



Farmingdale Union Free School District Financial Condition

Report of Examination

Period Covered:

July 1, 2014 – February 29, 2016

2016M-235



Thomas P. DiNapoli

Table of Contents

	Page
AUTHORITY LETTER	1
INTRODUCTION	2
Background	2
Objective	2
Scope and Methodology	2
Comments of District Officials and Corrective Action	3
FINANCIAL CONDITION	4
Budgeting	4
Fund Balance	5
Reserve for Encumbrances	7
Recommendations	8
APPENDIX A Response From District Officials	9
APPENDIX B Audit Methodology and Standards	11
APPENDIX C How to Obtain Additional Copies of the Report	12
APPENDIX D Local Regional Office Listing	13

State of New York Office of the State Comptroller

Division of Local Government and School Accountability

September 2016

Dear School District Officials:

A top priority of the Office of the State Comptroller is to help school district officials manage their districts efficiently and effectively and, by so doing, provide accountability for tax dollars spent to support district operations. The Comptroller oversees the fiscal affairs of districts statewide, as well as districts' compliance with relevant statutes and observance of good business practices. This fiscal oversight is accomplished, in part, through our audits, which identify opportunities for improving district operations and Board of Education governance. Audits also can identify strategies to reduce district costs and to strengthen controls intended to safeguard district assets.

Following is a report of our audit of the Farmingdale Union Free School District, entitled Financial Condition. This audit was conducted pursuant to Article V, Section 1 of the State Constitution and the State Comptroller's authority as set forth in Article 3 of the New York State General Municipal Law.

This audit's results and recommendations are resources for district officials to use in effectively managing operations and in meeting the expectations of their constituents. If you have questions about this report, please feel free to contact the local regional office for your county, as listed at the end of this report.

Respectfully submitted,

*Office of the State Comptroller
Division of Local Government
and School Accountability*

Introduction

Background

The Farmingdale Union Free School District (District) is located in the Towns of Oyster Bay in Nassau County and Babylon in Suffolk County. The District is governed by the Board of Education (Board), which is composed of seven elected members. The Board is responsible for the general management and control of the District's financial and educational affairs. The Superintendent of Schools is the District's chief executive officer and is responsible, along with other administrative staff, for day-to-day management and the development and administration of the budget, under the Board's direction. The Assistant Superintendent for Business Administration is the District's chief financial officer and is responsible for overseeing the District's Business Office and supervising employees who maintain the District's financial accounting records and prepare financial reports.

The District operates six schools with approximately 5,800 students and 1,000 full-time employees. The District's expenditures for the 2014-15 fiscal year were \$153 million, which were funded primarily by real property taxes and State aid. The District's budgeted appropriations for the 2015-16 fiscal year were approximately \$157.4 million.

Objective

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

- Did the Board and District officials effectively manage the District's financial condition by ensuring budget estimates were reasonable and encumbrances were accurately reported?

Scope and Methodology

We examined the District's financial condition for the period July 1, 2014 through February 29, 2016. We expanded our scope back to July 1, 2011 to analyze the District's fund balance and budget practices.

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 B of this report. 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.

**Comments of
District Officials and
Corrective Action**

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

The Board has the responsibility to initiate corrective action. Pursuant to Section 35 of General Municipal Law, Section 2116-a (3)(c) of New York State Education Law and Section 170.12 of the Regulations of the Commissioner of Education, a written corrective action plan (CAP) that addresses the findings and recommendations in this report must be prepared and provided to our office within 90 days, with a copy forwarded to the Commissioner of Education. To the extent practicable, implementation of the CAP must begin by the end of the next fiscal year. For more information on preparing and filing your CAP, please refer to our brochure, *Responding to an OSC Audit Report*, which you received with the draft audit report. The Board should make the CAP available for public review in the District Clerk's office.

Financial Condition

The Board is responsible for making sound financial decisions that are in the best interest of the District, the students it serves and the taxpayers who fund the District's programs and operations. Sound budgeting practices include adopting budgets with estimates of actual and necessary expenditures that are funded by realistic revenues and help ensure that the levy of real property taxes is not greater than necessary. New York State Real Property Tax Law limits the amount of fund balance a school district can retain to 4 percent of the ensuing year's appropriations.

Fund balance represents resources remaining from prior fiscal years. A school district may retain a portion of fund balance at the end of the fiscal year for cash flow needs or unexpected expenditures. Additionally, school districts are legally allowed to establish reserve funds to restrict reasonable portions of fund balance for specified purposes that comply with statutory directives.

The Board and District officials need to improve their management of the District's financial condition. The Board adopted budgets for fiscal years 2011-12 through 2014-15 that appropriated a total of \$28 million in fund balance to finance operations. However, because they underestimated revenues by a total of \$9.8 million and overestimated appropriations by a total of \$26.6 million over that period, District officials used only \$4 million (14 percent) of the appropriated fund balance. During this period, the District also increased the tax levy by \$10 million, or 8.8 percent. We also found that the Board properly reported encumbrances for the 2013-14 and 2014-15 fiscal years.

Budgeting

In preparing the budget, the Board and District officials are responsible for using the most reliable information available. Revenue and expenditure estimates should be developed based on prior years' operating results, past expenditure trends, anticipated future needs and available information related to projected changes in significant revenues and expenditures. Accurate estimates help ensure that the real property tax levy is not greater than necessary. Unrealistic budget estimates can mislead District residents and significantly impact the District's year-end surplus funds and financial condition.

We reviewed the District's budgets for 2011-12 through 2014-15 and found that revenue estimates were consistently understated and general fund budgeted expenditures were overstated in each of the four years. The Board adopted budgets that underestimated revenues by a total of \$9.8 million and overestimated appropriations by a total of \$26.6 million.

Figure 1: Budgeted Revenues vs. Actual Revenues

Fiscal Year	Budgeted Revenues	Actual Revenues	Underestimated Revenues	Percentage
2011-12	\$139,957,711	\$142,853,724	(\$2,896,013)	(2.0%)
2012-13	\$143,067,160	\$146,271,781	(\$3,204,621)	(2.2%)
2013-14	\$145,884,118	\$147,678,434	(\$1,794,316)	(1.2%)
2014-15	\$148,996,648	\$150,879,892	(\$1,883,244)	(1.2%)
Total Revenue Variance			(\$9,778,194)	(1.7%)

Figure 2: Budgeted Appropriations vs. Actual Expenditures (General Fund)

Fiscal Year	Budgeted Appropriations	Actual Expenditures	Overestimated Appropriations	Percentage
2011-12	\$146,527,711	\$138,124,737	\$8,402,974	6.1%
2012-13	\$150,137,160	\$143,365,310	\$6,771,850	4.7%
2013-14	\$152,954,118	\$148,027,489	\$4,926,629	3.3%
2014-15	\$156,046,648	\$149,566,346	\$6,480,302	4.3%
Total Expenditure Variance			\$26,581,755	4.6%

The Board underestimated revenues and overestimated its budgeted expenditures in nearly every category over the four-year period. The largest areas where revenues were underestimated were miscellaneous revenues and State sources (State aid). District officials underestimated miscellaneous revenues by \$6.9 million or 89.1 percent¹ and State sources by \$3.1 million or 2.9 percent.

Additionally, District officials overestimated appropriations in each of the four years, with the greatest discrepancies being employee benefit costs by \$13.2 million (9.4 percent), teacher salaries by \$5.7 million (3.3 percent), pupil transportation by \$3 million (10.2 percent) and other general support by \$2.1 million (12.3 percent). Over the same period, the District increased real property taxes by nearly \$10 million or 8.8 percent.

District officials told us that they were cautious when creating budget estimates because revenues and expenditures are difficult to forecast accurately. While budgeting is not an exact science, State aid revenue is generally known when school district budgets are enacted. Likewise, expenditures such as teacher salaries are contractual in nature and, therefore, should be reasonably estimated.

Fund Balance

Fund balance represents the cumulative residual resources from prior fiscal years that can, and in some cases must, be used to fund operations in the ensuing fiscal year. The District may appropriate a portion of fund balance to help finance the next fiscal year's budget. The remaining portion that can be used for cash flow purposes and

¹ The most significant variances were from insurance recoveries.

unanticipated expenditures is the unrestricted, unappropriated fund balance. Combining the legal limit of unrestricted, unappropriated funds with legally established reserve funds provides resources for both unanticipated events and other unidentified or planned needs. When fund balance is appropriated as a funding source, the expectation is that there will be a planned operating deficit in the ensuing fiscal year, financed by the amount of the appropriated fund balance. It is not sound practice to routinely adopt annual budgets that appropriate fund balance that will not actually be used and it is not transparent to residents voting on the District's budget.

While the District realized operating deficits in three of the four years ending June 30, 2015, the District's operating results were still better than planned because the Board appropriated more fund balance than was actually needed to fund operations. For the fiscal years ending June 30, 2012 through June 30, 2014, the Board appropriated fund balance of \$7.5 million each year and appropriated \$5.5 million at June 30, 2015 (Figure 3). This appropriation of fund balance made it appear that the District's unrestricted fund balance was within the 4 percent statutory limit.

Figure 3: Unrestricted Fund Balance at Year-End

	2011-12	2012-13	2013-14	2014-15
Total Beginning Fund Balance	\$45,351,274	\$44,945,331	\$46,478,109	\$44,663,782
Add: Operating Surplus/(Deficit)	(\$405,943) ^a	\$1,532,778	(\$1,814,327)	(\$2,164,207)
Total Ending Fund Balance	\$44,945,331	\$46,478,109	\$44,663,782	\$42,499,575
Less: Restricted and Nonspendable Funds	\$29,672,878	\$32,022,633	\$28,683,684	\$27,005,004
Less: Encumbrances	\$1,749,767	\$820,111	\$2,220,233	\$3,700,262
Less: Appropriated Fund Balance for the Ensuuing Year	\$7,500,000	\$7,500,000	\$7,500,000	\$5,500,000
Total Unrestricted Funds at Year-End	\$6,022,686	\$6,135,365	\$6,259,865	\$6,294,309
Ensuuing Year's Budgeted Appropriations	\$150,567,160	\$153,384,118	\$156,496,648	\$157,357,708
Unrestricted Funds as Percentage of Ensuuing Year's Budget	4%	4%	4%	4%

^a The Board appropriated \$7 million of fund balance for the 2011-12 budget. However, because the Board underbudgeted revenues and overestimated appropriations in the budget, the District did not use the total amount of fund balance appropriated.

Over the past four years, District officials have appropriated a total of \$28 million of fund balance, which should have resulted in planned operating deficits each year. However, the District experienced lower-than-expected operating deficits in three fiscal years (2011-12, 2013-14 and 2014-15) and an operating surplus in one year (2012-13). This occurred because revenues were underestimated and appropriations were overestimated. As a result, the District did not use most of the appropriated fund balance included in each year's budget.

When unused appropriated fund balance is added back, the District's recalculated unrestricted fund balance exceeded the statutory limit each year. Recalculated unrestricted fund balance averaged almost 8 percent (two times the statutory limit) of the ensuing year's operations during all four fiscal years.

Figure 4: Unused Fund Balance				
	2011-12	2012-13	2013-14	2014-15
Total Unrestricted Funds at Year-End	\$6,022,686	\$6,135,365	\$6,259,865	\$6,294,309
Add: Appropriated Fund Balance Not Used to Fund Ensuig Year's Budget	\$7,500,000	\$5,685,673	\$5,335,793	\$5,396,907 ^a
Total Recalculated Unrestricted Funds	\$13,522,686	\$11,821,038	\$11,595,658	\$11,691,216
Recalculated Unrestricted Funds as Percentage of Ensuig Year's Budget	9.0%	7.7%	7.4%	7.4%

^a Assumes an operating deficit of \$103,093 as projected by District officials in May 2016

The Board's practice of appropriating fund balance that was not needed to finance operations was, in effect, a reservation of fund balance that is not provided for by statute and a circumvention of the statutory limit imposed on the level of unrestricted fund balance that the District may retain. While the District has retained excessive fund balance, it also increased its real property taxes by approximately \$10 million, or 8.8 percent, over the same four-year period.²

District officials project an operating deficit of \$103,093 for the 2015-16 fiscal year. Therefore, most of the \$5.5 million appropriated in the 2015-16 budget will again not be used to finance operations. As a result, the District's unrestricted fund balance likely will exceed the statutory limit again. Had District officials used more realistic budget estimates, they could have avoided the accumulation of excess fund balance and possibly reduced the tax levy.

Reserve for Encumbrances

Encumbrances are commitments related to unperformed contracts for goods or services and are intended to help prevent a school district from exceeding approved appropriations. In order for school district officials to maintain budgetary control and to arrive at an accurate estimate of its uncommitted appropriations, it is necessary to establish an encumbrance when a contract is approved or a purchase is authorized. At the end of the fiscal year, a portion of fund balance can be set aside to carry forward appropriations for these commitments into the next fiscal year so that the following year's budget may be increased by these amounts. This restricted amount of fund balance is known as the reserve for encumbrances.

² The District levied \$111,248,590 in taxes for the 2010-11 fiscal year, \$114,419,424 for 2011-12, \$115,929,851 for 2012-13, \$118,805,062 for 2013-14 and \$120,848,908 for 2014-15.

The District's reported reserve for encumbrances as of June 30, 2014 was approximately \$2.2 million and as of June 30, 2015 was \$3.7 million. We reviewed the supporting documentation for five encumbrances for each year totaling \$667,250 and \$2.9 million, respectively. We determined that all 10 encumbrances totaling \$3.6 million were properly reported.

Recommendations

The Board and District officials should:

1. Adopt budgets that represent the District's actual needs, based on available current information and historical data.
2. Discontinue the practice of adopting budgets that result in the appropriation of fund balance that will not be used to fund District operations.
3. Reduce the amount of unrestricted fund balance and use the excess funds in a manner that benefits District residents. Such uses could include, but are not limited to:
 - Funding one-time expenditures;
 - Funding needed reserves; and
 - Reducing District property taxes.

APPENDIX A

RESPONSE FROM DISTRICT OFFICIALS

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



*THE GOAL OF THE FARMINGDALE PUBLIC SCHOOLS IS TO ESTABLISH
OURSELVES AS A HIGH ACHIEVING SCHOOL DISTRICT AS EVIDENCED BY HIGH
LEVELS OF STUDENT PERFORMANCE IN ALL AREAS.*

F A R M I N G D A L E P U B L I C S C H O O L S

JOHN LORENTZ
Superintendent of Schools

(516) 434-5100 – FAX (516) 847-0363

August 30, 2016

Mr. Ira McCracken
Office of the State Comptroller
NYS Office Building, Room 3A10
250 Veterans Memorial Highway
Hauppauge, NY 11788-5533

Dear Mr. McCracken:

The Farmingdale School District is in receipt of the Comptroller's Draft Report entitled "Farmingdale Union Free School District – Financial Condition." Although the district understands the Comptroller's position, it does not agree with the Comptroller's opinion on our financial condition or the recommendations offered in the subjected report. Farmingdale will continue to ensure the continuity and sustainability of student programs and the community's investment in its school system through sound fiscal management practices.

If you have any questions, please do not hesitate to contact my office.

Very truly yours,

John Lorentz
Superintendent of Schools

JL/pc

pc: Board of Education
Paul Defendini, Assistant Superintendent for Business
Michael Motisi, School Business Administrator

APPENDIX B

AUDIT METHODOLOGY AND STANDARDS

To achieve our audit objective and obtain valid audit evidence, we performed the following audit procedures:

- We interviewed Board and District officials to determine the processes in place for developing budgets and gained an understanding of the District's financial condition.
- We reviewed District policies and procedures involving the budget process.
- We researched appropriate laws and statutes that school districts must comply with.
- We reviewed the District's reserve funds to determine whether they have been legally established by the Board and that the reserve balances are reasonable.
- We analyzed the District's general fund financial records for the fiscal years ending June 30, 2012 through June 30, 2015 to determine financial trends.
- We compared the general fund's budgeted appropriations to actual results of operations for the fiscal years ending June 30, 2012 through June 30, 2015 to determine whether budgets were realistic and structurally balanced.
- We interviewed District officials to obtain the causes of any significant budget-to-actual variances.
- We requested the District's most current forecast for 2015-16 to determine if the District will have an operating surplus or deficit for the current fiscal year.
- We reviewed and analyzed reported fund balance levels in comparison to amounts appropriated in adopted budgets for the fiscal years 2011-12 through 2015-16.
- We selected a test of 10 vendors to test validity of encumbrances. We then tested the largest payment from each vendor for year-end legitimacy and subsequent year authenticity and liquidation.
- We investigated the District's 2016-17 budget, to ascertain if the District was including capital type expenditures in their newly adopted operating budget.

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

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