



Shoreham-Wading River Central School District

Financial Management

Report of Examination

Period Covered:

July 1, 2013 – December 31, 2016

2017M-75



Thomas P. DiNapoli

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State of New York Office of the State Comptroller

Division of Local Government and School Accountability

June 2017

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 Shoreham-Wading River Central School District, entitled Financial Management. 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 Shoreham-Wading River Central School District (District) is located in the Towns of Brookhaven and Riverhead, Suffolk County. The District is governed by the Board of Education (Board) which is composed of seven 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. The Assistant Superintendent for Finance and Operations (ASFO) is responsible for working with the Superintendent to develop the budget. The ASFO and the Business Manager are responsible for managing the budget and supervising the employees who maintain the District's financial accounting records and prepare financial reports under the Superintendent and Board's direction.

The District operates five schools with approximately 2,250 students and more than 400 employees. The District's 2015-16 general fund expenditures totaled \$61.1 million, funded primarily with real property taxes and State aid. The District's 2016-17 budgeted appropriations are \$72.7 million.

Objective

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

- Did the Board and District Officials develop reasonable budget estimates and appropriately maintain fund balance?

Scope and Methodology

We examined the financial condition of the District for the period July 1, 2013 through December 31, 2016.

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 are included in Appendix C of this report.

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. Except as specified in Appendix A, District officials generally agreed with our recommendations and indicated they plan to take corrective action. Appendix B includes our comment on an issue 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 Management

The Board must adopt structurally balanced and realistic annual budgets with sufficient revenues to finance actual, necessary and recurring expenditures, and reasonable levels of fund balance. Revenue and expenditure estimates should be based on prior years' operating results, past expenditure trends, anticipated future needs and available information related to projected changes in significant revenues and expenditures.

The Board must also estimate the amount of unassigned fund balance that will be available at fiscal year-end, some or all of which may be used to fund the ensuing year's expenditures. New York State Real Property Tax Law currently limits unassigned fund balance that school districts can retain to no more than 4 percent of the ensuing fiscal year's budget. After taking these factors into account, the Board establishes the expected tax levy necessary to fund operations. Accurate estimates help ensure that the real property tax levy is not greater than necessary. Unrealistic budget estimates can impact the District's year-end surplus funds and financial condition.

The Board has not adopted budgets with reasonable expenditure and fund balance appropriations. As indicated in Figure 1, for fiscal year 2015-16, revenue estimates were generally reasonable. The larger revenue variances for fiscal years 2013-14 and 2014-15 were due to the District receiving more State aid than expected. However, in two of the three years the Board adopted budgets that overestimated expenditures and appropriated fund balance and reserves that it did not actually need to fund operations.

Figure 1: Budget vs. Actual

	Budget	Actual	Variance	Percentage
2013-14				
Revenues	\$60,574,256	\$68,608,457	\$8,034,201	13.3%
Expenditures	\$66,263,229	\$61,522,408	\$4,740,821	7.2%
Operating Surplus/(Deficit)		\$7,086,049		
2014-15				
Revenues	\$62,005,452	\$65,170,558	\$3,165,106	5.1%
Expenditures	\$67,560,772	\$75,278,257	(\$7,717,485)	(11.4%)
Operating Surplus/(Deficit)		(\$10,107,699) ^a		
2015-16				
Revenues	\$63,463,657	\$64,224,498	\$760,841	1.2%
Expenditures	\$68,897,407	\$61,138,005	\$7,759,402	11.3%
Operating Surplus/(Deficit)		\$3,086,493		

^a Due to the voter-approved use of the District's tax stabilization reserve to fund capital projects.

Employee benefits represented the majority of the overestimated appropriations. From fiscal years 2013-14 through 2015-16, employee benefits were overestimated by an average of \$2.4 million (13.2 percent). Other appropriations that were consistently overestimated included Teaching – regular school¹ (by an average of \$1.2 million or 6.6 percent), central services (by an average of nearly \$678,000 or 11.5 percent), programs for students with disabilities (by an average of nearly \$671,000 or 8.5 percent) and pupil transportation (by an average of \$277,000 or 7.5 percent).

District officials indicated that they budget conservatively because certain items, such as retirement costs and State aid, are not always readily available. However, employee salaries and benefits costs are largely driven by contractual agreements and, therefore, should be reasonably predictable and not consistently overestimated.

Due to these expenditure variances, the District has reported operating surpluses for two of the last three fiscal years, with the 2014-15 operating deficit of \$10.1 million being due entirely to the voter-approved use of \$14.98 million from the District's tax stabilization reserve to fund capital projects. These surpluses occurred despite the Board appropriating an average of \$4.7 million in fund balance each year (\$4,335,428 of fund balance was appropriated from 2012-13 to the 2013-14 budget, \$4,944,733 from 2013-14 to the 2014-15 budget and \$4,938,517 from 2014-15 to the 2015-16 budget), which made it appear that the District would be using it to fund operations. The District also appropriated from \$149,000 to \$15.3 million in reserves in each of the last three fiscal years. However, because the Board has not adopted realistic budgets, the District has not used any of the appropriated unassigned balance during that time.

Figure 2: Unassigned Fund Balance at Year-End

	2013-14	2014-15	2015-16
Total Beginning Fund Balance	\$23,449,758	\$30,535,807	\$20,428,108
Add: Operating Surplus/(Deficit)	\$7,086,049	(\$10,107,699) ^a	\$3,086,493
Total Ending Fund Balance	\$30,535,807	\$20,428,108	\$23,514,601
Less: Restricted Fund Balance	\$22,630,073	\$12,401,311	\$15,418,375
Less: Appropriated Fund Balance for the Ensuing Year	\$4,944,733	\$4,938,517	\$4,869,685
Less: Encumbrances	\$269,343	\$346,233	\$319,959
Unassigned Fund Balance at Year-End	\$2,691,658	\$2,742,047	\$2,906,582
Ensuing Year's Budget	\$67,291,428	\$68,551,174	\$72,664,934
Reported Unassigned Fund Balance as a Percentage of Ensuing Year's Budget	4.0%	4.0%	4.0%

^a Due to the voter-approved use of the District's tax stabilization reserve to fund capital projects.

¹ Teaching – Regular School includes, among other things, teachers' salaries

Despite presenting budgets to District residents that made it appear that the District was depleting its reserves and fund balance, the Board's continued overestimation of appropriations has increased the District's unassigned fund balance. When unused appropriated fund balance was added back, the District's recalculated unassigned fund balance was nearly 11 percent of the ensuing year's appropriations, exceeding the statutory limit by almost 7 percentage points each year, as indicated in Figure 3.

During fiscal year 2015-16, the Board appropriated \$4.9 million in fund balance and another \$524,000 from its reserves for the 2016-17 budget. However, District officials project that they will not need any reserves, nor will they use the appropriated fund balance. As such, we expect the District's unassigned fund balance will continue to exceed the statutory limit.

Figure 3: Unused Fund Balance			
	2013-14	2014-15	2015-16
Reported Unassigned Fund Balance	\$2,691,658	\$2,742,047	\$2,906,582
Add: Appropriated Fund Balance Not Used to Fund Ensuing Year's Budget	\$4,944,733 ^a	\$4,938,517	\$4,869,685
Recalculated Unassigned Fund Balance	\$7,636,391	\$7,680,564	\$7,776,267
Recalculated Unassigned Fund Balance as Percentage of Ensuing Year's Appropriations	11.3%	11.1%	10.7%
^a The District financed the 2014-15 deficit of \$10,107,699 with a portion of the amount voters approved from the tax stabilization reserve fund. Therefore, it did not use its appropriated fund balance in this year.			

These budgeting practices made it appear that the District needed to both raise taxes and use fund balance and reserves to close projected budget gaps. However, the District's budgets resulted in significantly less fund balance and reserves being used than had been indicated in each of the three years that we reviewed. The practice of annually appropriating fund balance that is not needed to finance operations is, in effect, a reservation of fund balance that is not provided for by statute and a circumvention of the statutory limit imposed on the level of unassigned fund balance.

Recommendations

The Board and District officials should:

1. Develop realistic estimates of appropriations and the use of fund balance in the annual budget.
2. Discontinue the practice of adopting budgets that result in the appropriation of unassigned fund balance and reserves that are not needed to fund District operations.

3. Use the surplus fund balance identified in this report in a manner that benefits District residents. Such uses could include:

- Funding one-time expenditures;
- Funding needed reserves; and
- Reducing District property taxes.

APPENDIX A

RESPONSE FROM DISTRICT OFFICIALS

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

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Director of Student Services

June 7, 2017

Ira McCracken, Chief Examiner
Division of Local Government and
School Accountability
State of New York
Office of the State Comptroller
110 State Street
Albany, New York 12236

Dear Mr. McCracken:

On May 9, 2017, the Superintendent and Board of Education of the Shoreham-Wading River CSD received the preliminary Draft Audit Report of the recent audit conducted by the Office of the State Comptroller which began on January 24, 2017 and was concluded on May 9, 2017.

The following is a response to the draft audit report and the required corrective action plan.

On behalf of the District, we appreciate the Office of the State Comptroller's efforts to identify opportunities through the audit process to strengthen internal controls and improve District operations. I would also like to commend the audit team for their professionalism and courtesy in the undertaking of their responsibilities, and in their interactions with District personnel throughout the entire audit process.

Following an entrance meeting on January 24, 2017 with the OSC team, and the District Superintendent and Assistant Superintendent for Finance and Operations, the auditors began with a risk assessment to review many business office functions/systems in order to determine the final focus of the audit. A comprehensive review was performed on the following areas: policies, cash receipts and disbursements, accounting, payroll, banking procedures and many other financial aspects of the District. The audit did not bring to light any instances of fraud, overpayments of contracts, issues with bidding or RFP's, lack of internal controls, or backup material. The District was very pleased with these results. As a result of this risk assessment, the area of concentration for the audit

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Jack Costas, Trustee ~ Michael Lewis, Trustee

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Michael Yannucci, Trustee

was determined to be on Financial Management, as it relates to the development of school budgets.

The Shoreham-Wading River Central School District strives to ensure the effective and efficient use of all of the District's resources. This is accomplished by taking into account the community's needs, providing a supportive and professional environment for all staff while keeping abreast of, and instituting, the multitude of changing and increasing state and federal mandates. Most of all, adhering to the District's responsibility to provide the resources to meet the academic, physical and emotional needs of our children while giving them every opportunity to master the skills of learning, thinking and problem-solving to support the whole-child approach to education.

While the District confirmed the accuracy of the numbers outlined in the audit report, we would like to provide additional information as to the budget development process of the District and how estimates are made.

The auditor's report expresses the opinion that revenue estimates were generally reasonable for the year 2015-2016 and that the variances for 2013-2014 and 2014-2015 were due to the District receiving more state aid than expected. The District would like to clarify that this additional state aid was due to receipts of Prior Years' State Aid – an allocation that is not included with the annual state aid runs and is required by legislation to be transferred into a reserve upon receipt; therefore it was not included in the operating budget these years. The final payment of Prior Years' State aid was received August 2014.

In the Audit Report, Employee Benefit appropriations were cited for being overestimated. It has been the philosophy of the District to take a conservative approach when estimating future rates. Unknown insurance rates cause the most fluctuation in estimates. At the time of budget preparation, the District is estimating rates for the last six months of the upcoming school year. These estimates are based on an analysis of the health insurance costs and guidance from NYSHIP (the District's insurance provider) while considering the current participation and anticipated changes in participation. In addition, other unknown factors during the budget development process include economic and legislative factors that may affect insurance rates which are taken into consideration when developing the budget. While we agree with the audit report that this approach to estimating did result in available funds each year, the District adheres to a conservative approach within the budget development process in order to be able to operate under a worst-case scenario. Utilizing this approach has resulted in available funds, which are appropriated to the following year's budget.

The audit period reflects the Central Services Budget (Facilities and Operations) as being underspent by 11.5%. The District campus is comprised of five buildings and 135 acres of property, all which require continuous upkeep and maintenance while taking into account fluctuations in energy, fuel, water, and unforeseen emergency project costs. The budget codes that pertain to maintaining our facilities and grounds were at levels that could maintain the District grounds and preserve the facilities from further deterioration. If there are unspent funds each year because additional

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maintenance is not needed, emergencies do not arise, utility costs have remained low, or the District has been able to provide similar services with less funds than estimated; these available funds are appropriated to the following year's budget.

As discussed above regarding Employee Benefits and Central Services, a similar philosophy holds true for developing the budgets for Teaching - Regular School, Programs for Students with Disabilities, and Pupil Transportation. In order for the District to develop, implement, and achieve a multitude of opportunities for learning, planning for unforeseen and worst-case scenarios has been part of our budgeting philosophy. Utilizing this approach has resulted in available funds, which are appropriated to the following year's budget.

While this audit presents a re-calculated amount of unappropriated, unassigned fund balance to include the amount of appropriated fund balance not used to fund ensuing years' budgets (Figure 3, page 8), the District's Independent Audit Reports state that the District has not exceeded the allowable statutory limit of 4% of unappropriated fund balance. The District has appropriated approximately the same amount of fund balance each year to maintain and expand programs offered to students while ensuring the District stayed within the Tax Levy Limit for each year.

See
Note 1
Page 13

The recommendations within the audit report are as follows:

1. Develop realistic estimates of appropriations and the use of fund balance in the annual budget.

Corrective Action Plan – The District will look at its philosophy regarding budgeting for unanticipated expenditures and, where possible, align appropriations closer to actual anticipated expenditures. The result of any changes in budgeting philosophy will have a direct impact on the use of fund balance in the annual budget.

2. Discontinue the practice of adopting budgets that result in the appropriation of unassigned fund balance and reserves that are not needed to fund District operations.

Corrective Action Plan – As the District reviews its budgeting philosophy as outlined in the above corrective action, this should make for actual expenditures closer to appropriation amounts. With this being said, the reserves and appropriated fund balance included in the Revenue Budget should be needed to fund operations.

3. Use of surplus fund balance identified in this report in a manner that benefits the District residents. Such uses could include:

- Funding one-time expenditures
- Funding needed reserves; and
- Reducing District property taxes

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Michael Yannucci, Trustee

Corrective Action Plan – The District will review its options with regards to any surplus funds at the end of the 2016-2017 school year. We will review and determine if any onetime expenditures are needed, if all reserves are at the desired levels, and the possibility of reducing property taxes.

The Shoreham-Wading River Central School District appreciates the comments provided by the State Comptroller's Office. The District will be mindful of the recommendations highlighted within the audit when developing future budgets. We will remain committed to providing programs that promote educational excellence, in a safe and healthy learning environment, to the students of the Shoreham-Wading River School District.

Sincerely,

Neil Lederer
Superintendent of Schools

*Board of Education:
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Jack Costas, Trustee ~ Michael Lewis, Trustee
William J. McGrath, Trustee ~ Kimberly Roff, Trustee ~
Michael Yannucci, Trustee*

APPENDIX B

OSC COMMENT ON THE DISTRICT'S RESPONSE

Note 1

The District's Independent Audit Reports show that the District is within the statutory limit based on the amount of fund balance that the District planned to appropriate each year. However, as stated in our report, the District has not used any of that appropriated fund balance in the three years we examined, effectively bringing the District's unappropriated fund balance to approximately 11 percent instead of the statutorily allowed 4 percent.

APPENDIX C

AUDIT METHODOLOGY AND STANDARDS

To achieve our audit objective and obtain valid evidence, we performed the following procedures:

- We interviewed District officials to gain an understanding of the financial condition and budgeting process
- We reviewed the District's policies for developing and reporting information relevant to budgeting activities and fund balance.
- We reviewed past financial statements and compared budgeted revenues and appropriations to actual results for fiscal years 2013-14 through 2015-16 to determine whether budgets were realistic and structurally balance.
- We reviewed fund balance and amounts appropriated to the following year's budgets for the audit period.
- We restated unassigned fund balance amounts for the audit period to include appropriated fund balance not used and calculated the revised unassigned fund balance amount as a percentage of subsequent years' budget.

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 objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

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