



East Islip Union Free School District Financial Condition

Report of Examination

Period Covered:

July 1, 2013 – March 31, 2015

2015M-283



Thomas P. DiNapoli

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State of New York Office of the State Comptroller

Division of Local Government and School Accountability

January 2016

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 East Islip 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 East Islip Union Free School District (District) is located in the Town of Islip 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 is the District's chief executive officer and is responsible, along with other administrative staff, for day-to-day management and for development and administration of the budget, under the Board's direction. The Board President is the District's chief financial officer. The Assistant Superintendent for Business is responsible for overseeing the District's Business Office and supervising the employees who maintain the District's financial accounting records and prepare financial reports.

The District operates six schools with approximately 4,000 students and 540 full-time employees. The District's 2014-15 general fund expenditures totaled approximately \$107 million and were funded primarily with real property taxes and State aid. Budgeted appropriations for the 2015-16 fiscal year are approximately \$111 million.

Objective

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

- Does the Board adopt reasonable and structurally balanced budgets and take action to maintain the District's fiscal stability?

Scope and Methodology

We examined the District's financial condition for the period July 1, 2013 through March 31, 2015. We expanded our scope back to July 1, 2011 and forward through June 30, 2015 to review fund balance, budgetary practices and reserve fund trends.

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 planned to take corrective

action. Appendix B includes our comments on 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 is responsible for making sound financial decisions that are in the best interest 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 along with prudent fund balance management help ensure sufficient funding for necessary operations. The District's fund balance policy should stipulate the terms of fund balance usage. Prudent fiscal management also includes establishing reserves to address long-term obligations or planned future expenditures. Accurate budget estimates and the appropriate use of reserves help ensure that the real property tax levy is not greater than necessary and that the budget process is transparent.

The Board adopted budgets for 2011-12 through 2014-15 that appropriated a total of \$16.7 million in fund balance to finance operations. Because the District consistently overestimated expenditures over the four year period, most of the appropriated fund balance was not used. Furthermore, District officials did not have resolutions establishing two reserves totaling \$1.7 million or resolutions that included the intent or funding levels for three reserves totaling \$4.1 million. In addition, District officials have overfunded the unemployment reserve.

Budgeting

The Board is responsible for adopting budgets with estimates of actual and necessary expenditures that are funded by realistic revenues and ensuring that the levies of real property taxes are not greater than necessary. In preparing the budget, the Board and District officials should use the most reliable information available. 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 and expenditures. Accurate estimates help ensure that the real property tax levy is not greater than necessary. Unrealistic budget estimates can mislead District voters and taxpayers and significantly impact the District's year-end surplus funds and financial condition.

We reviewed the District's budgets from 2011-12 through 2014-15 and found that general fund expenditures were less than budgeted appropriations for each year. District officials overestimated expenditures by \$16.9 million over that four-year period, as shown in Figure 1.

Figure 1: Budgeted Appropriations vs. Actual Expenditures			
Fiscal Year	Budgeted Appropriations	Actual Expenditures	Overestimated Appropriations
2011-12	\$104,165,940	\$100,087,403	\$4,078,537
2012-13	\$106,125,212	\$101,679,221	\$4,445,991
2013-14	\$109,556,248	\$105,326,583	\$4,229,665
2014-15	\$110,871,918	\$106,760,960	\$4,110,958
Total Expenditure Variance			\$16,865,151

Much of the overestimated expenditures were for special education programs, employee health insurance and teachers' retirement contributions. District officials overestimated special education program costs by \$2.4 million, health insurance by \$2.3 million and teachers' retirement by \$2.1 million over the four-year period. These expenditures were overestimated in all four fiscal years. District officials told us they budget conservatively for these items. For example, although special education program costs have been no more than \$12.3 million in any of the years reviewed, estimates have been as high as \$13 million, causing the gaps between estimated and actual expenditures to increase each year. Officials stated that these costs are unpredictable because they have no idea how many students coming into the District will need services or how many students currently receiving services will remain in programs; services for one student can affect the budget by \$100,000. Further, Board members and District officials told us that their budget development procedure is to overstate appropriations by 4 percent and they have been advised by their accountants that this is an acceptable practice.

Because the Board did not use all information available at the time the budget was prepared and did not update financial data as more information was obtained, the Board continually overestimated expenditures. This could result in the accumulation and retention of excessive funds, placing an unnecessary burden on District taxpayers.

Fund Balance

Fund balance represents the cumulative residual resources from prior fiscal years that can, and in some cases must, be used to lower property taxes for the ensuing fiscal year. The District may retain a portion of fund balance to help finance the next fiscal year's budget. This is referred to as appropriated fund balance. When fund balance is appropriated as a funding source, the expectation is that there will be a planned operating deficit in the ensuing fiscal year that will be financed by the amount of the appropriated fund balance. It is not a sound practice to routinely adopt budgets that appropriate fund balance that will not actually be used. The Board should adopt a fund balance policy that provides guidelines for the maintenance and use of unrestricted and restricted fund balance.

The Board adopted a fund balance policy on August 18, 2011. However, the policy is vague because it simply explains the different classifications of fund balance and states that unassigned fund balance will be maintained for financial stability. The policy does not indicate the extent to which fund balance can be used and what a minimum acceptable balance is. It also states fund balance can be transferred with proper approvals but does not indicate when it is acceptable to use fund balance, either unrestricted or restricted, to fund operations, or identify a method of determining acceptable amounts to be appropriated.

The Board appropriated fund balance to finance operations each year from 2011-12 through 2014-15. Although \$16.7 million of fund balance was included in the budgets as a financing source, the District only used \$807,008 because expenditures were significantly overestimated for those years.

Figure 2: General Fund Results of Operations

	2011-12	2012-13	2013-14	2014-15
Revenues	\$99,265,612	\$101,543,415	\$105,021,503	\$106,478,804
Expenditures	\$99,651,854 ^a	\$101,311,398 ^a	\$105,160,113 ^a	\$106,760,960
Operating Surplus/(Deficit)	(\$386,242)	\$232,017	(\$138,610)	(\$282,156)
Appropriated Fund Balance ^b	\$3,669,561	\$3,569,883	\$4,577,700	\$4,866,622
Appropriated Fund Balance Not Used	\$3,283,319	\$3,569,883	\$4,439,090	\$4,584,466

^a Total expenditures were reduced to reflect the appropriation of restricted funds in the adopted budgets that were expended as follows: \$435,549 in 2011-12, \$367,823 in 2012-13 and \$166,473 in 2013-14.

^b Dollar amounts include funds totaling \$8.9 million appropriated from reserves.

The Board did not adopt realistic budgets because it consistently overestimated expenditures and appropriated fund balance that was not needed to fund operations. As a result, it experienced operating deficits that were significantly less than planned in all four years. Had District officials adopted realistic estimates for expenditures and used appropriated fund balance to finance operations, they could have possibly reduced the tax levies. Furthermore, routinely adopting annual budgets that appropriate fund balance that will not actually be used to finance operations diminishes transparency and can mislead District residents.

Reserve Funds

Fund balance may be restricted for particular purposes or appropriated to reduce the real property tax levy. Reserve funds may be established by Board action, pursuant to various laws, and can only be used to provide financing for specific purposes. When Board members establish reserve funds, it is important they develop a plan for funding the reserves, determining how much should be accumulated and how

and when the funds will be used to finance related costs. Generally, school districts are not limited as to how much money can be held in reserves unless such a limitation has been established by the Board. However, it is important that school districts maintain reserve balances that are reasonable. Reserve balances above reasonable amounts represent funds the district could have used for other purposes, including reducing tax increases.

As of June 30, 2015, the District had five reserve funds — employee benefits and accrued liability reserve (EBALR) (\$2.1 million), retirement contribution (\$1.9 million), workers' compensation (\$1.3 million), unemployment insurance (\$431,000) and insurance (\$35,000) — with a combined balance of \$5.8 million. District officials could not provide Board resolutions establishing the workers' compensation and unemployment insurance reserves. Further, although the Board adopted resolutions establishing the EBALR (June 2003), retirement contribution (March 2009) and insurance (December 1986) reserves, the resolutions did not include directives on the intent and/or funding levels for the reserves. Instead, they simply stated that the reserves were established under the applicable sections of General Municipal Law. While there is no clear directive from the Board, District officials explained that it is their practice to retain one to three years' worth of expenditures in each of the reserves.

District officials expended \$969,845 from the EBALR during the audit period. Although four of the five reserve funds do not appear to be overfunded, the unemployment insurance reserve is overfunded using the District's basis for funding. The District's four-year average unemployment insurance expenditure was approximately \$97,000. Therefore, the reserve balance of \$431,000 as of June 30, 2015 is 48 percent overfunded because it is \$140,000 more than three years' worth of expenditures (\$291,000).

Lastly, although the Board approved spending from the reserves, the District spent \$1,119 more than the Board authorized from its EBALR during 2011-12. A June 14, 2012 Board resolution authorized the use of \$434,430 from this reserve. However, the District used \$435,549. District officials could not explain why the amount used exceeded the Board-authorized amount.

Because the Board did not provide clear directives on reserve funds, District residents do not have adequate assurances that resources are being used in the most efficient manner. As a result, District officials may have missed opportunities to reduce taxes and operate in a consistent and transparent manner.

Recommendations

The Board should:

1. Adopt budgets with realistic estimates, using all information available.
2. Update its fund balance policy to indicate the extent to which fund balance can be used, what a minimum acceptable balance is and when it is acceptable to use fund balance, either unrestricted or restricted, to fund operations.
3. Discontinue the practice of adopting budgets that overestimate expenditures and result in the appropriation of fund balance not needed to fund District operations.
4. Ensure that all reserve funds are established by a resolution that includes the rationale, objective and funding level for each reserve.

District officials should:

5. Ensure reserve funds are funded in accordance with District standards and use any excess funds identified to benefit taxpayers in accordance with statutory requirements.
6. Use only those reserve fund amounts authorized by Board resolution.

APPENDIX A

RESPONSE FROM DISTRICT OFFICIALS

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

John V. Dolan
Superintendent of Schools



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1/4/2016

Dear Mr. McCracken:

Please allow for this correspondence to serve as the official response from the East Islip UFSD relating to the Report of Examination on Financial Condition (2015M-283) conducted by your office for the period of July 1, 2013 through March 31, 2015.

The East Islip UFSD is appreciative of the efforts of your staff while conducting the audit and welcomes the opportunity to strengthen fiscal controls based upon the procedural recommendations included in the report. However, the District is having difficulty reconciling the fact that it has been designated by the Office of the NYS Comptroller for three years running as being in moderate fiscal stress versus the characterization in your audit that unrealistic budgeting practices can be misleading to the taxpayers.

See
Note 1
Page 11

While the District has averaged unspent appropriations of 4% over the past four years, contingencies that were in the appropriation budget were offset by planned appropriation of fund balance. In reality, fund balance has continued to decline due to operating deficits. Fund balance has decreased from a high of \$13,312,639 in 2009/10 to the current level of \$9,181,940 in 2014/15. Not to mention that of the \$9,181,940, remaining, \$1,124,624 is due back to NYSED due to a building aid overpayment in the amount of \$2,249,249. The level of fund balance maintained by a school district is a key component in the Comptroller's calculation of determining the level of fiscal stress of a school district. This audit report on the financial condition of the District does not address the District's designation of being in moderate fiscal stress at all.

See
Note 2
Page 11

Over the past several years, the Board of Education and Administration have taken the designation of moderate fiscal stress very seriously. This issue has been discussed at board meetings, committee meetings, as well as, various internal staff meetings and external community forums. As an indication of the level of attention paid to this issue, the amount of appropriated fund balance used to support the 2015/16 was reduced. During the exit conference, it was mentioned by your Audit Team that based upon this particular audit, the District does not appear to be in moderate fiscal stress.

See
Note 1
Page 11

In trying to determine what an appropriate level of unspent appropriations should be, audits from other districts with similar or higher percentages of unspent funds were reviewed. Those reports seem to reflect a more positive perspective on higher percentages of unspent funds, than what was observed in East Islip. Also, the District did reach out to its independent auditors, who indicated that spending between 95% and 99% of the appropriation budget is within a reasonable range, as compared to other districts. This indication was retrospective based upon results, not an endorsement for overestimating expenses.

See
Note 3
Page 11

While not intended, it does seem that the your audit report runs contrary to the focus of the fiscal stress monitoring system, which in turn makes it more difficult to explain to community members the current financial condition of the District. Additionally, steps being contemplated to improve the financial condition of the District may be hampered by the commentary in the audit report.

See
Note 1
Page 11

The Board of Education and District Administration remain committed to improving not only the financial condition of the District but also the underlying procedures that govern financial operations, while at the same time providing essential educational programs to the students of East Islip UFSD. Over the next couple of months, the District will be developing the required corrective action plan based upon recommendations made by your office.

Sincerely,

Sincerely,

Mr. John Dolan
Superintendent of Schools

Mr. Philip Montuori, Sr.
President, BOE

APPENDIX B

OSC COMMENTS ON THE DISTRICT'S RESPONSE

Note 1

The District was designated by the State Comptroller's Fiscal Stress Monitoring System (FSMS) as being in moderate fiscal stress based on information the District reported. However, the FSMS designation can only be as good as the quality and accuracy of the District's reported data. The District was designated as being in moderate stress because it appropriated \$16.7 million in fund balance from 2011-12 through 2014-15. The continued appropriation of fund balance to fund operations is one indication of stress. However, because the District overestimated expenditures over this period by \$16.9 million, just \$807,008 of the appropriated fund balance was used. This may have occurred, in part, because the Board adopted a fund balance policy that is vague. For example, the policy does not indicate the extent to which fund balance can be used or when it is acceptable to use fund balance to fund operations. The policy also does not identify a method of determining acceptable amounts to be appropriated. The consistent appropriation of fund balance that is not used clouds the District's financial position and can be misleading to District residents.

Note 2

Although contingencies in the appropriation budget may have been offset by appropriated fund balance, most of the appropriated fund balance was not used. In addition, Education Law does not allow school districts to create a contingency account in their annual budgets, as budgeting for contingencies within the budget line items reduces budget transparency.

Note 3

In most instances, inflated budget estimates will result in unspent appropriations. Inflating a budget by as much as 4 percent, based on the District's unspent appropriations, can reduce transparency and could mislead District residents. This practice can also result in tax levies that are higher than necessary.

APPENDIX C

AUDIT METHODOLOGY AND STANDARDS

The objective of our audit was to review the District's financial condition for the period July 1, 2013 through March 31, 2015. We expanded our scope back to July 1, 2011 and forward through June 30, 2015 to review fund balance, budgetary practices and reserve fund trends. To achieve our objective and obtain valid audit evidence, we performed the following audit procedures:

- We interviewed Board and District officials to determine the processes in place for developing budgets and gain an understanding of the District's financial condition.
- We analyzed the District's general fund financial records for fiscal years ending June 30, 2012 through June 30, 2015 to determine financial trends.
- We compared the budgeted appropriations to actual results of operations for fiscal years ending June 30, 2012 through June 30, 2015 to determine whether budgets were realistic and structurally balanced.
- We interviewed District officials to determine the causes of any significant budget to actual variances.
- We obtained and reviewed the District's fund balance policy.
- We reviewed and analyzed reported fund balance levels in comparison to amounts appropriated in adopted budgets for fiscal years ending June 30, 2012 through June 30, 2015.
- We obtained and reviewed Board minutes establishing reserve funds.
- We reviewed accounting records for the reserve funds to determine whether they were reasonably funded and in compliance with applicable laws and the District's own plans.

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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