MIDDLETOWN
Rhode Island

TOWN ADMINISTRATOR

TOWN OF MIDDLETOWN
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To: Town Council, School Committee
From: Town Administrator
Subject: School Department – Fiscal Issues Requiring Immediate Attention
Date: November 30, 2021

I am writing to address significant financial issues that require the School Committee's immediate attention.

In 07/2021, the School Department reported a $266,000 operating surplus in its general fund for the fiscal year ending 06/30/2021. However, since that time, an additional $1,500,000 in expenditures have been posted to the department's financial statements, which has resulted in an operating deficit of $326K being reported for FY21 as of 11/24/2021. The change in operating results was first reported to me on 11/08/2021. At that time, I was advised that that the deficit was as much as $1,000,000; the reported amount of the deficit has been revised up and down a number of times since that date by the School Department, as they attempt to finalize their year-end financial reports.

The following schedule highlights the deterioration of the School Department's finances since 06/30/2020, highlighting the School Department's unrestricted fund balance decreasing from a favorable balance of $1,542,000 to a balance of $102,000 as of 06/30/2021. The balance decreased because the School Committee budgeted $524,000 to fund operations in FY21, an additional $590,000 to fund operations in FY22, and spent $326,000 in excess of the amount budgeted in FY21.

Town of Middletown
School Department - Fund Balance Analysis
as of 11/27/2021

	Date	FB - Committed	FB - Assigned
Beginning Balance	6/30/2020	$ (579.00)	$ (1,542.00)
FY21 events:			
Commitment - FY21 budget	7/1/2020	250	524
Commitment - FY22 budget	7/1/2021	250	590
Forecasted operating deficit	as of 11/24/2021	-	326
		500	1,440
Forecasted balance	6/30/2021	$ (79.00)	$ (102.00)

Notes: Balances in $1,000's, Debit/(Credit)

Fiscal year ending June 30, 2021

As of 6/20/2020, the School Department's unrestricted fund balance was $1,542,000. The FY21 budget approved by the School Committee budgeted spending $524,000 of that amount to fund operations for FY21. Instead, based on the information currently available, the School Department overspent its budget by $326,000, thereby reducing its unrestricted fund balance by $850,000 in FY21. In addition, because the FY22 budget approved by the School Committee budgeted spending an additional $590,000 of fund balance for FY22 operations, the School Department has exhausted most of its reserves, leaving its general fund with a balance at year-end of $102,000, which is inconsistent with its Spending Policy and Minimum Fund Balance Policy.

In addition, the School Department has been unable to produce financial statements and related supporting schedules necessary for the Finance Director to prepare legal entity financial reports and for the Town to complete the annual audit required by Town Charter and state statute. The Town must submit an annual audit to the state by December 31st each year; however, due to the delay in reporting by the School Department, the Town was forced to request that the deadline be extended to 02/28/2022. The inability to complete the financial statements is a material weakness in the Town's fiscal internal control structure and must be corrected immediately.

The failure to produce financial statements also makes it difficult to confirm the School Department's FY21 deficit. For example, the School Department budgeted $1,550,000 in unidentified reductions in its spending; however, those reductions have never been formally identified by the School Committee. This makes it challenging to complete a meaningful budget to actual variance analysis, which is necessary budgetary planning when considering FY22 & FY23.

Based on the forgoing, the following actions are necessary to close out FY21 properly:

- The financial statements and related supporting schedules must be completed and submitted to the Town's Finance Director and the Town's auditors.

- The School Committee must report to the Town Council that its expenditures have exceeded the approved FY21 appropriation and prepare a corrective action plan as required by R.I.G.L. § 16-2-9(f). That statute requires the School Committee to report any potential or actual over expenditure in excess of the amount budgeted to the Town Council within five (5) days of its discovery.

Fiscal year ending June 30, 2022

The School Department's FY22 budget is not balanced and therefore is likely to end in another deficit balance in the current fiscal year. With the available information, it is reasonable to assume that the School Department will overspend the appropriation approved by the Town Council on 06/07/2021. For example, the School Committee budgeted to make $379,000 of reductions in its spending, which has not been identified or implemented to date. Likewise, the FY22 budget does not budget any amounts for substitute teachers or maintenance costs, though it appears that expenditures are being made in those areas. As we approach the mid-way of the fiscal year, these savings and expenses must be identified as soon as possible, so that a meaningful analysis of the budget can take place.

Going forward, it is reasonable to assume there are structural issues in the FY22 budget carrying forward from the FY21 budget. The following actions are necessary to close out FY22 properly:

- The School Committee must adopt a balanced budget in compliance with RIGL § 16-2-9(e). The School Committee is responsible for adopting and maintaining a school budget that enables it to operate without incurring a debt.

- The School Committee must provide the necessary financial reports to determine whether expenditures for FY22 exceed the amount budgeted, and if so, to (a) report any potential or actual over expenditure to the Town Council; and, (b) prepare a corrective action plan.

- In that regard it should be noted that R.I.G.L. § 16-1-9 provides in pertinent part that:

  "...Should the town treasurer, finance director, or other charter officer charged with general responsibility for town finances, or the school financial officer, estimate that actual public school expenditures, encumbrances, and accruals may exceed the total revenue appropriated for the expenditures in any fiscal year, the school committee, the superintendent of schools, and the chief elected officials of the town shall be notified. *Purchase orders or financial commitments shall not be authorized even on the order of the school committee unless it can be proven that there will not be an excess of expenditures, encumbrances, and accruals over revenues...*"(emphasis added).

It is imperative that the School Committee address these actions as soon as possible, because the ability to finance a deficit with reserves no longer exists.

<u>Fiscal year ending June 30, 2023</u>

The School Committee must submit its FY23 budget request to the Town Administrator in 113 days. The existing structural deficits that need to be reconciled are significant and will complicate the formulation of the budget, placing fiscal uncertainty on the community as it considers the upcoming budget and the building plans currently being formulated. In particular:

- There will be no general fund reserves to fund operations, which have recently been budgeted in the range of $500,000 per year.
- There will likely be no operating surpluses from NESPED to apply towards the School Department's budgeted expenditures to the program, which have been recently budgeted in the range of $250K.
- Other structural deficits have yet to be identified in the school department's budgeting and must be corrected in the upcoming budget cycle.
- There will be significant cost pressures resulting from the inflationary environment we are operating in, along with the requirement to negotiate three labor contracts that will expire in 08/2022.

It is critical that we begin to address all of these issues now to ensure that the Town can meet its obligation to provide quality services now and in the upcoming fiscal year. I hope that we will come together over the following months to overcome the challenges presented above.

Please don't hesitate to get in touch with me or the Finance Director with any questions.