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Office of the State Auditor**

City of Bayonne School District

July 1, 2015 to June 30, 2016

**Stephen M. Eells
State Auditor**

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Enclosed is our report on the audit of the City of Bayonne School District for the period of July 1, 2015 to June 30, 2016. If you would like a personal briefing, please call me at (609) 847-3470.

A handwritten signature in black ink, appearing to read "Stephen M. Eells".

Stephen M. Eells
State Auditor
November 14, 2017

Table of Contents

Scope.....	1
Objectives	1
Methodology.....	1
Conclusions.....	2
Background.....	2
Findings and Recommendations	
General Fund Budgetary Deficit.....	5
Health Benefits.....	7
Auditee Response.....	9

Scope

We have completed an audit of the City of Bayonne School District (district) for the period July 1, 2015 to June 30, 2016. Our audit included financial activities accounted for in the district's General Fund.

General Fund expenditures of the district during the fiscal year 2016 were \$137 million. The district is a type II district (elected school board), having been reclassified from a type I district (appointed school board) during the general elections held on November 3, 2015. The district provides regular, vocational, and special educational services to grade levels Pre-K through twelfth. Average daily enrollment for fiscal year 2016 was 9,359.

The Commissioner of the Department of Education intends to appoint a state monitor to oversee the fiscal operations of the district.

Objectives

The objective of our audit was to determine the primary factors that contributed to the fiscal year 2016 year-end General Fund budgetary deficit of \$2,003,625 as reported in the district's Comprehensive Annual Financial Report.

This audit was conducted pursuant to the State Auditor's responsibilities as set forth in the "School District Fiscal Accountability Act", Title 18A:7A-57 of the New Jersey Statutes and pursuant to Article VII, Section I, Paragraph 6 of the State Constitution and Title 52 of the New Jersey Statutes.

Methodology

Our audit was conducted in accordance with *Government Auditing Standards*, issued by the Comptroller General of the United States. 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.

In preparation for our testing, we studied legislation, the administrative code, and policies of the Department of Education and the school district. Provisions we considered significant were documented, and compliance with those requirements was verified by interview, observation, and through our testing of financial transactions. We read the school district's budgets, reviewed financial trends, and interviewed school district personnel to obtain an understanding of the programs and the internal controls. In addition, we reviewed annual audited financial reports of the district issued by public school accountants.

A nonstatistical sampling approach was used. Our samples of financial transactions were designed to provide conclusions on our audit objectives as well as internal controls and

compliance. Sample populations were sorted and transactions were judgmentally selected for testing.

Conclusions

We found the primary factors that contributed to the fiscal year 2016 year-end General Fund budgetary deficit were the unreported designation of \$4.7 million in reserve for excess surplus at fiscal year-end 2015 and the inappropriate encumbering of at least \$1.8 million and \$4.2 million for payment of subsequent year expenditures at the end of fiscal years 2015 and 2016, respectively. If the reserve was properly identified and these funds were not encumbered, the district would not have reported the General Fund unassigned budgetary deficit of \$2,003,625, but rather a budgetary surplus of \$3.0 million. The district also under-budgeted \$5.7 million in various non-salary accounts which were funded by transfers from adequately budgeted salary accounts.

We also reviewed the unaudited financial activities accounted for in the district's General Fund for the period July 1, 2016 to June 30, 2017 and the district's corrective measures for fiscal year 2018. We estimate that the 2017 General Fund balance should not be in deficit at fiscal year end and corrective measures eliminating 41 staff positions and demoting 10 employees should result in an approximate salary savings of \$2.5 million and an additional \$860,000 in employee benefits savings for fiscal year 2018.

Background

The district ended fiscal year 2016 with a General Fund budgetary fund balance of \$5,460,037, and within the classification "unassigned" a budgetary fund balance deficit of \$2,003,625 per its audited Comprehensive Annual Financial Report (CAFR). A review of these reports for prior years indicate the district's General Fund ending fund balance increased steadily from \$1.4 million to \$20.4 million from fiscal year 2007 through 2014 as illustrated in the table on the following page.

CITY OF BAYONNE SCHOOL DISTRICT

General Fund	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014	FY 2015	FY 2016
Beginning Fund Balance	1,271,215	1,377,783	603,652	2,205,783	9,284,245	8,661,220	12,645,385	20,088,920	20,358,071	9,384,893

Revenues	100,192,130	107,786,553	119,259,358	121,985,769	117,795,652	122,265,711	126,433,224	125,998,983	128,335,522	131,498,972
Expenditures	104,193,017	110,346,376	125,771,240	113,523,457	110,686,482	112,006,295	122,951,192	123,486,064	140,152,608	137,315,009
Excess (deficiency) of Revenues over (under) Expenditures	(4,000,887)	(2,559,823)	(6,511,882)	8,462,312	7,109,170	10,259,416	3,482,032	2,512,919	(11,817,086)	(5,816,037)
Other Financing Sources (Uses)	4,107,455	1,785,692	8,114,013	(1,383,850)	(7,732,195)	(6,275,251)	3,961,503	(2,243,768)	843,908	1,891,181
Excess (deficiency) of Revenues and Other Financing Sources over (under) Expenditures and Other Financing Uses	106,568	(774,131)	1,602,131	7,078,462	(623,025)	3,984,165	7,443,535	269,151	(10,973,178)	(3,924,856)

Ending Fund Balance	1,377,783	603,652	2,205,783	9,284,245	8,661,220	12,645,385	20,088,920	20,358,071	9,384,893	5,460,037
Reserve for Excess Surplus – Prior Year – Designated for Subsequent Years	-	-	-	2,635,000	3,684,502	909,226	7,036,151	-	-	1,523,324
Reserve for Excess Surplus	1,075,216	247,619	350,000	3,684,502	716,285	7,036,151	-	4,744,715	1,523,324	-
Capital Reserve	-	-	-	-	-	-	1,750,000	-	-	-
Designated for Subsequent Year's Expenditures	-	-	-	-	-	-	885,693	366,944	651,077	-
Year-end Encumbrances	302,567	356,033	170,005	860,296	2,208,127	1,544,341	9,568,101	12,299,220	4,040,304	5,940,338
Unassigned Fund Balance	0	0	1,685,778	2,104,447	2,052,306	3,155,667	848,975	2,947,192	3,170,188	(2,003,625)

Reserve – For Excess Surplus – Prior Year – Designated for Subsequent Year's Budget – This reserve represents the prior year's audited excess surplus to be appropriated in the subsequent year's original budget.

Reserve – For Excess Surplus – This reserve represents the current year's audited excess surplus calculated in accordance with N.J.S.A. 18A:7F-7 and required to be appropriated in the subsequent year's original budget at end of next year.

Capital Reserves – This reserve represents the current year's commitment to accumulate funds for use as capital outlay expenditures in subsequent years.

Year-end Encumbrances – This reserve represents the current year's commitment for outstanding purchase orders and contracts at the end of the year.

Designated for Subsequent Year's Expenditures – This designation assigns a portion of fund balance to be used for a specific purpose.

Unassigned – This designation represents current available resources not restricted, committed, or assigned.

The accumulation of the General Fund's year-end fund balance through fiscal year 2014 was attributed to over-budgeting of employee salaries in anticipation of the pending teachers' contract settlement. A retroactive fiscal year 2011-2015 agreement with the teachers was reached in September 2014. As a result of the settlement, fiscal year 2015 salary expenditures increased nearly \$16.6 million (23 percent) in comparison to the previous year. Teachers received salary increments, and in total, 1,096 employees received \$10.5 million in retroactive pay ranging from \$44 to \$79,715 per employee as presented below.

Retroactive Amounts	Number of Employees	Total Retroactive Pay
\$70,000-79,999	24	\$1,761,763
\$60,000-69,999	7	434,606
\$50,000-59,999	5	266,937
\$40,000-49,999	30	1,239,352
\$30,000-39,999	8	287,661
\$20,000-29,999	21	503,443
\$10,000-19,999	141	1,982,786
\$ 5,000- 9,999	500	3,235,063
<\$5,000	360	781,969
Totals	1,096	\$10,493,580

The highest retroactive payments were due to the design of the teachers' salary guide and each teacher's placement within the guide when these payments were made. This guide contained 16 steps per teacher's title with a teacher eligible to move to the next step annually. Salary increments for the first 12 steps ranged from 1.5 percent to 2.4 percent per annum, and by advancing through the last four steps, a teacher could have received \$40,000 in cumulative increments. In addition, after 16 years of service, teachers receive a longevity increment ranging from \$4,400 to \$11,800 per year depending on the years of service. Longevity payments were frozen during the time period teachers worked without a contract and were included in the retroactive payments made during fiscal year 2015.

During fiscal year 2015, the district also hired 129 employees, which was 49 more than those who resigned or retired during the year, resulting in an additional \$2.2 million in net salaries.

These salary increments, retroactive payments, and additional positions significantly reduced the accumulated fund balance as reported at the beginning of the fiscal year 2015.

General Fund Budgetary Deficit

Appropriate reporting, accounting, and budgeting procedures were not followed for the reporting of fund balance reserves, the recording of year-end encumbrances, and the identification of accounts in deficit.

Unreported Prior Year Reserve

Pursuant to N.J.S.A. 18A:7F-7, all regular districts must perform the excess surplus calculation using the greater of 2 percent of general fund expenditures or \$250,000. Amounts calculated in excess of 2 percent that have not been appropriated in the subsequent year's budget must be reported in the "Reserve for Excess Surplus" category in the current year's CAFR and appropriated in the subsequent year's budget at the end of the next year. The amount which has been included in the subsequent year's budget should be reported in the "Reserve for Excess Surplus - Prior Year - Designated for Subsequent Years" category.

At fiscal year-end 2015, the district reported a General Fund budgetary fund balance of \$9,384,893 and within the classification "Reserve for Excess Surplus", a budgetary fund balance reserve of \$1,523,324 to be appropriated in the 2016-2017 budget. However, this reserve was determined without regard for a legally restricted prior year reserve for excess surplus of \$4,744,715 as reported at fiscal year-end 2014. This reserve was designated as a use of the General Fund budgetary fund balance in the fiscal year 2016 budget but was not disclosed at fiscal year-end 2015. When this amount is considered along with other identified restrictions on the fiscal year-end 2015 budgetary fund balance, there would not have been an excess surplus reserve of \$1,523,324 (see table following *Year-end Encumbrances*).

Year-end Encumbrances

The Department of Education (DOE), Office of School Finance 2015-2016 audit program urges district's public auditors to perform a thorough review and analysis of open purchase orders in conformity with the Year-End Encumbrance Hotline issued September 16, 2003. Per the audit program and the hotline, purchase orders to be honored in the subsequent year will be rolled over into the next fiscal year and will be shown at June 30 as year-end encumbrances. As a general rule, for other than construction contracts, the liquidation of these orders should be within 60-90 days of year end. Additionally, the district's audited financial statements state that the year-end encumbrances represent commitments related to unperformed contracts for goods and services.

The district's fiscal year 2016 General Fund year-end encumbrances were \$5.9 million (see first table in this report). We reviewed 97 of 375 encumbrances totaling \$5.6 million and concluded that over \$4.2 million was encumbered for the following year's expenditures and did not represent unperformed contracts at year end. The largest encumbrances included \$1 million for fiscal year 2017 worker's compensation insurance renewal (appropriateness of this encumbrance was also questioned by the DOE's Office of School Finance), over \$800,000 for

fiscal year 2017 electric and gas expenditures, \$720,000, for fiscal years 2017 and 2018 computer lease payments, and \$417,000 for fiscal year 2017 staff equipment lease payments. Encumbering money in the accounts that had significant end-of-year balances was a common accounting practice.

As a result of our review of fiscal year 2016 encumbrances, we also examined fiscal year 2015 General Fund year-end encumbrances greater than \$75,000, totaling \$2.3 million, and concluded that over \$1.8 million was encumbered for the following year's expenditures. Inappropriate encumbering of these funds had a significant impact on the reported unassigned budgetary fund balance deficit at the end of fiscal year 2016.

If the reserve was properly identified and fiscal year 2015 and 2016 funds were appropriately encumbered, the unassigned budgetary fund balance would have been a surplus of at least \$3.0 million instead of a \$2.0 million deficit. In addition, \$747,773 in excess surplus would be reported at fiscal year-end 2016 (see table below for our audit revisions).

General Fund	FY 2015			FY 2016		
	CAFR Reported	Audit Revision	Variance	CAFR Reported	Audit Revision	Variance
Ending Fund Balance	9,384,893	9,384,893		5,460,037	5,460,037	
Reserve for Excess Surplus-Designated for Subsequent Years	-	4,744,715	(4,744,715)	1,523,324	-	1,523,324
Reserve for Excess Surplus	1,523,324	-	1,523,324	-	747,773	(747,773)
Capital Reserve	-	-	-	-	-	-
Designated for Subsequent Year's Expenditures	651,077	651,077	-	-	-	-
Year-end Encumbrances	4,040,304	2,177,391	1,862,913	5,940,338	1,723,893	4,216,445
Unassigned Fund Balance	3,170,188	1,811,710	1,358,478	(2,003,625)	2,988,371	(4,991,996)

Accounts in Deficit

The district's actual fiscal year 2016 salaries were \$79.9 million and exceeded the final budget by over \$5 million. The original budget for total salaries would have been sufficient to provide for these salaries, however, over the course of the year, the district transferred nearly \$5.7 million from their salary accounts to other under-budgeted accounts including health benefits (\$2.5 million) and tuition to private and charter schools (\$1.4 million). The under-budgeting of these non-salary accounts further reduced fund balance as reported at the end of fiscal year 2016.

Salaries of teachers grades 9-12 was the single over-expended account reported in the district's fiscal year 2016 CAFR, Budgetary Comparison Schedule – General Fund. However, salary expenditures were not accurately reflected in their respective CAFR accounts because employee salaries were not always charged to the proper budgetary account during payroll processing. Also, at the end of the fiscal year 2016, the district made salary adjustments and reclassified \$5.2 million from salary accounts in deficit to the grades 9-12 salary account. The reclassifications ranged from \$2,600 to \$1.17 million. As previously mentioned, the reason for these pre-reclassification deficits were the budget transfers to non-salary accounts.

Recommendations

We recommend the district properly report legal restrictions on the use of the General Fund budgetary fund balance and discontinue the practice of encumbering funds for subsequent years' expenditures and use encumbrances only for the commitment of the current year's unperformed contracts at year-end. We further recommend the district adhere to the DOE's uniform minimum chart of accounts for the recording of expenditures to ensure proper identification and allow for adequate budgeting of all costs.



Health Benefits

Monthly billings are not reviewed to verify enrollment eligibility and to recover unreimbursed premiums.

The City of Bayonne School District (district) provides its eligible employees and their dependents medical and prescription coverage through the State Health Benefits Program (SHBP) and dental coverage through a private insurance company. Dental coverage is offered at no cost to active employees and can be purchased by retirees. The district is required to notify the plan administrators of any changes in coverage due to hiring, terminations, or changes in coverage status.

We compared the July 2017 billing lists of covered employees to the district employee listing and found the following errors.

- The district does not remove employees from benefits or bill them for their share of health cost until employees return from leave without pay and start receiving payroll checks again. Contributions are then collected retroactively from the employees' paychecks. We noted nine employees on approved leave of absence from whom premium contributions were not collected for periods ranging from two weeks to three months. As of August 30, 2017 the noted errors amounted to approximately \$10,000 in uncollected health benefits premiums.

- Four former employees were not removed (or billed) from health benefits coverage for periods ranging from one to eight months. As of August 30, 2017 the noted errors amounted to approximately \$11,500 in health benefits premiums.

The district has been providing medical, prescription, and dental benefit coverage to a spouse of a former employee since the employee passed away in June 2000. The February 23, 1998 employee's contract with the district stipulated that upon the employee's retirement, the district would provide the employee family health coverage in the district's plan. The employee did not retire and therefore the spouse was not entitled to coverage under the employee's contract. There was also no board resolution approving the provision of this coverage. In addition, when this individual was enrolled in the SHBP, the individual was inappropriately reported to the state's Division of Pensions and Benefits as an employee of the district. The annual cost of these benefits to the district was \$11,400 during fiscal year 2016.

Recommendation

We recommend the district ensure procedures are in place for the timely removal of ineligible individuals from the district's benefit plans. The procedure should require immediate billing of employees on leave without pay who elect to participate in benefits. The procedure should also require monthly billings to be reviewed for enrollment eligibility.





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November 8th, 2017

Mr. David J. Kaschak, Assistant State Auditor
New Jersey State Legislature
Office of Legislative Services
Office of the State Auditor

Dear Mr. Kaschak,

I have received and reviewed the findings and recommendations in the confidential draft of the audit report dated November 2nd, given to me on November 3rd, 2017. Prior to the issuance of this report, the District has modified its procedures related to almost all aspects of budgeting and accounting for expenditures. This will help to ensure that, in the future, the district will be proactive and aware of any potential budget deficit situations as well as having the proper information to only hire employee's which would be sustainable given the many budget and revenue constraints the district faces. Please see below our comments to each one of the recommendations made in the audit report.

Unreported Prior Year Reserve

The District will work with our auditor's to help ensure that the legal restrictions on the use of General Fund budgetary fund balances will be properly reported at each year-end.

Year-end Encumbrances

The District has changed its procedures and will only record encumbrances for valid commitments related to unperformed contracts for goods and services which will be liquated within 60-90 days of the district's year-end. For the year-ended June 30, 2017, the District recorded just under \$145,000 in general fund encumbrances, which was more than a 97% decrease as compared to the year ended June 30, 2016.

Accounts in Deficit

The District has changed its budgeting procedures to properly adhere to the NJ DOE's uniform minimum chart of accounts. The District has reviewed each and every salaried position in the district as well as all expenditures for work billed via time sheets (which includes all stipends approved by the board). The District has significantly expanded the number of payroll related general ledger accounts used, in order to properly account and budget for the District's expenses. Additionally, the District has reviewed each salaried position and ensured that the account code used both accurately reflects the work performed and is in compliance with the NJ DOE's uniform minimum chart of accounts. Finally, the District reviews the personnel related expenditures after each payroll period and encumbered for the full year ended June 30, 2018 estimated personnel related expenditures on October 8th, 2017.

Health Benefits

The vast majority of the individuals noted in the audit findings were relating to people who took leaves. The district agrees with the audit finding and has implemented procedures whereby the first month share of the required amount of each employee's contribution towards their medical and prescription premiums will be collected prior to the employee going on leave. Subsequently, each employee who is on leave will get billed on a monthly basis throughout his or her leave.

"The Bayonne Public School Family – Moving From Good to Great"

I would like to again mention two facts noted below which weighed heavily in our financial situation:

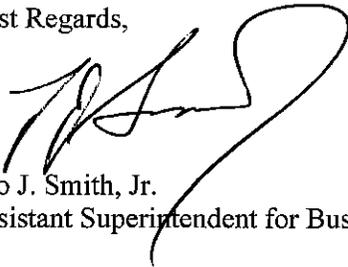
- During 2015 the district did hire a significant amount of staff to replace retirees, resignations and leaves. Most of the additional staffing was increased due to the fact that we were mandated and not funded by the state to hire additional special education and ESL staff to bring our programs into compliance. These two areas represented the largest areas of staff increases. The special needs staffing (15) cost the district an additional \$975,000 per year in salary and benefits (back up information was previously included to the remarks on the confidential draft audit report).
- In June of 2011, as part of our CAFR, our auditors recommended that a \$6.9 million dollar receivable be written off as uncollectable. This \$6.9 million dollars was money the Bayonne Board of Education, by way of Board of School Estimate approval, put forward on behalf of the municipality as its share of the Early Retirement Incentive in 2003-2004. The City was to make good on this at a future date and never did.

These two items taken separately or combined would have significantly reduced our “over commitment” in other areas. They also would have made it possible to fund our retro payments of December 2015 without the severe consequences that followed.

In closing I want to reiterate the fact that as Assistant Superintendent for Business/School Business Administrator I know my responsibility lies in overseeing every day functions in Payroll, Pension & Benefits, Accounts Receivable, Accounts Payable, Transportation both in and out of district, Facilities & Maintenance, Insurance matters to include both district liability and employee/personnel health, dental and prescription and district Food Services program. In overseeing these various aspects I put my faith and good will in those staff members who have an expertise in those areas. If there is a legal question I contact our Board Counsel, an employee health issue I contact our Chief Medical Inspector, an environmental issue regarding mold, asbestos, air quality I contact our Right to Know consultants, buildings & facilities concerns or issues I consult our architects and engineers. I relied on our in-house Accountant to effectively manage the budget and all of its details. Somewhere along the line he stopped effectively managing these details - which ultimately lead us to this point. We are and have been in the process of righting our financial ship and putting it back on course - it has been a long, long journey and we will continue to follow the above recommendations.

We want to thank the audit team for their high level of professionalism in dealing with our employees during the audit. Thank you for the opportunity to respond to the audit recommendations.

Best Regards,



Leo J. Smith, Jr.
Assistant Superintendent for Business/School Business Administrator

c: Paul Baron, Managing Auditor
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Luz Dow, Staff Auditor
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