

Southampton Union Free School District

Financial Management

2024M-43 | October 2024

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Report Highlights

Southampton Union Free School District

Audit Objective

Determine whether the Southampton Union Free School District (District) Board of Education (Board) and officials effectively managed fund balance and reserve funds.

Key Findings

The Board and District officials did not effectively manage fund balance and reserve funds. We determined that the Board and District officials:

- Annually appropriated fund balance, totaling \$5.3 million over five years, that was not used to pay operational expenses and made year-end unbudgeted transfers to reserves, totaling \$21.6 million, to stay within the statutory surplus fund balance limit.
- Consistently underestimated certain revenue accounts and overestimated certain expenditure accounts in the annual budgets.
- Did not have support for the establishment of six reserves, overfunded two reserves and may have overfunded an additional reserve.

Key Recommendations

- Ensure adopted budgets include realistic estimates for revenues and appropriations.
- Ensure reserve fund balances are necessary and reasonable, and use any excess funds identified to benefit residents in accordance with statutory requirements.

Except as noted in Appendix A, District officials generally agreed with our recommendations. Appendix B includes our comments on the District’s response.

Audit Period

July 1, 2018 – June 30, 2023

Background

The District is located in the Town of Southampton in Suffolk County. The District is governed by a seven-member Board, which is responsible for managing the District’s financial and educational affairs.

The Superintendent of Schools (Superintendent) is the chief executive officer and is responsible for the District’s day-to-day management under the Board’s direction.

The Assistant Superintendent for Business (Assistant Superintendent) oversees the District’s business operations. The Board, Superintendent and Assistant Superintendent are responsible for developing the budget.

Quick Facts	
2022-23 Adopted Budget	\$75 million
2022-2023 Actual Expenditures	\$72.6 million
Restricted Fund Balance at June 30, 2023	\$23.1 million
Unassigned Fund Balance at June 30, 2023	\$3.1 million

Financial Management

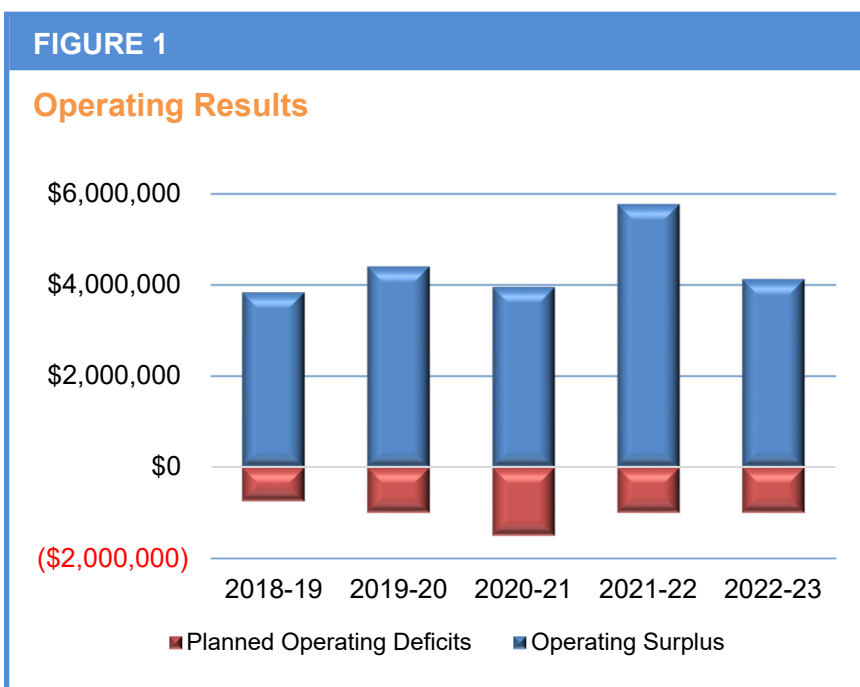
What Is Fund Balance and How Should It Be Used?

Fund balance is the difference between revenues and expenditures accumulated over time. School districts may retain a portion of surplus fund balance¹ for unexpected occurrences and fluctuations in cash flow. However, a school district board (board) and officials must comply with New York State Real Property Tax Law (RPTL) Section 1318, which limits the amount of surplus funds that a school district can retain to no more than 4 percent of the budget. Officials must apply any surplus fund balance in excess of the 4 percent limit to reduce the upcoming year's real property tax levy or appropriately fund needed reserves.

To properly manage fund balance, the board and school district officials should develop and adopt reasonably estimated and structurally balanced budgets based on historical data or known trends in which recurring revenues finance recurring expenditures. In preparing the budget, the board must estimate the amounts the school district will spend and receive, the amount of fund balance that will be available at fiscal year-end to use toward the upcoming year's budget, and the expected real property tax levy. Accurate and reasonable budget estimates help ensure that the tax levy is not greater than necessary, the budget is presented transparently to the public, and surplus fund balance does not exceed the legal limit. During the course of the fiscal year, as school district officials have a better understanding of the results of financial operations, they should consider using anticipated surplus fund balance to finance one-time expenditures, fund needed reserves or pay off debt.

The Board Appropriated Fund Balance That Was Not Used to Finance Operations

The Board appropriated fund balance as a financing source in each of the five years reviewed totaling \$5.3 million. This should have resulted in annual operating deficits equal to the funds appropriated. Instead, the District realized operating surpluses totaling \$22.1 million (Figure 1), or \$27.4 million more than planned and did not use any of the \$5.3 million of appropriated fund balance. For example, the District realized a \$4.0 million surplus in the 2020-21 fiscal year and did not use any of the \$1.5 million in fund balance

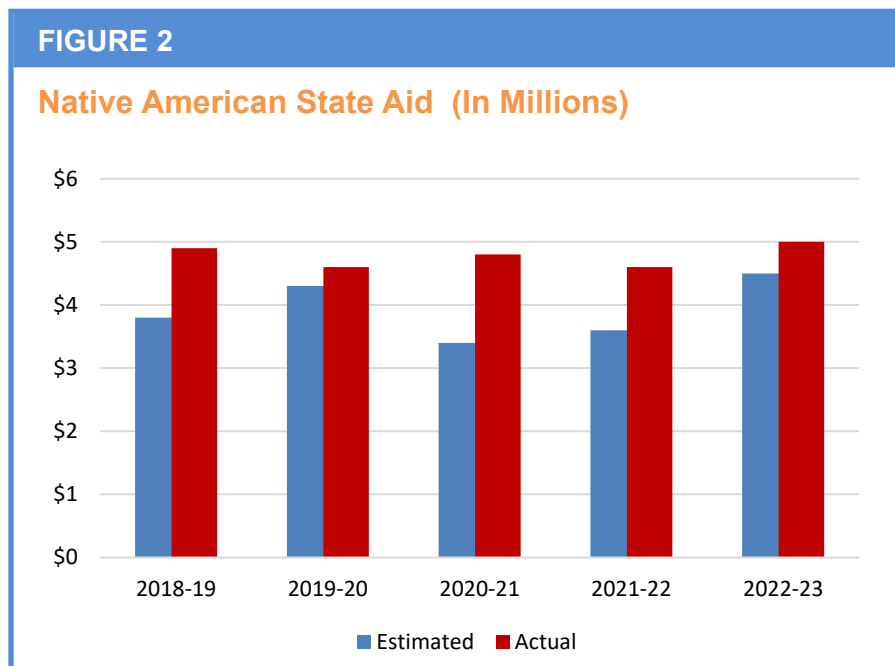


¹ For guidance on fund balance classification and reporting see <https://www.osc.ny.gov/files/local-government/publications/pdf/gasb54.pdf>

that was appropriated to finance operations. Furthermore, the 2023-24 adopted general fund budget appears to have continued this trend because it is likely the \$1 million of appropriated surplus fund balance will not be used to finance operations.

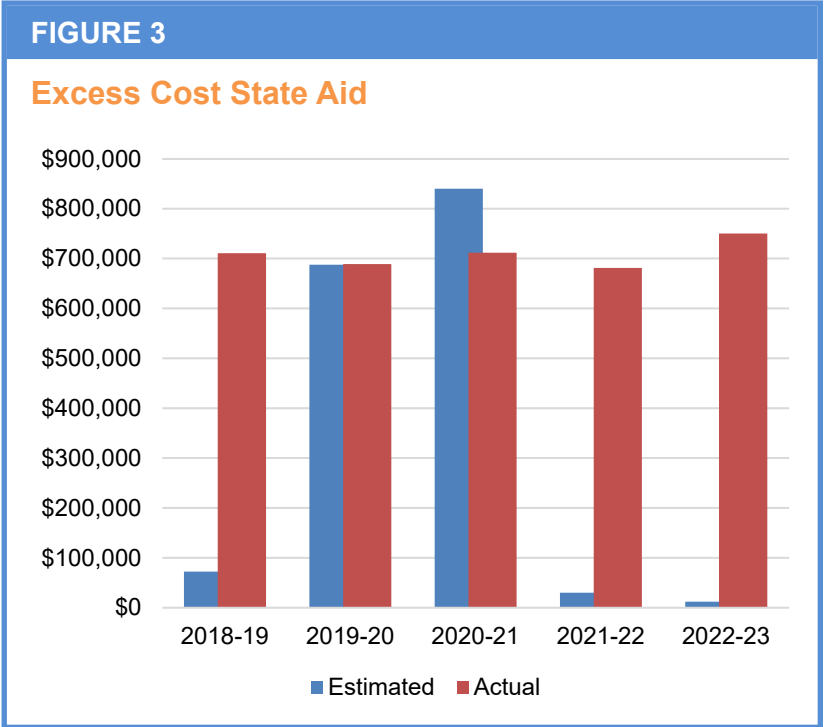
The Assistant Superintendent stated that the District appropriated fund balance to lower the tax levy and give back to the taxpayers. The Assistant Superintendent also stated that money left over was used to fund reserves, so the District did not have to raise taxes to fund reserves. However, because the District appropriated fund balance that was not used to fund operations, the taxpayers were taxed more than necessary.

To determine why none of the appropriated fund balance was used to fund operations over the past five years, we compared estimated revenues and appropriations to actual revenues and expenditures from 2018-19 through 2022-23. While total estimates and actual results for revenues and expenditures did not vary significantly, the District routinely underestimates certain revenue accounts and overestimates certain expenditure accounts. As a result, operating surpluses are realized each year instead of the District incurring its planned operating deficits, and none of the appropriated fund balance is actually used. For example, for the past five years, the revenue for Native American State Aid exceeded the estimated amounts. The District estimated that Native American State Aid would be \$3.4 million in 2020-21 but actually received \$4.8 million, an underestimation of \$1.4 million (Figure 2). The Assistant Superintendent indicated that the Native American State Aid was underestimated because it is based on student enrollment in the District, which is difficult to project, so he estimates conservatively to ensure the District is not short on revenue. However, the Native American State Aid has been relatively consistent over the past five years, while the estimates for this aid have not been consistent. We did notice the estimate for 2022-23 was increased and more reasonable than it had been in the two previous years.



Furthermore, District officials estimated that excess cost State Aid would be \$11,864 in 2022-23, but actually received \$750,261, an underestimation of \$738,397 (Figure 3). The Assistant Superintendent said the excess cost State Aid is also difficult to project and he would rather underestimate the value than overestimate it. However, the excess cost aid has held steady in recent years and District officials had made more reasonable estimates in 2019-20 and 2020-21 before substantially dropping the revenue estimates to unreasonable levels in 2021-22 and 2022-23. Had District officials used historical trends to estimate both the Native American and excess cost State Aid estimates, they would have established estimates more closely aligned with what was actually received.

Consistently overestimated expenditures from 2018-19 through 2022-23 included health insurance (\$2.6 million), social security (\$2.5 million), and Board of Cooperative Educational Services (BOCES) services (\$1.2 million). For example, the District budgeted \$8.6 million for health insurance expenditures in 2019-20, but spent only \$7.9 million, a variance of approximately \$700,000. Additionally, District officials budgeted \$8.7 million for health insurance expenditures in 2021-22, but spent only \$8.0 million, a variance of approximately \$700,000. The amount budgeted for health insurance in 2022-23 was more reasonable than it had been in prior years.



The Assistant Superintendent said that prior officials overestimated these expenditures before he started working for the District and he continued to use the same budget estimates during our audit period. He indicated that the social security and health insurance budgets were overestimated because the District wanted appropriations available if funds were needed for unforeseen circumstances. He also said that estimating the BOCES budget was difficult because when officials determine the projections, they are unsure how many students will be attending BOCES programs. The Superintendent also indicated that many students did not utilize BOCES services during our audit period due to the COVID-19 pandemic. However, this appropriation was overestimated in multiple years, including years prior and subsequent to the pandemic.

Had District officials used historical trends and included more reasonable budgetary estimates for all revenue and expenditure accounts, the District would have been able to reduce property taxes and actually use the fund balance it appropriated to finance operations.

How Should Reserve Funds Be Managed?

Districts may establish reserves to restrict a reasonable portion of fund balance for a specific purpose, in compliance with statutory directives. Reserves should be established, funded and disbursed in accordance with the applicable statutes governing different types of reserves. A board should adopt a written reserve policy or plan that communicates to taxpayers why money is being set aside, the board's financial objectives for the reserves, optimal funding levels, and conditions under which the assets will be utilized. In addition, a board should include provisions to fund and use reserves in budgets that are voted on by taxpayers to help ensure the amounts reserved are necessary and provide transparency to the taxpayers. Reserves should be maintained at reasonable levels to ensure real property tax levies are not higher than necessary. Maintaining higher than necessary reserve fund balances is a missed opportunity to lower the property tax burden and restricts funds from being used to fund operations.

Reserves Were Not Established by Board Resolution and Were Overfunded

The Board and District officials did not develop and adopt a reserve policy or plan detailing the objective of reserves or optimal funding levels. The District had 11 reserves with balances totaling \$23.1 million as of June 30, 2023. These included:

- Four capital reserves (bus, property, ten year and technology) totaling \$12.6 million,
- An employee benefit accrued liability reserve (EBALR) totaling \$5.3 million,
- A repair reserve totaling \$2.0 million,
- A teachers' retirement contribution reserve totaling \$1.3 million,
- An employee retirement contribution reserve totaling \$1.0 million,
- A workers' compensation reserve totaling \$406,425,
- An insurance reserve totaling \$364,384, and
- An unemployment reserve totaling \$198,943.

District officials provided Board resolutions establishing five of the reserves, including the teachers' retirement contribution reserve and four capital reserves. However, the Board resolution for the teachers' retirement contribution reserve did not establish the conditions under which the reserve should be used, or explain the reserve's optimal funding level. Further, the Board resolution funding the teachers' retirement contribution reserve did not indicate how the District calculated the amount they restricted in the reserve or how they established the amount was at a reasonable level to ensure real property tax levies are not higher than necessary.

We could not determine whether the Board properly established the remaining six reserves, as District officials could not provide Board resolutions establishing the workers' compensation reserve, unemployment insurance reserve, employee retirement contribution reserve, insurance reserve, EBALR and the repair reserve. The Assistant Superintendent said that the District could not easily locate Board

resolutions that predate the use of BoardDocs,² which the District started using in 2008. However, the Assistant Superintendent told us that the workers' compensation reserve was established around June 2017, which is almost 10 years after the date the District started using BoardDocs. The District Clerk said the resolution establishing the workers' compensation reserve could not be found.

Additionally, because officials could not provide resolutions establishing the six reserves and the resolution establishing the teachers' retirement contribution reserve is vague, there were no guidelines for their funding levels. The Assistant Superintendent could not explain the basis for the balances in these seven reserves. He told us that the reserve amounts are determined depending upon the District's surplus fund balance, which he discusses with the audit committee and they decide where to put surplus money after determining the 4 percent surplus that they can legally retain unrestricted. The Assistant Superintendent said he provided a memo to the Board each year for their approval that included how much money was being allocated to each reserve based on the surplus fund balance. However, simply transferring surplus fund balance to reserves is neither reasonable nor transparent to the taxpayers, and amounts transferred to reserves should instead be based on needs and reasonableness in consideration of the purpose and planned use of the reserves.

A repair reserve is permitted for repairs of capital improvements or equipment that are not reoccurring annually or at shorter intervals. Because District officials did not have support for the establishment of the repair reserve, the initial approved amount to fund this reserve was unknown and there was no basis to explain the balance in this reserve. Therefore, we question the reasonableness of the repair reserve balance of \$2.0 million as of June 30, 2023. Given that the District has no clear objective or intent regarding the future purpose and use for this reserve, we conclude that it may have been overfunded.

An EBALR is permitted to be used for the payment of accrued and unused sick, vacation and certain other leave to employees upon separation from service and expenditures related to the reserve's administration. The EBALR had a balance of \$5.3 million as of June 30, 2023. However, the District's compensated absences payable totaled \$4.7 million as of June 30, 2023, approximately \$600,000 less than the reserve balance. Therefore, this reserve was overfunded.

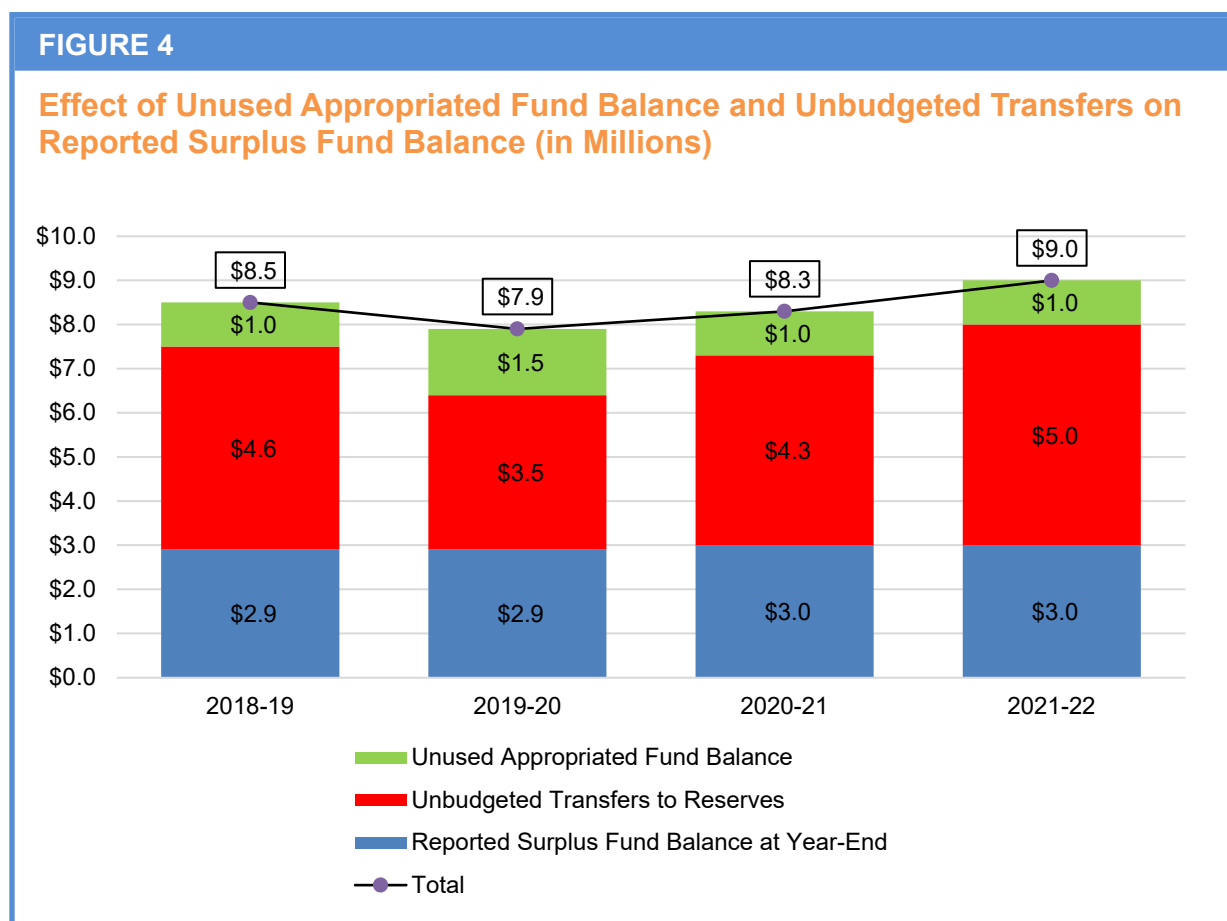
An unemployment insurance reserve is permitted to be used to pay into the unemployment insurance fund an amount equivalent to the amount of benefits paid to claimants and charged to the account of a district. The District's average annual unemployment insurance expense over the five years reviewed was \$17,494. However, the District did not use any of this reserve fund's proceeds for unemployment insurance payments between July 1, 2018 and June 30, 2023; the District instead made the payments from general fund's operating proceeds. The unemployment insurance reserve balance was \$198,943 as of June 30, 2023, which could pay the average annual unemployment insurance expense for more than 11 years. As such, this reserve was overfunded.

While it is prudent to provide for unforeseen circumstances, without Board resolutions establishing reserves or a reserve policy or plan, there is no assurance that reserves are necessary and reasonably funded, and that resources are being used in the most efficient manner. Furthermore, overfunding reserves results in real property taxes being higher than necessary because the funds are not being used to fund operations.

² BoardDocs is software used by the District to document and publicize Board meeting agendas, Board meeting minutes and District policies.

The Board Made Unbudgeted Transfers to Reserves

The District's Board-adopted budgets did not include provisions to fund reserves for each year during our audit period. Instead, District officials made year-end unbudgeted transfers to reserves totaling \$21.6 million from 2018-19 through 2022-23. We reviewed the effect of the unbudgeted transfers on the District's reported surplus balance. We determined that the District reported the surplus fund balance at 4 percent, which complied with RPTL Section 1318, from 2018-19 through 2021-22. However, this was achieved, in part, by making year-end unbudgeted transfers. Prior to making these transfers, the year-end surplus fund balance ranged from 10.8 percent to 12 percent of the upcoming year's budget, which exceeded the allowable fund balance level (Figure 4).



Instead of including funding for reserves in the annual budgets, District officials transferred money, at the end of the fiscal year, to reserve funds from operating surpluses generated by their budgets containing the unreasonable estimates for certain accounts previously discussed in this report, which allowed the District to stay within the statutory surplus fund balance limit. The Assistant Superintendent indicated that budgeting money to fund reserves would be putting a burden on taxpayers, and that the District's practice of unbudgeted reserve transfers were proper. However, the District's current practice is misleading and lacks transparency. It would not be putting a burden on the taxpayers if the estimates

for all revenues and expenditures were reasonable; the District could discontinue its practice of making unreasonable estimates for certain accounts and instead make reasonable estimates to transfer only what it determined as a reasonable amount to reserves. Transferring the surpluses at year-end that result from unreasonable budgetary practices leads to excessive levels in the reserves and is not in the best interest of the District's taxpayers.

What Do We Recommend?

The Board should:

1. Ensure adopted budgets include realistic estimates for revenues and appropriations.
2. Ensure that all reserve funds are established by Board resolution.
3. Ensure reserve fund balances are necessary and reasonable, and use any excess funds identified to benefit residents in accordance with statutory requirements.
4. Develop and adopt a reserve policy or plan.
5. Include provisions to fund reserves in budgets to ensure transparency to taxpayers.

Appendix A: Response From District Officials



SOUTHAMPTON UNION FREE SCHOOL DISTRICT DISTRICT ADMINISTRATION

Fatima Morrell, Ed.D.
Superintendent of Schools

Jean E. Mingot, *Assistant Superintendent for Business*
Jaime Bottcher, Ed.D., *Assistant Superintendent for Curriculum and Instruction*

September 19, 2024

Subject: Response to Audit Report Recommendations

To the Office of the State Comptroller:

I am writing in response to the recent draft audit report and the recommendations provided to the Southampton UFSD. Please see our response to each of the recommendations below:

1. Ensure adopted budgets include realistic estimates for revenues and appropriations.

We acknowledge this recommendation and will work to improve our budgeting process to ensure revenue and appropriation estimates are as accurate as possible. Going forward, we will implement additional review procedures to validate budget assumptions and projections before finalizing the adopted budget. In completing your final audit report, we would like to recommend you take the following factors into consideration:

- The Southampton UFSD is funded primarily by the taxpayers to the tune of 80%. Furthermore, an additional 14 to 15 percent of our budget derives from tuition revenue. State Aid only accounts for 4-5% of our total budget.
- All budgets for the years were under the state 2% tax cap limit
- Multiple public presentations of each budget in detail were done at board meetings to give the general public opportunities to comment and voice their objections
- The board is always kept informed of the district finances. The Audit and Finance Committee meets at least once a month. Members of that committee receive and review all of the district's financial documents for vetting before those reports are submitted for the board's approval.
- Appropriated fund balances were used to fund operations and so did our reverses every year.
- Revenues are not intentionally underestimated. A significant portion of our revenue (10-12 percent) is tuition dependent. The tuition is on a per-student basis, and the budget is prepared several months before the district is able to confirm how many students will be in attendance in September, therefore the tuition revenue is an estimate, and it fluctuates from year to year. The Native American Aid is also hard to predict because the rates, established by the state, change from year to year. We typically don't receive the final NA rates until late March or early April of the school year. Other neighboring districts send students to Southampton for special ed services, their counts vary year to year. Consequently, those are some of the many mitigating factors that contribute to the revenue projections not lining up with the actuals.

See
Note 1
Page 11

See
Note 2
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ANCHORING THE COMMUNITY

2. Ensure that all reserve funds are established by Board resolution.

We agree with this recommendation. All reserve funds will be formally established through Board resolution to ensure proper oversight and governance.

3. Ensure reserve fund balances are necessary and reasonable, and use any excess funds identified to benefit residents in accordance with statutory requirements.

We will review our current reserve fund balances to ensure they are necessary and reasonable. Any identified excess funds will be utilized to directly benefit our students and community in alignment with all applicable laws and regulations.

4. Develop and adopt a reserve policy or plan.

We will develop and adopt a comprehensive reserve policy or plan that outlines the purpose, funding levels, and appropriate use of each reserve fund maintained by the school district. This policy will provide greater transparency and accountability.

5. Include provisions to fund reserves in budgets to ensure transparency to taxpayers.

We will incorporate reserve funding into our annual budget development process. This will ensure the community has visibility into the district's efforts to adequately fund important financial reserves.

Thank you for your time and consideration of this response. We are committed to addressing these audit recommendations and continuously improving our financial management practices. Please let me know if you have any further questions or need additional information.

Sincerely,

Jacqueline Robinson
Board President
Southampton Union Free School District

Appendix B: OSC Comments on the District's Response

Note 1

The Board appropriated a total of \$5.3 million of fund balance as a financing source over the five years reviewed, thereby implying it was planning for annual operating deficits equal to the fund balance appropriated. However, instead of incurring operating deficits, the District realized operating surpluses totaling \$22.1 million over the five years, or \$27.4 million more than planned, and did not use any of the \$5.3 million of appropriated fund balance. The District then made year-end unbudgeted transfers to reserves totaling \$21.6 million from the surplus fund balance.

Note 2

The Native American State Aid has been relatively consistent over the past five years, averaging \$4.8 million annually, but District officials did not use these historical trends when estimating this aid. Over the same period, officials annually estimated, on average, \$3.9 million, resulting in estimates that were consistently lower than what was received (see Figure 2).

Appendix C: Audit Methodology and Standards

We conducted this audit 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. We obtained an understanding of internal controls that we deemed significant within the context of the audit objective and assessed those controls. Information related to the scope of our work on internal controls, as well as the work performed in our audit procedures to achieve the audit objective and obtain valid audit evidence, included the following:

- We interviewed Board members and District officials and reviewed Board meeting minutes, resolutions and policies to gain an understanding of the District's financial management policies, procedures and budgeting practices.
- We analyzed general fund financial records for fiscal years 2018-19 through 2022-23 to identify trends in operating results and fund balance.
- We reviewed the adopted general fund budgets for fiscal years 2018-19 through 2022-23 to determine whether they were reasonable and structurally balanced by comparing adopted budgets with actual results of operations and analyzing significant budget-to-actual variances.
- We inquired about and reviewed Board resolutions establishing District reserves to determine whether the reserves were properly established.
- We reviewed reserve fund balances from 2018-2019 through 2022-23 to understand the trends and assess whether they were reasonably funded.
- We reviewed increases and decreases made to District reserves in fiscal years 2018-19 through 2022-23 to determine why money was being moved and whether the activity was authorized.
- We reviewed adopted general fund budgets to determine whether budgets for fiscal years 2018-19 through 2022-23 included provisions to fund reserves, whether property tax report cards were appended, and the effect of unbudgeted transfers on reported surplus fund balance.
- We compared the District's restricted cash balance to the total reserve balance to confirm that the District had sufficient cash compared to the restricted fund balance.

We conducted this performance audit in accordance with generally accepted government auditing standards (GAGAS). Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

Unless otherwise indicated in this report, samples for testing were selected based on professional judgment, as it was not the intent to project the results onto the entire population. Where applicable, information is presented concerning the value and/or size of the relevant population and the sample selected for examination.

The Board has the responsibility to initiate corrective action. 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, 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. 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 CAP should be posted on the District's website for public review.

Appendix D: Resources and Services

Regional Office Directory

www.osc.ny.gov/files/local-government/pdf/regional-directory.pdf

Cost-Saving Ideas – Resources, advice and assistance on cost-saving ideas

www.osc.ny.gov/local-government/publications

Fiscal Stress Monitoring – Resources for local government officials experiencing fiscal problems

www.osc.ny.gov/local-government/fiscal-monitoring

Local Government Management Guides – Series of publications that include technical information and suggested practices for local government management

www.osc.ny.gov/local-government/publications

Planning and Budgeting Guides – Resources for developing multiyear financial, capital, strategic and other plans

www.osc.ny.gov/local-government/resources/planning-resources

Protecting Sensitive Data and Other Local Government Assets – A non-technical cybersecurity guide for local government leaders

www.osc.ny.gov/files/local-government/publications/pdf/cyber-security-guide.pdf

Required Reporting – Information and resources for reports and forms that are filed with the Office of the State Comptroller

www.osc.ny.gov/local-government/required-reporting

Research Reports/Publications – Reports on major policy issues facing local governments and State policy-makers

www.osc.ny.gov/local-government/publications

Training – Resources for local government officials on in-person and online training opportunities on a wide range of topics

www.osc.ny.gov/local-government/academy

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