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April 11, 2008

Dr. Susan A. Agruso, Superintendent of Schools
Members of the Board of Education
South Country Central School District
189 Dunton Avenue
East Patchogue, New York 11772-5598

Report Number: B7-8-7

Dear Dr. Agruso and Members of the Board of Education:

Chapter 375 of the Laws of 2006 authorizes the South Country Central School District (District) to issue debt totaling \$4,623,721 to liquidate the accumulated deficit in the District's general fund as of June 30, 2005. Local Finance Law Section 10.10 requires all local governments that have been authorized to issue obligations to fund operating deficits to submit to the State Comptroller each year, starting with the fiscal year during which the local government is authorized to issue obligations and for each subsequent fiscal year during which the deficit obligations are outstanding, their tentative or preliminary budget for the next succeeding fiscal year.

The budget must be submitted no later than 30 days before the date scheduled for the governing board's vote on the adoption of the budget or the last date on which the budget may be finally adopted, whichever is sooner. The State Comptroller must examine the tentative budget and make recommendations for any changes that are needed to bring the proposed budget into balance. Such recommendations are made after the examination into the estimates of revenues and expenditures of the District prior to the approval of the budget.

The District's Board of Education (Board), no later than five days prior to the adoption of the budget, must review all recommendations made by the State Comptroller and may make adjustments to its tentative budget consistent with those recommendations contained in this report. All recommendations that the Board rejects must be explained in writing to our Office.

Our Office has recently completed an audit of the District's budget for the 2008-09 fiscal year. The objective of the audit was to provide an independent evaluation of the tentative budget. Our audit addressed the following questions related to the District budget for the 2008-09 fiscal year:

- Are the significant revenue and expenditure projections in the District’s tentative budget reasonable?
- Did the District take appropriate action to implement or resolve recommendations contained in the budget review audit report issued in April 2007?

We conducted this performance audit in accordance with generally accepted government auditing standards (GAGAS), with the exception of reporting views of responsible officials. Officials’ views were not solicited for this report due to the necessity of providing the District with this time-sensitive information. However, the results of this audit have been discussed with District officials and their comments have been considered in preparing this report. GAGAS requires 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 objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions regarding the estimates in the tentative budget.

To accomplish our objectives in this audit, we requested your tentative budget along with other pertinent information. We analyzed the composition of revenues and expenditures in order to determine if the revenue and expenditure estimates are reasonable. We do not offer comments on public policy decisions, such as the type and level of services to be provided.

The tentative budget package submitted for audit for the fiscal year ended June 30, 2009, consisted of the following:

- 2008-09 Tentative Budget
- Supplementary Information

The tentative budget submitted to our office is summarized as follows:

Fund	Appropriations	Estimated Revenues	Appropriated Fund Balance	Real Property Taxes
General	\$ 103,578,175	\$ 59,327,228	\$ 0	\$ 44,250,947

Based on the results of our audit, we found that almost \$1.2 million in costs were not included in the budget or were underestimated, and that \$3.7 million in other costs were overestimated or over-budgeted. Debt principal repayments totaling \$500,000 were excluded from the budget, health and dental benefit costs may be underestimated by about \$390,000, and energy costs could be underestimated by approximately \$300,000. In addition, estimates for the District’s contributions to the Teachers and Employees Retirement Systems were calculated using incorrect percentages, resulting in the District’s estimates being more than \$1 million greater than what the District will be required to pay in 2008-09. Furthermore, based on support provided by the District, personal service costs are likely over-budgeted by almost \$2.7 million.

The observations and recommendations resulting from our audit are, to a great extent, influenced by the quality and quantity of materials submitted. Due to the inadequacies of the District’s accounting records, the totals of actual revenues, expenditures and fund balance in the current

year were not readily available, which hindered our ability to compare the current year's actual results with budget estimates, and to consider such results while reviewing estimates for the 2008-09 fiscal year.

Our audit disclosed the following findings which should be reviewed by the Board for appropriate action. Good management practices require that District officials take prompt action concerning our recommendations. We believe that prompt action by District officials will help improve the District's financial condition.

Financial Records

During our review of internal controls significant to the budget process, we noted significant deficiencies in the District's accounting system resulting in the unavailability of timely and accurate reports of the District's financial status. For example, in December 2007, the District made payments to employees totaling \$327,021 for opting out of the District's health insurance coverage. However, the appropriation status report provided for the period July 1, 2007 through March 6, 2008 shows the District has not spent any of the \$469,000 appropriated for this purpose. In another example, the District budgeted \$191,568 for the Superintendent's salary for the 2007-08 fiscal year. However, as of March 6, 2008, the District had recorded only \$64,435 for the Superintendent's salary expense, rather than the \$132,624 she had actually been paid as of that date. District officials indicated the reason records are not up to date is that the District has been in a period of transition following the resignation of the former District Treasurer in November 2007.

Due to the inadequacies of the accounting records, the totals of actual revenues, expenditures or fund balance in the current year were not readily determinable. Although the 2007-08 budget has been used as a guide in preparing the 2008-09 budget, without current year financial information, we question the extent to which reliance can be placed on some of the estimates. The Board should more closely monitor 2008-09 operations due to the difficulties and risks involved in developing a budget without the benefit of accurate and up-to-date current year financial information. Accurate and timely financial records are essential to provide financial information for the Board to monitor District finances.

Appropriations

We identified certain appropriations which are under-budgeted by \$1,186,659, and in some instances, are excessive, in the tentative 2008-09 budget. Accordingly, we suggest the following observations be considered during the budget adoption process.

Debt Principal

In January 2007, the District issued a Bond Anticipation Note (BAN) in the amount of \$4,623,721 to finance the accumulated deficit in the general fund. The District renewed this BAN in January 2008 in the amount of \$2.5 million after redeeming \$2.1 million of the BAN with funds resulting from an operating surplus in the 2007-08 budget year. The Assistant Superintendent for Business stated that the District plans to renew the BAN each year for four

years (completing the five year maximum allowable by Law) until January 2012. However, the tentative budget for the 2008-09 fiscal year does not provide for any principal repayment of the BAN, but rather, only the interest due at January 18, 2009 (\$70,845).

The Assistant Superintendent for Business said that although there is no provision in the budget for principal redemption, the District plans to use \$500,000 of general fund operating surplus at June 30, 2008 to redeem a portion of the BAN's principal.

The budget for the 2008-09 fiscal year requires an appropriation for the principal repayment. If the District plans to use surplus fund balance to make the 2008-09 principal payment, it should include an appropriation for the payment in the budget and an offsetting amount should be included as appropriated fund balance in the budget. As we recommended last year in our report, the Board should adjust the tentative budget to address this error.

Health and Dental Insurance Costs

Employee health benefit costs have been rising during the last few years. The District will be facing additional increases in the ensuing fiscal years. Using the District's projected insurance rate increases, the estimated total health and dental insurance costs for 2008-09 would be \$11,600,852. However, the District's estimate for these costs is \$11,210,453. Therefore, based on our review, health and dental insurance costs are under-budgeted by approximately \$390,000. We recommend that the Board consider increasing appropriations for these employee benefits.

Energy Costs

As a result of rising fuel prices, school districts will continue to be affected by increased costs for fuel and other energy products for heating/cooling. This will have a direct impact on costs for fuel purchased for vehicles and costs for oil, natural gas and electricity necessary to heat and cool facilities. Given the uncertainty of future fuel costs, the District should be somewhat conservative in estimating such costs.

The 2008-09 tentative budget for the general fund includes appropriations of approximately \$2.2 million for the costs of utilities and fuel. We projected, based on actual expenditures through March 2008, that the District will expend approximately \$1.9 million by the end of the 2007-08 fiscal year. Although the amount budgeted for 2008-09 is approximately 12.8 percent greater than the projected actual for 2007-08, based on the projected percentage increase over previous year actual expenditures, we estimated that the costs for utilities and fuel for the 2008-09 fiscal year will be \$2.5 million. This projection indicates that the District's tentative budget may be under-funded by approximately \$300,000 for energy costs. We recommend that District officials review the 2008-09 budget estimates and act to factor in the potential increases in energy costs.

Retirement Systems Expenditures

The tentative budget includes appropriations of \$3,970,000 for the Teachers Retirement System (TRS) and \$813,750 for the Employees Retirement System (ERS). We reviewed the District's

estimate of these amounts and determined that the TRS and ERS rates used by the District were incorrect.

Based on current information received from the TRS and ERS, we projected the 2008-09 retirement bills will total approximately \$3,187,164 for TRS and \$554,160 for ERS. Therefore, the District has budgeted \$1,042,426 more than will be needed to satisfy these costs. The Board should revise the amounts appropriated in the 2008-09 budget.

Personal Service Costs

Personal service costs are the District's largest item of expense. These costs are mainly affected by two factors: the number of staff and contracts with collective bargaining units. Accordingly, the District should project anticipated staffing levels and known commitments, such as contractual salary increments contained in collective bargaining agreements.

Total salaries included in the tentative 2008-09 budget are \$49,042,506. Preliminary work sheets provided by the Assistant Superintendent for Business to support the amount included in the tentative budget totaled only \$46,344,063, a difference of \$2,698,443. While District officials informed us that the difference was due to added staff positions, no support was provided to us to corroborate these additional monies in the tentative budget. Consequently, the 2008-09 appropriation is likely overestimated by \$2,698,443. We recommend that District officials review the personal service costs included in the 2008-09 budget.

Format and Content of the District Budget

In order for the District's budget document to be a useful tool to District officials and the residents of the District, it must contain sufficient information regarding the District's annual financial plan. The District's tentative 2008-09 budget document submitted to us included only the adopted budget from 2007-08 and the tentative 2008-09 budget. It did not include any information as to actual revenues and expenditures from the prior completed fiscal year and the current year-to-date.

We recommend that the Board revise the budget format to include the following information for comparative purposes:

- Actual revenues and expenditures for the last completed fiscal year
- Actual revenues and expenditures for the current year to date
- Revenue estimates and appropriations for the current fiscal year as amended to date.

This information allows for the tentative budget to be evaluated in light of the prior year's results of operations and the current year's budget.

The Board has the responsibility to initiate corrective action. Pursuant to Section 10.10 of Local Finance Law, the Board shall review the recommendations in this report and may make adjustments to its tentative budget. The Board must explain in writing to our office any recommendations that it has rejected. In addition, pursuant to Section 35 of the General

Municipal Law, Section 2116-a (3)(c) of the Education Law and Section 170.12 of the Regulations of the Commissioner of Education, the Board must approve a corrective action plan that addresses the findings in this report, forward the plan to our office within 90 days, forward a copy of the plan to the Commissioner of Education, and make the plan available for public review in the District Clerk's office. For guidance in preparing your plan of action and filing this report, please refer to the attached documents.

We request that you provide us with a copy of the adopted budget.

We hope that this information is useful as you adopt a budget for the District. If you have any questions on the scope of our work, please feel free to contact Jeffrey Leonard, Chief Examiner of our Long Island Regional Office, at (631) 952-6534.

Very truly yours,

Steven J. Hancox
Deputy Comptroller

cc: Frank Ferraro, Assistant Superintendent for Business
Judeth Degree, District Clerk
Edward J. Zero, Superintendent – Eastern Suffolk BOCES
Hon. Owen H. Johnson, Chair, Senate Finance Committee
Hon. Herman D. Farrell Jr., Chair, Assembly Ways and Means Committee
Hon. Patricia A. Eddington, State Assembly Representative
Hon. Caesar Trunzo, State Senator
Laura L. Anglin, Director, Division of the Budget
Richard P. Mills, Commissioner, State Education Department
James Conway, Director, Office of Audit Services, State Education Department
Jeffrey P. Leonard, Chief Examiner, Hauppauge Regional Office