



**Sullivan West  
Central School District  
Planning for the District  
Merger and Business Office  
Internal Controls  
Report of Examination**

Period Covered:

July 1, 2003 - June 8, 2005

2006M-50



ALAN G. HEVESI

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# State of New York Office of the State Comptroller

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## Division of Local Government Services and Economic Development

October 2006

Dear School District Officials:

One of the Office of the State Comptroller's top priorities is to identify areas where school districts can improve their operations and provide guidance and services that will assist school district officials in making those improvements. Further objectives are to develop and promote short-term and long-term strategies to enable and encourage school district officials to reduce costs, improve service delivery and to account for and protect their school districts' assets.

The reports issued by this Office are an important component in accomplishing these objectives. These reports are expected to be a resource and are designed to identify current and emerging fiscally related problems and provide recommendations for improvement. The following is our report on the Sullivan West Central School District — Planning for the District Merger and Business Office Internal Controls.

This audit was conducted pursuant to the State Comptroller's authority as set forth in Article V, Section 1 of the State Constitution, and Article 3 of the General Municipal Law. The report contains opportunities for improvement for consideration by school district officials.

If we can be of assistance to you or if you have any questions concerning this report, please feel free to contact the local regional office for your county listed at the back of this report.

Respectfully submitted,

*Office of the State Comptroller  
Division of Local Government Services  
and Economic Development*



## State of New York Office of the State Comptroller

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# EXECUTIVE SUMMARY

The Sullivan West Central School District (District) is governed by the Board of Education (Board) which comprises nine elected members. The Board is responsible for the general management and control of the District's financial and educational affairs. The Superintendent of Schools (Superintendent) is the chief executive officer of the District and is responsible, along with other administrative staff, for the day-to-day management of the District under the direction of the Board.

The District was formed in July 1999 by the merger of the Narrowsburg, Jeffersonville-Youngsville, and Delaware Valley central school districts. Since the time of the merger, the District has experienced declining pupil enrollment. Before the merger, the combined pupil enrollment for all three districts in 1997 was 1,721 pupils, while six years after the merger the District had 1,468 pupils attending school during the fall of 2005. However, according to a 1998 merger study, declining and/or stable pupil enrollment was expected. In June 2005, the Board approved the closing of the Narrowsburg and Delaware Valley school buildings and laid off 44 employees due to declining pupil enrollment and the need to control expenditures, because of the District's declining financial condition. Notwithstanding the Board's actions, District taxpayers were still faced with an 18.72 percent increase in the tax levy for the 2005-06 school year.

### **Scope and Objectives**

The objective of our audit was to determine if District officials had established an adequate control environment and internal control system to ensure that their goals and objectives relating to the short- and long-term financial and operational needs of the District would be achieved. Our audit addressed the following related questions for the period July 1, 2003 to June 8, 2005:

- Did the Board develop, institute and monitor comprehensive short- and long-term strategic operating plans at the time of the merger, or thereafter, to assist them in making informed decisions relating to the financial and operational needs of the District?
- Were internal controls designed and operating effectively over cash receipts and disbursements, purchasing, and capital assets?

We extended our audit period to 2002 to include a review of a payment to a former business manager. Our audit also addressed various taxpayer complaints received by our Office which are discussed in Appendix A.

## **Audit Results**

Because District officials failed to adopt a comprehensive strategic plan, they mismanaged the merger and wasted millions of taxpayer dollars. From before the merger to the release of this report, the Board did not adopt a plan to identify and address the District's financial, educational, managerial, and personnel issues. A clear example of District officials' mismanagement of the merger is that they were aware that building occupancy levels would obviously decline dramatically when they moved pupils in Grades 7 to 12 out of the Delaware Valley and Narrowsburg schools and into the new high school (Grades 9 to 12) and the Jeffersonville-Youngsville school building (Grades 7 to 8). However, they did not have a plan to address what financial impact this would have on the District. Consequently, their decision to renovate the Delaware Valley and Narrowsburg school buildings — which they later closed because they did not properly address building occupancy levels and declining pupil enrollment — resulted in their wasting \$12.5 million in taxpayer dollars.

District officials submitted materials to SED that showed they knew that they would receive only 75 percent of the capital project costs in State building aid.<sup>1</sup> However, District officials allowed taxpayers to think that this State funding would cover 95 percent of the costs of the District's capital projects. Because District officials did not have an ongoing comprehensive plan, they did not have a financial plan to cover the additional capital project costs that they knew would not be covered by the State building aid.

Without a comprehensive strategic plan in place, District officials also failed to address actual and projected staffing levels. Consequently, when total staffing levels increased after the merger, the District was unable to realize approximately \$2.1 million in savings due to economies of scale that were identified in the merger study.

District officials also did not properly plan for pupils-per-class levels. For example, the District had six kindergarten classes in the fall of 2004. Two of these classes had 10 pupils each, two classes had 16 pupils each, and the other two classes had 17 and 18 pupils, respectively. If District officials had combined these kindergarten classes into five different classes with approximately 17 pupils per class, the District would have been able to eliminate one kindergarten class, which would have allowed the District to achieve approximately \$75,000 in savings.

We also found that the District's system of internal controls were inadequate in the areas of segregation of the Treasurer's duties, purchasing, and capital assets. The Treasurer's duties regarding safeguarding cash and recording financial transactions did not provide a good set of checks and balances to protect taxpayer moneys. We found instances where District personnel did not comply with the procurement policy, and the purchasing agent was able to approve his own requisitions without any additional supervisory approval. Also, the Board did not enforce the requirements of its adopted capital assets policy.

Lastly, in 2002, the Board improperly paid \$8,400 to a former business manager for unused vacation time.

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<sup>1</sup> Charles Szuberla, Coordinator of SED's Office of School Operations and Management Services, made this statement in a September 8, 2005 letter to Superintendent Alan Derry.

### **Comments of District Officials**

The results of our audit and recommendations have been discussed with District officials and their comments, which appear in Appendix B, have been considered in preparing this report.

# Introduction

## Background

The Sullivan West Central School District (District) is located in eight towns and operates schools in the Towns of Callicoon and Cohecton, which are located in Sullivan County. The District is governed by the Board of Education (Board) which comprises nine elected members. The Board is responsible for the general management and control of the District's financial and educational affairs. The Superintendent of Schools (Superintendent) is the chief executive officer of the District and is responsible, along with other administrative staff, for the day-to-day management of the District under the direction of the Board. The District operates two schools, with approximately 1,468 pupils and 205 employees. The District's budgeted expenditures for the 2005-06 fiscal year are \$29 million, funded primarily with State aid, real property taxes and grants.

The District was formed in July 1999 by the merger of the Narrowsburg, Jeffersonville–Youngsville, and Delaware Valley Central School Districts. An independent consultant performed a merger study in 1998 which identified the projected advantages and disadvantages of consolidating these three school districts into a single school district. One of the primary advantages identified in the study was improved education. In May 1998, voters of the Jeffersonville-Youngsville and Narrowsburg Central School Districts approved the consolidation, while voters in the Delaware Valley Central School District did not. The Delaware Valley District held a revote in June 1999 and voters then approved the merger.

In June 2000, as part of the merger plans, voters approved a bond issue for \$49,938,453 for capital projects relating to the construction of a new high school and renovations to existing school buildings. The combined District opened the new high school in September 2003, even though the capital project was not completed. In fact, the new high school is currently still not completed.<sup>2</sup> Contractors completed the renovations to buildings in the former Narrowsburg District, but the renovations projects for buildings in the former Jefferson-Youngsville and Delaware Valley Districts are still underway. As of June 30, 2005, District officials have expended \$49,739,412 (99.6 percent) of the bond proceeds.

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<sup>2</sup> The District is currently in litigation with the architect and the site improvement contractor regarding issues with the construction and completion of the high school project.

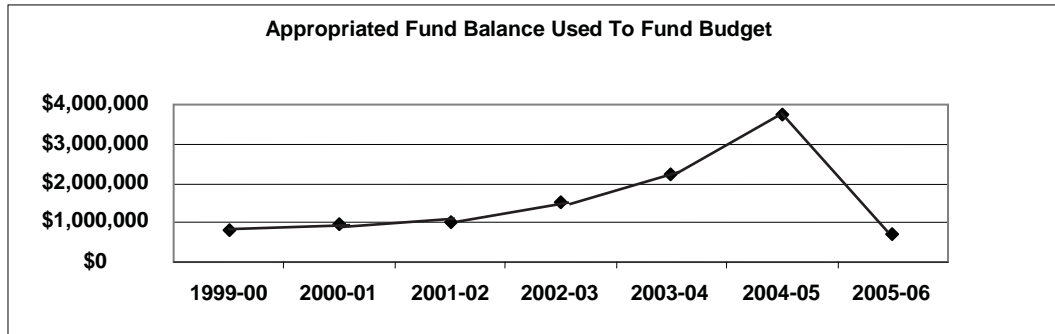
Since the time of the merger, the District has experienced declining pupil enrollment. Before the merger, the combined pupil enrollment for all three districts in 1997 was 1,721 pupils, while six years after the merger the District had 1,468 pupils attending school during the fall of 2005. However, according to the 1998 merger study, declining and/or stable pupil enrollment was expected. In June 2005, the Board approved the closing of the Narrowsburg and Delaware Valley school buildings due to declining pupil enrollment and the need to control expenditures. As of the release of this report, the District still has not completed the renovations in the Delaware Valley school building. Also, the District laid off 44 employees in June 2005 due to related economic reasons.

The District's financial condition has changed significantly over the past several years. During the past five years, reported expenditures have increased by 45 percent while revenues have only increased by 24 percent. In 2003-04, expenditures increased by 18 percent alone from the prior fiscal year primarily due to the costs of opening the new high school and contracting for busing service, which started in 2003. Other significant increases in expenditures were for the Employee and Teacher Retirement systems, because the District decided to prepay the liability owed to these retirement systems instead of amortizing the existing unpaid amounts over a period of 17 years. Further, employee health insurance costs continue to rise.

In addition, there have been significant changes in the District's revenues. For example, the District's share of Reorganization Incentive Aid (operating aid) declined, because in the first five years after the merger the District received an additional 40 percent operating aid over and above what the three former districts would have received had they not merged. Starting with the sixth year after the merger (in this case, 2004-05), this aid is annually reduced by 4 percent compounded for the next nine years until it is completely eliminated in the 15th year. The following chart shows total District revenues and expenditures over the past five years.

	2000-01	2001-02	2002-03	2003-04	2004-05
<b>Revenues</b>	\$21,446,496	\$20,510,631	\$26,148,907	\$25,963,064	\$26,630,604
<b>Expenditures</b>	\$20,392,895	\$22,719,388	\$23,279,479	\$27,483,707	\$29,557,043

Further, the annual use of unreserved fund balances to help fund the next years' budgets has also affected the District's current financial position. While District officials have annually appropriated unreserved fund balances to fund the next years' budgets in increasing amounts, the amount appropriated to the 2005-06 fiscal year reversed this trend as shown below:



The amount of fund balance available to fund the 2005-06 fiscal year was significantly less than previous years because District officials had been required to reduce the amount of unreserved, unappropriated fund balance to no more than 2 percent of the next year's budget to comply with statutory provisions of Real Property Tax Law.<sup>3</sup> In 2003, Board Member Arthur Norden and a District resident petitioned the Commissioner of the State Education Department (SED) alleging that the District improperly retained surplus funds in the 2003-04 school year, which led to the District having an unexpended, unreserved fund balance in excess of 2 percent of its operating budget. The Commissioner ordered the District to fully comply with the law and approve tax warrants in strict compliance with statutory requirements. District officials complied with the Commissioner's decision by appropriating \$3,725,000 of their estimated available fund balance at fiscal year end 2003-04 to reduce the tax levy for the 2004-05 year. District officials also used fund balance to pay down the District's debt by \$1.5 million. These actions brought the District's unreserved, unappropriated fund balance to \$446,788 at the close of the 2003-04 fiscal year. While District officials' actions to reduce excessive fund balance brought the District into compliance with statutory requirements, it eliminated the fund balance that they had been using in previous years as a funding source for operations. This funding source then had to be replaced by property taxes. This was partially the reason why District taxpayers were faced with an 18.72 percent increase in the tax levy for the 2005-06 school year.

<sup>3</sup> Real Property Tax Law, Section 1318

Our Office, along with Assemblywoman Aileen Gunther (who represents taxpayers in the Sullivan West District) and SED officials, received a number of complaints from District residents regarding the outcome of the merger of the three former school districts and the closing of the former Delaware Valley and Narrowsburg districts' school buildings. As a proactive response, Assemblywoman Gunther asked us to audit the District, and she obtained \$50,000 in funding for the District to hire an independent consultant to develop a three-to-five-year financial plan. Also, SED officials met with District officials and concerned residents in August 2005 to address their complaints. SED officials recommended that the Board use the moneys provided by Assemblywoman Gunther to conduct a full independent study of the merger, school budgeting decisions, the school closures, and the role played in these areas by District management and SED officials.

## **Objectives**

The objective of our audit was to determine whether District officials had established an adequate control environment and internal control system to ensure that their goals and objectives relating to the short- and long-term financial and operational needs of the District would be achieved. Our audit addressed the following related questions:

- Did the Board develop, institute and monitor comprehensive short- and long-term operating plans at the time of the merger, or thereafter, to assist them in making informed decisions relating to the financial and operational needs of the District?
- Were internal controls designed and operating effectively over cash receipts and disbursements, purchasing, and capital assets?

Our audit also addressed various taxpayer complaints received by our Office which are discussed in Appendix A.

## **Scope and Methodology**

We examined the District's control environment and internal control systems for the period July 1, 2003 to June 8, 2005. We extended our audit period to 2002 to include a review of a payment to a former business manager.

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 B, have been considered in preparing this report.

The Board has the responsibility to initiate corrective action. Pursuant to Section 35 of the General Municipal Law, the Board should prepare a plan of action that addresses the recommendations in this report and forward the plan to our office within 90 days. For guidance in preparing the plan of action, the Board may refer to applicable sections in the publication issued by the Office of the State Comptroller entitled *Local Government Management Guide*. For guidance in developing an on-going comprehensive strategic plan, District officials should refer to two modules contained within the guide: “Multiyear Financial Planning,” and “Multiyear Capital Plans.” We encourage the Board to make this plan available for public review in the District Clerk’s office.

## Lack of a Comprehensive Strategic Plan

One of the ways that District officials can ensure that they are properly overseeing District operations is through establishing an on-going, comprehensive strategic plan that addresses financial, educational, managerial, and personnel issues. A strategic plan becomes particularly important when Districts merge or when they are contemplating a merger.

As part of an on-going, comprehensive strategic plan, District officials should set short- and long-term goals and objectives, develop strategies to accomplish them, and define performance measures to help ensure that those goals and objectives are achieved. Such goals and objectives should include reasonable projections of revenue and expenditure flows, student enrollment, required staffing levels, teacher-pupil ratios, and appropriate facilities usage. District officials should routinely compare actual outcomes to set goals and objectives, and modify their strategies to address any deviations found.

It also is important for District officials to develop and monitor financial plans on a routine basis, and to update those plans on at least a yearly basis to reflect actual trends in fiscal operations. To develop long-term financial plans, District officials must perform multiyear planning to assess revenue trends, expenditure commitments, financial risks, and the affordability of new services and capital investments. Financial planning becomes even more critical when the District's overall financial position is declining. As part of multiyear planning, District officials should address deviations in revenue projections, including such items as changes in State aid allocations based on declining enrollment and the impact this would have on local real property taxes. When creating expenditure projections, District officials need to address issues such as inflationary cost increases in employee salaries and benefits, pupil transportation, and building use and maintenance costs. Effective multiyear planning also includes strategies to promote fiscal health.

During our audit we found that District officials had not adopted a comprehensive strategic plan at the time of the merger nor throughout our audit period. In fact, the only kind of plan we found was a "Long Term Financial Report" prepared by financial consultants from the New York State School Boards Association in June 2004 — five years after the merger took place. Even after District officials had this financial plan in hand, they still did not implement the recommendations in that report due to changes in the District's financial condition after the report was issued.

Although the District has had numerous changes in key management personnel since the merger,<sup>4</sup> the Board should have developed and implemented a comprehensive plan to identify and address the District's financial, educational, managerial, and personnel issues. Over the past several years, District officials have been faced with many issues relating to the merger and the closing of the two school buildings, but they have addressed these issues only in a reactive way. If District officials had a comprehensive strategic plan in place, they could have addressed at least some of these issues proactively, such as staffing levels and class sizes, and saved taxpayers approximately \$12.5 million in building renovation costs, and \$2.1 million in staffing costs.

### **Declining Enrollment and School Closings**

As a result of the merger and declining student enrollment, the District went from operating three school buildings in 1999<sup>5</sup> to operating four school buildings (which included the new high school) in 2003. In the fall of 2003, all high school pupils (Grades 9 through 12) were moved to the new high school, and all junior high school pupils (Grades 7 and 8) were moved to the Jeffersonville-Youngsville school building. As a result of the movement of pupils and declining enrollments, building occupancy levels at the Delaware Valley and Narrowsburg schools went from 79 percent and 64 percent, respectively, before the merger, to 28 percent and 27 percent,<sup>6</sup> respectively – which was an average decline in occupancy levels of more than 46 percent.

Although District officials knew that they would be moving pupils in Grades 7 through 12 out of the Delaware Valley and Narrowsburg schools, they still spent \$12.5 million (approximately 25 percent of the building construction and renovations bond issue) for renovations in these schools. In addition, District officials also knew – due to a 1998 merger study and a Facilities Needs Assessment Summary<sup>7</sup> submitted to SED – that the District's total pupil enrollment levels would be stable or decline.

As a result of declining enrollment and growing financial problems, District officials closed the Delaware Valley and Narrowsburg schools in June 2005. If District officials had an ongoing comprehensive

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<sup>4</sup> Since the merger in July 1999, the District has had three Superintendents, six Business Managers and four District Treasurers.

<sup>5</sup> Each of the three buildings housed Kindergarten through Grade 12 pupils and were located in the former Narrowsburg, Delaware Valley, and Jeffersonville-Youngsville school districts.

<sup>6</sup> These 28 percent and 27 percent building occupancy levels occurred during the fall of 2004.

<sup>7</sup> When a District decides to add new or expand existing educational facilities, it must file a Facilities Needs Assessment Summary form with SED.

plan, they could have identified building use and occupancy levels on a timely basis, and they could have identified and addressed any potential financial stress and the impact it would have had on the costs of keeping the schools open. Specifically, District officials should have had a plan to address occupancy levels in the Delaware Valley and Narrowsburg schools, because they knew the occupancy levels would significantly decline when they moved pupils in Grades 7 to 12 to the new high school and the Jeffersonville-Youngsville school building. This planning would have allowed District officials to look for possible alternatives to closing the two school buildings that had cost the District a considerable amount to renovate. In this case, comprehensive planning may have saved District taxpayers \$12.5 million in renovation costs of the two schools.

**Merger Savings – Staffing**

The report on the merger study prepared in 1998 indicated that school districts that merge can potentially realize savings due to economies of scale. Further, the report stated “precise cost savings measures are difficult to predict because the Board of Education and administration of a newly merged district would need to make many decisions as to organizational matters, staffing, etc. which are unknown at present.”

The District’s total staffing levels (which include professional staff, teaching assistants, paraprofessional staff and support staff) decreased the year of the merger. However, total staffing levels were higher than before the merger for at least three years after the merger. Total staffing levels from 1998 (before the merger) through the fall of 2005 were as follows:

	Fall 1998 (Pre-Merger)	Fall 1999	Fall 2000	Fall 2001	Fall 2002	Fall 2003	Fall 2004	Fall 2005
<b>Total Staff</b>	<b>275.5</b>	<b>265</b>	<b>280.3</b>	<b>277</b>	<b>281</b>	<b>274</b>	<b>241.5</b>	<b>205.5</b>

Because District officials did not have an on-going comprehensive strategic plan in place that addressed actual and projected staffing levels, they were unable to realize approximately \$2.1 million in savings due to economies of scale that were identified in the merger study. If staff levels after the merger had remained consistent with staff levels at the time of the merger, the District would have been able to save the cost of at least 12 positions.<sup>8</sup> The estimated cost of these 12 positions including employee benefits would have been approximately \$700,000 each year for three years following the merger (2002, 2003, and 2004), for a total potential savings of \$2.1 million. In June 2005, the Board initially did abolish 44 positions because of financial problems and to achieve efficiencies in District

<sup>8</sup> The District had 265 staff members at the time of the merger. In the three years after the merger, staffing was anywhere from 12 positions (277 in 2001) to 16 positions (281 in 2002) more than staffing levels at the time of the merger.

programs. However, at the same time, they also hired some additional staff which created a net decrease of 36 positions for the District. Overall, the District saved about \$2.2 million by eliminating these 36 positions.

Without a comprehensive strategic plan in place, District officials did not plan for economies of scale within the District's staffing levels, causing the District to miss approximately \$2.1 million in savings that were identified in the merger study.

### **Pupil Enrollment Per Class**

Information contained in the 1999 school improvement study implied that the District could achieve savings as a result of the merger by having more pupils per class. The study stated that "if a 20 pupil per kindergarten class policy were in effect there would be fewer teachers for the same number of children for the same period of time." The report also stated "it could be anticipated that similar economies would be realized at the junior-senior high school level." Because District officials did not adequately plan for the merger, they did not properly adjust class sizes to accommodate declining pupil enrollment. This faulty planning led to the District failing to achieve savings as a result of the merger.

For example, the District had 87 kindergarten pupils in six different classes in the fall of 2004. Two of these six classes had 10 pupils each, two classes had 16 pupils each and the other two classes had 17 and 18 pupils, respectively. If District officials had combined these kindergarten classes into five different classes with approximately 17 pupils per class, the District would have been able to eliminate one kindergarten class. At a minimum, the cost savings of eliminating one kindergarten class would have been approximately \$75,000, which includes the elimination of direct and indirect personal services costs of one teacher and teaching assistance.

Without an on-going comprehensive plan, District officials failed to achieve savings that could have come from adjusting and combining classes, as indicated in the merger study.

### **State Building Aid**

The State provides building aid to school districts that covers up to 95 percent of the debt service costs, or direct costs if a district is not borrowing, for eligible costs of a building project. To be eligible for building aid, projects must be approved by SED based on space needs, building capacities, and other factors. Taxpayers can approve school district capital projects whose costs exceed eligible building aid, but then they would have to provide additional local funds for the project beyond what was eligible for aid. Before sending out a capital project proposal to taxpayers, school district officials can reasonably calculate their estimated building aid using calculation

descriptions provided by SED.<sup>9</sup> Though calculating State building aid is a complicated process, according to an SED official, District officials submitted materials to SED that showed they knew that they would receive only 75 percent of the capital project costs in State building aid.<sup>10</sup> However, District officials allowed taxpayers to think that this State funding would cover 95 percent of the costs of the District's capital projects. Because District officials did not have an ongoing comprehensive plan, they did not have a financial plan to cover the additional capital project costs that they knew would not be covered by the State building aid.

Before the merger, in three instances District officials told taxpayers that their local contribution toward building costs would be only 5 percent of the total costs. The 1998 merger study stated that "the new building aid ratio will be 95 percent thus resulting in only a 5 percent local contribution from local taxpayers. This local contribution would be covered from the additional incentive operating aid received by the merged district." Further in the report, it states that "a Narrowsburg/Delaware Valley/Jeffersonville-Youngsville merger would result in 95 percent (the maximum allowed by the State) of any project's approved costs being returned in State aid based on current figures." A 1998 newsletter circulated by the Narrowsburg Central School District stated that "the new district would be eligible for 95 percent State aid." And a May 1999 article in the *Sullivan County Democrat* written by Martin Handler, the District Superintendent of Schools for the Sullivan BOCES, says that the State "will pay 95 percent of the cost of renovations and new structures."

After the merger, Sullivan West District officials notified taxpayers in a May 2000 newsletter that they anticipated receiving only 80 percent of projects costs in the form of State building aid. Actual State aid ratios cannot be determined until the capital projects are completed, so District officials could not give taxpayers an exact amount of how much State aid would cover the capital projects. In December 2005, SED notified District officials that the District would receive a total of approximately 75 percent to 80 percent building aid on their capital projects. Therefore approximately 25 percent of the costs would be above the cost allowance and ineligible for any building aid.

If District officials had had an ongoing comprehensive plan, they could have addressed the amount of State aid the District would actually receive and the impact this would have on real property taxes.

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<sup>9</sup> [www.emsc.nysed.gov/facplan/publicat/building\\_aid\\_guidelines\\_072804.html](http://www.emsc.nysed.gov/facplan/publicat/building_aid_guidelines_072804.html)

<sup>10</sup> Charles Szuberla, Coordinator of SED's Office of School Operations and Management Services, made this statement in a September 8, 2005 letter to Superintendent Alan Derry.

## **Recommendation**

1. District officials should develop an on-going comprehensive strategic plan, which should address:
  - School building use based on occupancy needs and enrollment projections
  - Staffing levels based on reasonable teacher-pupil ratios
  - Realistic projections of revenues and expenditures which consider changes in State aid allocations, assessed value of taxable real property, commitments under collective bargaining agreements, and capital asset needs.

## Internal Control Weaknesses

The Board of Education has overall responsibility for District operations, with the Superintendent of Schools and other administrative staff having responsibility for overseeing and managing day-to-day operations. These responsibilities include, but are not limited to, ensuring that an effective system of internal controls is in place. The District's internal controls consist of various processes created by the Board, department heads, and other District personnel that are designed to provide reasonable assurance that the Board's objectives are being achieved. These processes are essentially a coordinated set of policies and procedures developed to help ensure that the District complies with laws and regulations, reports financial data accurately, and operates efficiently and effectively. A good system of internal controls can result in the timely identification of errors and/or irregularities.

We noted significant weaknesses in the District's existing internal controls relating to segregation of duties, compliance with its procurement policy, approval of requisitions for purchases of goods and/or services, and recording of the District's capital assets.

### Segregation of Duties

An effective system of internal control provides for the separation of duties so that no single individual controls all phases of a transaction. When key duties and responsibilities are segregated, the District establishes checks and balances over its financial operations. Ideally, District officials should separate the duties of cash custody (i.e., collecting cash and check signing) from recordkeeping. However, where adequate segregation of duties may not be practical, at a minimum it is important for District officials to ensure that sufficient oversight is in place to reduce the risk that errors and/or irregularities will go undetected and uncorrected.

The District's system of internal controls did not separate some duties of the Treasurer enough to provide a good set of checks and balances over safeguarding cash and recording financial transactions. Without additional oversight provided by other District officials, the Treasurer collected, deposited and disbursed cash including investments (both by signing checks and transferring cash electronically), posted entries in the accounting records including cash journal adjustments, and performed bank reconciliations. The lack of segregation of duties and/or appropriate oversight significantly increases the risk that errors and/or irregularities might occur and not be detected, and not be corrected in a timely manner.

**Purchasing – Procurement Policy**

An important component of the District’s internal controls relates to policies and procedures over purchasing. The Board adopted a procurement policy which requires District officials to obtain verbal or written quotes from vendors for purchases of goods and/or services that are below statutory competitive bidding limits, but cost more than \$3,000. We found that District personnel did not always adhere to this policy.

We reviewed 18 claims for purchases made during the 2004-05 fiscal year for which District officials were required to obtain verbal or written quotes and found five claims totaling about \$28,500 that did not have any evidence documenting that District officials had obtained required verbal or written quotes. We also reviewed an additional 19 claims from 2003-04 and found another five claims totaling about \$25,500 that did not have any evidence documenting that District officials had obtained required verbal or written quotes.

The failure of District officials and employees to follow the Board’s procurement policy increases the risk that goods and/or services may not be acquired at the lowest possible costs.

**Purchasing – Approval of Requisitions**

A key internal control to help ensure that the District has an effective purchasing system is the requirement that District personnel prepare formal requisitions, and that District officials approve the requisitions for all items purchased. As the initial step in the purchasing process, this approval process informs the purchasing official of what items to buy, when they are required, and where they must be delivered. Further, it is important that different employees perform the specific steps in the purchasing cycle (initiation, authorization, approval, ordering, receipt, payment and recordkeeping) to minimize the risk that the District might pay inappropriate, unauthorized or fraudulent claims. However, in cases where particular steps in the process cannot be performed by different employees, management should institute compensating controls that can help prevent or reduce these risks.

The District’s system of internal controls over purchasing was deficient in that the purchasing agent was able to approve his own requisitions without any additional supervisory approval. For example, the purchasing agent purchased a used bus costing \$3,350 in May 2005, which the District later returned to the vendor after it spent \$550 on paint and materials to paint the bus. The purchasing agent initiated, authorized, approved, ordered and received the used bus without any supervisory approval. The Superintendent told us that because he had not approved the purchase, he requested that the bus be returned to the vendor. While the District did receive a refund for the purchase price of the used bus, the moneys spent on paint and

materials was lost. As was shown in this example, the District's lack of a good system of internal controls over purchasing caused it to incur unnecessary costs.

## **Capital Assets**

Capital assets are those that have a useful life of more than one year and include such things as land, buildings, furnishings, and equipment such as vehicles and electronic equipment. The District's inventory of capital assets represents a significant investment of financial resources. As of June 30, 2005 the District reported having approximately \$53 million in capital assets. District officials must ensure that capital assets are protected from loss, that their value is maintained and that they are used effectively. This protection can be accomplished by adopting policies, maintaining perpetual inventory records, conducting periodic inventories, and by establishing other safeguards.

The Board did not enforce the requirements of the District's capital assets policy. The policy requires District personnel to maintain detailed records and an annual inventory and appraisal of District property and equipment. However, District personnel did not have complete, accurate and up-to-date perpetual inventory records to substantiate equipment purchases throughout the year. Rather, personnel accumulated purchase orders throughout the year and recorded this information in the inventory records at year-end. Further, inventory records did not always contain sufficient information to uniquely identify specific capital assets. The District's last capital asset physical inventory was conducted in 2003.

Because the Board did not enforce the requirements of the District's capital assets policy, deficiencies exist in the District's internal controls over capital assets that leave it with little control over its capital assets. These assets are at risk for loss, or inappropriate use or disposal.

## **Recommendations**

2. The Board should review the duties of the Treasurer and institute controls to ensure that there is proper segregation of the Treasurer's duties. The Board should consider consulting with the District's internal auditor and audit committee to determine the most appropriate way to accomplish proper segregation of duties.
3. The Board should ensure that all staff follow the requirements of its procurement policy and obtain quotes for goods and/or services as specified in the policy.
4. The Board should enhance internal controls over the purchasing function by requiring that District officials provide prior approval

for all purchase requisitions initiated by the purchasing agent before releasing the related purchase orders.

5. The Board should ensure that District personnel maintain accurate and up-to-date capital asset records. Also, the Board should require that District personnel perform annual physical inventories and investigate any differences.

## Improper Payment of Unused Vacation Time

General Municipal Law<sup>11</sup> authorizes local governments to adopt a local law, ordinance<sup>12</sup> or resolution to provide for the cash payment of the monetary value of accumulated vacation credit of their officers and employees at the time of their separation from service or death. In addition, cash payments for accumulated vacation leave may be provided for in collective bargaining agreements or other similar employment agreements that can provide for the terms and conditions of employment. As a general rule, local governments may not make cash payments for accumulated vacation time to officers or employees if the entity does not have such a local law, resolution, ordinance, or employment agreement.

We reviewed an \$8,400 payment made by the District in 2002 to a former business manager for her unused vacation time and found that this payment was improper. The former business manager's employment contract with the District did not contain any provision for a cash payment of unused vacation time to her upon her separation from service. Before or during our audit period, the Board did not adopt a resolution providing for cash payments of unused vacation time to former employees.

Therefore, the Board was negligent in fulfilling its responsibilities by failing to ensure that this payment was legal. Without checking with the District's legal counsel, the Board approved a budget transfer that allowed the business office to make the payment. As a result, District officials did not comply with the law and made an improper payment to the former business manager.

### Recommendations

6. The Board should ensure that all leave benefits are paid in accordance with the terms of applicable written employment agreements, and/or Board resolutions.
7. The Board should consider taking steps to recover the improper payment made to the former business manager.

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<sup>11</sup> Section 92

<sup>12</sup> School districts may not adopt local laws or ordinances.

## APPENDIX A

### TAXPAYERS' COMPLAINTS

We received the following complaints from taxpayers on various matters and addressed them as follows:

1. Several complaints alleged that the District's reorganization vote held on June 10, 1999 was illegal.

Audit Conclusion: We did not perform audit work in this area because the Commissioner of Education dismissed the appeal stating that the petitioner failed to meet his burden of proof.

2. Several complaints alleged that the District's unexpended, unreserved fund balance was in excess of 2 percent of its 2003-04 operating budget, which is in violation of Real Property Tax Law, Section 1318(1).

Audit Conclusion: The SED Commissioner ordered the District to fully comply with Real Property Tax Law and approve tax warrants in strict compliance with statutory requirements. District officials did comply with the Commissioner's decision by appropriating \$3,725,000 of their estimated available fund balance at fiscal year end 2003-04 to reduce the tax levy for the 2004-05 year. District officials also paid down the District's debt by \$1,500,000. These actions brought the District's unreserved, unappropriated fund balance to \$446,788 at the close of the 2003-04 fiscal year, which was in compliance with statutory requirements.

3. Several complaints alleged that the District mishandled the planning, cost estimating and execution of the construction of the new high school.

Audit Conclusion: We did not perform significant audit work in this area because District officials are currently working with the District's attorneys to resolve related issues. The District is currently in litigation with the architect and the site improvement contractor regarding issues about the construction and completion of the high school project.

4. We received several complaints that alleged that a former business manager received compensation in 2002 for back vacation pay that she was not entitled to, because it was not included in her employment contract with the District.

Audit Conclusion: We reviewed the facts and circumstances regarding this payment and found that this payment was improper. Refer to the "Improper Payment of Unused Vacation Time" section for further information.

5. Several complaints questioned why SED officials approved the construction of a new high school with declining enrollments.

Audit Conclusions: According to SED officials, they approve plans consistent with the level of enrollments projected 10 years from the base year as provided by the District or their consultant and prepared in accordance with accepted guidelines for making such enrollment studies. The choice to

build a new facility is a local choice, and is approved by District voters. Constructing a new school involves many issues separate from levels of enrollment, such as the condition of the existing structure, suitability of the building for program needs, and location of the facility. In the case of Sullivan West, construction of the new building was to house the programs of the combined District. Further, it is up to the local Board to determine what size high school to build. It was also the responsibility of the Board to communicate to District taxpayers the difference between what the total costs of the capital project would be and the actual amount that the District would receive in State building aid for the project. Education Department officials determine how much State building aid the project will generate, but it is not within their realm to determine whether the project will be built, or to notify the public of any possible disparity between project costs and eligible State aid.

6. Several complaints alleged that the amount of State building aid the District would receive for their capital projects as published in newspapers was not accurate.

Audit Conclusions: We did find numerous newspaper articles that claimed the State would pay 95 percent of the cost of renovating the existing school buildings and building any new structure made necessary by the merger. However, according to SED officials, District officials knew that approximately 25 percent of the cost of the capital projects would be above the cost allowance and, therefore, would not be eligible for any building aid. Refer to the “State Building Aid” section for further information.

7. Several complaints alleged that the new high school was built on a toxic waste site.

Audit Conclusions: Officials from SED’s Office of Facilities Planning investigated the matter and found that there was no reason to suspect that the property was contaminated or otherwise unsuitable for use as a school. Therefore, we did not pursue the matter any further.

## **APPENDIX B**

### **RESPONSE FROM DISTRICT OFFICIALS**

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

BOARD OF EDUCATION

Arthur Norden  
President

Shaun C. Bailey  
Vice President

Margaret L. Luty  
Board Clerk

# Sullivan West Central School

Alan R. Derry, Superintendent

MEMBERS

Rose Crotty  
Richard Lander  
Jennifer Mann  
Anna Nemann  
Catherine Novak  
Shaun Sensiba  
Noel van Swol

October 5, 2006

[REDACTED]  
Office of State Comptroller  
Division of Local Government Services  
44 Hawley Street -- Room 1702  
Binghamton, NY 13901

Dear [REDACTED]

We appreciate the opportunity to respond to the audit of our school district by your office.

The stated examination period for your audit is July 1, 2003 to June 8, 2005. We believe your report more accurately reflects a study of our district's merger process and building projects from 1999 to 2005.

Your report fundamentally says three things: The district did not need a new high school, economies of scale were not made in the merger despite obvious unnecessary and overlapping positions, and operational problems existed in the business office. All these conditions were the result of a lack of strategic planning and leadership.

With respect to the new high school, the community, as your report notes: does have a right to build a new building for reasons of centralized location and to improve programs by updating and upgrading facilities. The community did vote for the new high school for these very purposes.

However, the community does have a right to expect that the need for such a facility will undergo scrutiny by the New York State Education Department with respect to the allotment of aid for new facilities.

SED's failure to adhere to its own guidelines for the approval of aid for new Construction resulted in an allotment of aid that was unnecessary for the purpose of fulfilling the district's need for a centralized facility and for the upgrading of facilities necessary for increased academic achievement for SW students.

In support of the contention that SED officials deviated from their own guidelines for the approval of new space, OSC was provided with:

- 1) SED Reference guide B.2 Approval of Preliminary Plans, Facilities Needs and Assessment Summary, June 20, 1998 which stipulates the information required by SED relative to a FNA Summary and enrollment projections.
- 2) SED Reference Guide A.6 which defines SED's enrollment projection requirements.
- 3) September 28, 2001 FOIL request to SED and ensuing SED response which

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stipulates that only the 2/1/2001 Fiscal Advisors enrollment projections – which clearly demonstrate a 20% decline in pupil enrollment over the following 10 year period - and the 1/29/01 FNA narrative from then Superintendent Michael Johndrow were used by SED officials in the approval process for the new high school project.

4) The 3/28/02 letter from SED's Charles Szuberla confirming item 3.

Had SED followed its own guidelines for the approval of aid for new space, district officials would not have had the opportunity to spend millions of tax dollars needlessly.

With respect to economies of scale, the district eliminated 44 positions during 2005-06 and an additional four positions for 2006-07. In addition, of course, the district closed two elementary schools to consolidate operations into one elementary campus (grades K-6) and one secondary campus (grades 7-12). This resulted in a savings of at least \$2.1 million *per year*.

With respect to business office operations, the district has already implemented your recommendations for segregation of duties, a procurement policy, approval of requisitions, capital assets and payment of leave benefits. In addition, the business office has significantly improved cafeteria and transportation operations

With respect to strategic planning, the district, over the past two years, has completed strategic plans in the following required areas: CDEP, PDP, APPR, AIS, SAVE, Guidance and RESCUE. In addition, we are engaged in multi-year staff development and curriculum development programs that are generally regarded to be the best in the country. Furthermore, at the beginning of this school year, the board of education began the process of developing an on-going comprehensive strategic plan.

Overall, we agree with your recommendations, having started #1 and implemented #s 2-6. The board of education will address recommendation #7 shortly.

We are aware that our board of education is responsible to take corrective action and to submit a plan of action to your office within 90 days. We wish to take this opportunity to comment informally on how we have responded to date to your recommendations.

Recommendation #1: Develop an on-going comprehensive strategic plan

We have already begun this process. Through a grant obtained by Assemblywoman Aileen Gunther, the district has received multi-year financial planning tools that conform to guidelines published in your "Local Government Management Guide." Additionally, the board of education has appointed members to a Finance Committee to prepare and maintain the district's multi-year financial plans. The board has also appointed members to a Facilities Needs and Assessment Committee to recommend best use of school buildings based on occupancy, projected enrollments and cost-effectiveness.

Recommendation #2: Segregation of District Treasurer's duties

This has been accomplished by means of the school business official 1) verifying the Treasurer's ledger balances against the monthly Treasurer's report and bank statements and 2) checking and approving all proposed wire transfers by the Treasurer prior to execution. In addition, the district has created the position of School District Accountant to further segregate

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duties and provide additional internal controls.

Recommendation #3: Enforce procurement policy

The district has notified all employees that it will henceforth enforce the procurement policy .

Recommendation #4: Internal control over requisitions by the purchasing agent

The purchasing agent will obtain the signature and approval of the superintendent for all requisitions initiated by the purchasing agent.

Recommendation #5: Maintain accurate and current capital asset records

The district has obtained the services of CBIZ through NYSIR to inventory its capital assets. CBIZ has performed all inventory, and the district is awaiting the records. Upon receipt of these records, the district will endeavor to update capital asset inventory as purchases are made instead of at the end of the year. In addition, as a matter of procedure, the district will ask classroom teachers and other employees to perform physical inventories of their resources at year end.

Recommendation #6: Ensure proper payment of leave benefits

Care is now being taken that all leave benefits are paid in accordance with the terms of applicable written employment agreements and board resolutions.

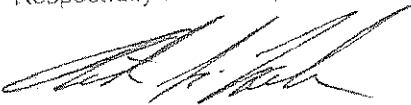
Recommendation #7: Consider recovery of improper payment to former business manager

The board of education will address this issue in a forthcoming meeting.

As we stated in the beginning of this letter, we believe that your report can be more accurately described as an examination of our district's merger and building project issues in the years prior to the period stated by your report. Most of the issues you identify had already been recognized and mitigated at the time your staff began its examination. Over the past two years, our board of education and administration have been proactive in meeting their fiduciary obligations to the public.

We thank you for your time and efforts in helping us to provide the best education possible for our community.

Respectfully submitted,



Arthur J. Norden  
President, Board of Education

Attachments

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## APPENDIX C

### AUDIT METHODOLOGY AND STANDARDS

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

During the initial assessment, we interviewed appropriate District officials, performed limited tests of transactions and reviewed pertinent documents such as District policies and procedures manuals, Board minutes and financial records and reports. In addition, we obtained information directly from the computerized financial databases and then analyzed it electronically using computer-assisted techniques. This approach provided us with additional information about the District's financial transactions as recorded in its database. Further, we reviewed the District's internal controls and procedures over the computerized financial databases to help ensure that the information produced by such systems was reliable.

After reviewing the information gathered during our initial assessment, we determined where weaknesses existed, and evaluated those weaknesses for the risk of potential fraud, theft and/or professional misconduct. We then decided upon the reported objectives and scope by selecting for audit those areas most at risk. We selected cash receipts and disbursements, purchasing and capital assets for further audit testing.

To accomplish the objectives of this audit and obtain valid audit evidence, our procedures included the following steps:

- We reviewed reports of studies relating to the merger of the former Districts.
- We reviewed statistical information from SED regarding trends in employment, pupil enrollments and building occupancy levels.
- We reviewed various accounting and financial reports and performed trend analyses of District operations.
- We reviewed pertinent documents including: bank statements and cancelled checks, requisitions and purchase orders, claims, inventory listings, and various other accounting and financial reports.
- We reviewed bank reconciliations for accuracy, completeness and timeliness. We also verified that information included on cancelled checks agreed with related supporting documentation and reviewed them for any unusual, improper, or suspicious payees.

- We reviewed check stock to see that checks were used in sequence, are physically secure, and that District personnel accounted for voided and unused checks. We verified that selected receipts were properly recorded and deposited in a timely manner. We verified that transfers made were properly authorized and documented.
- We compared vendor contact information with employee address listings for any potential conflicts or incompatibilities.
- We scanned warrants and tested claims to verify that purchases were properly authorized, supported, and complied with District policies.
- We scanned purchase order listings to verify that master purchase orders were used sparingly and that dollar limits were reasonable.
- We tested claims to verify that travel and meal reimbursements, as well as credit card purchases, were authorized, reasonable, and supported.
- We reviewed capital assets control account balances and attempted to verify that selected assets were in the proper District location and in custody by physically viewing them.
- We verified that assets acquired during the audit period were approved and recorded in purchase orders, the minutes, and the detail property records.
- We reviewed the District's Basic Educational Data System (BEDS) School District Summary Form.

We conducted our audit in accordance with generally accepted government auditing standards (GAGAS). Such standards require that we plan and conduct our audit to adequately assess those District operations within our audit scope. Further, those standards require that we understand the District's management controls and those laws, rules and regulations that are relevant to the District's operations included in our scope. An audit includes examining, on a test basis, evidence supporting transactions recorded in accounting and operating records and applying such other auditing procedures, as we consider necessary in the circumstances. We believe that our audit provides a reasonable basis for the findings, conclusions and recommendations contained in this report.

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