OFFICE OF THE NEW YORK STATE COMPTROLLER

DIVISION OF LOCAL GOVERNMENT
& SCHOOL ACCOUNTABILITY

Mount Sinai Union Free School District

Financial Management

Report of Examination

Period Covered:

July 1, 2011 — June 30, 2013

2013M-227

Thomas P. DiNapoli

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State of New York
Office of the State Comptroller

**Division of Local Government
and School Accountability**

October 2013

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 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 costs and to strengthen controls intended to safeguard district assets.

Following is a report of our audit of the Mount Sinai Union Free 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 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 Mount Sinai 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 comprises seven elected members. The Board is responsible for the general management and control of the District's financial and educational affairs, including budget development.

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 Assistant Superintendent of Business plays a key role in the budget development process and the Business Office's daily administration.

The District operates three schools, with approximately 2,600 students and 300 employees. The District's budgeted expenditures for the 2012-13 fiscal year were $54.6 million, which were funded primarily with State aid, real property taxes, and grants.

Objective

The objective of our audit was to evaluate the District's financial operations and the use of fund balance.[1] Our audit addressed the following related question:

- Did the Board provide adequate oversight and management of the District's budget and financial condition?

Scope and Methodology

We evaluated the Board's management of the District's financial condition and budgeting practices for the period July 1, 2011, through June 30, 2013. We extended our scope back to July 1, 2007, to evaluate the District's financial condition and to provide additional information for perspective and background.

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[1] The Governmental Accounting Standards Board (GASB) issued Statement 54, which replaces the fund balance classifications of reserved and unreserved with new classifications: nonspendable, restricted, and unrestricted (comprising committed, assigned, and unassigned funds). The requirements of Statement 54 are effective for fiscal years ending June 30, 2011, and beyond. To ease comparability between fiscal years ending before and after the implementation of Statement 54, we will use the term 'unexpended surplus funds' to refer to that portion of fund balance that was classified as unreserved, unappropriated (prior to Statement 54), and is now classified as unrestricted, minus appropriated fund balance, amounts reserved for insurance recovery and tax reduction, and encumbrances included in committed and assigned fund balance (post-Statement 54).

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 B 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. District officials generally agreed with our recommendations and indicated they planned to take corrective action.

The Board has the responsibility to initiate corrective action. Pursuant to Section 35 of the General Municipal Law, Section 2116-a (3)(c) of the 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 is responsible for making sound financial decisions that are in the best interests of the District, the students it serves, and the taxpayers who fund the District's programs and operations. Sound budgeting practices based on accurate estimates coupled with prudent fund balance management help ensure that sufficient funding will be available to sustain operations, address unexpected occurrences, and satisfy long-term obligations or future expenditures. Accurate budget estimates also help ensure that the real property tax levy is not greater than necessary. Further, the Board should prepare a multiyear financial plan based on reasonable estimates that project future revenues and expenditures and prepares the District for any future year fiscal challenges.

District officials consistently over-estimated expenditures over the past five years, which resulted in operating surpluses totaling $7.1 million. Although the Board appropriated unexpended surplus funds each year (exceeding $14 million over a five-year period) to help finance the ensuing year's operations, District officials actually used less than $1 million for District operations. As a result, the District's unexpended surplus funds routinely exceeded the amount allowed by statute[2] and District taxpayers paid more than necessary to sustain District operations.

Budgeting

The Board is responsible for preparing and presenting the District budget for voter approval. In preparing the budget, the Board is responsible for estimating revenues, expenditures, and how much unexpended surplus funds will be available at fiscal year-end, and determining the expected tax levy amount. Accurate estimates help ensure that the real property taxes levied are not greater than necessary.

Revenue and expenditure estimates should be developed based on prior years' operating results, past expenditure trends, anticipated future needs, and available information related to projected changes in significant revenues or expenditures. Unrealistic budget estimates can mislead District voters and taxpayers and can significantly impact the District's year-end unexpended surplus funds and financial condition.

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[2] Real Property Tax Law limits the amount of unexpended surplus funds that can be legally retained by District officials. This amount increased from no more than 3 percent of the next fiscal year's budget for the 2007-08 fiscal year, to no more than 4 percent for fiscal years thereafter.

District officials consistently presented, and the Board approved, budgets which significantly over-estimated appropriations over a five-year period. As shown in Table 1, District officials over-estimated expenditures by as much as $6.2 million each year from 2007-08 through 2011-12. For example, over this five-year period, the District overestimated employee benefits by a total of more than $6.9 million, programs for children with handicapped conditions by approximately $4.9 million, central services by approximately $2.9 million, teaching – regular school by approximately $2.2 million, and pupil services by more than $1.3 million.

Table 1: Budget Variance – Fiscal Years 2007-08 through 2011-12					
	2007-08	**2008-09**	**2009-10**	**2010-11**	**2011-12**
Appropriations	$50,934,542	$56,000,793	$53,914,740	$54,379,925	$55,056,535
Actual Expenditures	$47,514,173	$51,205,367	$48,870,004	$48,154,893	$50,910,382
Over-Appropriated	$3,420,369	$4,795,426	$ 5,044,736	$6,225,032	$4,146,153

Unexpended Surplus Funds

Estimating unexpended surplus funds is integral to the budget process because it represents resources remaining from prior fiscal years that can be used to benefit District taxpayers. Any unexpended surplus funds that exceed the statutory limit should be used to lower real property taxes, increase necessary reserve funds, pay for one-time expenses, or pay down debt. District officials should not appropriate unexpended surplus funds simply to circumvent the statutory limit.

District officials appropriated unexpended surplus funds that aggregated to more than $14 million over the past five years, which should have resulted in planned operating deficits each year. However, because they significantly over-estimated expenditures, the District experienced large operating surpluses in three years and smaller than expected operating deficits in the two other years. For that period, total actual revenues exceeded expenditures by more than $7 million and only $946,320 of appropriated unexpended surplus funds was used to finance operations, not the $14.6 million that was appropriated.

Table 2: General Fund Operating Results and Appropriated Unexpended Surplus					
	Revenues	**Expenditures**	**Operating Surplus/ (Deficit)**	**Appropriated Unexpended Surplus**	**Appropriated Unexpended Surplus Used**
2007-08	$49,763,000	$47,143,055	$2,619,945	$2,740,000	$0
2008-09	$50,833,410	$51,120,127	($286,717)	$2,236,000	$286,717
2009-10	$51,762,673	$48,737,089	$3,025,584	$1,968,500	$0
2010-11	$50,439,026	$48,020,263	$2,418,763	$4,223,500	$0
2011-12	$50,168,003	$50,827,606	($659,603)	$3,486,500	$659,603
Totals	**$252,966,112**	**$245,848,140**	**$7,117,972**	**$14,654,500**	**$946,320**

Because the Board consistently over-estimated expenditures and appropriated significant unexpended surplus funds that were not actually needed to sustain District operations, the District's unexpended surplus funds exceeded the statutory limits for each year. Based on the unexpended surplus funds District officials appropriated in the budgets for the fiscal years 2007-08 through 2011-12, the percentage of unexpended surplus funds to the budget appropriations varied from 6 to 14 percent as shown in Table 3:

Table 3: Percentages of Unexpended Surplus Funds to Budget Appropriations					
Year Ended June 30	**2007-08**	**2008-09**	**2009-10**	**2010-11**	**2011-12**
Unexpended Surplus Funds	$3,273,252	$4,465,351	$7,506,102	$7,064,484	$6,441,039
Ensuing Year's Budgeted Appropriations	$52,889,675	$53,829,500	$54,248,010	$54,921,905	$54,629,115
Unexpended Surplus Funds as a Percentage of the Ensuing Year's Budgeted Appropriations[a]	6%	8%	14%	13%	12%

[a] The percentages were calculated by dividing the unexpended surplus funds at year-end less encumbrances by the next year's adopted budgeted appropriations.

These budgeting practices continued even though the District's last five independent audit reports advised the Board that the District exceeded the unexpended surplus funds' statutory limit each year. At the same time that the unexpended surplus funds were increasing, District officials also increased the real property tax levy as shown in Table 4. As a result, the District levied and collected more taxes than were necessary in each of these years.

Table 4: Real Property Tax Trends						
Fiscal Year	**2007-08**	**2008-09**	**2009-10**	**2010-11**	**2011-12**	**2012-13**
Real Property Tax Levy	$32,752,948	$32,762,657	$33,783,230	$35,353,510	$36,167,469	$36,301,994
Real Property Tax Rate[a]	$1,792.90	$2,055.02	$2,118.06	$2,199.10	$2,285.60	$2,351.94

[a] Per $1,000 of assessed value

Multiyear Financial Plan

Multiyear financial planning is a tool school districts can use to improve the budget development process. Planning on a multiyear-basis enables District officials to identify developing revenue and expenditure trends, establish long-term priorities and goals, and consider the impact of near-term budgeting decisions on future fiscal years. It also allows District officials to assess the merits of alternative approaches (such as using unexpended surplus funds or establishing and using reserves) to finance its operations. Multiyear financial planning can also help District officials project the future costs of employee salaries and benefits provided for in collective bargaining agreements. Any long-term financial plan should be monitored and updated on a continuing basis to provide a reliable framework for preparing budgets and ensure that information used to guide decisions is current and accurate.

The District's multiyear plan did not address using unexpended surplus funds in a manner that benefits District taxpayers. Although the District has a five-year financial plan,[3] it contains future-year projections that continue the practice of over-estimating expenditures and appropriating significant unexpended surplus funds that most likely will not be used to fund future District operations. As a result, the Board and District officials will likely continue retaining significant excess funds. The failure to use realistic estimates in its multiyear financial plan inhibits the District's ability to effectively manage its finances.

Recommendations

1. The Board should develop and adopt budgets that include realistic estimates for revenues, expenditures, and unexpended surplus funds.

2. The Board should discontinue the practice of adopting budgets that result in appropriating unexpended surplus funds that will not be used to sustain District operations.

3. The Board and District officials should ensure that unexpended surplus fund amounts are within statutory limits.

4. The Board and District officials should develop a multiyear plan that addresses the use of unexpended surplus funds in a manner that benefits the District taxpayers. Such uses could include, but are not limited to:

    - Reducing real property taxes
    - Increasing necessary reserves
    - Paying off debt
    - Financing one-time expenditures.

[3] The Assistant Superintendent for Business developed the District's multiyear plan for the 2012-13 through 2016-17 fiscal years.

APPENDIX A

RESPONSE FROM DISTRICT OFFICIALS

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

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Maureen Poerio
District Clerk/Executive Assistant

Enrico Crocetti
Superintendent of Schools

Lynne Kirchenko
District Treasurer

September 30, 2013

Division of Local Government and School Accountability
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NYS Office Building, Room 3A10
250 Veteran's Memorial Highway
Hauppauge, NY 11788-5533

Re: Mt. Sinai Union Free School District – 2013M-227
Response from District

Dear Comptroller:

Please consider this to be in response to the Audit Report completed by the Office of the State Comptroller for the period July 1, 2011 – June 30, 2013.

The District has reviewed the findings and recommendations set forth within the Report and commits to having them serve as a catalyst to the District in providing its constituencies, including its taxpayers, with an accountable, efficient and productive institution; the perspectives of the Office of the State Comptroller provided in the "Report of Examination" are extremely useful and will provide the District with the underpinnings in moving forward with its financial planning for a great number of years.

The Mt. Sinai UFSD is committed through its financial planning to sustain and enhance those programs and educational initiatives that serve as the basis for this Board of Education's commitment to the community's students. The District seeks, in this context, to gain an independence from fiscal erosions that would tend to adversely affect its academic offerings. It is believed that the Comptroller's report together with the District's five-year fiscal planning (as amended) and the other financial information that it has evaluated and will continue to evaluate on an ongoing basis will serve to allow the Mt. Sinai UFSD to, in an accountable fashion, utilize the community's and the state's financial support.

Specifically, the District will be modifying the five-year fiscal plan that is presently in place. The modifications shall result in the District meeting its goal of compliance with the NY Real Property Tax Law's dictate on the matter of the limit of unassigned fund balance, which currently is to be no more than 4% of the subsequent fiscal year's budget amount. Again, under the modified five-year plan currently being developed, the District's intent/mission is to meet the 4% standard within a period less than the five year timeframe formerly established.

The variance between the budgetary appropriations approved by the Board and the revenues available to underwrite such appropriations has narrowed over the last several years and will, it is anticipated, lessen even further under the constraints of the "tax cap" legislation and other fiscal constraints. Further, the increases from budget year to budget year over the past five years have been minimal as reflected below:

	2009/10	2010/11	2011/12	2012/13	2013/14
Actual Budget Increases	1.03%	.78%	1.24%	-.53%	.97% *

**with capital project 1.56%*

In addition, the subject audit report has provided an impetus to consider the appropriate utilization of the various reserve funds permitted under law to be utilized by school districts throughout the State of New York. As part of that consideration, our review of the level of funding for the Workers' Compensation Reserve, in view of the most recent actuarial valuation of the District's workers' compensation liability, affords us the opportunity to release some funding from that reserve to be used for a more immediate purpose, the funding of the Retirement Contribution Reserve. Despite the impact of this escalating cost, the District has thus far not established nor funded this reserve. Equally important is our financial exposure with regard to mandatory termination payouts according to contractual arrangements. Although the District has an Employee Benefits Accrued Liability Reserve, the funding level is far below our potential financial exposure. The funding of these two reserves at sound levels that are adequate to mitigate the potential negative impact to the budget will be evaluated. This will directly reduce the unassigned fund balance. The District will examine the possible development of a Capital Reserve Fund going toward necessary capital improvements in order to assure that the District's physical plant is maintained in a manner that can assure the safety and appropriate accommodation of the District's staff and students (surveillance/access and related concerns may warrant the setting aside (with Board and electorate approval) of funds to meet the legitimate expectations of the community in safeguarding its most precious commodity; technologically advancing current IT systems may also require structural/capital improvements.

The Board of Education is mindful of OSC's charge set forth within its "Local Government Management Guide – Reserves":

> The practice of systematically saving for capital acquisitions and other contingencies is considered prudent management . . . an important concept to remember is that a reserve fund should be established with a clear intent or plan in mind regarding a future purpose, use and, when appropriate, replenishment of funds from the reserve. Reserve funds should not be merely a "parking lot for excess cash of fund balance."

Thus, this District will be mindful of this OSC caution; reserve funds will not be utilized to merely absorb funds that would otherwise become part of the District's un-assigned fund balance. Rather, they will only be utilized to foster "prudent management" of the District's legitimate current and future needs.

It is gratifying that the Mount Sinai UFSD will, in collaboration with the Office of the State Comptroller, adopt principles and initiate action that will comport with the audit's "Recommendations" in establishing a fiscal plan and methodology that will be accountable to the District's taxpayers to maintain a long term and financially healthy District that meets our community's high quality education needs.

Frankly, it is, as a practical matter, difficult to anticipate budgetary needs from year to year considering the many variables that affect the capacity of the District to estimate (with any degree of certainty) the revenues that may (or may not) be available; state aid figures, invariably, not being available prior to necessary finalizations of the annual budget computation; the assessed valuation of the District's taxable properties, likewise, not being available until well-after the annual budget is completed; (the District, in fact, recently having reduced unappropriated funding to make up for a $637,000 shortfall as the result of successful *tax certiorari* petitions).

The monographs issued by the Comptroller over the years have clearly indicated that sound fiscal planning must be part of the overall strategies developed by municipalities for its future intentions. It is the intention of this Board of Education to treat the revised five-year plan as part and parcel of a strategy to provide the Mount Sinai UFSD with, as aforementioned, a capacity to sustain as well as enhance its curriculum and programs while seeking, to the extent possible, to preserve an independence from fiscal shocks that would tend to undermine the community's expectations and mandates for the academic offerings and ancillary services provided to the Mount Sinai UFSD community.

Respectfully submitted,

Robert P. Sweeney, President
Board of Education
Mount Sinai UFSD

APPENDIX B

AUDIT METHODOLOGY AND STANDARDS

Our overall goal was to assess the adequacy of the internal controls put in place by officials to safeguard District assets. To accomplish this, we performed an initial assessment of the internal controls so that we could design our audit to focus on those areas most at risk. Our initial assessment included evaluations of the following areas: financial oversight, cash receipts and disbursements, purchasing, payroll and personal services, and information technology.

During the initial assessment, we interviewed appropriate District officials, performed limited tests of transactions and reviewed pertinent documents, such as District policies and procedures manuals, Board minutes, and financial records and reports. In addition, we reviewed the District's internal controls and procedures over the computerized financial databases to help ensure that the information produced by such systems was reliable.

After reviewing the information gathered during our initial assessment, we determined where weaknesses existed, and evaluated those weaknesses for the risk of potential fraud, theft and/or professional misconduct. We then decided on the reported objectives and scope by selecting for audit the area most at risk. We selected the Board's management of the District's financial condition and budgeting practices for further audit testing.

To accomplish our audit objective our examination included the following:

- We interviewed District officials and employees to gain an understanding of District operations.
- We reviewed District policies and procedures.
- We reviewed reserve funds to ensure that they were adequately funded and in compliance with applicable laws.
- We obtained an understanding of the District's internal control environment and specific controls that are significant to the District's budget process.
- We reviewed recent annual financial statements, the accompanying management letters prepared by the District's independent public accountant, and relevant budget reports.
- We compared the amounts reported in the District's externally audited financial statements with a trial balance, Treasurer's reports, and bank statements to verify their reliability.
- We analyzed revenue and expenditure trends and budget-to-actual comparisons for the operating funds for the fiscal years 2007-08 through 2011-12 and calculated the percentage of unexpended surplus funds compared with budget appropriations.
- We reviewed and analyzed reported fund balance levels in comparison to amounts appropriated in adopted budgets.

- We reviewed the real property tax rate and levy increases.

- We reviewed the District's multiyear financial plan.

We conducted this performance audit in accordance with generally accepted government auditing standards (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.

APPENDIX C

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