The budget officer utilizes information from the current and previous year's financial reports, information on current revenues and expenditures, debt service commitments and cash flow data. Other sources of information are derived from collective bargaining agreements, capital plans and any new or pending legislation. Other factors to be considered in the budget development are economic conditions, interest rates and input from taxpayers and other interested groups.

Budgets are developed in conjunction with a budget calendar which will vary depending on the time that is required to collect information from other departments, to create a budget, present it to the Board and hold a public hearing. Many budgets also contain a budget message summarizing the major features of the budget and highlighting challenges that a school district encounters and the related changes that may have been made to the budget compared to previous years.

A Board reviews and adopts a budget document and is responsible for presenting the District's budget, or spending plan to the public budget to vote. The Board is responsible for estimating the District's revenues and the amount of surplus fund balance, if any, that will be available to help offset the subsequent year's operations and to determine the ending tax levy. Underestimating revenues and/or overestimating expenditures may result in collecting more real property taxes than necessary. Once a budget is adopted and the tax levy has been determined, information such as updated State aid estimates and the amount of available fund balance becomes transparent for the accurate budgeting of expected revenues.

Reliable sources of information that should be utilized in preparing the budget are as follows:

- Modified budgets for the prior and current year;
- Prior year's financial reports;
- Current year revenue and expenditure information to date;
- Debt service requirements, contracts and other commitments;
- Cash flow reports and revenue projections;
- State and federal aid information;
- Collective bargaining agreements;
- Service contracts with other governments;
- Multiyear capital plans;
- New and pending legislation;
- Rate of inflation;
- Current interest rates;
- Tax and debt limitation, if applicable;
- Strategic plans; and
- Input from taxpayers and other interested groups.

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At the District, the Interim Assistant Superintendent for Business is responsible for developing the District's budget in conjunction with the Superintendent, Principals and Administrators. The District utilizes data derived from prior year expenditures, past and future spending trends as well as what they know in terms of rates for the future, current debt costs and the need for buildings expenditures.

The District procedures surrounding the budget preparation process includes moving employees to respective step levels and then reviewing the staffing in place to determine any increases or reductions in staffing levels (determined by discussions with the Board). The Interim Assistant Superintendent for Business maintains 10 years projected enrollments, utilizing the cohort survival method whereby grades are tracked each year. High school staffing levels are determined by the students' courses.

Discretionary items such as supplies, textbooks and equipment needs are determined by the Principals and Directors. Field trips and contracted services are determined at the building level and the Principals and Directors discuss their budget at Board of Education budget presentations as well as, discussion meetings with the Superintendent, the Interim Assistant Superintendent for Business and the Assistant Superintendent for Instruction.

Other budget measures include developing the contribution amounts to be paid for the New York State and Local Employees' Retirement System ("ERS") by utilizing the ERS estimated invoice and analyzing their projections to determine estimates for the last 3 months of the year. The New York State Teachers' Retirement System ("TRS") is determined by the standard rate and the related salaries can be projected. Health insurance premiums are determined by utilizing six months actual expense and then projecting the other six month expense.

Additionally, the Interim Assistant Superintendent of Business discusses any necessary equipment needs with the Principals and reviews the various collective bargaining agreements for insurance benefits and additional projected costs. Travel and conference expenditure amounts are determined by the Principals and are not based on prior year data, since amounts are different every year. Salary budgets begin in December and are based on historical data and projections through June 30.

The District's budget process begins with identifying expenses associated with a rollover budget that maintains current services, including all programs and staff. The rolled over budget is then compared to the prior year budget to assess the overall increase in expenses. The tax levy cap legislation is also considered when developing the budget.

Other factors considered are supply and contractual needs which are determined by the buildings and prior budget decisions. Additionally, the District reviews reserves to determine the maximum allowable funding to support the proposed budget and anticipates any additional revenues from state aid. The District utilizes the Governor's executive proposal that is published every January for projecting state aid. The proposal indicates an estimate of current year aid as well as next year's aid. Currently, the District is projecting a flat state aid amount based on the prior year.

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The Interim Assistant Superintendent for Business reviews the revenue report to project revenue amounts. Miscellaneous revenue is calculated using historical trends and knowledge of any future increases or decreases. The Interim Assistant Superintendent for Business also conducts budget meetings with the Directors and Administrators to review their budgets and to negotiate any necessary budget items.

The different departments submit their budget drafts to the business office in December. In January, the Interim Assistant Superintendent for Business reviews the budget with the Superintendent and the Assistant Superintendent for Instruction and has discussions with the Principals and Directors. During this time any modifications will be determined and updated such as pertaining to state aid projections, contractual expenses or building needs that may need updating. Also in January, an initial draft of the budget presentation is provided to the Board for review. A community forum is also held at the end of January to discuss the initial budget to address any community concerns with respect to the budget.

In March, the Board adopts a resolution for the budget election vote to be conducted in May. Subsequently, there are ongoing budget workshops with the Board, management and the various departments. In April, after thorough discussions, the proposed budget is adopted by the Board and any additional public meetings are held where all budget questions raised by the public are answered.

In May, the budget hearing is held and it provides another opportunity for residents to ask any remaining questions on the proposed budget and represents the last public meeting before the budget vote. A line by line printout of the proposed budget is available at the budget hearing as well as, an informative newsletter that can be utilized as a guide for learning about the budget. Budget brochures are also mailed out to every resident in the District. Additionally, a postcard is mailed after the budget hearing providing budget and tax cap impact information and basic voting information. The proposed budget document is also available to residents on the District's website, available in each school and can be obtained by contacting the District office. The budget for the subsequent school year is not official until it has been approved by the community in a public vote. If the community does not pass the budget in May, the Board and the District can conduct a second vote prior to July 1st; however, the District is not obligated to conduct a second vote. If the District decides to obtain second vote, the District can put forth the same budget or can opt to reduce the proposed budget in an effort to provide a lower tax impact budget for voters. Additionally, if the proposed budget increases the property tax levy by more than either 2% or the rate of inflation (whichever is less), it requires a supermajority of 60% of voters in order to pass. If the District opts not to hold a re-vote or if the budget is defeated in a re-vote scenario, the District has to operate on a contingency budget.

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IMPLEMENTING AND MONITORING THE BUDGET

Based upon our interviews and observations, we noted the procedures for implementing and monitoring the budget to be as follows:

After the budget has passed, the Board, budget officer and department administrators are responsible to ensure that services are delivered within budget limits. The progress of actual revenues and expenditures throughout the year should be closely monitored to identify any variances that might result in a significant surplus or deficit at the end of the year. Budget reports facilitate the monitoring of the adopted and amended budget. A budget report indicates the original budget; any authorized revisions and the actual transactions to date such as revenues, expenditures and encumbrances listed by account code. Budget reports should be prepared and reviewed at the end of each month during the fiscal year. These reports can also be compared to projected estimates of actual revenues and expenditures throughout the year. The budget officer should also prepare a narrative explaining the numbers in the budget report and recommending corrective action if shortfalls are known. By utilizing these reports, financial deficiencies can be identified in advance and the performance of departments and activities can be assessed. Quarterly expenditure plans should be developed for departments to help monitor the progress of the departments based on their respective budget and historical patterns.

Timely discovery of projected budget shortfalls allows a District to resolve the shortfall early when only small adjustments may be needed. If a school district waits until the end of the fiscal year, after the situation becomes more prevalent, a school district may need more drastic action with fewer options available at that time. Timely detection will enable appropriate action in the subsequent year's budget if it is an ongoing shortfall and not just a temporary situation. Some actions that may be utilized to address the shortfall may be a transfer between appropriations, where appropriate, use of reserves, appropriation of fund balance (when appropriate) and use of budget notes.

A Board may determine that sufficient revenues will not be derived to finance the total appropriations stipulated in the original budget. In this case, the Board may reduce appropriations to prevent expenditures in excess of money available. However, an appropriation may not be reduced below the minimum amount required by law nor be reduced by more than the unexpended balance less outstanding and unpaid claims chargeable to it. Additionally, a Board may appropriate certain revenues that were not included in the original budget such as grants received from state and federal governments, gifts stipulated for a specific purpose and certain insurance proceeds.

The District creates purchase orders at the beginning of the year and mass encumbers any estimated commitments including such items as salaries and fringe benefits, debt service obligations, utilities and other service contracts as a control to properly project the fund balance at the end of the fiscal year and to maintain budgetary control. Additionally, the District has controls in place within the accounting information system whereby overrides are not permitted to release a purchase order if appropriations are insufficient.

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The District reviews and analyzes encumbrances based on prior year spending and expected future expenditures for the remainder of the year. If adjustments are needed, the Purchasing Agent will determine the necessity and adjust the purchase order.

Encumbrances are reviewed on an ongoing basis and the Interim Assistant Superintendent for Business will liquidate a purchase order that may no longer be needed. The District also records an account payable if an invoice has been received which should be signed off by the respective school.

As needed, the Interim Assistant Superintendent for Business reviews the appropriation status reports to determine the budget line items that have available balances or that have negative balances. If there is a risk of over spending a budget line item, then a budget transfer will be discussed with the Interim Assistant Superintendent for Business and initiated between function codes. The Interim Assistant Superintendent for Business projects the fund balance amount and reviews revenue shortfalls where state aid figures are reviewed to determine the amounts that should be received. Year to date expense amounts are also reviewed to help determine the fund balance projected amount.

The Board receives a monthly packet consisting of trial balances for all funds, revenue and appropriation status reports for all funds, Treasurer's reports and warrants. Additionally the Board receives quarterly extraclassroom reports and fund balance projections.

In some cases, the District may modify the budget if necessary due to unforeseen circumstances. These modifications required Board approval to be adjusted from reserves or appropriated fund balance, where applicable. The Board would approve the resolution via a budget revision, and the business office would revise the budget to reflect an increase in the specific expenditure and an increase to revenue/use of reserves.

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FUND BALANCE/RESERVES

Based upon our interviews and observations, we noted the procedures for fund balance/reserves to be as follows:

Restricted fund balance represents an amount of money that a school district can set aside which may be utilized only for specific purposes, while the unassigned fund balance represents uncommitted funds. The remaining unassigned fund balance can be utilized for cash flow purposes and for any unforeseen unanticipated expenses and/or revenue shortfalls. Fund balance also represents resources remaining from prior fiscal years. Real Property Tax Law limits the unassigned fund balance to an amount not to exceed 4% of the subsequent year's budget. A portion of unassigned fund balance over the 4 % amount can be utilized to finance the subsequent year's budget and is referred to as appropriated fund balance.

Sound fiscal management includes maintaining sufficient balances in reserves to address long-term obligations or planned future expenditures. A school district can establish reserve funds to restrict a portion of fund balance for a specific purpose, in a reasonable amount and in compliance with Education Law. Reserve funds may be created by Board approval, pursuant to Education Law while statutes govern how the reserves are funded, expended or discontinued. School districts are not limited as to how much money that can be funded in reserves however, the reserve balances maintained should be reasonable.

Reserve funds should be transparent to the public and a Board that creates and funds reserves on a regular basis should adopt written policies communicating the rationale for establishing, funding and utilization and replenishment of the reserves. Reserve funds can be typically funded through amounts indicated in the annual budget process, through transfers from unexpended surplus balances of existing appropriations and other surplus money. Additionally, school districts should include amounts to be placed in reserve funds in the annual budget instead of routinely utilizing surplus funds to increase reserves at year-end. School districts should create a plan to utilize excess unexpended surplus funds; such usage should include, but are not limited to paying off debt, financing one-time expenses and reducing District property taxes. Reserves cannot be a "parking lot" for excess cash or fund balance; instead each reserve should be maintained at an amount that is reasonable and appropriate to pay future expenses or liabilities that it was established for. Additionally, interest earned on reserves must be allocated to each reserve.

Currently, the District has five reserves established which consists of a workers' compensation reserve, a reserve for tax reduction, an employee benefit accrued liability reserve, an unemployment reserve and a capital reserve. Interest earned on the reserves is allocated on a pro-rata basis at the end of the fiscal year.

On an annual basis, in June, the Board usually adopts a resolution to transfer an amount to the reserves from excess fund balance with a specific limit. After the external audit is complete, any excess fund balance are transferred to reserves to comply with Real Property Tax Law which limits the unassigned fund balance to an amount not to exceed 4% of the subsequent year's budget. The reserves are also utilized to balance the District's budget every year and the District budgets the related expenditures and revenues from the appropriated reserves as applicable. The

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District's goal is always to comply with Real Property Tax Law and any excess funds is transferred to the capital reserve instead of the District issuing bonds for any related capital projects. At the end of the year, the audit committee meets with the external auditors to review the District's financial position and then in September another meeting is conducted to discuss reserves and fund balance.

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FINDINGS AND RECOMMENDATIONS

Based on our interviews, observations and detailed testing, we provide our findings and recommendations to further strengthen the District's internal controls as they pertain to fund balance management procedures outlined above.

It should be noted that these recommendations are provided to assist management in improving the accounting and internal controls and procedures as they relate to the District's fund balance management procedures. It is important to note that our findings and recommendations are directed toward improvement of the system of internal controls and should not be considered a criticism of, or reflection on, any employee of the District.

Required Policies and Procedures

Procedure Performed: We reviewed the District policies, procedures, forms and practices to determine whether the District has adopted legally required policies pertaining to the fund balance management processing.

Findings: No exceptions were found as a result of applying this procedure.

Recommended Policies

Procedure Performed: We reviewed the District's policies, procedures, forms and practices with regards to the fund balance management processing.

Finding: No exceptions were found as a result of applying these procedures.

Budget Development

Procedure Performed: Reviewed the District's financial statements for the past four years to verify the following:

- Compared the District's budgeted expenditures for the fiscal years 2010-2011 through 2013-2014 with actual results of operations to determine overestimated amounts and determine if budgeted amounts are reasonable.
- Usage of reserves was included as part of the budget process to facilitate transparency.
- Reviewed the Governor's executive proposal projections for the District's state aid revenues and compared it to the District's state aid budgeted revenues to determine revenue shortfalls.

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- Compared actual state aid revenues received to the District's budgeted state aid revenues in the original budget.
- Determined if operating surpluses were consistently sufficiently over the appropriated fund balance and was enough to finance the District's operations without including the appropriated fund balance in the original budget.

Findings: No exceptions were found as a result of applying these procedures.

Budget Administration

Procedure Performed: Reviewed and sampled the monthly financial packet submitted to the Board and reviewed financial reports to verify the following:

- Trial Balances were submitted for all funds.
- Revenue and appropriation status reports were submitted for all funds.
- Cash flow projections and Treasurer's reports are submitted for all cash accounts.
- Fund balance projections are provided periodically to the board during the yearly budget process, in preparation for the board's annual budget workshop in early March.
- Monthly warrants and monthly or quarterly extraclassroom reports were provided to the Board.
- Reviewed appropriations status reports for all funds to determine over expended line items.

Finding: We noted cash flow projections are not provided in the monthly financial packet submitted to the Board for review. A cash flow projection is similar to a fund balance projection except that it charts the expected cash position of the district throughout the year. Cash flow should be projected for all funds and for the entire school year and updated monthly.

Recommendation: We recommend that the District implement a procedure to submit cash flow projections as part of the monthly financial packet submitted to the Board for review. This will aid the Board to view and monitor the cash position of the district throughout the year

Budget Transfers

Procedure Performed: Tested a sample of 20 budget transfers to verify the following:

- Budget Transfer was approved by an individual other than the preparer within guidelines stipulated in the *Budget Transfer Policy* No. 6150.
- Supporting documentation existed to substantiate the budget transfer.
- Budget transfer was properly coded to the correct general ledger account.
- Budget transfer was not made into a non-contingent code or between non-contingent codes.

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Findings: No exceptions were found as a result of applying these procedures.

Fund Balance/Reserves

Procedure Performed: Reviewed the District's fund balance and reserves to verify the following:

- Reserves were established with Board approval and were substantiated with a demonstrated need.
- Balance in the Employee Benefit Accrued Liability reserve did not exceed the estimated liability.
- Reviewed the District's financial statements for the past four years to determine the operating surpluses/deficits.
- Calculated the average expenditure pertaining to the reserve for the past four years to justify the balance in the reserve account.
- Interest earned had been allocated to the various reserves.
- Reviewed the District's fund balance to determine if fund balance did not exceed 4% of the subsequent year's budget.

Findings: We noted the District's reserve for tax reduction had a balance of \$347,340 as of June 30, 2014. However, we noted interest is not being allocated to this reserve and there was no evidence of usage of funds in the reserve. Additionally, we noted interest is not being allocated to the capital reserve on a pro-rata basis.

Recommendation: We recommend the District review the reserve for tax reduction to determine if the amounts set aside are necessary and reasonable and to ensure interest be allocated on a pro-rata basis to all the reserves.

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CORRECTIVE ACTION PLAN

The District is required to prepare a corrective action plan in response to any findings contained in the internal audit reports. As per Commissioner's Regulation §170.12, a corrective action plan, which has been approved by the Board, must be submitted to the State Education Department within 90 days of the receipt of a final internal audit report.

The approved corrective action plan and a copy of the respective internal audit report should be sent to the following address:

New York State Education Department
Office of Audit Services, Room 524 EB
89 Washington Avenue
Albany, New York 12234