

East Moriches Union Free School District

Financial Condition Management

JUNE 2022



OFFICE OF THE NEW YORK STATE COMPTROLLER
Thomas P. DiNapoli, State Comptroller

Contents

- Report Highlights 1**

- Financial Condition Management 2**
 - What Is Effective Financial Condition Management? 2
 - District Officials Overestimated Appropriations and Did Not Use
Appropriated Fund Balance 2
 - The Board Exceeded the Statutory Limit for Surplus Fund Balance. . 4
 - The Retirement Contribution Reserve Was Excessive 5
 - What Do We Recommend? 7

- Appendix A – Response From District Officials 8**

- Appendix B – Audit Methodology and Standards 9**

- Appendix C – Resources and Services 10**

Report Highlights

East Moriches Union Free School District

Audit Objective

Determine whether the East Moriches Union Free School District's (District) Board of Education (Board) and Superintendent effectively managed the District's financial condition.

Key Findings

The Board and Superintendent did not effectively manage the District's financial condition.

- District officials overestimated appropriations, which made it appear that the District needed to increase taxes and use appropriated fund balance to close projected budget gaps, but the appropriated fund balance was not used to finance operations.
- The surplus fund balance has continuously grown over the past five fiscal years. As of June 30, 2021, it was over \$7.1 million, or 24.3 percent of the next year's budget, exceeding the 4 percent statutory limit.
- The District's budgeted appropriations from 2016-17 through 2020-21 exceeded actual expenditures by \$6.3 million, or 4.5 percent.
- Officials did not use the retirement contribution reserve to pay annual retirement contributions. Its excessive balance is enough to cover annual retirement contributions for nine years.

Key Recommendations

- Develop and adopt realistic budgets and a comprehensive reserve policy.
- Comply with the statutory fund balance limit.
- Develop a plan to use excess surplus fund balance that benefits District taxpayers.

District officials generally agreed with our findings and indicated they plan to initiate corrective action.

Background

The District is located in the Town of Brookhaven, Suffolk County.

The elected five-member Board is responsible for managing the District's financial and educational affairs.

The Superintendent is responsible for the District's day-to-day management and developing the budget.

2020-21 Quick Facts

Enrollment	1,048
Employees	109
Total Expenditures	\$27,371,679
Budgeted Appropriations	\$29,365,342

Audit Period

July 1, 2020 – June 30, 2021

We extended the audit period back to July 1, 2016 to analyze trends in budgeting and reserves.

Financial Condition Management

What Is Effective Financial Condition Management?

To effectively manage financial condition, a board should adopt realistic and structurally balanced budgets based on historical data or known trends, in which recurring revenues finance recurring expenditures. In preparing the budget, a board estimates how much the district will spend and the amount it will receive in revenues, how much fund balance will be available at year-end and the expected tax levy needed to balance the budget. Accurate budget estimates help ensure the tax levy is not greater than necessary.

Fund balance is the difference between revenues and expenditures accumulated over time. A board may retain a portion of fund balance for unexpected events and cash flow within statutory limits. New York State Real Property Tax Law (RPTL) Section 1318 limits the amount of surplus fund balance¹ that a school district can retain to no more than 4 percent of the subsequent year's budget. When fund balance is appropriated in the budget, there is an expectation of a planned operating deficit (expenditures exceeding revenues) in the amount of the appropriated fund balance. This allows a district to use excess fund balance accumulated in prior years and reserves to finance current operations.

A board may establish reserves to restrict a portion of fund balance that it can use for specific purposes (e.g., capital projects or retirement contributions) in compliance with statutory requirements. However, reserve balances should be reasonable and should be routinely monitored by the board and district officials. This can be accomplished, in part, by adopting a comprehensive reserve policy addressing funding methods, optimal levels and use.

District Officials Overestimated Appropriations and Did Not Use Appropriated Fund Balance

We compared appropriations and estimated revenues in the adopted general fund budgets with actual revenues and expenditures for fiscal years 2016-17 through 2020-21 and found that revenue estimates were generally reasonable. However, over the five-year period, District officials overestimated appropriations, spending about \$6.3 million (4.5 percent) less than budgeted. While the average overestimation (4.5 percent) over the five years is not significantly material, the consistent practice and increasing level of overestimated appropriations led to operating surpluses totaling \$9.5 million, which helped increase fund balance over the past five years (Figure 1).

Accurate budget estimates help ensure the tax levy is not greater than necessary.

¹ Surplus fund balance is defined as unrestricted fund balance minus appropriated fund balance and encumbrances included in committed and assigned fund balance. See our accounting bulletin at <https://www.osc.state.ny.us/localgov/pubs/releases/gasb54.pdf>

Figure 1: General Fund Budget-to-Actual Comparison

	2016-17	2017-18	2018-19	2019-20	2020-21	Totals
Appropriations	\$26,874,825	\$27,387,799	\$28,001,605	\$28,858,591	\$29,365,342	\$140,488,162
Less Actual Expenditures	25,710,468	27,271,272	26,685,189	27,121,111	27,371,679	134,159,719
Variance	\$1,164,357	\$116,527	\$1,316,416	\$1,737,480	\$1,993,663	\$6,328,443
Variance as a Percentage	4.33%	0.43%	4.70%	6.02%	6.79%	4.50%
Operating Surplus^a	\$1,599,615	\$564,752	\$2,023,392	\$2,559,414	\$2,803,267	\$9,550,440

a) Operating Surplus = Actual Revenues less Actual Expenditures

We identified three budget codes that had overestimated appropriations in each of the five fiscal years totaling more than \$7.5 million (Figure 2). The remaining overestimated appropriations were distributed throughout the budget.

Figure 2: Overestimated Appropriations 2016-17 – 2020-21

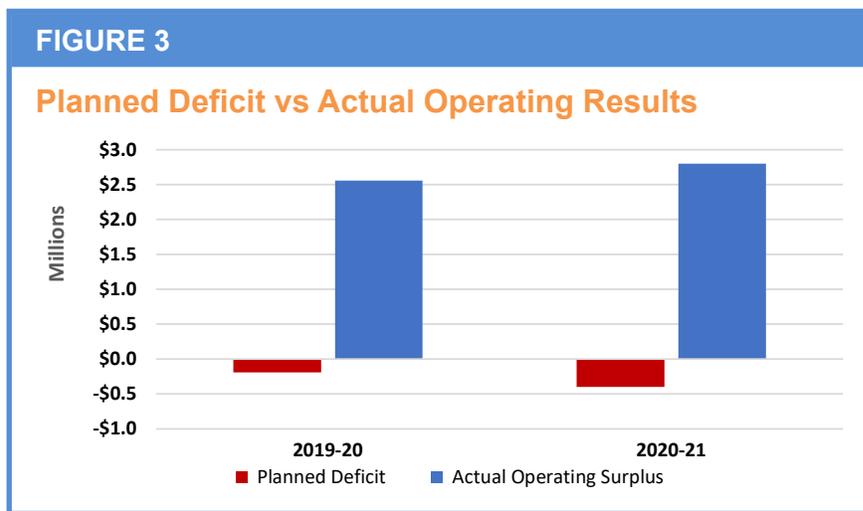
Appropriation	Overestimated	
	Percentage	Dollars
Contracted Services^a	36.7%	\$1,265,458
BOCES Services	27.8%	2,053,036
Tuition to Other Districts	9.2%	4,257,194
Total		\$7,575,688

a) Primarily for tuition for the District's Universal Pre-Kindergarten program.

The Superintendent stated that the District takes a conservative approach when budgeting for contracted services and tuition to other districts. The Superintendent also stated the contracted services budget includes costs for the total 70-80 students eligible to attend the Universal Pre-Kindergarten program; however, actual attendance is generally 40-50 students annually. Further, the Board of Cooperative Education Services (BOCES) services budget includes appropriations for resident special education students in which the District is eligible for reimbursement. The Superintendent told us that the 2016-17 and 2017-18 budgets mistakenly included these appropriations in more than one budget line, resulting in double budgeting. Finally, the Superintendent said the tuition rates for attending other districts are not available at the time the budget is developed, and tuition costs are significantly higher for special education students. Therefore, the District overestimates the expenditure in the event it receives additional special education students during the school year. However, instead of overestimating the appropriation, officials could have used the District's unrestricted fund balance for these unanticipated expenditures.

Because the Board and Superintendent overestimated appropriations, it appeared that more revenue and financing sources were needed to maintain structurally balanced budgets. This resulted in the Board levying more real property taxes than necessary.

Further, the Board appropriated fund balance as a financing source in 2019-20 and 2020-21, indicating the Board anticipated annual operating deficits equal to the amounts appropriated. However, because of the overestimated appropriations described above, the District generated operating surpluses totaling \$5.4 million in those two years (Figure 3) and did not need to use the appropriated fund balance totaling \$590,000.



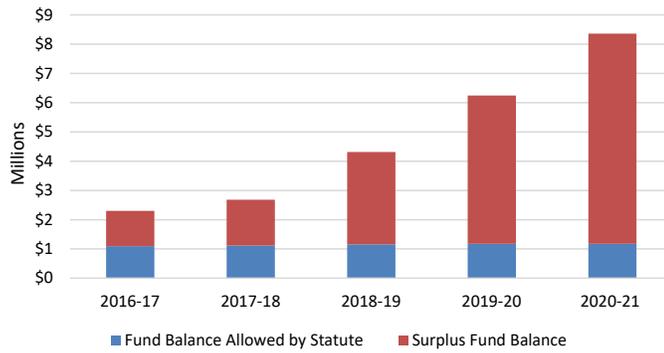
Ultimately, the Board's and Superintendent's general fund budgeting practices made it appear that the District needed to both increase taxes and use appropriated fund balance to close projected budget gaps. However, the District realized operating surpluses and did not need appropriated fund balance to finance operations.

The Board Exceeded the Statutory Limit for Surplus Fund Balance

As a result of the Board's and Superintendent's budgeting practice of overestimating appropriations, the District's reported surplus fund balance in the general fund exceeded the 4 percent statutory limit each year from 2016-17 through 2020-21. The surplus fund balance increased from \$1.2 million as of June 30, 2017 (4.4 percent of the 2017-18 budget) to over \$7.1 million as of June 30, 2021 (24.3 percent of the 2021-22 budget). This exceeded the statutory limit by approximately \$6 million, or 20.3 percentage points (Figure 4).

FIGURE 4

Surplus Fund Balance



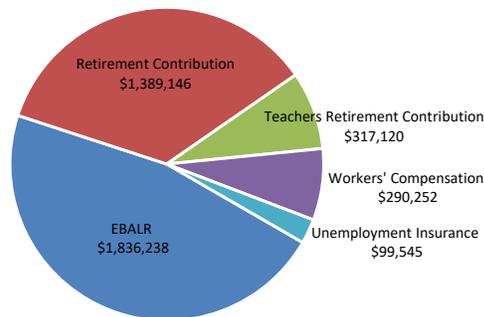
Given the District’s budgeting practices and fund balance levels, the Board levied more taxes than necessary to sustain operations and may have missed opportunities to manage fund balance more effectively.

The Retirement Contribution Reserve Was Excessive

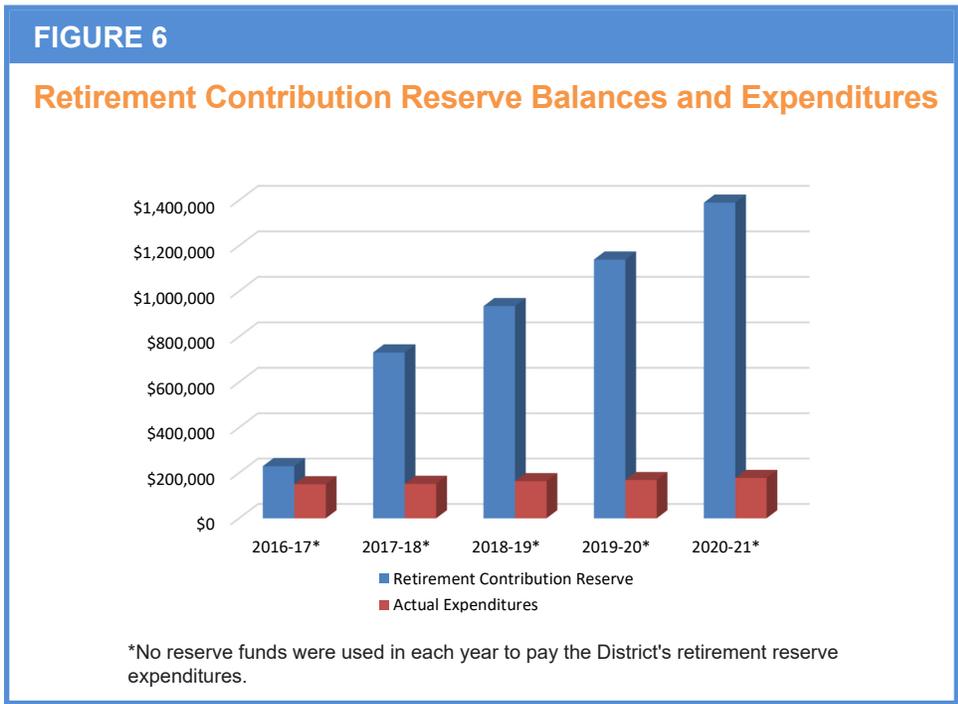
The Board did not establish an adequate reserve fund plan to ensure all restricted reserve funds were reasonable. The Board’s fund balance policy requires the Superintendent to review funding levels of all reserve funds. However, it does not state the purpose of each reserve, what funds can be used for, and the recommended funding levels for the reserves. As of June 30, 2021, the District had five reserves totaling approximately \$3.9 million (Figure 5).

FIGURE 5

Reserve Fund Balance



We reviewed each reserve to determine whether balances were reasonable. The employee benefits and accrued liabilities reserve (EBALR), workers' compensation, teachers' retirement contribution and unemployment insurance reserves appeared reasonable. However, the retirement contribution reserve appears to be overfunded. This reserve was established to fund payment contributions to the New York State and Local Retirement System. Since July 1, 2016, the balance in this reserve has increased by \$1.26 million and could cover annual retirement contributions for approximately nine years, based on the average contributions over the last five fiscal years of \$161,931 per year (Figure 6). The District did not use reserve funds for these expenditures over the five-year period, and instead provided appropriations in the annual budgets and paid them from the general fund.



District officials could not explain why this reserve balance was needed when the general fund budget included an appropriation of about \$177,000 each year to pay for these expenditures.

While it is prudent to plan and save for unforeseen circumstances, overfunding and/or not using reserves for their intended purpose results in property taxes being higher than necessary.

What Do We Recommend?

The Board should:

1. Adopt budgets with realistic appropriations and discontinue the practice of appropriating fund balance that will not be used to fund operations.
2. Maintain fund balance within the statutory limits and develop a plan to use excess surplus fund balance in a manner that benefits District taxpayers. Such uses include, but are not limited to:
 - a. Reducing real property taxes,
 - b. Financing one-time expenditures,
 - c. Establishing necessary reserves, and
 - d. Paying off debt.
3. Adopt a comprehensive reserve policy addressing funding methods, optimal levels and use.
4. Ensure that funds in the retirement contribution reserve are used for their intended purposes.

Appendix A: Response From District Officials



East Moriches Union Free School District

Middle School
9 Adelaide Avenue
East Moriches, New York 11940
Fax – (631) 909-1379

Elementary School
523 Montauk Highway
East Moriches, New York 11940
Fax – (631) 909-7505

Switchboard – (631) 909-7999
www.emoschools.org

Mr. Dean L. Mittleman
Superintendent of
Schools

Mr. William Holl
Middle School
Principal

Mr. Edward Schneyer
Elementary School
Principal

Ms. Michele Pepey
Director of Special
Education/PPS
Supervisor

Ms. Emily Eich
Curriculum
Coordinator/Assistant
Principal

May 23, 2022

Ira McCracken, Chief Examiner
NYS Office Building, Room 3A10
250 Veterans Memorial Highway
Hauppauge, NY 11788-5533

Dear Mr. McCracken:

The East Moriches Union Free School District has received and reviewed the draft Financial Condition Management Report of Examination 2022M-1 for the audit period 2016 through 2021. On behalf of the East Moriches Board of Education and the administrative team, we appreciate the work and professionalism demonstrated by the audit team. Most importantly, they were considerate of our perspectives regarding the findings of the audit. Please accept this letter as the District's response to our draft audit report.

The East Moriches Board of Education and administration spend many months developing and monitoring sound budgets and fiscal practices that balance the priorities of our school district. The Board of Education is committed to providing a robust educational program for its students while simultaneously being fiscally responsible to the larger community. The Board's commitment to fiscal responsibility is evidenced by a frozen tax levy for 2020-21, 2021-22, and 2022-23 school years.

The East Moriches Union Free School District acknowledges the findings and recommendations presented by the Office of the State Comptroller and will submit a written corrective action plan (CAP) in accordance with the applicable sections in New York State's General Municipal Law and Regulations of the Commissioner of Education. The District will continue to adopt conservative financial plans that manage the uncertain economic and social variables. East Moriches is proud of the reduced tax burden in the local tax levy while providing a strong educational experience for all of our children.

Sincerely,


Superintendent of Schools

Appendix B: Audit Methodology and Standards

We conducted this audit pursuant to Article V, Section 1 of the State Constitution and the State Comptroller's authority as set forth in Article 3 of the New York State General Municipal Law. To achieve the audit objective and obtain valid audit evidence, we performed the following audit procedures:

- We interviewed District officials and reviewed Board meeting minutes, relevant laws, District policies and the audited financial statements to gain an understanding of the District's fund balance management, procedures and budgeting practices.
- We reviewed the District's audited financial statements for a five-year period from 2016-17 through 2020-21 to determine whether the District was operating at a surplus/deficit. We then re-calculated unassigned fund balance to determine whether the District was within statutory limits.
- We reviewed District expenditure and revenue reports from 2016-17 through 2020-21 and compared budgeted appropriations to actual expenditures, and budgeted revenues to actual revenues to determine whether the District overestimated appropriations and underestimated revenues.
- We reviewed District reserve balances for a five-year period from 2016-17 through 2020-21 to determine whether reserves were reasonable or overfunded.

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

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

A written corrective action plan (CAP) that addresses the findings and recommendations in this report must be prepared and provided to our office within 90 days, pursuant to Section 35 of General Municipal Law, Section 2116-1(3) (c) of New York State Education Law and Section 170.12 of the Regulations of the Commissioner of Education. To the extent practicable, implementation of the CAP must begin by the end of the 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. We encourage the Board to make the CAP available for public review in the Clerk's office.

Appendix C: Resources and Services

Regional Office Directory

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

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

www.osc.state.ny.us/local-government/publications

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

www.osc.state.ny.us/local-government/fiscal-monitoring

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

www.osc.state.ny.us/local-government/publications

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

www.osc.state.ny.us/local-government/resources/planning-resources

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

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

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

www.osc.state.ny.us/local-government/required-reporting

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

www.osc.state.ny.us/local-government/publications

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

www.osc.state.ny.us/local-government/academy

Contact

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www.osc.state.ny.us/local-government

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