Office of the New York State Comptroller

Division of Local Government
& School Accountability

Freeport Union Free School District

Financial Condition

Report of Examination

Period Covered:

July 1, 2012 – April 30, 2016

2016M-300

Thomas P. DiNapoli

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State of New York
Office of the State Comptroller

Division of Local Government
and School Accountability

December 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 Freeport 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

State of New York
Office of the State Comptroller

EXECUTIVE SUMMARY

The Freeport Union Free School District (District) is located in the Town of Hempstead, Nassau 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 the District's day-to-day management under the Board's direction.

The District operates eight schools with approximately 7,000 students and 1,200 employees. The District's 2014-15 general fund expenditures totaled approximately $149.6 million, which were funded primarily with real property taxes and State aid. Budgeted appropriations for the 2015-16 fiscal year were $167.1 million.

Scope and Objective

The objective of our audit was to evaluate the District's financial condition for the period July 1, 2012 through April 30, 2016. Our audit addressed the following related question:

- Did the Board and District officials effectively manage the District's financial condition by ensuring that fund balance was within legal requirements and that reserve balances and budget estimates were reasonable?

Audit Results

The District's estimate of appropriations in the adopted budgets were not reasonable or based on historical data. District officials presented, and the Board approved, budgets that overestimated expenditures by $36.5 million from the 2012-13 through the 2014-15 fiscal years, or an annual average of $12.2 million (8 percent). The District reported year-end unrestricted fund balance in the general fund at levels that did not comply with the 4 percent statutory limit from fiscal years 2012-13 through 2014-15. Specifically, the District's unrestricted fund balance was about 6 percent each year, or 2 percentage points above the statutory limit.

The Board appropriated an average of $8.7 million each year to finance operations for the 2013-14 through 2015-16 fiscal years. The District did not use any of the appropriated fund balance because expenditures were overestimated for each of those years. When adding back unused appropriated fund balance, the District's recalculated unrestricted fund balance was as much as 12 percent of the ensuing year's budget, or more than three times the legal limit.

The District maintained five reserve funds with balances totaling $35.6 million as of June 30, 2015, four of which were overfunded. District officials appropriated reserves totaling $10.3 million to fund budgeted appropriations without disclosing to residents which reserves would be used and how much was appropriated from each reserve. Furthermore, the District did not have Board resolutions establishing two of the five reserve funds. In addition, the District restricted $325,813 of fund balance, which was reported as debt service in the District's audited financial statements. There is no statutory provision permitting the use of a debt service reserve in a school district.

If the debt service reserve fund balance and overfunded reserves were added back to unrestricted fund balance, the District's recalculated unrestricted fund balance would have further exceeded the statutory limit during the years reviewed. Specifically, unrestricted fund balance would have been 14.2 percent of the ensuing year's appropriations in 2012-13, 13.8 percent in 2013-14 and 12.9 percent in 2014-15.

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 disagreed with certain findings in our report. Appendix B includes our comments on issues raised in the District's response.

Introduction

Background

The Freeport Union Free School District (District) is located in the Town of Hempstead, Nassau 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 the District's day-to-day management under the Board's direction.

The District operates eight schools with approximately 7,000 students and 1,200 employees. The District's 2014-15 general fund expenditures totaled approximately $149.6 million, which were funded primarily with real property taxes and State aid. Budgeted appropriations for the 2015-16 fiscal year were $167.1 million.

Objective

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

- Did the Board and District officials effectively manage the District's financial condition by ensuring that fund balance was within legal requirements and that reserve balances and budget estimates were reasonable?

Scope and Methodology

We examined the District's financial records for the period July 1, 2012 through April 30, 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. District officials disagreed with certain findings in our report. Appendix B includes our comments on issues raised in the District's response.

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 and District officials are responsible for properly managing the District's finances. This responsibility includes adopting budgets with realistic expenditure estimates, ensuring that fund balance does not exceed the amount allowed by law, appropriating fund balance only to the extent necessary to fund District operations and ensuring reserves are legally established and reasonably funded. 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 and District officials did not effectively manage the District's financial condition by ensuring budget estimates were reasonable and adopting realistic budgets based on historical costs and trends. Because the District overestimated expenditures by a total of $36.5 million (8 percent) from July 1, 2012 through June 30, 2015, an average of more than $12.1 million per fiscal year, the appropriated fund balance (an average of about $8.7 million each year) was not used. Additionally, the District reported year-end unrestricted fund balance at levels that did not comply with the 4 percent statutory limit for the past three fiscal years. When adding back unused appropriated fund balance, the District's recalculated unrestricted funds were about 11 percent of the appropriations in the 2015-16 budget.

The District maintained five reserve funds[1] with balances totaling $35.6 million as of June 30, 2015, four of which were overfunded. District officials appropriated reserves totaling $10.3 million to fund budgeted expenditures without disclosing to residents which reserves would be used and how much was appropriated from each reserve.[2] Furthermore, the District did not have Board resolutions establishing two of the five reserve funds.

Overestimated Expenditures

When preparing the budget, the Board must estimate revenues, expenditures and the amount of fund balance that will be available at year-end, some or all of which may be used to fund the ensuing year's appropriations. 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.

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1 The workers' compensation reserve, unemployment insurance reserve, retirement contribution reserve, employee benefits accrued liability reserve (EBALR) and capital reserve

2 This does not include the capital reserve. The adopted budget was modified each year in the audit period for a cumulative total of $4 million. Each year, the voters approved a referendum to transfer funds from the general fund to the capital fund.

The District's estimates of appropriations in the adopted budgets were not reasonable or based on historical data. We compared the District's budgeted revenues and appropriations from the 2012-13 through the 2014-15 fiscal years with actual results of operations. The District's actual revenues did not significantly exceed budgeted revenues over the three-year period.[3] However, District officials consistently presented, and the Board approved, budgets that significantly overestimated appropriations by as much as $14.2 million (10 percent of actual expenditures) in one fiscal year. In total, appropriations were overestimated by $36.5 million from the 2012-13 through the 2014-15 fiscal years, or an annual average of $12.2 million (8 percent), as indicated in Figure 1.

Figure 1: Overestimated Expenditures

	Appropriations[a]	Actual Expenditures	Overestimated Appropriations	Percentage Overestimated[b]
2012-13	$151,212,463	$142,057,755	$9,154,708	6%
2013-14	$156,999,628	$142,823,273	$14,176,355	10%
2014-15	$162,854,430	$149,642,309	$13,212,121	9%

[a] Encumbrances are added to the original budget totaling more than $1.3 million for the three years.
[b] Overestimated Appropriations divided by Actual Expenditures

For the three years reviewed, the largest appropriations overestimates (87 percent of the total expenditure variances) were for employee health insurance (overestimated by $10 million, or 27 percent), teachers' salaries (overestimated by $9.5 million, or 26 percent), programs for students with disabilities (overestimated by $5.4 million, or 15 percent), computer assisted instruction (overestimated by $3.5 million, or 10 percent) and contract transportation (overestimated by $3.3 million, or 9 percent).

We reviewed the results of operations for 2015-16 as of April 30, 2016 and estimated appropriations for these budget lines based on the 2014-15 fiscal year. We project that, as of June 30, 2016, the District will have potentially overestimated these expenditures by as much as $12 million (12 percent).

District officials told us that their budgeting practices during the years we reviewed included building contingencies into the budget. For example, ongoing contract negotiations between the Board and employee unions were anticipated to increase teachers' salaries and health insurance costs. Additionally, there was uncertainty in transportation costs due to contract negotiations and uncertainty in the increase of students with disabilities who are dropped off at various sites. However, the practice of overestimating appropriations can reduce transparency to District residents and may result in the District's tax levies being higher than necessary.

[3] Budgeted revenues were underestimated by a total of $4.1 million, or 1 percent, of the actual revenues.

Fund Balance

Fund balance represents the cumulative resources remaining from prior fiscal years that can, and in some instances must, be used to lower property taxes for the ensuing year. The District may appropriate a portion of fund balance to help finance the next fiscal year's budget. The remaining portion is the unrestricted, unappropriated fund balance that can be used for cash flow purposes or unexpected expenses. However, New York State Real Property Tax Law (RPTL) requires that unrestricted fund balance not exceed 4 percent of the ensuing year's budgeted appropriations. Unrestricted fund balance that exceeds 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 unrestricted fund balance or reserve funds in excess of what is needed to fund District operations. When fund balance is appropriated as a funding source, the expectation is that there will be a planned operating deficit financed by the amount of the appropriated fund balance. It is not sound practice to routinely adopt annual budgets that appropriate fund balance that will not actually be used. This practice reduces budget transparency.

<u>Unrestricted Fund Balance</u> − The Board adopted a Budget Planning and Development Policy[4] that requires the Board to ensure that surplus funds in excess of the 4 percent limit be applied in determining the amount of the tax levy. The Board adopted a reserve policy[5] that explains the classifications of fund balance. The policy also indicates that unrestricted fund balance will be maintained to provide the District with financial stability and a margin of safety to fund unanticipated contingent expenditures that may occur during the fiscal year.

The District reported year-end unrestricted fund balance in the general fund at levels that did not comply with the 4 percent limit from fiscal years 2012-13 through 2014-15. Specifically, the District's unrestricted fund balance was about 6 percent each year, or 2 percentage points above the statutory limit (Figure 2).

4 The policy was adopted in November 2006 and last revised in September 2014.
5 The policy was adopted in June 2011.

Figure 2: Unrestricted Funds at Year-End

	2012-13	2013-14	2014-15
Beginning Unrestricted Fund Balance	$19,009,865	$19,293,759	$19,307,916
Plus: Operating Surplus	$212,020	$892,600	$945,827
Unrestricted Funds Subtotal	$19,221,885	$20,186,359	$20,253,743
Less: Appropriated Fund Balance for the Ensuing Year	$9,000,000	$9,000,000	$8,000,000
Less: Transfer to Debt Service	$0	$325,000	$813
Less: Transfer to Nonspendable	$0	$8,084	($8,084)
Less/(Plus): Transfer to/(from) Reserves	($71,874)	$545,359	$1,985,648
Less: Encumbrances	$636,794	$495,722	$299,022
Total Unrestricted Funds at Year-End	$9,656,965	$9,812,194	$9,976,344
Ensuing Year's Budgeted Appropriations	$156,362,834	$162,358,708	$167,132,054
Unrestricted Funds as a Percentage of Ensuing Year's Budget	6.18%	6.04%	5.97%

District officials told us that the unrestricted fund balance serves as a buffer for uncertain events, such as an increase in student population, while the revenue remains the same. District officials again appropriated $8 million of fund balance at the end of 2014-15 to fund the ensuing year's budget. However, because the planned deficit of $8 million as of June 30, 2016 will not materialize, the unrestricted fund balance will continue to increase.

Appropriated Fund Balance – The Board appropriated an average of $8.7 million each year to finance operations for the 2015-16 through 2015-16 fiscal years. The District did not use any of the appropriated fund balance because expenditures were overestimated for each of those years. The District's practice of consistently planning operating deficits by appropriating unrestricted fund balance that was not needed further exacerbated the amount of unrestricted fund balance retained in excess of the statutory limit. When adding back unused appropriated fund balance, the District's recalculated unrestricted fund balance was as much as 12 percent of the ensuing year's budget, or more than three times the legal limit (Figure 3).

Figure 3: Unused Fund Balance

	2012-13	2013-14	2014-15
Total Unrestricted Funds at Year-End	$9,656,965	$9,812,194	$9,976,344
Add: Appropriated Fund Balance Not Used to Fund Ensuing Year's Budget.	$9,000,000	$9,000,000	$8,000,000[a]
Total Recalculated Unrestricted Funds	$18,656,965	$18,812,194	$17,976,344
Ensuing Year's Budget	$156,362,834	$162,358,708	$167,132,054
Recalculated Fund Balance as Percentage of Ensuing Year's Appropriations	11.9%	11.60%	10.8%

[a] We are projecting an operating surplus for 2015-16 by comparing revenues and expenditures between July 1, 2014 - April 30, 2015 and July 1, 2015 - April 30, 2016.

Further, we reviewed 2015-16 operations and determined that the District will likely again spend less than planned. District officials also told us that the unrestricted fund balance will likely be more than $9.4 million. Since the District will not need the appropriated fund balance included in that budget, it will continue to significantly exceed the statutory fund balance limit.

District officials have no written plan to reduce unrestricted fund balance to within the statutory limit. They told us that they plan to reduce unrestricted fund balance by funding existing reserves. However, as indicated in our finding on reserve funds, four of the five reserves are already overfunded. The District's practice of consistently 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.

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, in accordance with applicable laws, and only used to provide financing for specific purposes. When the Board establishes reserve funds, it is important that it develops a plan for funding the reserves. This can be outlined in the resolution establishing each fund or in a written policy that communicates to residents why the money is being set aside, the Board's financial objectives for the reserves, optimal funding levels and conditions under which the assets will be used.

Funding reserves at greater than reasonable levels essentially results in real property tax levies that are higher than necessary. The Board adopted a reserve policy which stated that the District may establish and maintain reserve funds in accordance with applicable laws. The policy also required the Board to review the date each reserve was established and the amount of each sum paid into the fund.

The District had five reserves with balances totaling $35.6 million as of June 30, 2015.[6] District officials could not provide Board resolutions establishing two of the five reserves totaling $7.9 million: workers' compensation ($7.1 million) and unemployment insurance ($786,000). The Board also did not develop a plan for the funding of these two reserves and the maximum funding levels. District officials told us that the establishment of these reserves predates the tenure of all members of the current administration, and, therefore, they could not determine the dates they were established. Without Board resolutions establishing the reserve funds, there is no assurance that

[6] The District's reserves were EBALR ($14.7 million), retirement contribution ($10.9 million), workers' compensation ($7.1 million), capital reserve ($2.1 million) and unemployment insurance ($786,000).

reserves were legally established, necessary and reasonably funded. Lacking this key information, District residents do not have adequate assurances that resources are being used in the most efficient manner.

Additionally, District officials could not explain the basis for the balances maintained in four reserves that were overfunded, as follows:

- A workers' compensation reserve is used to pay for workers' compensation benefits and the expenses to administer a workers' compensation self-insurance program. During the three fiscal years reviewed, the District budgeted $3.2 million and spent $2.9 million to pay for related costs. District officials used a total of $331,861 from the reserve to pay for related costs and funded the $2.6 million balance from other revenue sources. As of June 30, 2015, the workers' compensation reserve had a balance of $7.1 million; however, the District's average annual workers' compensation expenditures for the last three years were $975,123. As such, the current reserve fund balance is more than seven times the average annual expenditure.

- An unemployment insurance reserve is used to reimburse the New York State Unemployment Insurance Fund (SUIF) for payments made to claimants when a school district has elected the "benefit reimbursement" method of funding the cost of unemployment benefits. If, at the end of any fiscal year, the amount of the fund exceeds the amount required to be paid into the SUIF, plus any additional amount to pay all pending claims, the Board, within 60 days of the close of the fiscal year, may elect to transfer all or part of the excess amount to another authorized reserve fund or apply the excess to the ensuing year's budgeted appropriations. The District's unemployment insurance reserve balance was $785,749 as of June 30, 2015. However, the annual average expenditures for the last three years were $91,644 (for a three-year total of $274,932), while budgeted appropriations totaled $285,165. As such, the current reserve balance is more than eight times the average annual expenditure. Although the District did not put additional funds into the reserve during the audit period, it used only $60,163 from the reserve (7.6 percent of the balance) to pay for unemployment benefits.

- The retirement reserve is used to pay the District's retirement contribution to the New York State and Local Retirement System (NYSLRS). The Board resolution to establish the reserve states that the purpose of the reserve is to finance contributions to the NYSLRS. During the three fiscal years reviewed, the District had total contributions of $5.9 million and budgeted $7.2 million for them. District officials did not use the reserve to pay related costs; instead, they used other revenue sources, including the tax levy. The retirement reserve had a balance of $10.9 million as of June 30, 2015. However, the District's average annual retirement contribution expenditures for the last three fiscal years were $2 million. Therefore, the retirement insurance reserve balance is more than five times the average annual expenditure.

- The EBALR is used to finance cash payments to employees for accrued and unused sick, vacation and certain other leave time owed to them when they leave District employment. However, the Board resolution to establish this reserve states that its purpose is to account for compensated absence payments and post-employment benefits. While the compensated absences payments are statutorily allowed, post-employment benefits are not. This reserve had a balance of $14.7 million as of June 30, 2015. However, the District's compensated absence liability associated with this reserve was $12.3 million as of June 30, 2015. The reserve was therefore overfunded by $2.4 million. District officials used $298,380 of the reserve to pay for $1,743,420 of authorized compensated leave benefits to employees who separated from the District during the three years reviewed.

During fiscal years 2012-13 through 2014-15, the Board appropriated approximately $14.3 million of reserve funds to offset a portion of expenditures in the adopted budgets. However, the Board generally did not keep records of which reserves the funds were appropriated from. District officials provided us with records documenting the appropriation of $4 million from the capital reserve. However, they did not have records documenting which reserves the remaining $10.3 million was appropriated from. District officials did document that $690,404[7] of the $10.3 million appropriated was actually used.

According to the financial statements, the remaining $9.6 million comprised unused appropriated reserves, although District officials did not maintain documentation to identify which reserves were appropriated and unused. Even though $9.6 million was returned unused, the District had expenses that statutorily could have been charged to the reserves (Figure 4). For example, in 2012-13, District officials appropriated $3.1 million in reserves in the budget. Although they had expenses totaling $3.7 million that could have been charged

[7] See Figure 4. The $690,404 is comprised of all funds expended from the District's reserves with the exception of the capital reserve.

to reserves, they charged only $354,718 (11 percent) of the $3.1 million appropriated. The remaining $2.8 million was returned unused during that fiscal year.

Figure 4: Appropriated Reserves

	Reserves Appropriated to Fund Budget[a]	Reserves Used	Reserves Unused	Costs Related to Reserves
2012-13	$3,110,000	$354,718	$2,755,382	$3,744,152
2013-14	$3,600,000	$37,306	$3,562,694	$3,596,063
2014-15	$3,600,000	$298,380	$3,301,620	$3,254,476
Total	**$10,310,000**	**$690,404**	**$9,619,696**	**$10,594,691**

[a] This chart does not include the District's capital reserve. This reserve was not appropriated into the adopted budget during the fiscal year. Each year, the District appropriated the capital reserve through a budget adjustment. All of the $4 million appropriated into the budget for the capital reserve was used for the intended purpose.

District officials cannot identify how much was appropriated for each reserve and only expended $690,404 from reserves despite having $10.6 million in related costs that could have been charged against the reserves. Instead, District officials mainly used operating funds to pay for related costs. By maintaining reserves that are significantly overfunded, the Board has withheld funds from productive use, unnecessarily levied taxes and reduced the transparency of District finances.

Furthermore, the District restricted $325,813[8] of fund balance, which was reported as debt service in the District's audited financial statements. There is no statutory provision permitting the use of a debt service reserve in a school district. District officials told us that these funds are from a settlement with a vendor and the money was initially received from the bond proceeds. These debt service proceeds were included in restricted general fund balance, thereby decreasing the unrestricted and unappropriated fund balance that is subject to the 4 percent limitation.

The proceeds from the issuance of debt should be accounted for in the debt service fund and used to pay debt service payments on that debt. In addition, if a district has residual bond proceeds or interest earned on bond proceeds upon completing a project, the money must be maintained in the debt service fund and used to pay debt service on any related obligations.

If the debt service reserve fund balance and overfunded reserves were added back to unrestricted fund balance, the District's recalculated unrestricted fund balance would have further exceeded the statutory limit during the years reviewed. Specifically, unrestricted fund balance

[8] The District reported $325,000 in 2013-14 as restricted fund balance. In 2014-15, it again restricted $325,813, which includes $813 of earned interest.

would have been 14.2 percent of the ensuing year's appropriations in 2012-13, 13.8 percent in 2013-14 and 12.9 percent in 2014-15.

Recommendations

The Board and District officials should:

1. Develop a written plan to reduce the level of unrestricted fund balance to legal limits and consider adopting a fund balance policy to require compliance. The reduction of unrestricted fund balance can be accomplished by using it as a financing source for:

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

2. Adopt budgets that realistically reflect the District's operating needs based on historical trends or other identified analysis.

3. Discontinue the practice of adopting budgets that result in the appropriation of unrestricted fund balance not needed to fund District operations.

4. Ensure that each reserve fund is established by a Board resolution that includes the financial objective for the reserve, optimal funding level and conditions under which it will be used.

5. Use excess reserves, funds identified to benefit District residents in accordance with statutory requirements.

6. Document which reserves and the amount from each reserve, are being appropriated in the budget to offset budgeted appropriations and, when statutorily allowed, charge related costs to reserves appropriated in the budget.

7. Determine the appropriate account in which the funds reported as restricted for debt service should reside and transfer the funds to this account.

APPENDIX A

RESPONSE FROM DISTRICT OFFICIALS

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

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On behalf of the Freeport Public Schools District (the "District"), we would like to thank you and your staff for providing us with an opportunity to respond to the Financial Condition Report of Examination (the "Draft Audit Report" or "Report"). We take note of the fact that your review covers the period from July 1, 2014, through September 30, 2016, which was further expanded to include the 2012 and 2013 fiscal years. Please note that this response will also serve as the Corrective Action Plan.

Freeport Public Schools is extremely committed to providing an outstanding educational program and world-class opportunities for all students to blossom to their full potential and prepare them to be global citizens, college and career ready in the 21st Century world. At the same time, we are equally committed to the long-term tradition of solid and sound fiscal responsibility in the management of the District's finances and to the community. Our budget development and creation of sound financial condition for the District is strongly based on the District goals, strategic plan, and guiding principles such as improving student achievement and increasing academic rigor, maximizing available resources through economies and efficiencies, providing a strong educational program, affordability to community members, and continued focus on the long-term financial stability of the District. The national economy, economic uncertainties in the state, state budget deficit, tax levy cap, unfunded/underfunded mandates, loss of state aid, and frozen aid formulas have created unprecedented challenging financial times that continue to have a profound impact on the District's financial condition.

The opinions expressed by your Office, throughout your report of the District's practices, are primarily the result of a difference in philosophy on financial planning and budgeting for a sound and secure educational program. The District's mission is to provide the best educational programs and opportunities for our students and to create stability and predictability for our community. This is only achieved through long-range fiscal planning, which addresses

See Note 1 Page 33

E D U C A T I O N A L   E X C E L L E N C E unpredictability and the increasing needs of our over 7,200 students. Your report omits the practical realities of the multiple challenges our District faces that impacts our ability to fund an excellent educational program. We must take a pragmatic approach when funding reserves and budgets. While the District acknowledges the opinions in the Draft Audit Report, we are concerned that the tone of the Report would mislead a reader, unfamiliar with the entirety of the audit process, to conclude that the District has over funded reserves and expenditures, which is a gross mischaracterization of the District's long-term fiscal approach. The subjective manner in which the Report calculated the fund balance along with the reserves is a distortion resulting in a skewed presentation of the data. There are no regulations that define appropriate levels of reserve amounts. We have established reserves carefully after consultation with our auditors and in alignment with our philosophy of long-term fiscal stability and responsibility for our students and community.

See Note 2 Page 33

See Note 3 Page 33

See Note 4 Page 33

The financial condition of Freeport Public Schools is excellent. Notably, our External Auditors and Standard & Poor's Bond Ratings have repeatedly commended the District for maintaining an exemplary fiscal condition that includes well-funded reserves and fund balances. For four of the last nine years, the tax levy has been decreased including the last two consecutive years. For the period covering the scope of the audit, the average tax levy increase has been 1.8 percent and for the last nine years about two percent. During this time, despite the economic climate and our increasing fiscal and educational challenges, the District managed to add instructional staff, increase AP courses, expand enrichment programs, and improve facilities, all of which directly relate to a better education for children. Respectfully, when criticizing the District for its well-funded reserves and fund balance, the audit fails to mention any of the profound challenges faced by the District during the years examined, namely, the tax levy cap, frozen Foundation Aid, increasing enrollment, unfunded/underfunded mandates, collective bargaining negotiations, unaccompanied minors, increasing English as a New Language (ENL) students, Students with Interrupted Formal Education (SIFE), and Students with Disabilities (SWD), threat of tax certiorari, PILOT payments, Gap Elimination Adjustment (GEA), and the unpredictability of state aid. The impact of the above factors for any given year can be more than $10,000,000.

See Note 2 Page 33

Freeport is a high-need, low wealth suburban school district and is dependent on state aid. The philosophy of the District has always been to take a long-term view of both sound and stable fiscal and educational leadership. We believe we must maintain fiscal prudence and educational excellence that can withstand the tremendous uncertainties attached to state aid distribution and our inability to raise revenue due to the tax levy cap limitations and other factors as noted earlier. As you are aware, within the past few years, in order to balance the state deficit of $10 billion, the Gap Elimination Adjustment (GEA) was enacted which cumulatively reduced our state aid by $35,000,000 since 2009. The Campaign for Fiscal Equity court decision that required New York State to adequately and equitably fund school districts such as Freeport through Foundation Aid in 2007-2008 was not fully enacted by the state. This has resulted in a staggering loss of more than $20,000,000 over the last five years to our District. School districts statewide have been shortchanged by $3.9 billion in Foundation Aid. Due to the unpredictability of state aid, which includes reductions and unfulfilled Foundation Aid, we must protect our students' future by being fiscally responsible. The District does not believe it is prudent financial management to operate on a declining fund balance or a deficit and spend down its reserves to lower levels. We believe the current reserves are reasonable and appropriately funded based on our philosophy, special circumstances, and ongoing discussions with our auditors.

See Note 5 Page 33

Contrary to the statements and recommendations within the Draft Audit Report of the District, it appears the Office of the State Comptroller ("OSC") shares this financial management philosophy. Specifically, OSC has recently implemented a "School District Fiscal Stress Monitoring System" in which both a declining fund balance and operating in a deficit will count against school districts when being classified with regard to fiscal stress. Since the inception of this monitoring system, Freeport Public Schools, because of strong fiscal management, has attained the highest fiscal score along with the top rating of "No Designation," which is considered the best rating that a school district can achieve.

See Note 6 Page 34

Our prudent fiscal management has led to the highest bond rating ever in the history of the District. The District is very proud of our Standard & Poor's AA bond rating which demonstrates our excellent financial condition. The Management's Discussion and Analysis (MD&A) statement, which is part of the annual financial statements during the period of time reviewed in the audit consistently and continuously note that the District has a "strong and stable financial profile, low direct debt, and highly rated fiscal management." We are one of a handful of districts in the state that has received this exceptional AA bond rating that has allowed the District to receive favorable borrowing rates and the District continues to save the community several millions on the District's bond interest expense. Due to a strong financial condition, it has been more than a decade since the District has gone out for annual short-term borrowings - Tax Anticipation Notes (TANS) and Revenue Anticipation Notes (RANS). As a result, the District has saved millions of dollars in interest expense. Freeport is one of the lowest per-pupil spending school districts in Nassau County. In comparison to the average per pupil cost in Nassau County, Freeport spends $6,000 less per year per student. Freeport's tax levy per pupil is one of the lowest in Nassau County. The tax levy per pupil collection in comparison to all other K-12 Nassau County School Districts is $9,700 less each year. Yet, we have not only maintained, but enhanced and expanded our educational programs. The District has worked persistently over the years to update policies, strengthen internal controls, and develop budgets that balance short-term financial priorities with long-term financial well-being. The District has reduced the tax levy for four years in the last nine years. The District's budgets and other capital propositions continue to be supported by our community with an overwhelming majority.

While decreasing the tax levy for several years and despite the challenges previously mentioned, Freeport Public Schools has achieved amazing new heights. Freeport is a high need district, where 70 percent of our children are economically disadvantaged. We have seen extraordinary academic achievements for Freeport's students including a jump in the graduation rate from 63 percent to 83 percent. We are proud that our graduation rate for African American students exceeds the NY State average for this group by 23 percentage points and our Hispanic students exceed the state Hispanic graduation rate by 13 percentage points, together which represents over 90 percent of students. The District has expanded from having zero-dual enrollment collegiate credit courses to now offering students over 25 courses with the opportunity to earn over 50 dual-enrollment credits. We have significantly increased the number of AP course opportunities for students from 15 to 22. A record number of students have been inducted into the National Honor Society. Our Grades 3-8 test scores have shown impressive gains along with a significant increase in reading proficiency rates in grades K-4. We have established strong academic support programs for our students before and after school and during the summer. A record number of academic teams have advanced to national competitions, including Vex Robotics, Odyssey of the Mind, Future Problem Solvers, and DECA. The District's Science Research program has produced contenders in the national Siemens Math, Science & Technology Competition and Physics Olympiad. The District was recently awarded the "Be the Change for Kids" Innovation Award from the New York State School Boards Association and the Middle School received international recognition from the International Alliance for Invitational Education for its social, emotional learning programs. Our music program is a National Grammy Signature School Semifinalist for 2016, has performed at Carnegie Hall, Radio City Music Hall, and other prestigious institutions and has record numbers of students receiving county and state recognitions. Our athletic teams continue to win championships at county and state levels. Our students excel in the classroom, on the stage, and on the field.

The District takes pride in the actions which it has taken to create a sound and secure future for our students through solid fiscal management and educational excellence. However, the District appreciates any constructive recommendations by the OSC. It is imperative that we explain, once again, (as previously explained in our discussions), the District's philosophy and the economic, financial, legislative, and political contexts which seriously impact our planning, purpose, and existence. To that end, we provide the following responses to the recommendations offered in the Draft Audit Report.

OSC Recommendation

Develop a written plan to reduce the level of unrestricted fund balance to legal limits and consider adopting a fund balance policy to require compliance. Use the surplus unrestricted fund balance as a financing source for funding one-time expenditures, funding needed reserves, and reducing District property taxes.

Response to Recommendation

Maintaining an adequate fund balance is a prudent fiscal practice that provides critical benefits for any school district. These include the ability to minimize educational service disruptions, stabilize educational performance, fund educational growth, and manage unforeseen expenditure demands and revenue shortfalls.

The Government Finance Officers Association (GFOA) avers (and we agree) that, "It is essential that governments maintain adequate levels of fund balance to mitigate current and future risks and to ensure stable tax rates." They also note that a school district's particular situation may often require a level of unrestricted balance in excess of recommended levels. GFOA clearly recommends an unrestricted fund balance to be a minimum of two months of general fund operating revenues or general fund operating expenditures. This amounts to 16.7 percent of either general fund operating revenues or regular general fund operating expenditures. Across the United States, 40 states have no mention of fund balance restrictions and only 10 states have some requirement related to school district fund balance. Even in those instances, the lowest limit is six percent as opposed to the four percent limit in New York State. The state and local governments such as counties, towns, villages, and fire districts in New York State have no limit on unrestricted fund balance and can carryover a "reasonable amount" for their particular situation to address volatility of revenues and expenditures and for contingencies.

See Note 5 Page 33

The OSC Report states that the District's unrestricted fund balance is two percent over the unrealistic limit of four percent. Optimum fund balance levels are a critical component of the well-being of a district or, for that matter, any organization. The District will continue to analyze anticipated revenues, expenses, and educational challenges on the horizon when considering its fund balance. The District's main goal has been, and will always be, to provide a strong educational program for our students to ensure they are college and career ready while keeping costs low for our residents. Our decisions are made thoughtfully and are aligned with the District goals and Strategic Plan to ensure a successful future for our students while not ignoring the challenges outlined above. Hopefully, the Governor and state legislature consider the practical and sound models that exist in the rest of the country and raise the unrestricted fund balance to a minimum of six percent or similar laws that apply to state and local governments (of no limit).

Despite having to address the challenges mentioned earlier, the District has reduced the amount of unrestricted fund balance during the period of the audit. This has been accomplished by adopting budgets with a decrease in tax levy for our community. The District has also lowered its bond-debt balances by paying down debt, thereby, reducing long-term obligations which saves on interest costs. Additionally, the District has made one-time purchases to eliminate borrowing costs on large critical purchases such as technology infrastructure, educational technology devices, and facilities' maintenance. The District has reduced the property taxes four times over recent years. The District has, since its inception, funded the voter-authorized Capital Reserve Fund on an annual basis to ensure our buildings and infrastructures remain sustainable and strong. The District continues to address the unrestricted fund balance by reducing the tax levy and will continue to look for opportunities to lower the amount, while still maintaining vitally needed financial liquidity.

See Note 2 Page 33

OSC Recommendations

Adopt budgets that realistically reflect the District's operating needs based on historical trends or other identified analysis.

Discontinue the practice of adopting budgets that result in the appropriation of unrestricted fund balance not needed to fund District operations.

Response to Recommendations

As OSC has stated, budgeting is not an exact science. In a recent report issued by OSC, school districts are advised that it is crucial that they develop strategies to effectively manage fiscal challenges. Appropriating for potential unforeseen expenditures within the budget is an entirely appropriate strategy. Districts appropriate some amount of fund balance to fund the budget appropriations. As mentioned earlier, unanticipated expenses such as meeting the needs of 187 federally placed unaccompanied minors at costs in excess of $1,000,000 per year are out of our control and impact the budget without notice. Proper budgeting requires that we consider and anticipate the need for contingencies to avoid educational service disruptions and the erosion of our existing excellent student programs. The District's budgets are realistic and in line with our budgeting philosophy. At the time the budget is formulated, estimates must be made with regard to future expenditures. The District develops its budgets by balancing the financial responsibilities of the current year, and unknown costs, such as salaries and health

See Note 7 Page 34

See Note 8 Page 34

benefits, retirement and social security, and long-term debt service, while also anticipating unknown financial responsibilities of future years, such as health insurance, transportation, and utilities. The District must budget keeping in mind unpredictable costs including the uncertainties of unfunded mandates which include unaccompanied minors, Race-to-the-Top requirements, implementation of Common Core Learning Standards and testing, Annual Professional Performance Review (APPR), revisions to educating ENL students, special education costs and any new requirements including the recent mandate to test all water outlets for lead, which is an unanticipated cost for the current budget year.

Unforeseen natural disasters must be kept in mind as well. Superstorm Sandy cost the District upfront $1,800,000 in clean up. In addition, the District aggressively manages its budget throughout each fiscal year in an effort to generate any possible savings, which are used to lower the tax levy and fund reserves. Further, the Board of Education has supported budgets with tax levy decreases in four out of the last nine years with the two most recent years both having tax levy decreases.

Despite the unknown financial impacts the District may incur in a year, the District carefully manages its budget in an effort to generate any possible savings for the community, while simultaneously anticipating unknown financial responsibilities in the upcoming school year, and believes that the budgeted funds will be needed to fund District operations. Any shortsightedness in funds or reserves can swiftly move a district into fiscal or educational insolvency, an oblivion from which it will take a district several years to recover. The appropriated fund balance is a lawful budget tool along with estimated revenues to support the appropriations in the adopted budget. It is important in light of the tax levy cap and other constraints to plan wisely and protect student programs from the volatility of revenue and expenditures by creating predictability in the budgeting process. Absent appropriated fund balance, estimated revenues would need to increase or budget reductions would occur that would negatively impact the students, staff and community.

See Note 9 Page 34

The Report ignores the unique and specific circumstances and challenges faced by the District when asserting that the District's budget estimates do not realistically reflect our budgeting needs. All governmental agencies developing a budget understand a variety of uncertainties make it fundamentally impossible to precisely estimate the exact amount of money that will be needed to maintain current operations. The District must maintain liquidity despite any financial challenges. As a result, the District plans for the year ahead by prudently budgeting known predictable costs and cautiously projecting future estimated costs based on a thorough assessment of prior history of expenditures and current economic conditions.

See Note 2 Page 33

See Note 10 Page 34

Please note that every year it is impossible to predict the extent of all of the fiscal challenges that our District will need to meet and to know which may, or may not, be offset by state aid. Below you will find a list of the unique and specific challenges faced by our District that must be taken into account when developing our budget.

See Note 2 Page 33

Unaccompanied Minors: The Federal government has placed 187 unaccompanied minors in Freeport. Fifty students have been placed so far this year. New students arrive weekly. The cost of educating these students is unplanned for and out of the control of the District. The District will not shortchange these students nor can it cut other existing programs midyear to accommodate these new costs. There is no federal or state funding available to assist districts with these increased costs. The unexpected arrival of these students requires more than **$1,000,000** of unbudgeted funding each year.

Increased Enrollment: In addition to unaccompanied minors, enrollment in general has been on the increase. Student enrollment has increased by more than 600 students in the past several years. We have had to increase staffing to accommodate the rising enrollment each year. An unplanned increase in enrollment impacts all resources: class size, programs, staffing, technology, and transportation costs. Since the Foundation Aid has been frozen at 2008 levels, there is no additional state aid per pupil to assist in the increased cost of educating our students. This translates into a loss of more than $3,000,000 a year in Foundation Aid. On an annual basis, staffing, and related costs for this enrollment increase is can be more than **$1,000,000** per year.

Unfunded Mandates for Increasing ENL (English as a New Language) & SWD (Students With Disabilities) Student Programs: An increasing number of ENL students and unfunded mandates based on changes to the Part 154 Regulations have created a staffing and financial burden. The costs to meet the needs of students who have Limited English Proficiency (LEP) and/or are immigrant students in Freeport have risen steadily as enrollments of those students have increased and new Part 154 NYSED mandates were implemented last year. The number of students requiring LEP services in Freeport has increased by 30 percent since 2008. The Foundation Aid formula for these students has remained unchanged and the minimal Federal Title III funding allocated to Freeport may only be used for supplemental support program costs. Over 1,300 students in the District require Part 154 services. During the past few years, as this population has increased and mandates required additional new services, the District has had to hire additional ESL staff at a cost of **$1,000,000**.

Approximately 13 percent of our students require special education programming, which, in some instances, exceeds $150,000 per student per year. Unplanned enrollments of students with special education programs and increased classifications of students with these types of program place a financial and often unpredictable burden on the District. Federal and state aid have historically underfunded the cost of educating these students and special education costs for these students have risen by a staggering 20 percent for the audit period. One family moving into the District midyear with multiple students can require services that can cost up to **$500,000**.

State Aid: There is a long history of New York State balancing its budget at the expense of school districts. In December 1990, school districts faced significant cuts in state aid midyear, after it had been promised, leaving districts scrambling to make up the difference. The Deficit Reduction Assessment (short-changing state aid) impacted Freeport Schools by $15,000,000 starting in 2005. New York State had substituted federal stimulus dollars for state funds by supplanting the state aid. It was incumbent on the District to make up for this shortfall in aid in the meantime. Governor Paterson attempted cutting state aid midyear in 2009, so it is highly plausible that the amount of State Aid provided annually is not guaranteed to be distributed during the year, contrary to the New York State Constitution Education clause¸ Article XI.

In 2006, the New York State Court of Appeals ruled on the Campaign for Fiscal Equity (CFE) and determined the state was not providing students with the necessary resources for a sound basic education, specifically in districts with a high percentage of minority students. The state adopted the Foundation Aid formula with a promised four-year phase in of $5.5 billion in state aid. In 2009, the Foundation Aid was frozen and the plan was further deferred and there was an insignificant increase in the last two years. The state has blatantly ignored the court order to pay and the promise remains only partially fulfilled. School districts are still owed $3.9 billion in Foundation Aid, and Freeport continues to lose more than **$3,000,000** every year.

The Foundation Aid formula, which was designed to help our District by New York State, has not come through. Due to the formulas being frozen, the loss of aid to be received by the Freeport School District is in excess of **20,000,000** despite partial restoration over the last two years. However, the District still managed to improve the educational program even with such a loss in aid due to carefully allocating resources properly, enacting efficiencies, aggressively pursuing competitive grants, and persistently planning to ensure all dollars spent make a difference.

The GEA, a penalty/assessment that reduced the amount of state aid each school district is entitled to receive, was introduced in the 2009-2010 school year to partially offset the state's own $10 billion cumulative deficit and lack of any reserves. Although the GEA was eliminated this year, the Freeport School District has lost approximately **$35,000,000** in state aid due to the GEA. Freeport has lost more state aid, as a result of the GEA, than any other school district in Nassau County. The GEA, along with state aid reductions, combined with insufficient mandate relief, and the enactment of the property tax levy cap, have created irreversible financial consequences for the Freeport School District.

Suffice it to say, state aid continues to be unpredictable and can be withheld in whole or part on a whim to assist in balancing the state budget. Clearly, it is important to have the state budget and funds in good order, however, districts must take this unpredictability into account and have funds available to offset this if needed.

Impact of Tax Levy Cap: The tax levy cap is a major drawback and serious constraint to raising revenue. It is flawed in that it creates an inequity for districts reliant on state aid. The impact of affluent districts by the tax levy cap is less than for districts with lower socioeconomic standings. The tax levy cap is limited to the lesser of two percent or the Consumer Price Index with certain exclusions. Over the last two years, the tax levy cap increase has been well below one percent. Without prudent financial management, the tax levy cap could crush an educational system. Based on the fact that districts are rated for fiscal stress, the State Comptroller's Office is aware this could happen. Freeport Public Schools is a high need, suburban school district. We are underfunded by New York State. Additional exclusions should be added to the current tax levy cap law for increases in enrollment. Freeport enrollment has increased by more than 600 students since October of 2010 and it is projected that we will continue to experience significant enrollment growth during the next few years. These new enrollments include unaccompanied minors and an increase in Students with Disabilities. The tax levy cap calculation does not provide exclusions for added enrollments and there is no additional state aid support for increased staffing, supplies, and special services costs. Unplanned enrollments of students with special education programs and increased classifications of students with these types of program costs should be excluded from tax levy cap calculation as well. In the past, funding formulas under rules for contingent budgets gave consideration for increases in enrollments.

At the very least, the "two percent tax levy cap" should be just that, a cap of two percent of total budget, and it should not be tied with the Consumer Price Index. The tax levy cap under current conditions may eventually eliminate completely the ability of the District to create additional reserves or fund balances. The result, lacking a political correction, renders the fate of our school program for children entirely under the control of the governor and the state legislature. Without increases in state aid, as per the law, and with limited taxing authority, the reserves serve as a mechanism to safeguard our students' future during challenging times.

Negotiations and Salary Increases: First, during the period examined, the District was engaged in negotiations with all bargaining units that spanned fiscal years 2012-2013 through 2015-2016, and it accrued anticipated salary increases accordingly. Pursuant to Interpretation No. 6 of the Governmental Accounting Standards Board ("GASB"), the accrual of anticipated salary increases in the year earned "would be appropriate as it represents an estimate of a claim against current financial resources." The GASB standard upon which the interpretation rests, GASB (6) (12), states, in relevant part that "in the absence of an explicit requirement to do otherwise, a government should accrue a governmental fund liability and expenditure in the period in which the government incurs the liability." Governmental fund liabilities and expenditures that should be accrued include liabilities that, once incurred, normally are paid in a timely manner and in full from current resources; for example, salaries, professional services, supplies, utilities, and travel. To the extent not paid, such liabilities generally represent claims against current financial resources and should be reported as governmental fund liabilities. Therefore, to account for the estimated wage settlement in the year during which the monies were earned is in accord with GASB's regulation. Accordingly, it is proper for the District to make a good faith estimate of anticipated retroactive salary increases during collective bargaining when a settlement is not achieved prior to contract expiration and transcends budget years. Accounting for these potential liabilities was both prudent and in compliance with standard practice and regulations, including the duty to bargain in good faith established by the Public Employment Relations Board ("PERB"). Any surplus that resulted from a settlement favorable to the District benefitted the fund balance.

LIPA Payment in Lieu of Taxes (PILOT): Due to a PILOT agreement that was negotiated between Nassau County and LIPA solely excluding the School District, the District's 2015-2016 tax levy was reduced significantly subsequent to voter approval. In addition, there was a discrepancy within the agreement that required the District to seek legal counsel along with many other Districts to ensure we would receive our planned revenue. The impact of this agreement has posed unintended financial burdens. In addition to the legal fees the District incurred due to this agreement, the larger long-term implication is the fact that since our overall tax levy was reduced, any future tax levy increases will not include this LIPA PILOT amount since they are excluded from the increase resulting in a cumulative loss of revenue over time.

Threat of Tax Certiorari: At the present time, the amount the District levies is the amount that the District receives. Whatever funds are not collected by Nassau County, the County is responsible to make up the difference so that the school district receives the entire levied amount. However, for years there have been discussions and legal proceedings by the County to cease making up the difference, therefore, leaving the school district with a shortfall of revenue. This was stopped by a court decision. In addition, discussions have all included having the school district collect the taxes, which would be a labor intensive and high cost process. This potential loss in revenue, as well as additional expenses, would be more than **$1,000,000** and would significantly impact the District.

See Note 11 Page 34

Superstorm Sandy: Freeport is a waterfront community that is subject to flooding. Any significant tropical storm or hurricane will have a fiscal impact on the District. Superstorm Sandy was a natural disaster that devastated the Freeport community and the District. Many homes were lost and one of our schools, home to 700 students, was severely damaged by flooding. These students had to be relocated to our other buildings and students had to be transported to school from shelters and residences far outside the District catchment area. These unforeseen upfront costs, related to the storm, were in excess of **$1,800,000.**

Other Uncertainties: The District budgets for expenses that can be unpredictable and beyond the District's control. The budget is expected to fund educational programs to meet the needs of the students and community regardless of any changes in external factors which can lead to unexpected increases to the budget. The federal mandate for health insurance, under the Affordable Care Act, requires the District to extend new coverage to specific classes of employees and/or face huge financial penalties. This uncertainty is revisited on a year-to-year basis. In addition, the Federal Government, in response to parent/student "opt-outs" has threatened the public schools with a loss of Title I and other essential aid which would total over a **$1,000,000** loss for our District. In 2015-2016, the District's opt-out rate was 30 percent which is well over the five percent limit. The District has no control over this issue and could be penalized by the federal government. Funding for our Pre-Kindergarten program was cut annually by **$600,000** beginning in 2008 per year amounting to **$4,800,000**. Our homeless student population has risen dramatically during the past several years and transportation costs associated with these students have risen.

Freeport Public Schools methodically reviews every budget line of the appropriations and adopts realistic estimates for expenditures. Uncertainties that translate into increased expenses or a loss in revenue can only be offset by taxation, which is not possible under the tax levy cap, and/or the elimination of student programs and the excessing of staff. Provisions are built into the budget to account for unanticipated expenses. The contingencies allow the District to be prepared for unforeseeable increases to the budget due to various items such as increases in the number of special education students/services, fluctuations in utility prices, or health insurance premium increases. The District's philosophy is to leave enough flexibility in the budget to meet any worst-case financial demands, which may arise during the school year. Any of the aforementioned challenges could deplete our fund balance in just one year.

OSC Recommendation

Ensure that all reserve funds are established by Board of Education resolution that includes the financial objective for the reserve, optimal funding level, and conditions under which it will be used.

Use excess reserve funds identified to benefit District residents in accordance with statutory requirements.

E D U C A T I O N A L   E X C E L L E N C E

Response to Recommendation

Freeport Public Schools establishes reserve funds through Board of Education resolutions that include the financial objectives, optimal funding levels, and the conditions under which it will be used. This sound practice has been in place and will be continued. For the two required reserve resolutions established more than 20 years ago, which could not be located in the District records, (Worker's Compensation reserve and Unemployment Insurance reserve), corrective action will be taken at Board of Education meeting on November 16, 2016. Reserve funds are used thoughtfully to benefit District residents, maintain our excellent financial condition, and secure the future of our students. In fact, we have been systematically reducing the tax levy by $8,000,000 each year, which is beneficial to our taxpayers. Based on best practices, industry standards, economic realities, and discussions with our auditors and Board of Education on an on-going basis, we review the balances of the reserves to ensure our reserves are appropriately funded for our current and future needs.

See Note 4 Page 33

OSC Recommendation

Document which reserve and the amount from each reserve being appropriated in the budget to offset budgeted appropriations and, when statutorily allowed, charge related costs to reserves appropriated in the budget.

Response to Recommendations

Currently, with respect to the use of reserves as a revenue funding source, the District does provide the amount being transferred from the reserves in the budget documents. Within the expenditure budget, the District also documents the corresponding budget lines which are being offset by the transfer from reserves. As a District that presents a comprehensive budget document to our community, we will examine and provide any additional notes regarding the amount from each reserve being appropriated in our budget document as deemed necessary.

See Note 12 Page 35

With respect to charging related costs to reserves, the District does use our reserves to fund the related costs. Specifically, in looking at the time period discussed within the audit, the District used all of its reserves funds to fund the related costs. The amount to fund from each reserve was based upon the review of the actual expenditures and revenues at the end of each fiscal year, which can change considerably from the time the expenditure and revenue budgets, were adopted the prior year. For example, this past year, there was an increase in the District's state aid after the District's budget planning due to a state error in regard to projecting expense-driven aid. This resulted in an unanticipated increase in overall revenue from state aid. Therefore, the need to fully use the appropriated reserves as a revenue source was unnecessary. The District has already addressed this matter with our auditors to change the reporting practice in the financial statements and will continue to monitor it.

See Note 4 Page 33

OSC Recommendation

Determine the appropriate account that the funds reported as restricted for debt service should reside and transfer the funds to this account.

Response to Recommendation

As discussed with the OSC auditor, the District recovered these funds in a lawsuit taken against a contractor associated with the construction of one of our buildings. We were instructed by our External Auditors to segment out these funds so that they may be used only to pay down the bond debt associated with the construction of this building. These funds were classified as "restricted" to be used only for this purpose. There was not a specific reserve set-up and, therefore, a Board of Education resolution was not needed. We will address using these funds as intended, in the current year or as we prepare our 2017-2018 budget.

See Note 13 Page 35

Conclusion:

Due to sound fiscal practices, well-funded reserves and careful budgeting, the educational program for students in Freeport has remained strong and has, in fact, expanded during a period of economic instability and severe cuts in state aid to schools in New York State. In fact, the per-pupil tax levy during the periods reviewed remained unchanged. The District's fiscal prudence and long-term planning allowed the Freeport community to be minimally impacted by the onslaught of uncertainties and challenges that our District faced since the economic downturn that began in 2008, including the period of the OSC audit and beyond. According to the Comptroller's Office, districts that could not maintain well-funded reserves and fund balances are prone to fiscal stress.

We sincerely urge the Comptroller, as an influential leader, to advocate for some key actions in New York State that would help school districts, students, and taxpayers. These actions would help all school districts, including Freeport, to overcome the tremendous challenges we face as outlined in this letter.

Foundation Aid - Advocate for the unfreezing of all Foundation Aid and ensure that midyear cuts, Deficit Reduction Assessment, and Gap Elimination Adjustment will not be implemented in the future. New York State must also keep the promise of the *Campaign for Fiscal Equity vs. State Court* decision of 2007-2008 and adequately fund education.

Tax Levy Cap Reform - Advocate for exclusions in the tax levy cap for enrollment and spikes in populations of high-needs students, such as Students with Disabilities and English as a New Language Learners. Make the tax levy cap a two percent cap on the total budget and not just on the levy. Decouple the tax levy cap calculation from the Consumer Price Index and eliminate the supermajority requirement to override the tax levy limit.

Unaccompanied Minors - Advocate for the full funding of unaccompanied minors placed by the federal government in school districts. These students come with varied needs and there is no additional funding available.

Unfunded Mandates -The state must not impose new mandates upon school districts without proper funding. Mandate Relief should be an integral part of all legislative discussions which is helpful for the continued success of our schools.

In conclusion, the District is proud of its long-term fiscal planning which has resulted in an excellent financial condition as recognized by Standard & Poor's Bond Ratings, our auditors, and the Office of the Comptroller's Fiscal Stress Monitoring System. Freeport Public Schools is committed to providing outstanding world-class educational opportunities for our students and to our long-term tradition of solid and sound fiscal responsibility to the community in the management of the District finances. This approach has resulted in amazing outcomes for our students and in the tax levy being decreased four times in recent years. We note that the comments expressed in our response are primarily the result of a difference in philosophy on financial planning and budgeting that protects our exemplary educational programs, carefully accounts for the special circumstances faced by our District, and provides fiscal prudence. The District thanks the Office of the State Comptroller for their courteousness and professionalism displayed throughout the review.

Sincerely,

Kishore Kuncham, Ed.D.
Superintendent of Schools

Cc: Michael C. Pomerico, President, Board of Education, and
Members of the Board of Education, Freeport UFSD
Alan Yu, Cullen & Danowski, LLP (External Auditors)
Ernest P. Smith, Nawrocki Smith, LLP (Internal Auditors)

APPENDIX B

OSC COMMENTS ON THE DISTRICT'S RESPONSE

Note 1

The recommendations made in the report are based on RPTL, laws relating to establishing and maintaining reserve funds and good business practices.

Note 2

RPTL is applicable to all school districts, regardless of the challenges that they may face. The objective of our audit was to evaluate the District's financial condition. Our audit addressed a number of factors including the unrestricted fund balance in relation to the statutory limit, the appropriation of fund balance that was not needed to fund operations and reserve fund balances in relation to associated liabilities or annual expenditures and whether the reserves were used to fund related costs.

Note 3

Our audit shows that the District's budget practices lacked transparency regarding the manner in which it used fund balance. We added back the unused appropriated fund balance and unused appropriated reserves to show that the District actually exceeded the statutory unexpended fund balance limit by more than the amounts presented in the audited financial statements. Additionally, our audit disclosed that the District annually overestimated expenditures by as much as 10 percent and appropriated fund balance and reserves without using those amounts.

Note 4

Our review of the reserve balances in relation to their liabilities or annual expenditures showed that four of the five reserves were overfunded. During the audit period, the District budgeted to use $10.3 million from the reserve funds to pay for related costs. However, it actually used only $690,000 of that amount and returned the majority of that amount to the reserves. Instead of using reserves to pay for expenditures, the District funded them from operating funds.

Note 5

RPTL requires that a school district's unrestricted fund balance cannot exceed 4 percent of the ensuing year's budgeted appropriations. To comply with this law, the District must reduce unrestricted fund balance from its current level. Our report does not suggest that the District should operate at a deficit. However, when fund balance is appropriated in the budget as a funding source, the expectation is that there will be a planned operating deficit, which is financed by the appropriated fund balance. Furthermore, although District officials do not believe it is prudent financial management to spend down reserves to lower levels, the Board appropriated reserves totaling $10.3 million into the District's budget as a funding source during the audit period.

Note 6

The OSC Fiscal Stress Monitoring System takes a number of factors into consideration when rating a school district's level of fiscal stress. Regardless of whether or not a district is rated in a fiscal stress category, it is not exempt from complying with RPTL regarding the level of unrestricted fund balance that can be retained.

Note 7

The appropriation of fund balance is a tool that can occasionally be used to fund a portion of the budget with actual and available surplus funds. However, the routine appropriation of fund balance for potential unforeseen expenditures is not appropriate. When these funds are not used, the budget is misleading because it indicated that the money would be used to finance operations.

Note 8

The District's budgeting practices have reduced transparency to District residents. For example, the District's 2013-14 actual expenditures were nearly $14.2 million less than budgeted. Because the District overestimated expenditures in the annual budgets, it never actually used the appropriated fund balance – an annual average of $8.7 million each of the three years reviewed – to reduce its fund balance. Therefore, the District's unrestricted fund balance has continually exceeded the legal limit.

Note 9

While the appropriation of fund balance is a lawful budget tool to support appropriations in the adopted budget, such an appropriation should result in a planned operating deficit, which did not occur over the three years reviewed. As a result, the District did not use any of the $26 million appropriated during this time.

Note 10

Based on our review of the five budget codes with the largest variances, District officials do not adjust their estimations of future costs based on an assessment of the prior history of expenditures. District officials told us that the budgets for these codes included contingencies. The District's response also acknowledges that contingencies for potential unforeseen expenditures are built into the budget. Budgeting in this manner reduces the transparency. When formulating budget estimates, District officials should consider trend analysis, which can show predictable patterns of the District's significant revenues and expenditures over time.

Note 11

Superstorm Sandy, which occurred during the 2012-13 fiscal year, resulted in unforeseen costs related to the storm for many municipalities. However, in the 2012-13 fiscal year, even with the unforeseen costs of $1.8 million described in the District's response, the District overbudgeted total expenditures by almost $9.2 million and had an operating surplus of $212,000 at the end of the fiscal year.

Note 12

Budget documents have not disclosed the amount being appropriated from each reserve. Instead, they disclosed the cumulative amount being appropriated from reserves, with no mention of individual reserves. This presentation is not transparent to District residents.

Note 13

There is no statutory provision permitting the use of a debt service reserve in a school district. Our audit did not recommend a Board resolution to establish the reserve. These funds should be accounted for in the debt service fund.

APPENDIX C

AUDIT METHODOLOGY AND STANDARDS

The objective of our audit was to evaluate the District's financial condition. To achieve our audit objective and obtain valid evidence, we performed the following procedures:

- We interviewed District officials and employees to gain an understanding of the budget process and determined reasons for large expenditure variances.
- We reviewed District policies and procedures.
- We reviewed Board minutes and resolutions to gain an understanding of the District's control process and budget monitoring procedures.
- We compared appropriations to actual expenditures for fiscal years 2012-13 through 2015-16.
- We reviewed and analyzed reported fund balance levels in comparison to amounts appropriated in the adopted budgets for fiscal years 2012-13 through 2014-15.
- We restated unrestricted fund balance and calculated the unrestricted fund balance as a percentage of the next year's budget.
- We reviewed Board resolutions to determine if reserves were funded as authorized.
- We reviewed the District's budget booklet for fiscal years 2012-13 through 2015-16 to determine if reserves budgeted to be appropriated in the budget were documented.
- We reviewed and compared year-to-date expenditures in 2015-16 (July 1, 2015 through April 30, 2016) with the year-to-date expenditures for the same period in 2014-15. Based on year-end expenditures for 2014-15, we projected total expenditures for 2015-16 for the budget account codes with four of the five largest expenditure variances (health insurance, teachers' regular school, program for children with disabilities, computer assisted instruction and contract transportation).
- We reviewed and compared total year-to-date revenues and expenditures from July 1, 2015 through April 30, 2016 with year-to-date revenues and expenditures for the same period in 2014-15. Based on this information, we projected an operating surplus for 2015-16 and that District officials would not use fund balance appropriated into the 2015-16 budget.
- We reviewed transfers from fund balance into reserves, reserve balances used to fund budgeted appropriations and unused reserve fund balances to determine if they were returned to applicable reserves. We also reviewed expenditures that could have been statutorily charged to the District's reserves.

- We requested documentation for the establishment of District reserves to determine if reserves were appropriately funded and in compliance with applicable legal requirements.

- We reviewed annual financial statements from 2012-13 through 2014-15, the accompanying management letters prepared by the District's external auditors and relevant budget reports.

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.

APPENDIX D

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