



Quogue Union Free School District Financial Condition and Cash Receipts

Report of Examination

Period Covered:

July 1, 2011 — March 31, 2013

2013M-274



Thomas P. DiNapoli

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State of New York Office of the State Comptroller

Division of Local Government and School Accountability

December 2013

Dear School District Officials:

A top priority of the Office of the State Comptroller is to help local government officials manage government resources efficiently and effectively and, by so doing, provide accountability for tax dollars spent to support government operations. The Comptroller oversees the fiscal affairs of local governments 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 operations and Board of Education governance. Audits also can identify strategies to reduce costs and to strengthen controls intended to safeguard local government assets.

Following is a report of our audit of the Quogue Union Free School District, entitled Financial Condition and Cash Receipts. 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 local government 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*



State of New York Office of the State Comptroller

EXECUTIVE SUMMARY

The Quogue Union Free School District (District) is governed by the Board of Education (Board) which comprises five elected members. The Board is responsible for the general management of the District's financial and educational affairs. The Superintendent of Schools 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 Treasurer is the chief fiscal officer and is responsible for collecting and depositing District funds.

The District provides educational services to non-resident students and milk for students, for which cash is collected. Actual expenditures for the 2011-12 fiscal year were \$6,641,760 and \$6,176,464 for the 2012-13 fiscal year, funded primarily with real property taxes.

Scope and Objective

The objective of our audit was to examine the District's controls over its budgeting practices and cash receipts process for the period July 1, 2011 through March 31, 2013. We extended our scope to July 1, 2009 through June 30, 2013 to analyze budgeting practices, fund balance trends and reserve accounts. We also reviewed the District's budget for the 2013-14 fiscal year. Our audit addressed the following related questions:

- Does the Board adopt realistic and structurally balanced budgets?
- Does the District have adequate controls over cash receipts?

Audit Results

District officials have consistently overestimated expenditures and appropriated unexpended surplus funds that they did not use. Therefore, the District's unexpended surplus funds exceeded the statutory 4 percent limit during the 2011-12 and 2012-13 fiscal years and tax levies may have been higher than necessary. Additionally, the District had four established reserves that totaled approximately \$969,000 at June 30, 2013 and had no formal plan on funding or use of these reserves. The District's retirement reserves balance of \$310,000 was five times what the District spent during the 2013 fiscal year.

The District has a well-designed set of control procedures that can provide reasonable assurance that thefts of cash receipts will be prevented or detected. We reviewed the District's procedures for the

collection of cash receipts for milk sales¹ and non-resident tuition, totaling \$169,576, and found no exceptions.

Comments of District Officials

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 initiate corrective action.

¹ The District sells milk to students; sales are accounted for in the cafeteria fund. Additionally, the District offers non-residents the opportunity to enroll at the District at a cost.

Introduction

Background

The Quogue Union Free School District (District) is located in the Town of Southampton, in Suffolk County. The District is governed by the Board of Education (Board) which comprises five elected members. The Board is responsible for the general management 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 Treasurer is the chief fiscal officer and is responsible for collecting and depositing District funds.

The District encompasses approximately five square miles and has a population estimated at 1,000. The District has one building, a student population of 177 and 38 employees. The District provides educational services to non-resident students and milk for students, for which cash is collected. Actual expenditures for the 2011-12 fiscal year were \$6,641,760 and \$6,176,464 for the 2012-13 fiscal year, funded primarily with real property taxes.

Objective

The objective of our audit was to examine the District's controls over its budgeting practices and cash receipts. Our audit addressed the following related questions:

- Does the Board adopt realistic and structurally balanced budgets?
- Does the District have adequate controls over cash receipts?

Scope and Methodology

We examined the District's financial condition and controls over cash receipts for the period of July 1, 2011 to March 31, 2013. We extended our scope to July 1, 2009 through June 30, 2013 to analyze budgeting practices, fund balance trends and reserve accounts. We examined non-resident tuition payments made from July 1, 2012 through March 31, 2013. We also reviewed the District's budget for the 2013-14 fiscal year.

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 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 initiate 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 forwarded to our office within 90 days. 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 responsibility for accurate and effective financial planning in school districts rests with the board and the superintendent. District officials should accurately depict and report financial activity and use available resources to ensure that the tax burden is not greater than necessary. To fulfill this responsibility, it is essential that officials develop reasonable budgets and manage fund balance responsibly and in accordance with statute. Districts may also establish reserves to restrict a portion of fund balance for a specific purpose, but must do so in compliance with statutory directives. A formal plan should be developed that specifies how much should be set aside in the reserves and details how these funds will be used. Generally, school districts are not limited as to how much money can be held in reserves; however, reserve balances should be reasonable. Funding reserves at greater than reasonable levels contributes to real property levies that are higher than necessary.

Over the last four fiscal years, the Board did not adopt budgets that were realistic. Expenditures were consistently and significantly overestimated. Even though the Board assigned at least \$120,000 of unexpended surplus funds² each year, the District did not actually use any fund balance during this period. As a result, the District has accumulated unexpended surplus funds up to six times the amount allowed by statute. In addition, as of June 30, 2013, the retirement reserve fund had a balance of \$310,000, six times the average annual expenditures.

General Fund Budget

A key measure of financial condition is the level of fund balance, which represents resources remaining from prior fiscal years. When the annual budget is structurally balanced, recurring expenditures are financed with recurring revenues. A reasonable amount of fund balance should be maintained for cash flow purposes or to fund unexpected expenditures. Accordingly, it is important for the Board to adopt realistic budgets. Operating surpluses (when budgeted appropriations are underexpended, expected revenues are exceeded

² The Government 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 it now classified as unreserved, unrestricted, less any amounts appropriated for the ensuing years budget (after Statement 54).

or both) can indicate that budgets are not realistic and/or not properly monitored. Real Property Tax Law limits school district unexpended surplus funds to a maximum of 4 percent of the ensuing year's budget.

The District's budgeted expenditures were consistently and significantly overestimated. We compared the District's budgeted expenditures with actual results for fiscal years 2009-10 through 2012-13 and found that the District overestimated expenditures by approximately \$3.8 million during that period. Overestimated expenditures were spread throughout the budget line items, but the largest variances were for operations contractual expenditures, full-day teacher salaries and tuition paid to other districts, which were overestimated by a total of more than \$2.6 million during this period.

Fiscal Year	Budgeted Expenditures	Actual Expenditures	Variance
2009-10	\$7,252,966	\$6,481,957	\$771,009
2010-11	\$7,255,882	\$6,585,048	\$670,834
2011-12	\$7,546,553	\$6,641,760	\$904,793
2012-13	\$7,676,325	\$6,176,464	\$1,499,861
Total	\$29,731,726	\$25,885,229	\$3,846,497

As shown in Table 2, during this four-year period, the District assigned a total of \$752,500 to fund the subsequent years' operations, which should have resulted in annual operating deficits equal to amounts assigned. In reality, because of the large variances between budgeted and actual expenditures, the District realized operating surpluses in all four fiscal years. As a result, the District did not use any of the assigned fund balance.

Fiscal Year	Actual Revenues	Actual Expenditures	Operating Surplus/(Deficit)	Assigned Funds in the Budget (Not Used)
2009-10	\$6,771,106	\$6,481,957	\$289,149	\$250,000
2010-11	\$7,022,502	\$6,585,048	\$437,454	\$120,000
2011-12	\$7,319,386	\$6,641,760	\$677,626	\$142,500
2012-13	\$7,323,845	\$6,176,464	\$1,147,381	\$240,000
Total	\$28,436,839	\$25,885,229	\$2,551,610	\$752,500

The District assigned \$240,000 of their unexpended surplus funds to fund the 2012-13 fiscal year; however, the remaining 2011-12 unexpended surplus funds exceeded the four percent statutory limit

by almost 5 percent. Based on the District's 2012-13 audited financial statements, the unexpended surplus funds again exceed the statutory limit by approximately 19 percent. District officials attempted to reduce this amount by assigning funds for the 2013-14 fiscal year's operations. However, assigning \$240,000 is not sufficient, especially when it is not used.

The unnecessary reservation of funds and overestimation of expenditures causes available fund balance to be artificially lower. As a result, the Board and District officials have withheld significant funds from productive use and have not adequately reflected the financial condition of the District to the taxpayers. Additionally, tax levies may have been higher than necessary.

Reserves

Reserves may be established by the Board in accordance with applicable laws. Moneys set aside in reserves must be used only in compliance with statutory provisions which determine how reserves are established and how they may be funded, expended and discontinued. Generally, school districts are not limited as to how much money can be held in reserves. However, reserve balances should be reasonable. Funding reserves at greater than reasonable levels contributes to real property levies that are higher than necessary, because the excessive reserve balances are not being used to fund operations. The Board is responsible for developing a formal plan for the use of its reserves, including how and when disbursements should be made, and for ensuring that appropriate documentation is maintained to account for and monitor reserve activity and balances.

As of June 30, 2013, the District had four reserves in the general fund totaling approximately \$969,000. We analyzed these reserves for reasonableness and adherence to statutory requirements and found the employee benefit accrued liability reserve, unemployment and repair reserves to be reasonable. However, the reserve for retirement contributions, with a balance of \$310,000, was in excess of the amount required and was not supported by a plan or other documentation validating the amount retained. District officials have not developed a formal plan stating how much would be set aside in each reserve, how each reserve would be funded or when the balances would be used.

By law, the retirement reserve can only be used to pay benefits for employees covered by the New York State and Local Retirement System (NYSLRS). The District cannot use this reserve for the cost of financing contributions for employees covered by the New York State Teachers' Retirement System. This reserve was originally funded in the 2010-11 fiscal year with \$172,000 and has increased to \$310,000 as of June 30, 2012. No moneys have been expended from the reserve since it has been funded. Instead, the Board budgeted for

retirement costs in the general fund and levied taxes to fund them. Over the past four fiscal years, 2009-10 through 2012-13, the District appropriated \$205,000 and spent \$206,000 on New York State and Local Retirement System costs. The District spent no more than \$68,500 in any of the four fiscal years.

By maintaining a balance in this reserve that is six times the average annual expenditures, while paying for retirement costs from general fund appropriations, District officials are not using these funds in a prudent manner.

Recommendations

1. The Board and District officials should develop and adopt budgets that include realistic estimates for expenditures based on contractual and historical data.
2. The Board should discontinue the practice of adopting budgets that result in assigning fund balance that will not be used.
3. The Board and District officials should ensure that the unexpended surplus fund amounts are within statutory limits.
4. District officials should develop a plan to use the surplus fund balance identified in this report in a manner that benefits District taxpayers. Such uses include, but are not limited to, reducing District property taxes or funding one-time expenditures.
5. District officials should develop a formal plan indicating how reserves will be funded, how much will be reserved and when reserves will be used.

Cash Receipts

The Board and District officials are responsible for establishing effective internal controls over cash receipts to ensure that all moneys are properly collected, safeguarded and accounted for. Duties should be appropriately segregated so that someone other than the person receiving and recording cash receipts is responsible for reconciling bank accounts and making bank deposits. When it is not practical to segregate duties because of limited staff resources, District officials should establish compensating controls. Cash records should provide sufficient detail to fully identify each transaction. The Treasurer should prepare and maintain deposit slips that are detailed enough to identify the composition between cash and individual checks being deposited, thereby identifying potential cash receipt errors or irregularities.

The District receives cash³ for selling milk to students and tuition for non-resident students. The District has set up procedures that ensure that cash and checks received are documented by District staff upon collection and deposited. Also, duties are segregated so that no one person has control of the cash receipt and deposit process.

When moneys are collected, District employees maintain a detailed log of the amount received. Cash received is safeguarded until District employees turn it over to the Treasurer. The Treasurer provides the employees with a computer generated receipt and retains a copy of the receipt for her records. A custodian brings cash to the bank, along with the deposit ticket, at least weekly. All checks are electronically deposited from the District office. The Treasurer attaches the receipts to the deposit ticket along with copies of all checks that were electronically deposited that same week.

We audited all cash received for milk sales, totaling \$1,864, and all tuition receipts, totaling \$167,712, for the period of July 1, 2012 through March 31, 2013 to determine if the District's procedures were being followed and were properly working. We found only minor issues which we discussed with District officials. All deposits were intact and reconciled to the bank statements and the Treasurer's detailed account transaction report. By having proper procedures in place over the collection and depositing of cash, the District has minimized the risk that the misappropriation of assets will occur.

³ The District sells milk to students; sales are accounted for in the cafeteria fund.

APPENDIX A

RESPONSE FROM DISTRICT OFFICIALS

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

Quogue Union Free School District
PO Box 959 - 10 Edgewood Road
Quogue, NY 11959
Richard J. Benson, Superintendent

December 4, 2013

Mr. Ira McCracken, Chief Examiner
Office of the State Comptroller
NYS Office Building, Room 3A10
250 Veterans Memorial Highway
Hauppauge, NY 11788-5533

Dear Mr. McCracken :

On behalf of the Quogue Union Free School District Board of Education, I am writing in response to the recent audit of the Quogue Union Free School District entitled : *Financial Condition and Cash Receipts, Report of Examination 2013M-274.*

Overall we are very pleased with your findings and appreciate the advice and direction your department has provided. Your staff was knowledgeable and considerate and worked well with our personnel. During our meeting on November 12, 2013, a number of issues were discussed and clarified.

In response to your recommendations noted on page 11 :

1. The Board and District Officials have reassessed our budgetary process and will project expenditures that are based on contractual and historical data. In years past we overestimated several expenditure categories including out of district tuition and transportation costs.
2. The Board will discontinue the practice of adopting budgets that result in assigning fund balance that will not be used.
3. The Board, Budget Committee and District Officials will more closely oversee the budget to ensure that unexpended surplus funds are within the statutory limits.

1.

4. The Board, Budget Committee, Legal Counsel and District Officials are in the process of developing a plan to use the surplus fund balance in a manner that will reduce District property taxes and support the District's five year Capital Plan.

5. The Board, Budget Committee, Legal Counsel and District Officials are in the process of developing a formal plan that indicates how reserves will be funded, how much will be reserved and when the reserves will be used.

Yours truly,

Richard J. Benson,
Superintendent of Schools

cc. Quogue Board of Education Members
Cheryl Krome, District Treasurer
Lisa Prosano, District Clerk
R.S. Abrams & Co., LLP

2.

APPENDIX B

AUDIT METHODOLOGY AND STANDARDS

Our overall goal was to determine if the Board provided adequate oversight of fiscal operations. To accomplish this, we performed an initial assessment of the internal operations 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 management, cash receipts, cash disbursements, purchasing, payroll and personnel services, asset management and information technology.

During the initial assessment, we interviewed appropriate District officials to obtain an understanding of the organization and the accounting system, performed limited tests of transactions and reviewed pertinent documents, such as District policy and procedure manuals, Board minutes and financial records and reports. Further, we reviewed the District's internal controls and procedures over computerized financial databases to help ensure that the information provided by such systems was reliable.

After reviewing the information gathered during our initial assessment, we determined where weaknesses existed and evaluated those weaknesses for risk of potential fraud, theft and/or professional misconduct. We then decided on the reported objective and scope and selected financial condition and cash receipts for further audit testing. Our procedures included the following:

- We interviewed officials to gain an understanding of the District's budgeting process.
- We reviewed the results of operations and analyzed changes in fund balance for the general fund.
- We compared the adopted budgets and actual operating results to determine if budget assumptions were reasonable.
- We reviewed expenditures to identify those that were significant and analyze trends.
- We reviewed Board meeting minutes and resolutions to verify the establishment of the reserves.
- We tested the reliability of the data reported in financial statements by reviewing bank statements, bank deposits and cash receipts.
- We reviewed budget and revenue status reports.
- We interviewed staff and observed controls over receipts.
- We examined check logs, receipts, bank processed receipts, bank deposits, bank statements and detailed transaction reports.
- We audited 100 percent of the cash received for milk and 100 percent of the tuition receipts for the period of July 1, 2012 through March 31, 2013 to determine if the District's procedures were being followed and if they were properly working.

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.

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