

Newburgh Enlarged City School District

Financial Management and Information Technology

JUNE 2019



OFFICE OF THE NEW YORK STATE COMPTROLLER
Thomas P. DiNapoli, State Comptroller

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Report Highlights

Newburgh Enlarged City School District

Audit Objective

Determine whether the Board effectively managed the District's financial condition.

Determine whether the District's information technology (IT) system was adequately secured and protected against unauthorized use, access and loss.

Key Findings

- Appropriations were overestimated resulting in an operating surplus of \$18.8 million in 2015-16.
- Reserves were not used as intended and were overfunded by \$7.3 million as of June 30, 2016.
- IT Director did not adequately monitor the electronic devices inventory resulting in items not being recorded.

In addition, sensitive IT control weaknesses were communicated confidentially to District officials.

Key Recommendations

- Adopt budgets with reasonably estimated appropriations and use excess fund balance and reserves to benefit District residents in accordance with statutory requirements.
- Review all reserves and determine whether the balances are necessary, reasonable and compliant with statutory requirements.
- Ensure all electronic and digital equipment are inventoried and devices purchased are needed.
- Address confidentially communicated IT recommendations.

Except as specified in Appendix A, District officials generally agreed with our recommendations. Appendix B includes our comments on the issues raised in the District's response.

Background

The Newburgh Enlarged City School District (District) is located in the City of Newburgh in Orange County. The Board of Education (Board) is responsible for managing the District's operations. The Superintendent of Schools is responsible for the District's day-to-day management, budget development and administration. The Assistant Superintendent of Finance (Assistant Superintendent) began District employment in August 2016 and the Executive Director of Information Technology (IT Director) began District employment in July 2016.

Quick Facts

Employees	2,160
Enrollment	10,830
2015-16 Expenditures	\$239.2 Million
2016-17 Appropriations	\$264.3 Million

Audit Period

July 1, 2015 – April 18, 2017

We extended our audit period back to July 1, 2011 to review fund balance trends and reserve funding.

Financial Management

What Is Effective Financial Management?

The Board is responsible for making sound financial decisions that are in the best interest of the District, the students it serves and the residents who fund the District's programs and operations. This responsibility includes adopting budgets with realistic expenditure estimates, appropriating fund balance to the extent necessary to fund District operations and ensuring reserve funds are legally established and reasonably funded.

District officials should ensure that unrestricted fund balance does not exceed the amount allowed by New York State Real Property Tax Law, which currently limits unrestricted fund balance to no more than 4 percent of the following year's appropriations. Any unrestricted funds that exceed the statutory limit may be appropriated to partially fund the next year's appropriations, pay for one-time purchases, fund needed reserves or reduce debt. Accurate budget estimates and the appropriate use of reserve funds help ensure that the real property tax levy is not greater than necessary and that the budget process is transparent.

District Officials Overestimated Appropriations

The Board overestimated expenditures by \$17.7 million (7 percent) in 2015-16, resulting in an operating surplus of more than \$18.8 million. We identified seven budget line items that contributed to this variance. Overestimated appropriations included teaching-regular school and computer assisted instruction, which were each overestimated by more than \$4 million. In addition, hospital, medical, dental insurance and teacher's retirement were each overestimated by more than \$2 million.

Our review of 2016-17 financial reports and estimated total expenditures showed that these line items were also overestimated by about \$10 million. We estimated the operating surplus to be about \$9.4 million as of June 30, 2017.

While some expenditures are difficult to accurately estimate, others, such as teaching-regular school, computer assisted instruction and retirement costs can be easily predicted and should be budgeted appropriately. Most of the Board's significant overestimates were avoidable.

The Assistant Superintendent told us that he is planning on using the surplus to pay a \$13 million penalty¹ to the New York State Education Department (SED). The Assistant Superintendent also told us that he inherited the 2016-17 budget from the previous administration, since he took office, and is trying to improve the accuracy of the 2017-18 and future budgets.

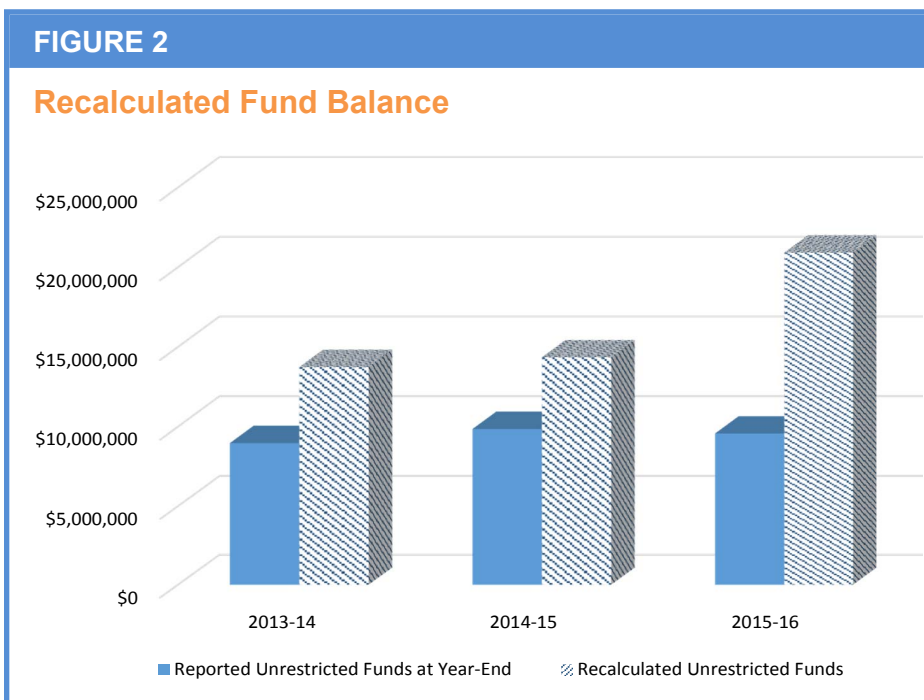
¹ The District must pay an SED imposed penalty for not properly filing final cost reports for 11 capital projects to be paid in ten equal installments with the first payment due in June 2018.

Recalculated Fund Balance Exceeded the Statutory Limit

The Board appropriated \$4 million in fund balance in 2015-16, but did not use it to finance operations. In addition, from 2013-14 through 2015-16, the Board accumulated excess reserves, which annually averaged approximately \$5.5 million. When unused appropriated fund balance and excess reserves are added back, the District's recalculated unrestricted fund balance exceeded the statutory limit in each of the three years.

Figure 1: Recalculated Fund Balance

	2013-14	2014-15	2015-16
Total Unrestricted Funds at Year End	\$8,969,767	\$9,851,138	\$9,568,754
Unrestricted Funds as a Percentage of Ensuing Year's Appropriations	4%	4%	4%
Add: Appropriated Fund Balance Not Used to Fund Ensuing Year's Budget	\$0	\$0	\$4,000,000
Add: Excess Reserves	\$4,766,248	\$4,496,437	\$7,348,138
Total Recalculated Unrestricted Funds	\$13,736,015	\$14,347,575	\$20,916,892
Ensuing Year's Budgeted Appropriations	\$244,792,719	\$256,916,269	\$264,314,605
Recalculated Unrestricted Funds as a Percentage of Ensuing Year's Budget	6%	6%	8%



Overestimating expenditures and maintaining unnecessary reserve fund balances caused available fund balance to appear to be within the statutory limit. As a result, the Board and District officials have withheld significant funds from productive use and not accurately presented the District's financial condition to its residents.

What Is the Purpose of Reserve Funds?

Reserve funds may be established by Board action or voter approval, pursuant to various laws and can be used to finance specific purposes (e.g., capital projects or retirement expenditures), in compliance with statutory requirements. The Board and District officials have a responsibility to ensure that all District resources, including reserve funds, are classified and reported correctly and maintained within established limits. The laws allowing each of the reserves determine how the reserves may be funded, expended or discontinued.

When the Board establishes a reserve fund, it is important they develop a plan for funding it, establish how much should be accumulated and how and when the reserve will be used to finance related costs. Such a plan serves to guide officials in accumulating and using reserve funds and to inform District residents about how their tax dollars will be used.

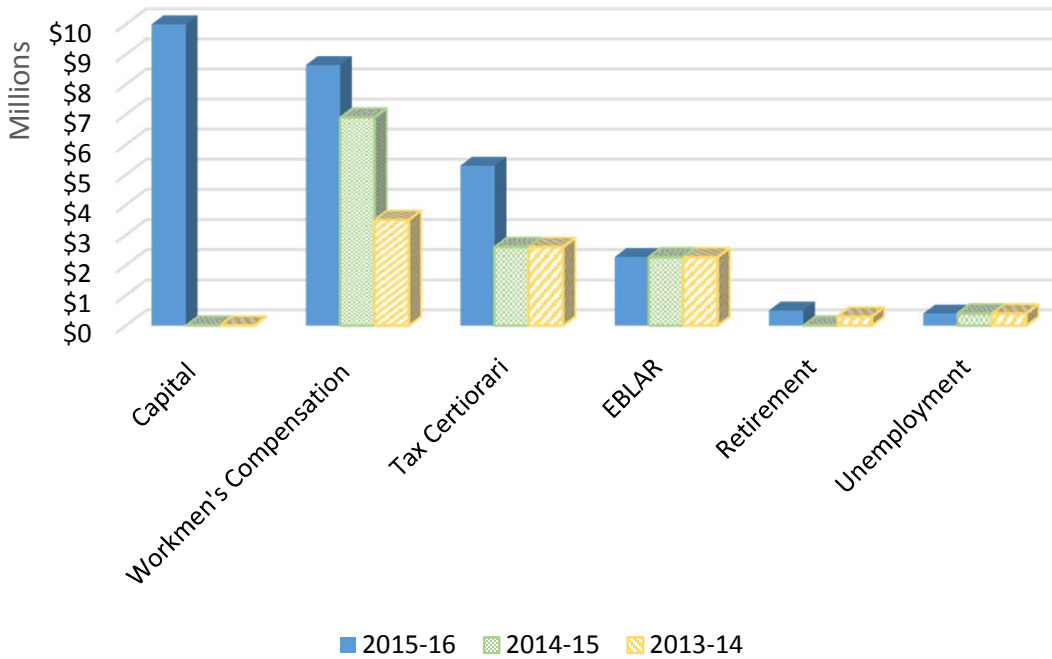
Generally, school districts are not limited as to how much money they can maintain in reserves. However, school districts should maintain reserve balances that are reasonable. Funding reserves at greater than reasonable levels essentially results in real property tax levies being higher than necessary. Amounts to be placed in reserve funds should be included in the annual budget to ensure residents are aware of the Board's intent to fund reserves in the upcoming year.

Reserves Were Not Used as Intended

The District maintained six reserve funds with a cumulative balance totaling \$27 million as of June 30, 2016. These included capital (\$10 million), workers' compensation (\$8.6 million), tax certiorari (\$5.3 million), employee benefits accrued liability reserve (EBALR) (\$2.3 million), retirement contribution (\$500,000) and unemployment insurance (\$401,000) reserves. While the Board properly established four of these reserves, District officials were unable to provide us with Board resolutions establishing and authorizing expenditures for the EBALR and retirement contribution reserves. Further, officials did not always use reserves as intended. Often related reserve costs were paid through the general fund, while at other times reserve funds were used for unexplained purposes.

FIGURE 3

Reserve Balances Over the Past Three Years



Workers' Compensation Reserve – The amount maintained in this reserve was in agreement with the District's actuarial projected needs. However, District officials generally did not use the reserve to pay for related expenditures. During 2012-13 and 2013-14, the Board did not budget for the worker's compensation claims and used the reserve to make the payments. However, the Board budgeted and paid for the claims from the general fund during 2014-15 and 2015-16. Over the last five years, the District incurred and paid \$6.4 million for workers' compensation claims but used only a total of \$1.3 million from the reserve to pay for these expenditures.

Tax Certiorari Reserve – This reserve has not been used to fund related expenditures in the last three years. Instead the Board budgeted for these payments from the general fund. In the last five years, the District paid about \$5.5 million in tax certiorari claims. However, only about \$2.8 million in reserves were used in 2011-12 and 2012-13 to pay for these expenditures.

Moreover, supporting documentation for the amount held in the tax certiorari reserve, which totaled approximately \$5.3 million at the end 2015-16, was not available to help District officials determine the amount that should be maintained in this reserve. Most of the reserved balance is based on old claims, going as far back as 2011, with no evidence of continued proceedings and these claims appear to be abandoned. Therefore, some of the funds in this reserve should be included in unrestricted fund balance.

The Tax Collector told us that she receives tax certiorari claims from the claimants' attorney and any payment notice from the Court. She is not notified when a case is denied. As a result, many cases are incorrectly considered open and unsettled. The Business official told us that they have hired an attorney to help sort out the cases so they can be more certain of the potential liability and necessary reserve amount.

EBALR – This reserve has not been used in the last five years. We recalculated the reserve based on related employment contracts and found that the amount of the reserve should be approximately \$2 million, while the amount in the reserve was \$2.27 million. Therefore, the District's liability showed that it is overfunded by about \$274,000. Over the last five years, compensated absences paid to employees leaving District employment totaled \$266,695. These payments were made from the general fund operating budget.

Retirement Contribution Reserve – This reserve was not used as intended. Over the last five years (2011-12 through 2015-16), District officials paid retirement expenditures of about \$15.4 million (funded by \$14.1 million from its operating funds and \$1.3 million from the reserve). However, an additional \$778,000 was expended from the reserve (\$213,588 in 2015, \$19,350 in 2013, and \$545,432 in 2012), which was not used for retirement payments. As a result, reserve funds expended totaled almost \$2.1 million over these years. Officials were unable to provide an explanation for why more funds were expended than needed to pay retirement expenditures.

Unemployment Reserve – In 2013, District officials did not budget for unemployment expenditures and incurred expenditures totaling about \$714,000. However, \$1 million was expended from the reserve (the only time the reserve was used in the last five years). Officials were unable to provide an explanation for why the difference of \$286,000 was expended from the reserve.

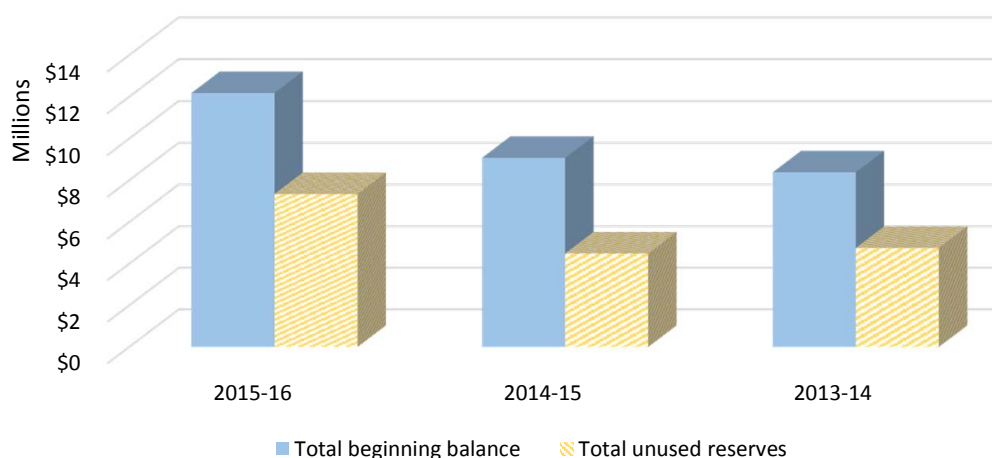
We estimate that from 2013-14 through 2015-16 excess reserves annually averaged approximately \$5.5 million (\$7.3 million in 2016, \$4.5 million in 2015 and \$4.8 million in 2014) based on the unused reserve amounts and the amount of reserve related expenditures that were paid from the general fund.

Figure 4: Excess Reserves Balance Over the Last Three Years

	2015-16	2014-15	2013-14
Workers' Compensation	\$1,102,101	\$1,205,267	\$1,377,047
EBALR	\$44,497	\$69,006	\$82,428
Tax Certiorari	\$5,300,150	\$2,607,936	\$2,606,373
Unemployment	\$401,390	\$400,640	\$400,400
Retirement	\$500,000	\$213,588	\$300,000
Total Unused Reserves	\$7,348,138	\$4,496,437	\$4,766,248

FIGURE 5

Reserve Balances vs. Excess Amounts



District officials retained these excess funds and presented annual budgets that lacked transparency. As a result, the Board and District officials have withheld significant funds and levied taxes that were higher than necessary.

What Do We Recommend?

The Board should:

1. Develop realistic budgets with reasonably estimated appropriations based on historical or other known trends.

-
2. Review the practice of appropriating fund balance and discontinue using it when it is not needed or used to fund District operations.
 3. Use surplus funds as a financing source to benefit District residents for:
 - Funding one-time expenditures
 - Funding needed reserves
 - Reducing District property taxes.
 4. Ensure that tax certiorari cases are reviewed to identify the District's actual liability and make sure that old cases are followed-up on.

District officials should:

5. Review all reserves and determine if the balances are necessary, reasonable and in compliance with statutory requirements.
6. Ensure that all money expended from reserve funds is used for the purposes for which the funds were established, or as otherwise provided by law.

Information Technology

How Should Assets Be Safeguarded?

The Board is responsible for adopting policies and procedures and District officials are responsible for implementing internal controls to safeguard computerized data and assets. The Board adopted an inventory policy that requires that all electronic and digital equipment, such as laptops and printers, and all other equipment costing more than \$1,000 be inventoried.

Good governance and accountability require that proper procedures are in place to safeguard personal, private and sensitive information (PPSI) against unauthorized access, misuse or abuse. It is essential that IT personnel follow best practices when designing, programming and configuring computers and applications, including protecting sensitive data from both external and internal threats, reducing the number of security vulnerabilities that can be exploited and ensuring data can be accessed only by authorized users for legitimate purposes.

While using the Internet is a nearly indispensable resource for conducting business, users are susceptible to significant threats from cybercriminals exploiting IT system vulnerabilities to gain unauthorized access to sensitive data. Internet browsing increases the likelihood that users will be exposed to some form of malicious software that may compromise data confidentiality. District officials should ensure there is an adequate web filtering process in place to limit vulnerabilities resulting from Internet browsing and ensure the District's network is used for appropriate purposes. District officials can reduce the risks to sensitive data and IT assets by monitoring Internet use and using web filtering software to block access to unacceptable websites.

Electronic Assets Were Not Used or Properly Inventoried

In June 2016, District officials purchased 18 outdoor cameras for \$39,890. These items were not recorded in the inventory. We found that seven cameras, with a total value of over \$20,000, were in storage and not being used.

In September 2015, District officials entered into a three-year lease agreement with a computer vendor for 300 tablet computers and made the first payment of \$123,540 in January 2016. None of these devices were included in the District's inventory records. District officials are continuing to make lease payments for devices that they are not properly tracking. Without inventory records and periodic inventory verification the District has an increased risk that these items will be lost or stolen.

PPSI Is Not Adequately Protected

District officials did not have adequate procedures to adequately safeguard PPSI or prevent inappropriate personal computer use. To evaluate website use, we reviewed web histories on 10 computers² and identified Internet use by District employees that appeared to be personal in nature rather than work related and instances of PPSI contained on the visited webpages. Employees visited social networking websites, viewed personal email, visited education, business and financial websites and shopping, real estate, travel, video and audio streaming and other entertainment websites using District IT assets.

There were several instances of potentially exposed PPSI, such as personal email addresses contained in web addresses of email servers and usernames and email addresses exposed in the District's facility use application web addresses along with other student information. We also found a relatively large amount of advertising content that may indicate a spyware infection on one of these computers.

This can be harmful to users because it can be taken advantage by an attacker to make changes to computer settings without the user's knowledge or fill the computer's disk space with unnecessary files. Certain types of spyware can also be used by an attacker to view or copy confidential information or redirect browsers to malicious websites without the user's knowledge.

What Do We Recommend?

The IT Director should:

7. Ensure all electronic and digital equipment are inventoried and that only devices needed by the District are purchased.
8. Locate all leased computer tablets and add them to the inventory.
9. Ensure that PPSI is not inappropriately disclosed via District web applications.

² See Appendix B for information on our methodology.

Appendix A: Response From District Officials



Dr. Roberto Padilla

Mr. Ed Forgit
Mr. Michael McLymore
Ms. Sara Feliz
Mr. Gregory Kern

Superintendent of Schools

Deputy Superintendent
Asst. Superintendent, Human Resources
Asst. Superintendent, Curriculum & Instruction
Asst. Superintendent, Finance

October 26, 2017

New York State Office of State Comptroller
Division of Local Government and School Accountability
Newburgh Regional Office
Chief Examiner
33 Airport Road, Suite 103
New Windsor, NY 12553

Dear Chief Examiner:

Thank you for the report on the Financial Management and Information Technology of the Newburgh Enlarged City School District for the period July 1, 2015-April 18, 2017. We are pleased that the Comptroller's Office found and recognized our internal controls to be sound and did not find any evidence of fraud, malfeasance, or any other negative financial accounting practices. We appreciate the help with our information technology and take seriously the safeguarding of personal information with which we are entrusted.

The Newburgh Enlarged City School District is committed to providing outstanding educational programs for all students. It is the goal of the District to maintain programs that promote intellectual, cultural, physical and emotional growth for all students in a safe and supportive environment while maintaining fiscal responsibility.

Since there were no improprieties found in your audit, we take exception to the harsh tone of the report given the fact that a budget is an estimate of revenues and expenditures that may vary from year to year in terms of actual expenditure, with school districts being restricted to a going forward unassigned fund balance of just 4% by law, while your office recommends a multiple of that for other municipalities as being fiscally prudent where the law is silent in that regard. In any event, the actual unassigned fund balance was maintained within the 4% limit. It is easy to evaluate a budget at the end of the budget cycle. It is far harder to estimate a budget with a number of undetermined variables. These variables range from changes in enrollment, particularly as associated with special education, fluctuations in State Aid, unsettled contracts, escalating health costs, budgeting within the tax cap and being able to maintain a favorable bond rating. The strong financial position of the District should allow for favorable interest rates for the upcoming capital project that will save the taxpayers money over the 15-year payback of the bonds.

See
Note 1
Page 13

See
Note 2
Page 13

See
Note 3
Page 13

Due to conservative budgeting practices, the Newburgh Enlarged City School District

- has not been listed as a District in Fiscal Stress by the Comptroller’s Office.
- has received a bond rating of AA from Standard and Poors Global Ratings.
- has remained under the 2% tax cap since the inception in 2011.
- has maintained excellent internal controls as evident by this audit.

The District takes pride in developing budgets that allow for the excellent educational opportunities that make Newburgh an ideal place to learn, while monitoring and evaluating the financial condition of the school district on behalf of the taxpayers of the community.

Upon review of the laws governing reserve funds, there was nothing found that would justify the discounting of monies in the several reserve funds that would justify imputing additional monies to the count toward unassigned fund balance with the strictures of Section 1318(1) of the Real Property Tax Law. Each of the reserve funds was legal for establishment by the Board, except for the Capital Reserve fund that was subject to voter approval. Regarding that fund, there was no reason to include it in a graphic representation that seems aimed at displaying excessive reserve funds when the deposits in such fund may only be expended via a second vote of the school district’s taxpayers, pursuant to Section 3651(1-a) of the Education Law.

See
Note 4
Page 13

See
Note 5
Page 13

The District’s fiscal proceedings have always been within the contours of the law, including during the audit period at issue and has stayed faithfully within the Tax Levy Limit of Section 3023-a of the Education Law.

Once again, thank you for the report. Please feel free to contact me if you have any questions.

Sincerely,

Dr. Roberto Padilla
Superintendent of Schools

c: Carol Mineo, Board President
Gregory Kern, Assistant Superintendent of Finance

Appendix B: OSC Comments on the District's Response

Note 1

While we recognize that budgets are estimates, the budget line estimates identified in our report can be accurately estimated based on known facts and prior trends.

Note 2

While reported unassigned fund balance was within the 4 percent limit, this was due to appropriating unneeded fund balance and funding of reserves that were not used as intended.

Note 3

We acknowledge that operating surpluses and excess fund balance reduce the cost and need for borrowing. However, District officials are not legally permitted to retain more than 4 percent of the ensuing year's budget.

Note 4

District officials did not use the amounts retained in several reserve funds over the past five years. We recalculated unrestricted fund balance to show the effect of this trend.

Note 5

In our report, Figure 4 shows reserve balances over the past three years. Our report does not indicate the capital reserve is overfunded and Figure 5 shows the total amount of excess reserves, which does not include the capital reserve fund.

Appendix C: Audit Methodology and Standards

We conducted this audit pursuant to Article V, Section 1 of the State Constitution and the State Comptroller's authority as set forth in Article 3 of the New York State General Municipal Law. To achieve the audit objective and obtain valid audit evidence, audit procedures included the following:

- We interviewed District officials to obtain an understanding of the oversight and practices for budgeting and financial management.
- We reviewed Board minutes for procedures relating to budgeting and financial management and Board actions.
- We compared the District's appropriations and estimated revenues with the actual results of operations to determine whether there were any significant budget variances from 2011-12 through 2015-16.
- We reviewed and analyzed the District's reserves and fund balances to ensure they complied with applicable statutes and to determine whether the balances were reasonable.
- We reviewed and analyzed reported fund balance levels in comparison to amounts appropriated in adopted budgets for 2012-13 through 2015-16. We compared the unrestricted fund balance to the subsequent year's budgeted appropriations to determine whether the District's unrestricted fund balance was within the statutory limit.
- We recalculated the 2013-14 through 2015-16 unrestricted fund balances to include appropriated fund balance not used as percentages of subsequent years' budgets.
- We interviewed officials and reviewed applicable laws, Board resolutions, accounting records, annual reserve reports to the Board and audited financial statements to determine whether reserves were legally established, had reasonable balances and were funded and expended in accordance with statutory provisions.
- We traced electronic equipment purchased to the District's inventory and to physical location.
- We judgmentally selected and examined web browsing histories of 10 computers by running audit software.

Our audit also examined the adequacy of certain information technology controls. Because of the sensitivity of some of this information, we did not discuss the results in this report, but instead communicated them confidentially to District officials.

We conducted this performance audit in accordance with GAGAS (generally accepted government auditing standards). 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.

Unless otherwise indicated in this report, samples for testing were selected based on professional judgment, as it was not the intent to project the results onto the entire population. Where applicable, information is presented concerning the value and/or relevant population size and the sample selected for examination.

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, pursuant to Section 35 of General Municipal Law, Section 2116-1(3)(c) of New York State Education Law and Section 170.12 of the Regulations of the Commissioner of Education. To the extent practicable, implementation of the CAP must begin by the end of the 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. We encourage the Board to make the CAP available for public review in the District Clerk's office.

Appendix D: Resources and Services

Regional Office Directory

www.osc.state.ny.us/localgov/regional_directory.pdf

Cost-Saving Ideas – Resources, advice and assistance on cost-saving ideas

www.osc.state.ny.us/localgov/costsavings/index.htm

Fiscal Stress Monitoring – Resources for local government officials experiencing fiscal problems

www.osc.state.ny.us/localgov/fiscalmonitoring/index.htm

Local Government Management Guides – Series of publications that include technical information and suggested practices for local government management

www.osc.state.ny.us/localgov/pubs/listacctg.htm#lgmg

Planning and Budgeting Guides – Resources for developing multiyear financial, capital, strategic and other plans

www.osc.state.ny.us/localgov/planbudget/index.htm

Protecting Sensitive Data and Other Local Government Assets – A non-technical cybersecurity guide for local government leaders

www.osc.state.ny.us/localgov/pubs/cyber-security-guide.pdf

Required Reporting – Information and resources for reports and forms that are filed with the Office of the State Comptroller

www.osc.state.ny.us/localgov/finreporting/index.htm

Research Reports/Publications – Reports on major policy issues facing local governments and State policy-makers

www.osc.state.ny.us/localgov/researchpubs/index.htm

Training – Resources for local government officials on in-person and online training opportunities on a wide range of topics

www.osc.state.ny.us/localgov/academy/index.htm

Contact

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