Texas Education Agency

Commissioner Mike Morath

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March 31, 2023

James Josh Ballinger, Interim Superintendent
Tioga Independent School District
P O Box 159
Tioga, TX 76271

RESPONSE REQUIRED

Dear Mr. Ballinger,

RE: Preliminary follow-up and fiscal management review for FY 2021 and FY 2022

The Financial Compliance Division at the Texas Education Agency (TEA) has conducted a preliminary review of Tioga Independent School District, as conveyed in the notification letter dated November 15, 2022, in accordance with the Texas Education Code, §7.021(b)(13). During our review, we examined the corrective actions taken by the district in response to issues identified during the school's annual financial audits for fiscal years 2021 and 2022, and performed a review of the district's overall fiscal management.

In accordance with the Texas Education Code (TEC), §11.1511(b)(9) and §11.201(d)(5), it is the responsibility of the board of trustees and the superintendent to ensure that school districts have an internal control structure in place to provide reasonable assurance that the school district's assets are safeguarded from unauthorized use or disposition. It is also their responsibility to ensure that the objective of an effective and efficient operation is achieved, financial data is reliably and accurately reported, and the district is compliant with applicable laws and regulations.

This report includes findings and the corresponding recommendations and required actions that resulted from this preliminary review.

Follow-up Review

External Auditor Findings and Comments

The external auditor noted the following items during the district's annual financial audit for the 2022 fiscal year. No findings were identified during the FY 2021 annual financial audit.

External Auditor Finding 2022-001: Material Weakness – Classification of Transactions/Lack of Management Review

In accordance with TEA's Financial Accountability System Resource Guide ("FASRG"), short-term debt transactions, relating to repayment of debt principal, are not reflected on the statement of revenues and expenditures, nor are they included in the Debt Service Fund. These entries are recorded as balance sheet only.

The former business manager improperly recorded a short-term liability net of debt issuance expenses of $989,000 as lease proceeds which is reflected on the statement of revenues and expenditures for the General Fund. No review of monthly financial statements or significant transactions was conducted by the former superintendent.

Statement of revenues and expenditures and the balance sheet for the General Fund were materially misstated.

External Auditor Recommendations

The Board should implement internal control procedures that will ensure the regular monitoring of significant transactions and accuracy of the financial statements.

Management's Corrective Action Plan

To be presented to the Board on November 14, 2022.

TEA Follow-up Requirement for the District

- **Please provide the district's corrective action plan, along with steps taken to ensure the regular monitoring of significant transactions and accuracy of the financial statements.**

External Auditor Finding 2022-002: Material Weakness – Violation of Bond Covenants/Classifications of Transactions

In accordance with covenants listed in the general obligation bond documents, the Debt Service fund shall be kept separate and apart from all other funds and accounts and shall be used only for paying the interest on and principal of the bonds.

Various cash transfers totaling a net $175,000 were authorized by the former superintendent from the Debt Service bank account to the General Operating account during FY2022 to cover payroll obligations and other operating expenses. These transfers were recorded to accounts "7915 – Transfers In" in the General Fund and "8911 – Transfers Out" in the Debt Service Fund, instead of due to/due from accounts on the balance sheet, therefore overstating the General Fund balance and understating the Debt Service Fund balance.

Debt Service funds were used improperly in violation of bond covenants and fund financial statements were materially misstated.

External Auditor Recommendations

Bank transfers over a certain amount should be approved by the Board. Typically, the county tax assessor deposits tax collections into the General Operating account and the I&S funds are transferred to the Debt Service Fund bank account on a monthly basis. The District should inquire as to whether the I&S funds can be deposited directly to the Debt Service bank account.

Management's Corrective Action Plan

To be presented to the Board on November 14, 2022.

TEA Auditor Comments

See comments noted under TEA Finding #3 in the following Fiscal Management Review section.

TEA Follow-up Requirement for the District

- **Please provide the district's corrective action plan.**

External Auditor Finding 2022-003: Material Weakness – Violation of Bond Covenants/Classification of Transactions

In accordance with covenants listed in the general obligation bond documents, the Debt Service fund shall be kept separate and apart from all other funds and accounts and shall be used only for paying the interest on and principal of the bonds.

At the specific direction of the former superintendent, a payment of $103,498 for a finance contract used to purchase furniture and equipment for the high school was made directly from the Debt Service bank account. The loan is not general obligation debt that is covered by the Debt Service tax collections, and payments are to be made from the General Operating account. No cash was transferred and no due to/due from or transfers were recorded between the General Fund and the Debt Service Fund.

Debt Service funds were used improperly in violation of bond covenants and fund financial statements were materially misstated.

External Auditor Recommendations

Transactions over a certain amount should be approved by the Board.

Management's Corrective Action Plan

To be presented to the Board on November 14, 2022.

TEA Auditor Comments

See comments noted under TEA Finding #2 in the following Fiscal Management Review section.

TEA Follow-up Requirement for the District

- **Please provide the district's corrective action plan.**

Fiscal Management Review

TEA Auditor Findings

The TEA Financial Compliance Division noted the following items during their review of the annual financial audits for fiscal years 2021 and 2022, and the district's overall fiscal management.

TEA Finding #1 – Going Concern and General Fund Deficit

TEA's AFR Review Letter Comment for FY 2021

The Governmental Funds Balance Sheet (FY 2021 AFR, Exhibit C-3, page 22) shows a general fund deficit of $418,423, which is a deficit decrease from the prior year general fund deficit of $646,981. In accordance with the Texas Education Code §44.006, funds of a current year may not be used to pay the debts of a preceding year, thus making end-of-year fund deficits unlawful. The board of trustees will have to monitor expenditures carefully to prevent future deficits.

Similar comments were noted in the 2020, 2019, 2018, 2017, and 2016 AFR review letters.

Management's Comments

TISD declared financial exigency on November 14, 2022, and began a reduction in force (RIF) of staff in December 2022. The district has cut $1,000,000 in annualized salary, paid those employees with their accruals in January 2023, and is moving forward with the next steps of finishing this school year.

TEA Follow-up

We noted in the district's FY 2022 Annual Financial Report (AFR) that the external auditor expressed a substantial doubt about the district's ability to continue as a going concern attributable to cash flow issues related to foundation school program payments due to attendance overestimates in previous fiscal years that have reduced payments in FY 2022 and FY 2023. Per the FY 2022 AFR, "There is significant uncertainty as to whether payroll and debt obligations can be met for the remainder of FY 2023."

In 2016, the Tioga Independent School District Public Facilities Corporation issued $26,780,000 in lease revenue bonds to provide funds for construction and other projects. The debt obligation for these lease revenue bonds were to be repaid out of the general fund, which depleted resources available to fund other functions within the general fund and hindered the district's ability to maintain a secure general fund balance. Initially, payments from the general fund for the bond debt appeared plausible, but they increased annually to an unsustainable amount as demonstrated in the following diagram.

Tioga ISD: Selected Financial Data from the General Fund

	AFR 13-14	AFR 14-15	AFR 15-16	AFR 16-17	AFR 17-18	AFR 18-19	AFR 19-20	AFR 20-21	AFR 21-22
Revenue	**3,212,764**	**3,888,602**	**4,943,536**	**5,252,921**	**6,369,969**	**7,072,814**	**9,185,875**	**9,636,770**	**9,279,431**
Facilities/Maintenance	302,068	426,055	407,955	1,769,801	417,359	576,995	723,482	870,362	1,010,497
GF Principal	62,649	31,478	71,350	38,245	269,557	118,585	118,792	497,317	555,830
GF Interest	3,750	1,836	5,732	19,607	51,871	744,369	941,000	1,195,767	1,187,479
GF Debt Fees	-	-	-	-	-	-	15,750	11,000	12,479
Total Debt	**66,399**	**33,314**	**77,082**	**57,852**	**321,428**	**862,954**	**1,075,542**	**1,704,084**	**1,755,788**
Facilities Acquisition	-	-	1,300,000	3,717	250,099	700,000	-	-	65,400
Other Expenditures	2,842,690	3,765,995	4,110,347	4,829,858	4,852,658	5,333,289	6,649,446	7,465,138	7,640,379
Total Expenditures	3,211,157	4,225,364	5,895,384	6,661,228	5,841,544	7,473,238	8,448,470	10,039,584	10,472,064
Other Sources: Trans In	-	200,000	72,113	1,384,707	-	1,236,849	-	695,000	-
(Other Uses / Trans Out)	(90,617)	(221,638)	(63,039)	(54,326)	(9,218)	(2,125,431)	(645,938)	(63,628)	-
Net Change in Fund Balances	(89,010)	(358,400)	(942,774)	(77,926)	519,207	(1,289,006)	91,467	228,558	(1,192,633)
Beginning Fund Bal + Adj.	1,499,461	1,410,451	1,052,051	109,277	31,351	550,558	(738,448)	(646,981)	(418,423)
Ending Fund Balance	**1,410,451**	**1,052,051**	**109,277**	**31,351**	**550,558**	**(738,448)**	**(646,981)**	**(418,423)**	**(1,611,056)**

Since FY 2019, the district has continued to maintain a general fund deficit. The FY 2022 Annual Financial Report (AFR) reported a general fund deficit of $1,611,056, which is an increase from the prior year deficit of $418,423. Note P (FY 2022 AFR, page 53) disclosed that the primary reason for this was that state funding for FY 2022 was reduced by $1,361,804 for an overpayment in FY 2021 due to over estimates in average daily attendance (ADA).

The district continues to have a failed FIRST rating for the 2021-2022 FIRST ratings due to a low or failing score for indicators 6, 7, 8, 9, and 12. Contributing factors included low assigned and unassigned fund balances, cash on hand and current investments were insufficient to cover operating expenditures, current assets to current liabilities ratio was insufficient to cover short-term debt, general fund revenues were less than operating expenditures, material budget variances, and the debt ratio was insufficient to support future debt repayments.

In February 2023, the TEA assigned a monitor, Jeff Adams, to the district for accreditation. The monitor’s roll includes reporting to the TEA on the activities of the board of trustees and/or the superintendent.

TEA Follow-up Requirements for the District

- **Please provide the district’s solvency plan, including a cash flow projection spreadsheet through August 2023.**

TEA Finding #2 – Insufficient Balance in the Debt Service Fund to Cover Bond Debt Payments

Note P, page 53, of the FY 2022 AFR stated, “The shortfall in resources resulted in depletion of the General Fund cash balance requiring cash transfers of $200,000 from the Debt Service fund to cover payroll expenses in Spring 2022”. Nevertheless, these types of transactions are not allowable because they are in violation of bond covenants for the unlimited tax school building and refunding bonds, Series 2015 (Order agreement, section 6) and the unlimited tax refunding bonds, Series 2021 (Order agreement, section 8). The external auditor indicated this as a material weakness finding number 2022-003. The bond covenants state that a special interest and sinking fund is created solely for the benefit of the bonds, and the interest and sinking fund shall be kept separate and apart from all other funds and accounts to be used only for paying the interest on and principal of the bonds.

Note P went on to state that "Future debt related payments from the General Fund service in February 2023 include a $564,388 interest payment on the lease purchase bonds and the repayment of the $1,200,000 Tax Anticipation Note. The district does not anticipate having the cash available to make the debt payments."

TEA Required Actions

The district must discontinue transfers from the Debt Service fund to cover expenditures in other funds.

TEA Follow-up Requirements for the District

- **a)** **Please provide the district's analysis about the debt pay cycle and how debt is being paid.**
- **b)** **Please provide the district's plan for paying its upcoming bond obligations, leases, and tax anticipation note.**
- **c)** Transferring funds from the Debt Service Fund to cover expenditures in another fund such as payroll or other operating expenditures is **<u>not allowable</u>. Please provide the district's plan for repaying the Debt Service Fund.**

<u>TEA Finding #3 – Covering Other Fund Expenditures out of the Debt Service Fund</u>

Note I of the Notes to the Financial Statements (see FY 2022 AFR, page 51) disclosed that a net $175,000 was transferred from the Debt Service Fund and $40,000 was transferred from Special Revenue Funds to cover the operating deficit of the General Fund. The amounts in the General Fund were not transferred back to the respective funds as of June 30, 2022. The external auditor indicated this as a material weakness finding, 2022-002.

TEA Required Actions

The district must discontinue transfers from the Debt Service fund to cover expenditures in other funds.

TEA Follow-up Requirement for the District

- **Please provide an explanation of the district's justification for these transfers.**

<u>TEA Finding #4 – Unfavorable Budget Variances</u>

The district continues to experience negative budget variances. This indicates that an encumbrance system of accounting may not be adequately utilized. For the past two fiscal years, the general fund reported that function 81 (facilities and acquisition) was budgeted materially high and functions 71, 72, and 73 (debt service) were budgeted materially low. We also note that the district did not appear to have budgeted for the Series 2019 bond liabilities in prior years, which amounted to over $1.5M in both FY 2021 and FY 2022. The current school district budget schedule for FY 2023 reveals that the district has budgeted for its Series 2019 bond liabilities.

TEA Recommendations

We recommend that the district require a separate finance budget board item before:

- Any line item in any fund is increased which requires additional local or state funding appropriations.
- Any funds are moved between funds.
- Any funds are moved between functions in the general fund, cafeteria fund, debt service fund, capital projects fund, or other appropriate funds.
- Any revenue or expenditure is anticipated in any 7000 or 8000 account.

We also recommend that the district review its business services procedures and analysis of account transactions and balances. Actual and budgetary reports should be presented to the Board of Trustees on a monthly basis. Budget amendments should be considered and proposed to the Board of Trustees for approval whenever it is projected that actual expenditures will be more than currently budgeted before the actual expenditure of funds.

TEA Follow-up Requirements for the District

a) Tioga ISD's original and amended budgets are the same. Typically, an encumbrance system should be used for specific items such as bond liabilities, and budget increases should be anticipated. **Please provide an explanation of how expenditures were processed for payment of bills when there were no amendments to the budget.**

b) Proper training is essential to the success of any budget process. Board members should also receive training on what to look for in a budget and to be aware that the budget may need to be amended from time to time. **Please provide the district's detail plan for training staff, administrators, and the Board on budgeting. This training should include proper budget preparation, monitoring and reviewing the budget, along with determining which funds may pay for certain bills or invoices such as bond liabilities.**

c) Please provide the district's detailed plan for creating, monitoring, and amending future budgets. This plan should include reviewing monthly budget reports with the Board.

TEA Finding #5 – External Auditor Also Listed as a Board Member

We noted that Shawn D. Nesmith, CPA, PLLC performed the Tioga ISD's annual financial audits for fiscal years 2021 and 2022. We also noted that during fiscal year 2021 it appears Shawn Nesmith served on the board of trustees for Tioga ISD and on the board of directors for Tioga Independent School District Public Facilities Corporation. The board minutes included on the district's website disclosed that Mr. Nesmith was last indicated as a present board member in the Tioga ISD's board meeting minutes on May 10, 2021. The district's website also includes board minutes for the Tioga Independent School District Public Facility Corporation, which listed Shawn Nesmith as a present board member during its November 16, 2020, board meeting.

Title 22 TAC §501.73(c) states that certain professional engagements, such as audits, reviews, and other services, require independence. If services are performed that require independence, the Texas State Board of Public Accountancy recommends consulting with the organization that promulgates the independence standards applicable to that type of work (e.g., American

Institute of Certified Public Accountants, Government Accountability Office, etc.) in order to obtain guidance specific to those standards. Auditors and audit organizations should avoid situations that could lead reasonable and informed third parties to conclude that the auditors and audit organizations are not independent and thus are not capable of exercising objective and impartial judgment on all issues associated with conducting the engagement and reporting on the work (Government Auditing Standards, section 3.19). Examples of circumstances that create a management participation threat to independence include an auditor serving as a voting member of an entity's management committee or board of directors, making policy decisions that affect future direction and operation of an entity's programs, supervising entity employees, developing or approving programmatic policy, authorizing an entity's transactions, or maintaining custody of an entity's assets (Government Auditing Standards, section 3.43(b)).

TEA Follow-up Requirements for the District

- **a) Please provide the date when Shawn Nesmith no longer served on the board of trustees for Tioga ISD.**
- **b) Please provide the status of Shawn Nesmith's membership on the board of directors for Tioga Independent School District Public Facilities Corporation.**
- **c)** Auditors should determine whether identified threats to independence are at an acceptable level or have been eliminated or reduced to an acceptable level, considering both qualitative and quantitative factors to determine the significance of a threat (Government Auditing Standards, section 3.31). **Please have your external auditor, Shawn Nesmith, CPA, provide a response of their evaluation of independence for the annual financial audits of Tioga ISD.**

Please use letterhead to provide your district's written response of the findings, recommendations, and required actions contained in this report within 20 business days from the date of this letter via email at fiscalreviews@tea.texas.gov.

Should you have any questions, please contact Gary Micinski at (512) 936-4628 or email at Gary.Micinski@tea.texas.gov.

Sincerely,

Peggy Watts
Manager, Financial Compliance Division

cc: Kelly Evans, Chief Financial Officer, Tioga Independent School District
Paul Rodarmer, Board President, Tioga Independent School District
Jeff Adams, Monitor, TEA
David Marx, Director, Financial Compliance Division, TEA
Paul Moreno, Assistant Director, Financial Compliance Division, TEA