Office of the New York State Comptroller

Division of Local Government
& School Accountability

Hewlett-Woodmere Union Free School District

Financial Condition

Report of Examination

Period Covered:

July 1, 2012 – May 31, 2016

2016M-402

Thomas P. DiNapoli

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State of New York
Office of the State Comptroller

Division of Local Government
and School Accountability

January 2017

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 Hewlett-Woodmere 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

State of New York
Office of the State Comptroller

EXECUTIVE SUMMARY

The Hewlett-Woodmere Union Free School District (District) is located in the Town of Hempstead, Nassau 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 the District's day-to-day management under the Board's direction. The Deputy Superintendent for Business[1] was responsible for overseeing the District's Business Office and supervising the employees who maintain the District's financial records. These responsibilities included developing and administering the budget.

The District operates five schools with approximately 3,000 students and 660 employees. The District's budgeted appropriations for the 2014-15 fiscal year were approximately $112 million, which were funded primarily with State aid and real property taxes. Budgeted appropriations for the 2015-16 fiscal year were $113.6 million.

Scope and Objective

The objective of our audit was to review the District's financial condition for the period July 1, 2012 through May 31, 2016. We extended our scope forward through June 30, 2016 to analyze the District's fund balance, budget practices and reserve fund trends. Our audit addressed the following related question:

- Did the Board and District officials ensure that budget estimates were reasonable and appropriately maintain fund balance?

Audit Results

The Board and District officials did not ensure that budget estimates were reasonable and did not properly manage fund balance. The District's budgeted appropriations were overestimated by $31.1 million (10.4 percent) from 2012-13 through 2014-15. In addition, the District's adopted budgets for the same years included appropriated fund balance totaling $9.6 million.[2] However, because the Board overestimated expenditures over the three-year period, the appropriated fund balance was not used,

[1] The Deputy Superintendent for Business retired on June 30, 2016 and was replaced by an Assistant Superintendent for Business on July 1, 2016.

[2] Includes $3,526,205 appropriated from 2011-12 to finance 2012-13 operations.

resulting in the District's unrestricted fund balance exceeding the statutory limits. When the unused appropriated fund balance is added back to the District's unrestricted fund balance, the recalculated fund balance was as much as 6.5 percent of the subsequent year's appropriations. We also reviewed the results of operations for the 2015-16 fiscal year and found that appropriations were overestimated by as much as $11.4 million.

The Board also overfunded six of its reserve funds by almost $30.5 million. District officials did not have documentation establishing the employee benefits accrued liability reserve (EBALR) and the insurance reserve totaling $17.2 million. Officials accumulated funds in these two reserves for purposes not permitted by law. As of June 30, 2015, the District's compensated absence liability was approximately $2.1 million and the EBALR balance was $13.4 million. Officials explained that the EBLAR fund includes $11.7 million accumulated for other post-employment benefit (OPEB) costs. District officials also improperly established, funded and used the insurance reserve fund to pay for dental and vision costs, which is not permitted by law. As of June 30, 2015 the insurance reserve had a balance of $3.9 million. Because the District's identified use is a self-insured dental program and GML does not permit health insurance related expenditures, the District's use of this reserve is not permitted by law. Therefore, the entire $3.9 million balance is considered to be overfunded. The Board also overfunded the retirement contribution reserve by $10.8 million, property loss and liability reserve by $3.4 million and unemployment insurance reserve by $653,000. As a result, the Board may have levied more taxes than needed for District operations. Finally, the Board transferred $327,704 more from reserves[3] than the actual related expenditures for compensated absences, unemployment insurance and property loss and liability claims.

Comments of District Officials

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. Except as specified in Appendix A, District officials generally agreed with our recommendations and indicated they planned to take corrective action. Appendix B includes our comment on an issue raised in the District's response.

[3] $25,000 excess from property loss reserve, $175,450 excess from unemployment reserve and $127,254 excess from the EBALR

Introduction

Background

The Hewlett-Woodmere Union Free School District (District) is located in the Town of Hempstead, Nassau 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 the District's day-to-day management under the Board's direction. The Deputy Superintendent for Business[4] was responsible for overseeing the District's Business Office and supervising the employees who maintain the District's financial records. These responsibilities included developing and administering the budget.

The District operates five schools with approximately 3,000 students and 660 employees. The District's budgeted appropriations for the 2014-15 fiscal year were approximately $112 million, which were funded primarily with State aid and real property taxes. Budgeted appropriations for the 2015-16 fiscal year were $113.6 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 ensure that budget estimates were reasonable and appropriately maintain fund balance?

Scope and Methodology

We examined the District's financial condition for the period July 1, 2012 through May 31, 2016. We extended our scope forward through June 30, 2016 to analyze the District's fund balance, budget practices and reserve fund trends.

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. Except

[4] The Deputy Superintendent for Business retired on June 30, 2016 and was replaced by an Assistant Superintendent for Business on July 1, 2016.

as specified in Appendix A, District officials generally agreed with our recommendations and indicated they planned to take corrective action. Appendix B includes our comment on an issue raised in the District's 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 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 residents who fund the District's programs and operations. This responsibility includes adopting budgets with realistic expenditure estimates, appropriating fund balance only to the extent necessary to fund District operations and ensuring reserve funds are legally established and reasonably funded. Accurate budget estimates and the appropriate use of reserve funds help ensure that the real property tax levy is not greater than necessary and that the budget process is transparent. Any remaining fund balance, exclusive of the amount allowed by law to be retained to address cash flow and unexpected occurrences, should be used in the District's best interest.

The Board and District officials did not ensure that budget estimates were reasonable and did not properly manage fund balance. The Board adopted budgets for fiscal years 2012-13 through 2014-15 that appropriated fund balance totaling $9.6 million.[5] However, because the Board overestimated expenditures by $31 million over the three-year period, the appropriated fund balance was not used. As a result, the District's unrestricted fund balance has exceeded statutory limits. When adding back unused appropriated fund balance, the District's recalculated unrestricted fund balance was as much as 6.5 percent of the subsequent year's appropriations.

Additionally, District officials did not have documentation establishing two reserve funds totaling $17.2 million and accumulated funds in these two reserves for purposes not permitted by law. Further, the Board transferred $327,704 more from reserves than actual related expenditures and overfunded six of its reserve funds by almost $30.5 million.[6] As a result, the Board may have levied more taxes than necessary to operate the District.

Budgeting and Use of Fund Balance

When preparing the budget, the Board must estimate revenues, expenditures and the amount of fund balance that will be available at year-end, some or all of which may be used to fund the subsequent year's appropriations. 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 or expenditures. Unrealistic

[5] Includes $3,526,205 appropriated from 2011-12 to finance 2012-13 operations.

[6] EBALR ($11.7 million), retirement contribution ($10.8 million), insurance ($3.9 million), property loss ($3.4 million), liability ($3.4 million) and unemployment insurance ($653,000).

budget estimates can mislead District residents and have a significant impact on the District's year-end surplus fund balance and financial condition.

New York State Real Property Tax Law (RPTL) requires school districts to maintain their unrestricted fund balance at or below 4 percent of the subsequent year's appropriations. Any unrestricted funds that exceed the statutory limit may be assigned to fund the next year's appropriations to reduce the tax levy. When the Board appropriates fund balance 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 appropriated fund balance. The Board should not appropriate more fund balance than necessary to fund District operations.

Overestimated Appropriations — We compared the District's budgeted appropriations with actual results of operations from 2012-13 through 2014-15. General fund expenditures were less than budgeted appropriations for each year reviewed. The Board overestimated expenditures by $31.1 million (10.4 percent) over that three-year period (Figure 1).

Figure 1: Overestimated Appropriations

Fiscal Year	Appropriations[a]	Actual Expenditures	Overestimated Appropriations	Percentage Overestimated
2012-13	$106,321,492	$97,503,087	$8,818,405	9.04%
2013-14	$110,713,244	$100,388,957	$10,324,287	10.28%
2014-15	$113,419,009	$101,443,725	$11,975,284	11.80%
Total	**$330,453,745**	**$299,335,769**	**$31,117,976**	**10.40%**

[a] Includes year-end encumbrances from the prior fiscal year

A significant portion of overestimated appropriations were for special education programs, teachers' salaries, employee health insurance and transportation, which were overestimated in each of the three years. During 2012-13 through 2014-15, the Board overestimated appropriations for special education programs by a total of $9.1 million (27.4 percent), teachers' salaries by $5.5 million (6.4 percent), employee health insurance by $4.2 million (15.8 percent) and transportation costs by $2.1 million (15.8 percent). District officials indicated that they prepare budgets conservatively to ensure appropriations will be available for unanticipated expenditures. For example, District officials indicated that special education program variances occur because the budget is prepared before student enrollment figures are known. Therefore, officials cannot predict with accuracy the special education student enrollment figure.

We reviewed the 2015-16 results of operations and determined that budgeted appropriations were again overestimated, by $11.4 million. The Board overestimated special education programs by $3.8 million, teachers' salaries by $1.9 million, employee health insurance by $916,170 and transportation by $527,555. Our review of the 2016-17 budget indicates that similar trends will continue in these areas for the 2016-17 fiscal year. For example, although special education costs have not been higher than $11.5 million in any year reviewed, the Board has budgeted $14.5 million for 2016-17.

Contingency Appropriations — Education Law does not contain provisions for a contingency account in school district annual budgets. However, during the audit period, the Board appropriated $3.4 million to four contingency accounts: tuition ($1.9 million), payroll ($960,000), staff salaries ($520,000) and supplies ($24,000). No expenditures were directly charged to these appropriation accounts and no funds were transferred from these accounts to other appropriation accounts in any of the years reviewed. The use of these contingency accounts contributed to the District's overestimated appropriations each year. The Board continued this budgeting practice in both the 2015-16 and 2016-17 fiscal years, budgeting a total of $978,000 and $2.1 million, respectively, for contingencies. District officials told us that they were unaware that Education Law does not authorize the use of contingency accounts for school district budgeting.

Unused Appropriated Fund Balance — The Board adopted a fund balance policy on June 15, 2011. The policy addresses the different classifications of fund balance, acknowledges the RPTL 4 percent limit on unrestricted fund balance and establishes the District's minimum unrestricted fund balance to be 3 percent of the subsequent year's budget. The policy also states that, if after allocating excess surplus funds to reserves the District's unrestricted fund balance is over 4 percent of the subsequent year's budget, the Board will appropriate the amount in excess of the statutory limit and apply it to the subsequent year's budget. For fiscal years 2012-13 through 2014-15, the Board appropriated fund balance totaling $8.4 million to finance District operations. By appropriating fund balance, the District reported year-end unrestricted fund balance that essentially complied with the 4 percent statutory limit for the three fiscal years.

Figure 2: Unrestricted Fund Balance at Year-End			
	2012-13	2013-14	2014-15
Total Beginning Fund Balance	$51,685,666	$58,432,206	$65,089,949
Add: Operating Surplus/(Deficit)	$6,746,540	$6,657,743	$8,122,027
Total Ending Fund Balance	$58,432,206	$65,089,949	$73,211,976
Less: Restricted Funds	$50,107,750	$56,429,384	$65,565,438
Less: Encumbrances	$1,203,145	$1,463,242	$922,272
Less: Appropriated Fund Balance for the Subsequent Year	$3,228,971	$2,831,047	$2,322,178
Total Unrestricted Funds at Year-End	$3,892,340	$4,366,276	$4,402,088
Subsequent Year's Budgeted Appropriations	$109,605,682	$111,955,771	$113,628,101
Unrestricted Funds as Percentage of the Subsequent Year's Budget	3.55%	3.90%	3.87%

The appropriation of fund balance should have resulted in planned operating deficits. However, because the Board consistently adopted budgets that overestimated appropriations, the District realized operating surpluses totaling $21.5 million and did not use any of the appropriated fund balance. When unused appropriated fund balance was added back to unrestricted funds, the District's recalculated unrestricted fund balance as a percentage of the subsequent year's budget ranged from 5.9 percent to 6.5 percent.

Figure 3: Unused Fund Balance			
	2012-13	2013-14	2014-15
Reported Unassigned Fund Balance	$3,892,340	$4,366,276	$4,402,088
Add: Unused Appropriated Fund Balance	$3,228,971	$2,831,047	$2,322,178
Recalculated Unassigned Fund Balance	$7,121,311	$7,197,323	$6,724,266
Recalculated Fund Balance as Percentage of the Subsequent Year's Appropriations	6.50%	6.43%	5.92%

The District spent an average of $10.4 million less than planned each year and the Board included $3.4 million in appropriations for contingencies in the District's budgets for which there is no statutory provision. Budgeting practices that continually overestimate appropriations and result in the accumulation and retention of excess funds can result in tax levies that are greater than necessary. 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 law and a circumvention of the RPTL

limit imposed on the level of unrestricted fund balance. As a result, the Board may have levied more taxes than necessary to fund the District's operations.

Reserve Funds

Reserve funds may be established by Board action or voter approval, pursuant to various laws and can be used to finance specific purposes, in compliance with statutory requirements. The Board and District officials have a responsibility to ensure that all District resources, including reserve funds, are classified and reported correctly and maintained within established limits. The statutes pursuant to which the reserves are established determine how the reserves may be funded, expended or discontinued.

When the Board establishes reserve funds, it is important they develop a plan for funding the reserves and establish how much should be accumulated and how and when funds will be used to finance related costs. Such a plan serves to guide officials in accumulating and using reserve funds and to inform District residents about how their tax dollars will be used.[7] Generally, school districts are not limited as to how much money they can maintain in reserves. However, school districts should maintain reserve balances that are reasonable. Funding reserves at greater than reasonable levels essentially results in real property tax levies being higher than necessary.

The Board receives an annual reserve report from the Deputy Superintendent that includes a description of each established reserve and its balance. The report does not address the establishment of the reserves, specific funding levels, reserve expenditures to date or an analysis of the projected needs.

The District maintains nine reserve funds with a cumulative balance totaling $65.6 million as of June 30, 2015. This includes the retirement contribution reserve ($16.4 million), employee benefits accrued liability reserve (EBALR) ($13.4 million), capital reserve ($9.7 million), workers' compensation reserve ($7.3 million), unemployment insurance reserve ($4.3 million), insurance reserve ($3.9 million), repair reserve ($3.8 million), property loss reserve ($3.4 million) and liability reserve ($3.4 million). The Board properly established seven of the nine reserve funds. District officials could not provide documentation for establishing and using the EBALR and the insurance reserve funds and accumulated money in both reserves for purposes not permissible by law. We reviewed the records for each reserve and determined that officials transferred more out of four reserves than was needed to cover the costs of the related

[7] See our publication entitled *Local Government Management Guide – Reserve Funds* available at http://www.osc.state.ny.us/localgov/pubs/lgmg/reservefunds.pdf.

expenditures and overfunded six of the nine reserves by almost $30.5 million.

EBALR — General Municipal Law (GML) authorizes school districts to use this reserve to accumulate funds for the cash payment of the monetary value of accumulated but unused sick leave, personal leave, holiday leave, vacation time, time allowances granted in lieu of overtime compensation and any other forms of payment for accrued but unliquidated time earned by employees payable upon termination of service. The District may make expenditures from the reserve fund for any accrued employee benefit payment due to an employee upon termination of the employee's service. School districts are not authorized to use an EBALR to accumulate funds for other post-employment benefit costs (OPEB), such as life or health insurance costs for retirees.

District officials could not locate the resolution establishing the EBALR. The Board passed a resolution reaffirming all the District's reserves on June 13, 2013. However, the resolution does not include details on the intent or future purpose and use of the reserves. Other than accrued interest of $21,000, no funds were added to this reserve during the audit period. For the same period, approximately $1.2 million was expended from the reserve. However, compensated absences for the period totaled $1.1 million, $127,254 less than the amount expended from the reserve. Officials included amounts that should not have been paid from the reserve. For instance, officials expended $471,615 from the reserve in 2013-14, but support for the calculation confirmed that $389,211 was compensated absences, and the remaining $82,404 was the District's portion of retirement contributions. As of June 30, 2015, the District's compensated absence liability was approximately $2.1 million and the reserve balance was $13.4 million. Officials explained that, although not permitted by statute, the EBLAR fund includes $11.7 million accumulated for OPEB costs.

In 2009, the Comptroller's office issued a report citing the District for accumulating $10.1 million in OPEB costs in the EBALR fund and recommended that, among other things, the Board pass a resolution requiring the EBALR be used only for its intended statutory purpose and transfer funds not needed to satisfy incurred and accrued liabilities to other reserves authorized by GML or Education Law. Since that time, the amount of money accumulated for OPEB in the reserve fund has increased by almost $2 million. The Board has not passed resolutions requiring that the reserve fund be used for its intended statutory purpose or transferred excess funds into other reserves.

The former Deputy Superintendent told us that the District believes

there should be statutory provisions for accumulating funds for OPEB costs. Therefore, the District is holding on to the money that had been accumulated for OPEB until it can be transferred into a legally authorized reserve for OPEB. As of the end of our fieldwork, the Assistant Superintendent for Business explained that officials are currently working with the District's counsel to more accurately certify the compensated absences liability and use the EBALR excess to fund a capital project reserve. The accumulation of money for costs related to OPEB is not permitted by GML and therefore the reserve is overfunded by $11.7 million.

Retirement Contribution Reserve — GML authorizes school districts to establish a retirement contribution reserve fund for the purpose of financing the portion of the retirement contribution amount payable to the New York State Local Retirement System (NYSLRS). Expenditures from the reserve must be authorized by the Board. If the Board determines that there is no longer a need for the reserve, it must pass a resolution terminating the reserve and transfer funds to one or more other District reserve funds.

The retirement contribution reserve was established by resolution on June 11, 1992. Officials could not locate the resolution but provided Board minutes showing the approval of its establishment. There is no policy documenting the purpose, future use, funding level or procedures for the reserve. Although there is no policy, District officials told us that the Board's intent was to maintain three years' of NYSLRS liabilities in this reserve. As of June 30, 2015, the reserve fund had a balance of $16.4 million. The District disbursed $5.6 million to NYSLRS from the general fund during the audit period but no funds were expended from the reserve to cover related expenditures. Officials transferred $7.3 million of surplus fund balance to the retirement contribution reserve between the 2012-13 and 2014-15 fiscal years. The District's cumulative liability for the three fiscal years ending 2013 through 2015 was approximately $5.6 million. Using the District's basis for funding the reserve, the reserve is overfunded by $10.8 million.

District officials told us that the reserve is overfunded as a result of accumulation of funds over many years. Because it was the responsibility of the former Deputy Superintendent, they were not aware the reserve was not being used to cover NYSLRS contribution costs.

Insurance Reserve — GML authorizes school districts to use this reserve to fund certain uninsured losses, claims, actions or judgments for which the District is authorized or required to purchase or maintain insurance, with a number of exceptions. One of the noted exceptions is for "accident and health insurance." This reserve may be used to

fund the payment of judgments and the uninsured portion of certain losses to property owned by the District, as well as expenditures for certain services. It may also be used to pay the cost of actions or claims that have been compromised or settled with judicial approval. If the amount of the settlement or compromise does not exceed $25,000, then judicial approval is not required to fund the payment. GML authorizes the transfer of insurance reserve fund money to certain other reserve funds upon a determination that the fund is no longer needed but only to the extent that the money in the fund exceeds a sum sufficient to satisfy all liabilities incurred or accrued against the fund.

In June 1992 the Board established and funded an insurance reserve for a purpose that was not permissible. Although District officials could not provide the Board resolution establishing the reserve, they did provide an abstract of the Board minutes dated June 11, 1992 referencing the establishment of a health insurance reserve which District officials contend is the establishment of the insurance reserve. District officials told us that expenditures for the District's vision and self-insured dental programs are paid from this reserve. However, generally GML does not permit health insurance related expenditures to be paid from this reserve. Therefore, the District is not in compliance with the statutory provisions.

The Board transferred almost $2.1 million of excess fund balance to the reserve between June 2013 and June 2015 and expended $2.2 million during that same period to pay dental and vision claims. As of June 30, 2015 this reserve had a balance of $3.9 million. Because the District's identified uses are dental and vision insurance programs and GML does not permit health insurance-related expenditures, the District's use of this reserve is not permitted by law. Therefore, the entire $3.9 million balance is considered overfunded.

Because officials misunderstood the related statutory provisions, they improperly established, funded and used this reserve fund.

Property Loss and Liability Reserves — Education Law authorizes school districts to establish and maintain reserves, not to exceed 3 percent of the annual budget, to cover property loss and liability claims. The primary purpose of this statute is to provide the ability to "self-insure" for all or portions of claims that would typically be covered by insurance, to reduce a school district's insurance costs. Once established, these reserves may not be reduced below the total amounts estimated to be necessary to cover incurred but unsettled claims or suits. Payments may not be made for purposes other than those for which the reserve was established unless authorized by public vote. One exception is that the Board may authorize use of

the reserve funds (other than amounts allocated for unsettled claims or suits, including related expenses) to pay premiums for insurance policies purchased to insure subsequent losses in areas previously self-insured, in the event of dissolution of the self-insurance plan.[8]

In August 1985 the Board established and funded reserve funds to cover property loss and liability claims. Although District officials could not provide the Board resolution establishing the reserves, they did provide a copy of an internal memorandum dated January 23, 1986 referencing the establishment of insurance reserves. The memo confirms setting up two separate funds and identifies that the initial funding in each would be $25,000. District officials told us that the primary purpose of the property loss reserve was to cover insurance gaps in the case of a catastrophic loss and the liability reserve was to cover any lawsuit defense or indemnity payment not otherwise covered by insurance policies. As of June 30, 2015 the District had a total of $6.8 million in these two reserves, $3.4 million in each.

District officials have no estimate of expected losses but referenced a 2011 statistical analysis completed by a federal agency confirming sharply increased losses from wind storm exposure as the basis for funding the reserves at the maximum permitted by law. However, we believe the reserve is overfunded because the statute permits only a maximum of 3 percent of the annual budget. Each of the reserves (liability and property loss) is maintained with a balance of 3 percent of the annual budget instead of an aggregate in both. The reserve balances exceed the limit by $3.4 million. The Board's improper funding of these reserve funds was due to a misunderstanding of the related statutory provisions.

We also found that the Board transferred $38,306 in 2013-14 from the property loss reserve to unrestricted fund balance. However, actual expenditures paid from the general fund for property loss settlements totaled $13,306, $25,000 less than was transferred.

Further, while the Board members made the decision to fund these two reserves to the maximum amount allowed by law, they do not have a plan for the use of the reserves, including how and when disbursements should be made, optimal or targeted funding levels and why these levels are justified.

Unemployment Insurance Reserve — School districts that have elected to make payments in lieu of contributions to the State Unemployment Insurance Fund (SUIF) are authorized by GML to establish an unemployment insurance reserve. Payments are made

[8] Pursuant to GML, the school district may also discontinue the liability reserve fund and transfer the unexpended balance to an insurance reserve fund.

to reimburse the SUIF for the amount of unemployment insurance benefits paid to claimants and charged to the account of the District.

The District established the reserve in March 1979. The intent of the reserve was that money not expended as of June 1979 for unemployment insurance be used for payments in subsequent years. According to District officials, the basis for funding the reserve is to provide benefits for hourly and per diem employees who are eligible for unemployment during the summer. However, officials could not provide documentation showing the number of eligible employees or calculations for the total estimated unemployment liability.

The Board transferred almost $1.4 million of surplus fund balance to the reserve between June 2013 and June 2015 and reported that it used $245,737 from the reserve during that same period. However, actual unemployment insurance costs for the period totaled only $110,102. For example, in 2014-15, actual costs totaled $10,287 but $185,737 was transferred from the reserve, an excess of $175,450. Officials could not provide evidence to support that the excess transferred pertained to unemployment insurance. As of June 30, 2015 the reserve had a balance of $4.3 million. Therefore, the reserve has a balance that is 116 times the average annual expenditures of $36,700. The District had about 171 hourly and per diem employees in the 2014-15 fiscal year. If all of these employees were eligible for unemployment benefits for an entire year, the District would incur expenses of $3.6 million, which is still $653,000 less than the reserve fund balance.

District officials told us that they expect the number of unemployment insurance claims to increase over the next few years because changes may result in employee terminations. They agree the reserve is overfunded and stated that they will create a plan to reduce the balance.

The Board did not properly establish the EBALR fund and established the insurance reserve for a purpose not allowed by law. The Board has accumulated $15.6 million in EBLAR and insurance reserve funds for uses not permissible by law, transferred $327,704 more from reserves than actual related expenditures and overfunded the retirement contribution, property loss, liability, and unemployment insurance reserve funds by almost $15 million.

Without Board resolutions properly establishing District reserves, there is no assurance that the reserves meet statutory guidelines and are necessary and reasonably funded. When reserve funds are accumulated or used for purposes not permitted by law, District residents do not have adequate assurance that resources are being used in the most efficient manner. Further, funding reserves at greater than

reasonable levels contributes to real property levies that are higher than necessary because excessive reserve balances are not being used to fund operations.

Recommendations

The Board should:

1. Adopt general fund budgets that include realistic estimates for appropriations.

2. Discontinue the practice of including contingency appropriation accounts in the District's budget.

3. Discontinue the practice of adopting budgets that result in the appropriation of unrestricted fund balance that is not needed to fund District operations.

4. Ensure reserve funds are financed in accordance with District standards and use any excess funds identified to benefit District residents in accordance with statutory requirements.

5. Transfer excess reserve funds to other legally established reserves, as applicable and permitted by statute, or use funds to reduce the tax levy.

6. Review insurance and liability coverages to identify potential gaps in coverage and evaluate the reasonableness of amounts in the property loss and liability reserve funds.

7. Review all reserves currently established and determine if the balances are necessary, reasonable and in compliance with statutory requirements. To the extent that they are not, the Board should reduce the balances in the reserves in the manner provided for by law to benefit taxpayers.

District officials should:

8. Ensure that all money expended from reserve funds is only for the purposes for which the reserve funds were established or as otherwise provided by law.

9. Develop a formal plan for the use of reserves, including how and when disbursements should be made and optimal or targeted funding levels.

APPENDIX A

RESPONSE FROM DISTRICT OFFICIALS

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

RALPH MARINO, JR., Ed.D.
Superintendent

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January 19, 2017

Mr. Ira McCracken
Chief Examiner
Office of the New York State Comptroller
NYS Office Building, Room #3A10
250 Veterans Memorial Highway
Hauppauge, New York 11788-5533

Dear Mr. McCracken:

On behalf of Hewlett-Woodmere Public Schools, thank you for providing us with an opportunity to respond to the Financial Condition Report of Examination (the "Draft Audit Report" or "Report"). We take note of the fact that your review covers the period from July 1, 2012, through May 31, 2016.

Hewlett-Woodmere Public Schools is committed to providing outstanding educational programs and world-class opportunities for all students. We pride ourselves in our ability to develop the whole child, both academically and socially. Through our small class sizes and rich academic programs, we proudly prepare our students to be global citizens, as well as college and career ready.

At the same time, we are equally committed to our financial responsibility to the community. The District's budget planning and development process is based on the delicate balance between providing the educational opportunities the community has come to expect from Hewlett-Woodmere Public Schools, and keeping a watchful eye on spending. Maintaining our instructional programs and services has become even more challenging in light of the tax levy cap, unfunded/underfunded mandates, loss of state aid, and frozen aid formulas. Clearly, our philosophy with respect to financial planning and budgeting is to ensure that we have the resources available to continue to provide the best educational programs possible for our students long into the future.

The community consistently demonstrates their support for the District's budgetary decisions, as evidenced by more than 70% of the voters approving the proposed budgets in recent years. Similarly, in 2015, the voters approved the establishment of a $25 million Capital Reserve fund. In 2016, the community authorized a $10.8 million Capital Project that is funded through our Capital Reserves and available fund balance.

The financial condition of Hewlett-Woodmere Public Schools remains excellent. Notably, Moody's has repeatedly commended the District for maintaining well-funded reserves and fund balances, which has resulted in a Moody's Bond rating of Aa1. Our strong financial position, responsible

budgeting, and long-term planning has allowed us to avoid the tough financial decisions and short-term cash flow borrowing plaguing many other districts.

The District acknowledges the opinions in the Draft Audit Report regarding budgeting and use of fund balance. Given vast financial uncertainties and the unpredictability of budget development, we created budgets that anticipated significant expenditures, such as an increase in special education students, an increase in the cost of health insurance, or the cost of salary settlements for expiring contracts. We concur that some of these predictions resulted in substantial fund balances, however, it was always the District's understanding and belief that we were in compliance with both the law and our Fund Balance Policy (#6145).

As you are aware, with respect to fund balance, we set aside the legal undesignated 4%. In addition, we applied appropriated fund balances to manage the tax levy and put any other available balances into our reserves. We began the process of addressing "contingencies" during the development of the 2016-2017 budget, and this process is continuing this year. Specifically, the business office has been analyzing actual expenditure data over the past five years in order to develop budgets more in line with actual expenses. In particular, we are looking closely at the codes associated with special education programs, teachers' salaries, employee health insurance, and transportation. It is important to keep in mind that those surpluses and contingencies did not accumulate over one budget year. Therefore, our Corrective Action Plan is to steadily and systematically correct these budget appropriations over multiple budget years. Also of note, over the past five years, the District's budget-to-budget increases have averaged about 2%. This year, for the second year in a row, the District is planning a zero increase in the tax levy.

The District acknowledges the opinions in the Draft Audit Report regarding the District's reserves. Currently, we have nine reserve funds, some of which were established as far back as 1979. It is important to note that the audit by OSC in 2008 did not identify any of the District's reserves as contrary to General Municipal Law. Prior to the completion of your audit, the District began working with the Audit Committee to develop a comprehensive Reserve Fund Management Plan. This Reserve Fund Management Plan outlines the strategy the District will take for each of our nine reserves. These strategies may include closing certain accounts, adjusting funding levels, and plans for the transfer of funds to other reserves. The Reserve Fund Management Plan will be shared with your office as part of the Corrective Action Plan associated with this audit.

See Note 1 Page 21

It is important to note that OSC recommends the establishment of reserves as an integral part of managing the fiscal health of a school district. Never was this more indisputable than in 2012 when the District suffered sizable losses due to Superstorm Sandy. Our insurance reserves helped us close coverage gaps that otherwise would have jeopardized our ability to make necessary repairs. Also, the existence of our current reserves will assist us in accomplishing a significant portion of a $100 million District-wide capital improvements initiative identified in our Five-Year Building Condition Survey. The establishment of a new Capital Projects reserve will be presented to voters in May 2017 for approval. These projects, once approved, can be accomplished without the need to borrow money

or raise taxes. This action will also help to "right size" any reserves that have been identified as overfunded.

The District takes pride in developing budgets that allow us to preserve the educational and community programs that make Hewlett-Woodmere such a special place to learn and grow, while keeping a watchful eye on the bottom line for our taxpayers. Once again, the District appreciates and respectfully acknowledges the Comptroller's recommendations regarding our fiscal practices. As always, our goal is to maintain the exceptional education provided by Hewlett-Woodmere Public Schools well into the future. We look forward to the submission of our Corrective Action Plan which will provide greater details on how we plan to address each of the recommendations.

Sincerely,

Ralph Marino, Jr., Ed.D.
Superintendent

APPENDIX B

OSC COMMENT ON THE DISTRICT'S RESPONSE

Note 1

The 2009 audit report issued by the Comptroller's office identified that the District's funding and use of the EBALR was not in compliance with GML. This was the only reserve reviewed during the 2009 audit which focused on selected financial operations.

APPENDIX C

AUDIT METHODOLOGY AND STANDARDS

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

- We interviewed Board members and District officials to determine the processes in place for developing budgets and to gain an understanding of the District's budgeting practices and use of fund balance.

- We obtained and reviewed District policies related to budgeting, unrestricted fund balance and reserves.

- We compared the general fund's budgeted appropriations to actual results of operations for the fiscal years ending June 30, 2012 through June 30, 2016 to identify any significant budget variances and determine whether the budgets were realistic.

- We interviewed District officials to determine the causes of any significant budget-to-actual variances.

- We obtained and reviewed the District's 2016-17 adopted budget and compared it to prior years' results of operations to determine whether budgeted appropriations were reasonable, based on historical data.

- We analyzed the District's general fund financial information between July 1, 2012 and June 30, 2016 to determine financial trends.

- We reviewed and analyzed reported fund balance levels in comparison to amounts appropriated in adopted budgets for fiscal years 2012-13 through 2015-16. We compared the unrestricted fund balance to the subsequent year's budgeted appropriations to determine if the District was within the statutory limitation during the same fiscal years.

- We restated the 2012-13 through 2014-15 unrestricted fund balance amounts to include appropriated fund balance not used and calculated the revised unrestricted fund balance amounts as percentages of subsequent years' budgets.

- We interviewed officials and reviewed applicable laws, Board resolutions, accounting records, annual reserve reports to the Board and audited financial statements to determine if reserves were legally established, had reasonable balances and were funded and expended in accordance with statutory provisions and Board authorizations.

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.

APPENDIX D

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APPENDIX E

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