



Middle Country Central School District Financial Management

Report of Examination

Period Covered:

July 1, 2012 – November 30, 2015

2016M-121



Thomas P. DiNapoli

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State of New York Office of the State Comptroller

Division of Local Government and School Accountability

June 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 Middle Country Central School District, entitled Financial Management. 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 Middle Country Central School District (District) is located in the Town of Brookhaven, Suffolk County. The District is governed by the Board of Education (Board), which is composed of 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 is the District's chief executive officer and is responsible, along with other administrative staff, for the District's day-to-day management and for developing and administering the budget, under the Board's direction. The Board President is the District's chief financial officer. The Assistant Superintendent for Business and Director of Finance are responsible for assisting with budget preparation and supervising the employees who maintain the District's financial accounting records and prepare financial reports.

The District operates 14 schools with nearly 9,800 students and 1,944 employees. The District's 2014-15 general fund expenditures totaled approximately \$215.2 million and were funded primarily with State aid, real property taxes and grants. Budgeted appropriations for the 2015-16 fiscal year were approximately \$235.8 million.

Objective

The objective of our audit was to examine the District's budget. Our audit addressed the following related question:

- Did the Board adopt reasonable and structurally balanced budgets?

Scope and Methodology

We examined the District's budgeting practices, focusing on the general fund, for the period July 1, 2012 through November 30, 2015.

We conducted our audit in accordance with generally accepted government auditing standards (GAGAS). More information on such standards and the methodology used in performing this audit are included in Appendix C of this report.

Comments of District Officials and Corrective Action

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

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

Financial Management

The Board is responsible for the District's financial oversight. The Board must adopt structurally balanced and realistic annual budgets in which sufficient revenues finance actual, necessary and recurring expenditures and reasonable levels of fund balance are maintained. In preparing the budget, the Board should develop revenue and expenditure estimates based on prior years' operating results, past expenditure trends, anticipated future needs and available information related to projected changes in significant revenues and expenditures. School districts are legally allowed to establish reserve funds and accumulate funds for certain future purposes (e.g., capital projects or retirement costs).

The Board must also estimate the amount of unassigned fund balance that will be available at fiscal year-end, some or all of which may be used to fund the ensuing year's expenditures. New York State Real Property Tax Law currently limits unassigned fund balance that school districts can retain to no more than 4 percent of the ensuing fiscal year's budget. After taking these factors into account, the Board establishes the expected tax levy necessary to fund operations. Accurate estimates help ensure that the real property tax levy is not greater than necessary. Unrealistic budget estimates can impact the District's year-end surplus funds and financial condition.

The Board has not adopted reasonable and structurally balanced budgets. As indicated in Figure 1, from fiscal years 2012-13 through 2014-15, revenue estimates were generally reasonable. However, the Board annually adopted budgets that overestimated expenditures and appropriated fund balance and reserves that it did not actually use to fund operations. The Board overestimated expenditures by between \$16.2 million (7.4 percent) and \$18.3 million (8.1 percent) during this time. We had reported on the District's unrealistic expenditure estimates in our previous report of examination issued in 2009.¹

¹ *Internal Controls Over Selected Financial Activities, 2009M-192, December 2009*

Figure 1: Budget vs. Actual				
	Budget	Actual	Difference	Percentage
2012-13				
Revenues	\$201,462,026	\$201,784,496	\$322,470	0.2%
Expenditures	\$219,414,576	\$203,131,901	\$16,282,675	7.4%
2013-14				
Revenues	\$208,666,624	\$206,965,802	(\$1,700,822)	(0.8%)
Expenditures	\$226,429,926	\$208,159,261	\$18,270,665	8.1%
2014-15				
Revenues	\$215,347,973	\$210,364,178	(\$4,983,795)	(2.3%)
Expenditures	\$233,058,885	\$215,202,496	\$17,856,389	7.7%

As we also reported in 2009, employee benefits represented the majority of the overestimated appropriations. From fiscal years 2012-13 through 2014-15, employee benefits were overestimated by an average of \$6.6 million (10.8 percent). Other appropriations that were consistently overestimated included programs for students with disabilities (by an average of \$2.9 million or 9.3 percent), teaching – regular school² (by an average of \$2.2 million or 3.5 percent), pupil transportation (by an average of \$1.4 million or 8.6 percent) and central services (by an average of nearly \$663,000 or 4.3 percent).

District officials indicated that they budget conservatively to ensure appropriations will be available for unanticipated expenditures. However, employee salaries and benefits costs are driven by contractual agreements and, therefore, should be reasonably predictable and not consistently overestimated.

Despite these expenditure variances, the District has reported operating deficits for each of the last three fiscal years, as indicated in Figure 2. The deficits occurred because the Board appropriated an average of \$3.9 million in fund balance each year, which made it appear that it would be using it to fund operations. The District also appropriated \$12.8 million in reserves in each of the last three fiscal years. However, because the Board has not adopted realistic budgets, the District has actually used an average of \$238,534 of unassigned fund balance (6 percent) and \$1.5 million of reserves (11 percent).

² Teaching – Regular School includes, among other things, teachers’ salaries.

Figure 2: Unassigned Fund Balance at Year-End			
	2012-13	2013-14	2014-15
Total Beginning Fund Balance	\$33,504,176	\$33,232,073	\$33,061,526
Add: Operating Surplus/(Deficit)	(\$272,103)	(\$170,547)	(\$3,876,383)
Total Ending Fund Balance	\$33,232,073	\$33,061,526	\$29,185,143
Less: Restricted Funds	\$19,277,586	\$18,892,176	\$14,925,848
Less: Encumbrances (Assigned Funds)	\$1,075,302	\$1,022,912	\$961,935
Less: Appropriated Fund Balance for the Ensuuing Year	\$3,865,000	\$3,865,000	\$3,865,000
Total Unassigned Funds at Year-End	\$9,014,185	\$9,281,438	\$9,432,360
Ensuuing Year's Budgeted Appropriations	\$225,354,624	\$232,035,973	\$235,809,197
Unassigned Funds as Percentage of Ensuuing Year's Budget	4.0%	4.0%	4.0%

Despite presenting budgets to District residents each year that made it appear that the District was depleting its reserves and fund balance, the Board's continued overestimation of appropriations has actually resulted in the District's unassigned fund balance increasing. When unused appropriated fund balance was added back, the District's recalculated unassigned fund balance was nearly 6 percent of the ensuing year's appropriations, exceeding the statutory limit by almost 2 percentage points each year, as indicated in Figure 3.

During fiscal year 2014-15, the Board appropriated \$9.4 million from its reserves and another \$3.9 million in fund balance for the 2015-16 budget. However, District officials project that they will use \$4.3 million (46 percent) from reserves but they will not use the appropriated fund balance. As such, we expect the District's unassigned fund balance will continue to exceed the statutory limit.

Figure 3: Unused Fund Balance			
	2012-13	2013-14	2014-15
Reported Unassigned Fund Balance	\$9,014,184	\$9,281,438	\$9,432,360
Reported Fund Balance as a Percentage of Ensuuing Year's Appropriations	4.00%	4.00%	4.00%
Add: Appropriated Fund Balance Not Used to Fund Ensuuing Year's Budget	\$3,694,453	\$3,865,000 ^a	\$3,865,000
Recalculated Unassigned Fund Balance	\$12,708,637	\$13,146,438	\$13,297,360
Recalculated Unassigned Fund Balance as Percentage of Ensuuing Year's Appropriations	5.6%	5.7%	5.6%

^a The District financed the 2014-15 deficit of \$3,876,383 with reserve funds. Therefore, it did not use its appropriated fund balance in this year.

These budgeting practices made it appear that the District needed to both raise taxes and use fund balance and reserves to close projected budget gaps. However, the District's budgets resulted in significantly less fund balance and reserves being used than had been indicated in each of the three years that we reviewed. The Board increased the tax levy from \$123.8 million in 2012-13 to \$133.6 million in 2015-16,

an increase of about 8 percent. Furthermore, the practice of annually appropriating fund balance that is not needed to finance operations is, in effect, a reservation of fund balance that is not provided for by statute and a circumvention of the statutory limit imposed on the level of unassigned fund balance.

Recommendations

The Board should:

1. Develop realistic estimates of appropriations and the use of fund balance in the annual budget.
2. Discontinue the practice of adopting budgets that result in the appropriation of unassigned fund balance and reserves that are not needed to fund District operations.
3. Use the surplus fund balance identified in this report in a manner that benefits District residents. Such uses could include:
 - Using surplus funds as a financing source;
 - 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 pages.

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AT CENTEREACH

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Roberta A. Gerold, Ed.D., Superintendent of Schools
Francine McMahon, Deputy Superintendent for Instruction
Herbert B. Chessler, Assistant Superintendent for Business
James G. Donovan, Assistant Superintendent for Human Resources

May 31, 2016

Ira McCracken, Chief Examiner
Office of the State Comptroller
Division of Local Government and School Accountability
NYS Office Building, Room 3A10
250 Veterans Memorial Highway
Hauppauge, New York 11788-5533

Dear Mr. McCracken,

The Middle Country School District is in receipt of the New York State Comptroller's Audit of its budgeting practices. We have carefully reviewed the report, compared its findings and recommendations to our current practices, and offer the following in response:

We would like to acknowledge the courtesy and professionalism of the Comptroller's auditors assigned to our audit. They were respectful to our staff and of district resources, careful to minimize impact on our daily operations and considerate of our perspectives regarding the findings of the audit.

Budget processes are multiyear in nature and must be so in order to ensure reasonableness, efficacy and accuracy, constructs we take very seriously in Middle Country. Our budgets are built six months prior to the start of the year they are to cover, a full eighteen months prior to the end of those school years. We closely examine each budget line, apply actual expenses incurred versus anticipated expenditures in the future. We believe that the resultant budgets are realistic, supportive of our students and respectful of our community's support of its public school system. We are very proud that, in Middle Country, programs and services for students have been preserved, and new programs such as STEM, initiated, something that is not mentioned in your report.

The district, in the three years included in this report, expended 92.6%, 91.9% and 92.3% of the budgeted amount respectively, a budget that was in excess of \$218 million in the initial year included in this report. This pattern of expenditure represents realistic, tight budgeting practices and fiscal responsibility.

The audit report fails to acknowledge examples of actions that evidence fiscal responsibility. The district, for example, realized savings of over \$4 million through negotiations with its bargaining units to remove a majority of the more costly health plan offerings that had been available to the various units.

Middle Country has consistently maintained, not increased, the 4% unassigned fund balance allowed by law. To suggest otherwise because of an accounting interpretation is a misstatement of facts.

See
Note 1
Page 11

The mission of the MCCSD is to empower and inspire all students to apply the knowledge, skills, and attitudes necessary to be creative problem solvers, to achieve personal success, and to contribute responsibly in a diverse and dynamic world.

We remind you that in the years 2013/14, 2014/15 and 2015/16, the district stayed within a restrictive tax cap, putting forth tax levy amounts below the allowable tax cap percentage in two of those years and advancing a tax levy for the 2016-17 school year which is below the prior year. To intimate in any way that we should have used additional reserve funds/fund balance to further reduce a tax levy which has already been rendered anemic through a poorly thought out tax cap formula, is, in our opinion, short sighted and indicative of fiscal irresponsibility.

See
Note 2
Page 11

We are now in a position where our dwindling reserves, which have decreased by approximately 36% since 2010, caused Moody's investment services to revise our rating outlook to negative. This outlook statement may cost our local taxpayers hundreds of thousands of dollars in future borrowing costs.

See
Note 3
Page 11

The Middle Country Central School District believes in continuous improvement of its functions so that students – and community, may be well served. We reflect on processes, consider all recommendations and make adjustments when appropriate. Therefore, while we acknowledge your statements and recommendations, any corrective actions would imply that we are in agreement with your report, which we are not. The Middle Country Central School District will continue its practices of fiscally responsible, student centered budgeting.

See
Note 4
Page 11

Sincerely,

Roberta A. Gerold, Ed.D.
Superintendent of Schools

RAG:mvl

cc: Board of Education
Herbert Chessler, Assistant Superintendent for Business
Stephanie Larkin, District Clerk

The mission of the MCCSD is to empower and inspire all students to apply the knowledge, skills, and attitudes necessary to be creative problem solvers, to achieve personal success, and to contribute responsibly in a diverse and dynamic world.

APPENDIX B

OSC COMMENTS ON THE DISTRICT'S RESPONSE

Note 1

The District reported that fund balance was within the statutory limit because it was reduced by the amount of fund balance appropriated to fund operations. However, because the District actually needed only a fraction of the amount appropriated, the District maintained an actual unassigned fund balance that exceeded the statutory limit.

Note 2

Our report does not say the District should use more reserves or fund balance. When District officials appropriate fund balance, they are telling the public they need to use fund balance to finance operations. When District officials consistently appropriate more fund balance than is actually needed, they are not being transparent about their estimated financial results. For the last three years, District officials have appropriated fund balance equal to nearly 16 times what was needed.

Note 3

From June 30, 2010 through June 30, 2015, the District's reserves decreased by \$5.7 million, or 27.6 percent. The total reserve balance as of June 30, 2015 of approximately \$15 million is equivalent to more than 6 percent of the 2015-16 budget.

Note 4

Regardless of whether the District agrees with our report, General Municipal Law, Education Law and the Regulations of the Commissioner of Education require that a written CAP addressing the findings and recommendations in this report be prepared and provided to our office within 90 days of this report being issued.

APPENDIX C

AUDIT METHODOLOGY AND STANDARDS

The objective of our audit was to examine the District's budgeting practices for the period July 1, 2012 through November 30, 2015. To achieve our audit objective and obtain valid evidence, we performed the following procedures:

- We interviewed District officials to gain an understanding of the District's financial condition and budgeting processes.
- We reviewed the District's policies for developing and reporting information relevant to budgeting activities.
- We reviewed our last issued report and the District's budgets and financial reports to gain a historical perspective of trends regarding budgeted appropriations in comparison to actual expenditures.
- We compared budgeted revenues and appropriations to actual results for fiscal years 2012-13 through 2014-15 to determine whether budgets were realistic and structurally balanced.
- We reviewed and analyzed reported fund balance and reserve levels in comparison to amounts appropriated in adopted budgets for the fiscal years 2012-13 through 2014-15.

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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