

# Connetquot Central School District

## Financial Management

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NOVEMBER 2019

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

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# Report Highlights

## Connetquot Central School District

### Audit Objective

Determine whether the Board and District officials effectively managed the District's financial condition.

### Key Finding

- The District reduced its total fund balance by \$12.3 million (20 percent) from June 30, 2017 to June 30, 2019. However, its unassigned fund balance remains at \$8 million,<sup>1</sup> 0.1 percentage points above the statutory limit.

### Key Recommendations

- Review the District's plan to continue reducing its surplus of unassigned fund balance to comply with the statutory limit in a manner that benefits District taxpayers.
- Develop budgets that include realistic estimates for revenues, appropriations and unassigned fund balance based on historical data and known trends.
- Adopt a comprehensive reserve policy that communicates the purpose and intent for establishing each reserve fund levels and conditions under which each fund's assets will be used or replenished.

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

### Background

The Connetquot Central School District (District) is located in the Town of Islip in Suffolk County.

The five-member Board of Education (Board) is responsible for managing financial and educational affairs. The School Superintendent is responsible for day-to-day District management and budget development. The Assistant Superintendent for Business and Operations (ASBO) is responsible for the District's business activities and operations.

#### Quick Facts

2018-19 Employees	1,353
2018-19 Enrollment	5,709
2018-19 General Fund Expenditures	\$188 million
2018-19 Year-End Unassigned Fund Balance <sup>a</sup>	\$8 million

a As per draft of audited financial statements

### Audit Period

July 1, 2016 – June 30, 2019

<sup>1</sup> As per an October 28, 2019 draft of the 2018-19 audited financial statements.

# Financial Management

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## What Is Effective Financial Management?

To effectively manage a school district's financial condition, a board must adopt reasonably estimated and structurally balanced budgets based on historical data or known trends, in which recurring revenues finance recurring expenditures. In preparing the budget, a board and district officials must estimate the district's spending, revenue, available fund balance at fiscal year-end, and the expected tax levy. Accurate estimates help ensure that the real property tax levy is not greater than necessary.

Fund balance represents the cumulative residual resources from prior fiscal years. New York State Real Property Tax Law (RPTL)<sup>2</sup> currently limits unassigned fund balance to no more than 4 percent of the next year's budget. Any unassigned fund balance over this percentage must be used to fund needed reserves or reduce the upcoming year's real property tax levy. When fund balance is appropriated for the ensuing year's budget, the expectation is that there will be a planned operating deficit equal to the amount of fund balance that was appropriated. Additionally, a board should adopt a fund balance policy to ensure sufficient funding for necessary operations is available and that the real property tax levy is not greater than necessary.

Finally, districts can establish reserves to accumulate reasonable funds for certain future purposes (e.g., capital project, retirement expenditures). District officials should plan for the funding and use of reserves by balancing the desire to accumulate funds for future needs against their obligation to ensure that the district's real property tax levy is not greater than necessary. Ideally, amounts to be placed in reserves should be included in the annual budget to ensure taxpayers are aware of the board's intent to fund reserves in the upcoming year.<sup>3</sup>

## The Board and District Officials Need to Improve Budgeting Practices

The District incurred operating deficits in two of the last three fiscal years, resulting in a \$12.3 million (20 percent) decrease in total fund balance – from \$60.3 million as of June 30, 2017 to \$48 million as of June 30, 2019 (Figure 1). This was due, in large part, to use of approximately \$10.5 million in fund balance to retire debt in 2017-18. Approximately \$36.5 million of fund balance was restricted in reserve funds as of June 30, 2019. However, approximately \$8 million was unassigned fund balance.<sup>4</sup> This is equivalent to 4.1 percent of the next year's budget, which is still slightly above the statutory limit, despite the District's efforts to reduce fund balance and its annual budget development guidelines specifying that District officials should maintain a target unassigned fund balance between 3 percent and 4 percent.

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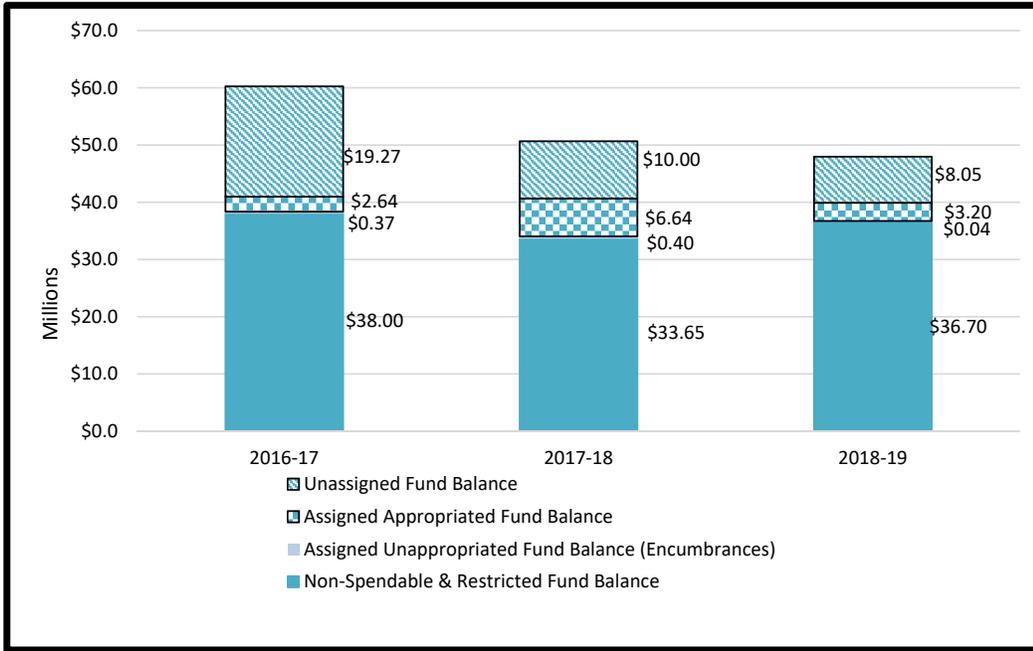
2 New York State Real Property Tax Law (RPTL), Section 1318

3 Refer to our publication *Reserve Funds* available at [www.osc.state.ny.us/localgov/pubs/lgmg/reservefunds.pdf](http://www.osc.state.ny.us/localgov/pubs/lgmg/reservefunds.pdf).

4 As per an October 28, 2019 draft of the 2018-19 audited financial statements.

**FIGURE 1**

**Total Year-End Fund Balance**



Despite incurring operating deficits, the District annually adopted budgets that overestimated expenditures by \$1.8 million to \$8.3 million<sup>5</sup> and underestimated revenues by \$1.8 million to \$6 million. While unanticipated State aid generally accounted for revenue variances, employee benefits represented the largest portion of overestimated appropriations. Specifically, the employees’ retirement system (ERS) contribution was overestimated by an average of \$857,325 or 23 percent, social security was overestimated by an average of \$1.1 million or 13.1 percent, and the teachers’ retirement system (TRS) contribution was overestimated by an average of \$905,595 or 10.4 percent. Employee salaries and related benefits costs are driven by contractual agreements and contribution rates established by and available from the retirement systems. Therefore, these amounts are reasonably predictable and should not be overestimated by such significant amounts.

<sup>5</sup> Excluding \$10.5 million of debt service expenditures over the 2017-18 budgeted amount, as this was a mid-year decision to retire debt early using fund balance.

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The District's 2019-20 budget includes a TRS contribution of \$7,210,405, which is in line with past expenditures and the published 2019-20 contribution rate. However, the adopted social security appropriation of \$8,591,716 is a 15.8 percent increase over the 2018-19 expenditure when this amount typically increases by 3 percent per year. In addition, the ERS contribution appropriation stayed at \$3.6 million when the 2018-19 expenditure was \$2.8 million and the contribution rate did not change. Payments in lieu of taxes (PILOTs) represented the majority of underestimated revenues, with District officials routinely budgeting for approximately half of the amounts received each year. District officials appear to have corrected this in the District's 2019-20 budget.

The Board also routinely adopts a resolution at the end of each fiscal year to transfer amounts not to exceed those specified in the resolutions to reserves from operating surpluses and/or available unassigned fund balance to stay within, or at least closer to, the 4 percent statutory limit. For example,

- On June 19, 2017, the Board authorized transfers not to exceed \$2,730,000 to the Employee Retirement Contribution Reserve, \$1,320,000 to the Workers' Compensation Reserve and \$1,000,000 to the Employee Benefit Accrued Liability Reserve (EBALR). The District transferred \$2,730,000 to the Employee Retirement Contribution Reserve on June 30, 2017. It did not make transfers to the other reserves.
- On June 12, 2018, the Board authorized transfers not to exceed \$2,500,000 to the Employee Retirement Contribution Reserve, \$1,500,000 to the EBALR, \$160,000 to the Workers' Compensation Reserve and \$20,000 to the Unemployment Insurance Reserve. The District transferred \$2,206,222 to the Employee Retirement Contribution Reserve and \$160,000 to the Workers' Compensation Reserve on June 30, 2018.
- On May 14, 2019, the Board authorized transfers not to exceed \$2,915,000 to the Employee Retirement Contribution Reserve, \$1,290,000 to the Workers' Compensation Reserve, \$1,200,000 to the EBALR, \$101,204 to the Repair Reserve and \$20,000 to the Unemployment Insurance Reserve. The District did not make any transfers to these reserves.<sup>6</sup>

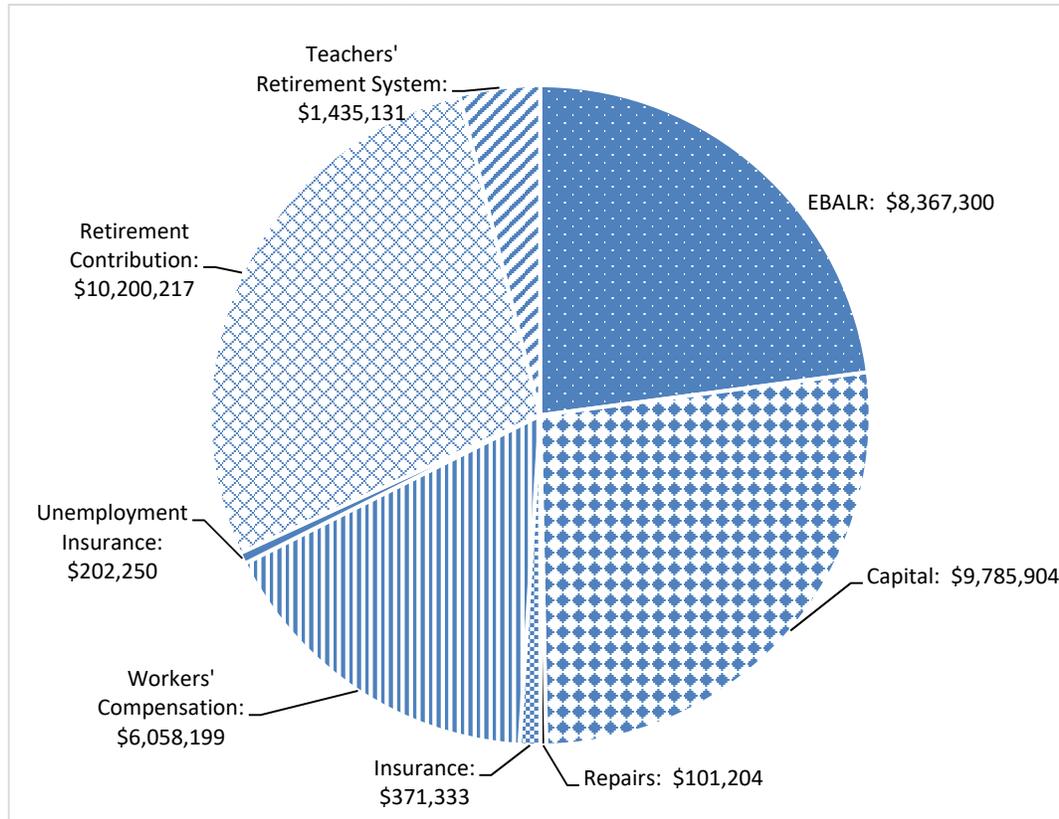
Ideally, reserve financing should be included in the annual budget so taxpayers are given an opportunity to know the Board's plan for funding its reserves. The District's current method of funding reserves by transferring money from operating surpluses and/or available unassigned fund balance is not transparent. Further, these transfers occurred generally without adequate Board approval because the related Board resolutions indicated only an amount "not to exceed" those specified for the transfers. As of June 30, 2019, the District reported \$36.52 million in eight reserves (Figure 2).

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<sup>6</sup> According to the District's unaudited records, as of September 9, 2019.

**FIGURE 2**

**Reserve Funds Balances as of 6/30/2019**



The Board has not adopted a reserve fund policy or created a formal written plan to govern the funding and use of reserves. However, the District's annual budget guidelines indicate that the District will use reserves to help alleviate tax increases. The Board generally reviews the District's reserves annually. However, we question the need for the insurance reserve totaling \$371,333 as of June 30, 2019, as the District has insurance coverage for known risks. Further, District officials have not used the reserve to fund related expenditures during the last three completed years. The Board can discontinue this reserve if it determines it is unnecessary, but money from the discontinued reserve must be transferred in compliance with statute.

By overestimating expenditures, underestimating revenues and maintaining an overfunded and/or unnecessary reserve, District officials have levied more taxes than necessary to sustain District operations and may have compromised the transparency of District finances.

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## What Do We Recommend?

The Board should:

1. Review its plan to continue reducing the District's surplus of unassigned fund balance to comply with the statutory limit in a manner that benefits District taxpayers. Surplus funds can be used as a financing source for:
  - Funding one-time expenditures;
  - Funding needed reserves;
  - Paying off debt; and
  - Reducing District property taxes.
2. Adopt budgets that include realistic estimates for revenues, appropriations and unassigned fund balance based on historical data and known trends.
3. Adopt a comprehensive reserve policy that clearly communicates the purpose and intent for establishing each reserve fund, the manner in which the Board will fund and maintain each reserve fund, and the optimal or targeted funding levels and conditions under which each fund's assets will be used or replenished.
4. Review reserve fund balances and develop a plan to bring the balances into compliance with the reserve policy.

District officials should:

5. Prepare an estimate of year-end fund balance to assist in developing and adopting budgets that include reasonable estimates for appropriations, revenues and the amount of fund balance needed to fund operations.
6. Develop budgets that include realistic estimates for revenues, appropriations and unassigned fund balance based on historical data and known trends.

# Appendix A: Response From District Officials



**CONNETQUOT CENTRAL SCHOOL DISTRICT OF ISLIP**  
CENTRAL OFFICES: 780 Ocean Avenue, Bohemia, New York 11716-3629  
(631) 244-2215 • Fax (631) 589-0683  
District Website: [www.connetquot.k12.ny.us](http://www.connetquot.k12.ny.us)

## Board of Education

**Milynn Augulis, President**  
**Eileen Panico, Vice President**  
**Lee Kennedy, Trustee**  
**Jaclyn Napolitano-Furno, Trustee**  
**Mark Warshaw, Trustee**

**Mary Jane Budde, District Clerk**

**Lynda G. Adams, Ed.D.**  
**Superintendent of Schools**

Mr. Ira McCracken, Chief Examiner  
Division of Local Government and School Accountability  
Hauppauge Regional Office  
NYS Office Building, Room 3A10, 250 Veterans Memorial Highway, Hauppauge, NY 11788-5533

The Connetquot Central School District of Islip is in receipt of the draft State Audit concerning the District's Financial Management and its Financial Condition. First, the District thanks the team from the Office of the State Comptroller for their efforts on our behalf. They comported themselves professionally in examining the District's finances, interfacing with the District staff very efficiently. We thank them for their hard work and diligence.

The District finds that the data is represented fairly and accurately and demonstrates the District's continued efforts to comply with state regulations regarding reserves. The report notes that the District's Independent Auditor had not yet concluded its annual audit as of the date of this audit report, September 8, 2019.

This letter addresses the contents of the audit and specifically the key recommendations contained therein. There are three key recommendations:

1. "Review the District's plan to continue reducing its surplus of unassigned fund balance to comply with the statutory limit in a manner that benefits District taxpayers."

*The audit reveals that the District has been progressively decreasing the unassigned / unreserved fund balance as a percentage of the subsequent year's budget from 10.3% to 5.2% and most recently to 4.8 %. The District plans to continue this progression toward full compliance with the regulation.*

2. "Develop budgets that include realistic estimates for revenues, appropriations and unassigned fund balance based on historical data and known trends."

*The report notes that the District overestimated expenditures in key benefit areas, notably the Employees' Retirement System (ERS), the Teachers' Retirement System (TRS) and Social Security. The former two systems, while currently experiencing favorable performance results have, in the past, been subject to fairly substantial increases in that their rate structure is based on profits released through investments. The District will continue to monitor these funds and their budgetary implications. Additionally, health insurance premiums have been volatile over time. That premiums change in mid-year makes predictions more difficult. The District errs on the side of caution when predicting the impact 10 months in advance. On the revenue side, the District has been cautious with estimating state aid noting that state aid for 2019/2020 has actually been reduced, an unforeseen occurrence. Conversely, late in one year, 2017/2018, the District received additional and unforeseen state aid for prior years of almost \$3.6 million. Prudent planning*

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*recognizes the uncertainty of state aid on an annual basis as well as levels of expenditures outside of the District's sphere of control such as those cited in the report. Nevertheless, the District will closely monitor trends and forecasts in each of these areas.*

3. "Adopt a comprehensive reserve policy that communicates the purpose and intent for establishing each reserve fund levels and conditions under which each fund's assets will be used or replenished."

*The District will take this recommendation under advisement and refer the issue to the Board's Policy Committee, which has the sole authority to effect policy changes. One reserve is cited for potential dissolution as it has not been utilized for several years, that being the Insurance Reserve. The District is aware of recently passed legislation, the Child Victims Act, which expands the time frame significantly for the filing of allegations of harassment and victimization. It is unknown at this time what the impact of this legislation may be and thus this reserve should not only be retained but increased until there is more clarification on the law's ramifications.*

The District accepts the audit report while noting the exceptions discussed above. Again, we thank the team for their efforts on our behalf and the District will continue to incorporate their suggestions into budget planning and future actions.

Sincerely,

Lynda G. Adams, Ed.D.  
Superintendent of Schools

## Appendix B: Audit Methodology and Standards

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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, our audit procedures included the following:

- We interviewed District officials and reviewed Board minutes, policies and procedures, and documentation relevant to short- and long-term planning to gain an understanding of the budgeting and financial management processes and procedures, including the rationale for determining the levels to maintain for unassigned fund balance and reserves.
- We compared budgeted appropriations and estimated revenues to actual results for the last three completed fiscal years and identified significant variances.
- We reviewed the adopted 2019-20 general fund budget to determine whether District officials had addressed the significant variances we identified in previous years in the District's budgeted appropriations and estimated revenues.
- We calculated general fund operating results for the past three years and assessed the use of budgeted appropriated fund balance.
- We calculated unassigned fund balance as a percentage of the next year's appropriations to assess District compliance with statute.
- We analyzed reserve fund balances to determine whether balances were reasonable and/or used as intended.

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.

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

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### **Regional Office Directory**

[www.osc.state.ny.us/localgov/regional\\_directory.pdf](http://www.osc.state.ny.us/localgov/regional_directory.pdf)

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

[www.osc.state.ny.us/localgov/costsavings/index.htm](http://www.osc.state.ny.us/localgov/costsavings/index.htm)

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

[www.osc.state.ny.us/localgov/fiscalmonitoring/index.htm](http://www.osc.state.ny.us/localgov/fiscalmonitoring/index.htm)

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

[www.osc.state.ny.us/localgov/pubs/listacctg.htm#lmgm](http://www.osc.state.ny.us/localgov/pubs/listacctg.htm#lmgm)

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

[www.osc.state.ny.us/localgov/planbudget/index.htm](http://www.osc.state.ny.us/localgov/planbudget/index.htm)

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

[www.osc.state.ny.us/localgov/pubs/cyber-security-guide.pdf](http://www.osc.state.ny.us/localgov/pubs/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/localgov/finreporting/index.htm](http://www.osc.state.ny.us/localgov/finreporting/index.htm)

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

[www.osc.state.ny.us/localgov/researchpubs/index.htm](http://www.osc.state.ny.us/localgov/researchpubs/index.htm)

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

[www.osc.state.ny.us/localgov/academy/index.htm](http://www.osc.state.ny.us/localgov/academy/index.htm)

## Contact

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