



Rocky Point Union Free School District Financial Condition

Report of Examination

Period Covered:

July 1, 2013 — March 31, 2015

2015M-170



Thomas P. DiNapoli

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State of New York Office of the State Comptroller

Division of Local Government and School Accountability

November 2015

Dear School District Officials:

A top priority of the Office of the State Comptroller is to help school district officials manage their districts efficiently and effectively and, by so doing, provide accountability for tax dollars spent to support district operations. The Comptroller oversees the fiscal affairs of districts statewide, as well as districts' compliance with relevant statutes and observance of good business practices. This fiscal oversight is accomplished, in part, through our audits, which identify opportunities for improving district operations and Board of Education governance. Audits also can identify strategies to reduce district costs and to strengthen controls intended to safeguard district assets.

Following is a report of our audit of the Rocky Point Union Free School District, entitled Financial Condition. This audit was conducted 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.

This audit's results and recommendations are resources for district officials to use in effectively managing operations and in meeting the expectations of their constituents. If you have questions about this report, please feel free to contact the local regional office for your county, as listed at the end of this report.

Respectfully submitted,

*Office of the State Comptroller
Division of Local Government
and School Accountability*

Introduction

Background

The Rocky Point Union Free School District (District) is located in the Town of Brookhaven in Suffolk County. The District is governed by the Board of Education (Board), which is composed of five elected members. The Board is responsible for the general management and control of the District's financial and educational affairs. The Superintendent of Schools (Superintendent) is the District's chief executive officer and is responsible, along with other administrative staff, for the District's day-to-day management under the Board's direction. The Board, Superintendent and School Business Official share responsibility for budget development.

The District operates four schools with approximately 3,240 students and 511 employees. The general fund budgeted appropriations for 2014-15 were \$76,886,042, which were funded primarily with real property taxes and State aid.

Objective

The objective of our audit was to evaluate the District's financial condition. Our audit addressed the following related question:

- Did the Board and District officials ensure that budget estimates were reasonable and appropriately maintain reserve funds?

Scope and Methodology

We examined the District's financial records for the period July 1, 2013 through March 31, 2015. We extended our scope back to July 1, 2009 to analyze the District's financial condition and to provide perspective and background information.

We conducted our audit in accordance with generally accepted government auditing standards (GAGAS). More information on such standards and the methodology used in performing this audit is included in Appendix C of this report. 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 size of the relevant population and the sample selected for examination.

Comments of District Officials and Corrective Action

The results of our audit and recommendations have been discussed with District officials, and their comments, which appear in Appendix A, have been considered in preparing this report. District officials disagreed with certain aspects of our findings and recommendations in our report but indicated that they planned to implement some of

our recommendations. Appendix B includes our comments on the issues raised in the District's response letter.

The Board has the responsibility to initiate corrective action. Pursuant to Section 35 of General Municipal Law, Section 2116-a (3)(c) of New York State Education Law and Section 170.12 of the Regulations of the Commissioner of Education, 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, with a copy forwarded to the Commissioner of Education. To the extent practicable, implementation of the CAP must begin by the end of the next 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. The Board should make the CAP available for public review in the District Clerk's office.

Financial Condition

The Board, Superintendent and School Business Official are responsible for making sound financial decisions that are in the best interests of the District, the students it serves and the taxpayers who fund its programs and operations. Reasonable fund balance management helps ensure that sufficient funding will be available to sustain operations, address unexpected occurrences and satisfy long-term obligations or future expenditures, and that taxpayers are not unduly burdened by unnecessary or excessive tax levies. Prudent fiscal management also includes maintaining sufficient balances in reserves to address long-term obligations or planned future expenditures. In doing so, District officials should adopt a policy governing the use of reserve funds and ensure that residents are fully informed of all reserve funding and activity.

We found that District officials employed budgeting practices that generated operating surpluses while simultaneously appropriating fund balance in the budgets. This caused fund balance appropriations to be unneeded. As a result, during the 2009-10 through 2013-14 fiscal years, the District's unassigned fund balance was 5.4 to 7.8 percent of the ensuing year's budgets, while the statutory limit for fund balance is 4 percent. In addition, District officials transferred moneys to the District's reserves without calculations or justifications for the funding levels in the reserves. Consequently, the amounts retained in two of the District's seven reserves were excessive, with balances that would pay related costs for several years.¹ These ongoing budgeting practices resulted in taxpayers paying more than necessary to sustain District operations.

Fund Balance

The Board is responsible for preparing and presenting the District's budget for voter approval. In preparing the budget, the Board must estimate revenues (e.g., State aid), expenditures and the amount of unrestricted funds that will be available at the end of the fiscal year, which may be used for the ensuing year's appropriations and to balance the budget. After taking these factors into account, the Board should determine the expected tax levy that is necessary to fund operations. Accurate estimates help ensure that the real property tax levy is sufficient and reasonable.

Fund balance represents resources remaining from prior fiscal years. A district may retain a portion of fund balance at the end of the fiscal

¹ Eleven years for the retirement compensation reserve and nine years for the unemployment insurance reserve. Refer to the Reserve section for further information.

year for cash flow needs or unexpected expenditures. However, New York State Real Property Tax Law requires that unrestricted fund balance cannot exceed 4 percent of the ensuing year's appropriations. Districts may establish reserve funds to restrict reasonable portions of fund balance for specified purposes that comply with statutory directives. However, District officials should not appropriate fund balance or establish reserves mainly to remove fund balance amounts from the calculation of the 4 percent statutory limit.

During the 2009-10 through 2013-14 fiscal years, the Board adopted budgets that included the use of unrestricted fund balance to finance operations and increased amounts held in reserve funds. When fund balance is appropriated to finance operations, the District will have a planned operating deficit. Although the Board's adopted budgets included the appropriation of fund balance aggregating to approximately \$13.1 million during those five years, the District actually experienced operating surpluses and used only \$1.2 million of appropriated fund balance to finance operations. Therefore, because the District did not actually use fund balance to finance operations, it exceeded the 4 percent statutory limit, ranging from 7.8 percent (2010-11) to 5.4 percent (2013-14) of the ensuing year's budget (Figure 1).

Figure 1: Unrestricted Funds at Fiscal Year End

	2009-10	2010-11	2011-12	2012-13	2013-14
Beginning Fund Balance	\$4,639,741	\$5,439,013	\$6,110,106	\$6,095,855	\$6,116,981
Operating Surplus/(Loss)	\$5,993,834	\$152,236	\$1,688,439	(\$221,343)	(\$988,995)
Less: Appropriated Fund Balance	\$2,659,000	\$2,600,000	\$2,600,000	\$2,600,000	\$2,600,000
Less: Transfers to/(From) Reserves	\$5,194,562	(\$518,857)	\$1,702,690	(\$242,469)	(\$297,510)
Less: Encumbrances	\$105,796	\$729,723	\$636,301	\$546,517	\$287,844
Unrestricted Funds at Fiscal Year End	\$2,674,217	\$2,780,383	\$2,859,554	\$2,970,464	\$2,537,652
Actual Unrestricted Funds at Fiscal Year End ^a	\$4,534,972	\$5,439,383	\$5,459,554	\$5,349,121	\$4,148,657
Amount as a Percentage of Ensuing Year's Appropriations	6.8%	7.8%	7.6%	7.2%	5.4%

^a These amounts include unrestricted funds available at the end of the year plus appropriated fund balance from the previous year that was not used.

Operating surpluses occurred because the Board overestimated expenditures when developing the District's budgets. The largest variances between budgeted and actual expenditures included teacher salaries by as much as \$2.3 million (13.4 percent), programs for special needs students by as much as \$2.3 million (21.9 percent), employee benefits by as much as \$976,732 (9.8 percent), pupil transportation by as much as \$937,473 (22.8 percent) and central services by as much

as \$714,816 (16.2 percent).² District officials told us that they were very careful when creating budget estimates and did not feel that they overestimated any District expenditures.

In addition, District officials funded two reserves at greater-than-reasonable levels and did not always pay related expenditures with those reserved moneys. The District's practice of consistently appropriating fund balance that was not needed to finance operations allowed District officials to appear to maintain the District's fund balance within the 4 percent statutory limit while at the same time increasing reserves. As a result, the Board and District officials have not accurately represented the District's funding of reserves to the taxpayers, and the District has levied and collected more taxes than were necessary to fund District operations.

Reserves

Reserve funds may be established by Board action, pursuant to various laws, to provide financing for specific purposes, such as unemployment insurance and workers' compensation payments. The statutes under which the reserves are established determine how the reserves may be funded, expended or discontinued. Generally, school districts are not limited as to how much money can be held in reserves, but should maintain reserve balances that are reasonable. The Board should have a formal plan for the use of its reserves that includes how and when disbursements should be made, optimal targeted funding levels and procedures for maintaining appropriate documentation to account for and monitor reserve activity and balances.

The District's seven reserves have increased by approximately \$1.2 million, from about \$14.5 million to approximately \$15.7 million, during the 2010-11 through 2013-14 fiscal years. Despite this increase, District officials have not established a formal plan stating how much would be set aside in each reserve, how each reserve would be funded or when the reserve funds would be used. In addition, District officials did not provide any calculations or justifications for the funding levels of various reserves. Furthermore, District officials did not have resolutions authorizing the creation of six reserves.

The District funded its capital, employee benefit accrued liability, insurance, property loss and liability, and workers' compensation reserves at reasonable levels. However, the amounts retained in the retirement contributions and unemployment insurance reserves, totaling approximately \$9.4 million, appear to be excessive, with balances that would pay related costs for several years: 11 years

² The largest variances in teacher salaries, employee benefits and pupil transportation expenditures occurred in 2009-10, programs for special needs students expenditures in 2010-11 and central services expenditures in 2011-12.

for the retirement compensation reserve and nine years for the unemployment insurance reserve.

Retirement Contributions Reserve – New York State General Municipal Law (GML) restricts the use of this reserve fund to payments to the New York State and Local Retirement System.

As of June 30, 2014, this reserve had a balance of approximately \$8.8 million. From the 2009-10 through 2013-14 fiscal years, the District paid a total of \$3,989,094 for retirement contributions. However, District officials paid less than half of that amount (\$1,862,468) using funds from the reserve. The Board budgeted for the remaining amount (\$2,126,626) in the annual budgets.

Based on the District's average annual retirement contribution of \$797,819, its current reserve balance is sufficient to pay these costs for approximately 11 years. The District does not have a written plan indicating why the Board feels that this funding level is necessary.

Unemployment Insurance Reserve – GML authorizes school districts to create a reserve to reimburse the State Unemployment Insurance Fund (SUIF) for payments made to claimants. If there are excess amounts after claims are paid and pending claims are considered, the Board can transfer all or part of the excess amounts to certain other reserve funds or apply all or part of the excess to the budgeted appropriations of the next fiscal year.

As of June 30, 2014, this reserve had a balance of \$614,529. From the 2009-10 through 2013-14 fiscal years, the District paid a total of \$354,131 for unemployment reimbursements to the SUIF from this reserve.

Although the District's use of these funds complied with legal requirements in making payments for unemployment reimbursements, the District also used these funds for ineligible purposes. In the 2011-12 fiscal year, the District budgeted for \$75,000 of unemployment reimbursements to the SUIF and transferred these funds out of the reserve to the general fund for this purpose. However, the District paid only \$54,112 to the SUIF and did not return the difference to the reserve. This resulted in \$20,888 being removed from the reserve for ineligible purposes.

Given the District's average annual expenditures of \$70,826 paid to the SUIF, its current reserve balance is sufficient to pay these costs for nearly nine years. The District does not have a written plan indicating why the Board feels that this funding level is necessary.

By maintaining excessive or unnecessary reserves, the Board and District officials have withheld significant funds from productive use and levied more property taxes than necessary.

Recommendations

The Board should:

1. Adopt realistic appropriations estimates in the District's budgets.
2. Develop comprehensive policies for establishing and using reserve funds. These policies should outline targeted funding levels, the need for these funding levels and the conditions under which the funds will be used or replenished.
3. Review all reserves and determine if the amounts reserved are necessary, reasonable and in compliance with statutory requirements.
4. Ensure that it has adopted resolutions to authorize the creation of each reserve.

District officials should:

5. Reduce the balances in the retirement contributions reserve and unemployment insurance reserve to more reasonable levels that reflect realistic future expenditure needs.
6. Develop a plan for the use of the excess fund balance and reserve funds in a manner that benefits District taxpayers. Such uses could include, but are not limited to:
 - Reducing real property taxes.
 - Increasing other necessary reserves.
 - Paying off debt.

APPENDIX A

RESPONSE FROM DISTRICT OFFICIALS

The District officials' response to this audit can be found on the following pages.



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Dr. Michael F. Ring
Superintendent of Schools

October 28, 2015

Ira McCracken, Chief Examiner
Office of the State Comptroller
NYS Office Building, Room 3A10
250 Veterans Memorial Highway
Hauppauge, NY 11788

RE: Rocky Point UFSD Response to Financial Condition Report of Examination

Dear Mr. McCracken:

The Rocky Point UFSD thanks the Office of the State Comptroller for the efforts expended conducting a thorough examination of the internal controls of the District. By this letter the District is both responding to the Report of Examination and providing its Corrective Action Plan associated with recommendations contained therein.

The District is pleased that the extensive work of auditors from your office resulted in no findings of operational improprieties, fraud, waste or abuse. Accordingly, the focus of the referenced examination was Financial Condition, which resulted in recommendations pertaining to reserves, fund balance and budgeting of expenditures.

In developing the Corrective Action Plan incorporated herein, the District is mindful of its long history of proposing fiscally responsible and sustainable operating budgets. This practice has allowed our school system to maintain and grow successful academic and co-curricular programs during the most challenging financial period in United States history since the Great Depression. Moreover, notwithstanding the comments pertaining to reserves and fund balance contained in the referenced audit, the District also heeds the important fiscal health measures that are key elements of the State Comptroller's fiscal stress monitoring system. This annual measurement system, to which the District is subject, contains, among other things, a scoring system that reflects negatively on the use of reserves and fund balance through the budgeting of operating deficits [indicator 3] and reflects positively on the maintenance of higher levels of both undesignated and total fund balances as a percentage of expenditures [indicators 1 and 2]. Regarding the latter, it must be noted that said amounts have not exceeded the statutory level of 4% of budgeted expenditures in the Rocky Point UFSD, as evidenced by the District's annual audited financial statements.

See
Note 1
Page 12

With the aforementioned seemingly antithetical elements of the State Comptroller's fiscal stress monitoring juxtaposed with the findings of the referenced audit notwithstanding, as shown in Figure 1, line 2, of the Comptroller's audit of the District, during the five year period covered by the audit the cumulative

expenditure budgets totaled \$348,965,535 and resulted in cumulative surpluses created of \$6,624,171. This amounts to surpluses of 1.9% of budgeted expenditures. Moreover, the vast majority of surpluses generated during the period covered by the audit occurred six fiscal years ago during the 2009-2010 fiscal year. Excluding the 2009-2010 fiscal year, over the ensuing four fiscal years covered by the audit the District produced a cumulative surplus of just \$630,337 from cumulative expenditure budgets of \$282,200,590. This amounts to surpluses of 0.2% of the budgeted expenditures for the entire four-year period, which we believe represents fiscally prudent and conservative budgeting.

See
Note 2
Page 12

Therefore, the District's corrective action plan, in order of recommendations received, is as follows:

1. The Board of Education will continue its long-standing practice of adopting fiscally prudent budgets based on appropriation estimates that are founded on the best information and expectations available at the time of budget development.
2. The Board of Education shall review its existing policies pertaining to financial operations and shall, as appropriate, amend existing and develop new policies pertaining thereto, particularly relating to reserves, for consideration and adoption by the Board. Also, the Board has heretofore validated the creation of all existing reserves, including the six referenced in the audit as requiring evidence of authorizing resolutions.
3. As it does each year, the Board of Education will continue to review all reserves. Additionally, the Board will continue to ensure that all reserves remain in compliance with statutory requirements.
4. The District will continue to apply reserves restricted for retirement contributions and unemployment insurance to offset anticipated annual expenditures.
5. The District will review fund balance and reserves to determine if allocations are appropriate. Moreover, reserves and fund balance will continue to be appropriated to offset anticipated annual expenditures in order to reduce the amount of real property taxes that would otherwise need to be levied.

As previously indicated, we are pleased with the overall findings of the audit and look forward to continuing to maintain a fiscally secure and sustainable environment for our school system and community.

Sincerely,

Michael F. Ring, Ed.D.
Superintendent of Schools

cc: Rocky Point UFSD Board of Education

APPENDIX B

OSC COMMENTS ON THE DISTRICT'S RESPONSE

Note 1

The District made it appear that these amounts had not exceeded the statutory level of 4 percent by appropriating \$2.6 million of fund balance each fiscal year. However, because the amounts appropriated were not needed to fund operations, the actual amount of fund balance was actually higher than reported, by nearly double the amount allowed by law.

Note 2

The cumulative surplus of \$630,337 consisted of operating surpluses totaling \$1,840,675 for 2010-11 and 2011-12 and operating deficits totaling \$1,210,338 for 2012-13 and 2013-14. This resulted in the District using less than 12 percent of the cumulative \$10.4 million fund balance appropriated during those four years. Because the amounts appropriated were not needed, this increased the actual amount of fund balance that the District retained.

APPENDIX C

AUDIT METHODOLOGY AND STANDARDS

The objective of this audit was to evaluate the District's financial condition for the period July 1, 2013 through March 31, 2015. We expanded our scope period back to July 1, 2009 to analyze the District's financial condition and to provide perspective and background information.

To accomplish our audit objective and obtain valid audit evidence, our procedures included the following:

- We interviewed District officials and staff to obtain an understanding of District operations.
- We reviewed District policies and procedures and Board meeting minutes and resolutions to gain an understanding of the District's budget development, use of fund balance and reserves.
- We reviewed the District's annual financial statements for the 2009-10 through 2013-14 fiscal years and the accompanying management letters prepared by the District's independent public accountant.
- We compared the general fund's budgeted revenues and appropriations to actual revenues and expenditures for the 2009-10 through 2013-14 fiscal years.
- We reviewed and analyzed reported fund balance levels in comparison to amounts appropriated in adopted budgets for the 2009-10 through 2013-14 fiscal years.
- We reviewed reserve fund balances and activity to ensure reserve funds were adequately funded.

We conducted this performance audit in accordance with GAGAS. 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.

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Gabriel F. Deyo, Deputy Comptroller

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