



Bellmore-Merrick Central High School District

Financial Condition

Report of Examination

Period Covered:

July 1, 2012 – June 30, 2016

2016M-341



Thomas P. DiNapoli

Table of Contents

	Page
AUTHORITY LETTER	1
INTRODUCTION	2
Background	2
Objective	2
Scope and Methodology	2
Comments of District Officials and Corrective Action	3
FINANCIAL CONDITION	4
Budgeting	4
Fund Balance	6
Reserves	8
Recommendations	10
APPENDIX A Response From District Officials	11
APPENDIX B OSC Comments on the District's Response	14
APPENDIX C Audit Methodology and Standards	15
APPENDIX D How to Obtain Additional Copies of the Report	16
APPENDIX E Local Regional Office Listing	17

State of New York Office of the State Comptroller

Division of Local Government and School Accountability

November 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 Bellmore-Merrick Central High School District, entitled Financial Condition. This audit was conducted pursuant to Article V, Section 1 of the State Constitution and the State Comptroller's authority as set forth in Article 3 of the New York State General Municipal Law.

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

Respectfully submitted,

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

Introduction

Background

The Bellmore-Merrick Central High School District (District) is located in the Town of Hempstead in Nassau County. The District is governed by the Board of Education (Board), which is composed of eight appointed members from the following elementary school districts: Bellmore Union Free School District (UFSD), North Bellmore UFSD, Merrick UFSD and North Merrick UFSD.¹ 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 Business² was primarily responsible for overseeing the District's Business Office and supervising the employees who maintain the District's financial records. These responsibilities include developing and administering the budget.

The District operates six schools with approximately 5,500 students and 800 employees. The District's 2014-15 general fund expenditures totaled approximately \$133 million, which were funded primarily by real property taxes and State aid. Budgeted appropriations for the 2015-16 fiscal year were \$142.8 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 adequately monitor the District's financial condition and take appropriate action to maintain the District's fund balance?

Scope and Methodology

We examined the District's financial condition for the period July 1, 2012 through June 30, 2016 to analyze the District's fund balance, budgetary practices and reserve 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.

¹ Each of the four component elementary school districts appoints two of its members to serve on the District's Board.

² The Deputy Superintendent for Business retired on June 30, 2016 and was replaced by an Assistant Superintendent for Business on July 1, 2016.

**Comments of
District Officials and
Corrective Action**

The results of our audit and recommendations have been discussed with District officials, and their comments, which appear in Appendix A, have been considered in preparing this report. District officials disagreed with certain findings in our report. Appendix B includes our comments on issues 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 adopting budgets that contain estimates of actual and necessary expenditures that are funded by realistic revenues. Sound budgeting provides sufficient funding for necessary operations. Prudent fiscal management includes establishing reserves needed to address long-term obligations or planned future expenditures. Once the Board has addressed those issues, any remaining fund balance, exclusive of the amount allowed by law to be retained to address cash flow and unexpected occurrences, should be used to fund operations. Additionally, the Board should establish and fund reserves appropriately, monitor reserve amounts and use them as intended for planned expenditures.

The Board and District officials did not adequately monitor the District's financial condition and take appropriate action to maintain the District's fund balance. The Board adopted budgets for fiscal years 2012-13 through 2014-15 that appropriated a total of \$17.4 million in fund balance and \$7 million in reserve funds,³ or a total of \$24.4 million in funds, to finance operations. However, because the District overestimated expenditures by \$21.3 million over the three-year period, most of 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 funds averaged almost 8 percent of the subsequent year's appropriations.

Additionally, District officials did not have proper documentation for establishing and using two of four reserve funds totaling \$1.1 million and, for the audit period, the District used only \$632,640 of the almost \$7 million of appropriated reserve funds. The District also overfunded its workers' compensation and unemployment insurance reserve funds by \$308,210 for the audit period. As a result, the Board may have levied more taxes than necessary to maintain operations.

Budgeting

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

³ Appropriated unrestricted fund balance of \$6.8 million (for 2012-13) + \$5.5 million (for 2013-14) + \$5.1 million (for 2014-15) = \$17.4 million. Appropriated reserve funds of \$2.1 million (for 2012-13) + \$2 million (for 2013-14) + \$2.9 million (for 2014-15) = \$7 million.

projected changes in significant revenues or expenditures. Unrealistic budget estimates can mislead District residents and have a significant impact on the District’s year-end surplus fund balance and financial condition.

We compared the District’s budgeted revenues and appropriations with actual results of operations for the 2012-13 through 2014-15 fiscal years. Budgeted revenues were generally close to the actual revenues received, with the District receiving \$4.8 million (1.2 percent) more than expected over the three-year period. However, actual general fund expenditures were less than budgeted appropriations for each of the three years reviewed. The Board adopted budgets that overestimated appropriations by \$21.3 million, or 5.5 percent, over the period.

Figure 1: Overestimated Appropriations

Fiscal Year	Budgeted Appropriations ^a	Actual Expenditures	Overestimated Expenditures	Percentage of Overestimated Expenditures
2012-13	\$132,852,330	\$125,401,477	\$7,450,853	5.94%
2013-14	\$136,171,777	\$129,093,465	\$7,078,312	5.48%
2014-15	\$139,725,579	\$132,968,397	\$6,757,182	5.08%
Totals	\$408,749,686	\$387,463,339	\$21,286,347	5.50%

^a Includes year-end encumbrances from the prior fiscal year

The majority of the overestimated expenditures were attributed to employee benefits, teachers’ salaries and plant operations, which were overestimated in each of the three years. District officials overestimated employee benefit costs by \$4.3 million (10.4 percent), teachers’ salaries by \$4.3 million (3.1 percent) and plant operations by \$2.6 million (13 percent) over the three-year period. Officials told us that, overall, they budget conservatively in order to meet the District’s potential financial obligations based on their analyses using historical data.

District officials explained that they budget conservatively for employee benefit costs such as health insurance because the New York State Health Insurance Program operates on a calendar year and they only have partial information for insurance costs at the time of budget preparation. Officials also told us that, when budgeting for teachers’ salaries, they account for every teacher on payroll at the time of budget preparation and their anticipated salary increases. However, they cannot control instances such as teachers taking leaves of absences or separating from the District during the school year, all of which impact the actual expenditure totals. District officials explained that the budget for plant operations include estimates for the salaries of highly transient positions, such as custodians, as well as fluctuating fuel costs which are calculated based on the District’s highest number of heating days and the average of the cost per unit of fuel from prior fiscal years.

We reviewed the District's budget-to-actual report as of June 30, 2016 which indicates that the District will again achieve budget surpluses for 2015-16 in these three areas due to overestimated expenditures.

The District spent an average of \$7.1 million (5.5 percent) less than budgeted each year. Budgeting practices that continually overestimate appropriations result in the accumulation and retention of excessive funds, which makes the tax levies higher than necessary.

Fund Balance

Fund balance represents resources remaining from prior fiscal years that can be used to finance operations in the subsequent fiscal year. The District can retain a portion of fund balance at year-end, known as unrestricted fund balance, for unexpected events or cash flow purposes. New York State Real Property Tax Law (RPTL) requires that unrestricted fund balance retained not exceed 4 percent of the subsequent year's budgeted appropriations. Fund balance in excess of that amount must be used to fund a portion of the next year's appropriations or be used to fund legally established reserves.

When the Board appropriates fund balance, the expectation is that there will be a planned operating deficit in the subsequent fiscal year, which will be financed by the amount of the appropriated fund balance. The Board should not appropriate more fund balance than is necessary to fund District operations.

The Board adopted a Fiscal Accounting and Reporting policy (fund balance policy) in August 2011, which explains the classifications of fund balance. The fund balance policy states that the District's unassigned fund balance will be maintained to provide sufficient working capital and a margin of safety to address local and regional emergencies without borrowing. The fund balance policy also states that unassigned fund balance may be appropriated only by Board resolution and any portion of fund balance may be applied or transferred for a specific purpose only by formal action of the Board. Amendments to the applied or transferred amount must also be approved by formal action of the Board. The fund balance policy does not address compliance with RPTL.

The District's budgets included appropriations of \$17.4 million from unrestricted fund balance and \$7 million from reserve funds to finance District operations between 2012-13 and 2014-15. By appropriating fund balance, the District reported year-end unrestricted fund balance that essentially complied with the 4 percent statutory limit for fiscal year 2014-15 and reported levels just over the statutory limit in fiscal years 2012-13 and 2013-14.

Figure 2: Unrestricted Fund Balance at Year-End			
	2012-13	2013-14	2014-15
Total Beginning Fund Balance	\$25,980,907	\$26,391,074	\$27,093,700
Add: Operating Surplus/(Deficit)	\$410,167	\$702,626	(\$218,108)
Total Ending Fund Balance	\$26,391,074	\$27,093,700	\$26,875,592
Less: Restricted Funds	\$14,666,593	\$16,012,609	\$15,897,373
Less: Encumbrances	\$250,889	\$306,934	\$266,126
Less: Appropriated Fund Balance for the Subsequent Year ^a	\$5,500,000	\$5,128,800	\$5,000,000
Total Unrestricted Funds at Year-End	\$5,973,592	\$5,645,357	\$5,712,093
Subsequent Year's Budgeted Appropriations	\$135,920,888	\$139,418,645	\$142,802,333
Unrestricted Funds as Percentage of the Subsequent Year's Budget	4.39%	4.05%	4.00%

^a The appropriated fund balance for the subsequent year does not include funds totaling \$7.7 million appropriated from restricted funds between 2012-13 and 2014-15.

The appropriation of fund balance should have resulted in planned operating deficits in each of the above years. However, the Board's budgets significantly overestimated appropriations and the District did not need most of the fund balance that was appropriated. Instead, the District realized operating surpluses in fiscal years 2012-13 and 2013-14 totaling \$1.1 million and a significantly lower than planned operating deficit of \$218,108 in 2014-15. The District did not use \$17.2 million of the appropriated unrestricted fund balance in fiscal years 2012-13 through 2014-15 and, therefore, levied more taxes than necessary to fund District operations. When adding back the unused appropriated fund balance, the District's recalculated unrestricted fund balance ranged between 7.5 and 8.4 percent of the subsequent year's budget.

Figure 3: Unused Fund Balance			
	2012-13	2013-14	2014-15
Reported Unassigned Fund Balance	\$5,973,592	\$5,645,357	\$5,712,093
Reported Fund Balance as a Percentage of the Subsequent Year's Appropriations	4.39%	4.05%	4.00%
Add: Unused Appropriated Fund Balance	\$5,500,000	\$4,910,692	\$5,000,000
Recalculated Unassigned Fund Balance	\$11,473,592	\$10,556,049	\$10,712,093
Recalculated Fund Balance as Percentage of the Subsequent Year's Appropriations	8.44%	7.57%	7.50%

For the fiscal year ended June 30, 2016, the District reported expenditures totaling \$134.4 million,⁴ which was \$8.4 million less than the budgeted appropriations of \$142.8 million. Therefore, the District will not use a large portion of the \$5 million appropriated fund balance and will continue to exceed the statutory limit. Further, we reviewed the 2016-17 budget figures and determined that the District continued this same practice and will likely again have overestimated appropriations.

⁴ Unaudited amount

The appropriation of fund balance causes available fund balance to appear lower than it actually is. The District did not use \$23.6 million of the \$24.4 million of fund balance and reserves that the Board appropriated in adopted budgets between 2012-13 and 2014-15 to finance operations. As a result, the Board has withheld funds from productive use and has not adequately reported the District's financial condition to District residents. The practice of consistently 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.

Reserves

The Board may establish reserves to restrict a reasonable portion of fund balance for a specific purpose, in compliance with statutory directives. The statutes under which the reserves are established determine how the reserves may be funded, expended and discontinued. The Board is responsible for developing a formal plan for using reserves, including determining how and when disbursements should be made, optimal or targeted funding levels, why these levels are appropriate and, when appropriate, replenishment of funds into the reserve. Generally, school districts are not limited as to how much money can be held in reserves unless such a limitation has been established by the Board. However, it is important that reserve balances are reasonable. Reserve balances above reasonable amounts represent funds that could have been used for other purposes, including reducing the tax levy. Further, the Board is responsible for ensuring that reserve funds are properly established by resolution and that appropriate funding levels have been determined.

The District's fund balance policy states that before year-end, the Board will determine whether or not to authorize an amount of surplus funds to be transferred to reserves. The policy further states that, if reserves are appropriated in the budget or during the year, the Board will determine at the fiscal year-end how much of the appropriated amount will actually be transferred from the reserve and requires that the amount transferred not exceed the amount of the related expenditure.

As of June 30, 2015, the District had four reserve funds with a combined balance of \$15.9 million. We reviewed the accounting records for each reserve and determined that between 2012-13 and 2014-15 the District appropriated almost \$7 million from reserves and used \$632,640.⁵ Two of the four reserves were not properly established and three of the four reserves appear to be overfunded.

⁵ The District used \$584,887 of employee benefit accrued liability reserve (EBALR) funds during our audit period. The EBALR was properly established by Board resolution and appropriately funded.

Retirement Contribution Reserve – The reserve was established by Board resolution in September 2005. Although the Board has not established a threshold for the retirement contribution reserve, officials stated that upon the advice of the District’s independent auditor, their goal is to maintain five years’ worth of expenditures in the reserve. As of June 30, 2015, the reserve balance was \$7.7 million. The District appropriated a total of \$5.7 million to fund adopted budgets between 2012-13 and 2014-15; \$1.8 million for 2012-13, \$1.5 million for 2013-14, and \$2.4 million for 2014-15. The District paid \$5.9 million to the New York State Employees’ Retirement System during this period. Of this amount, only \$47,753 was expended from the reserve.

The Board authorized a transfer of \$1.25 million from surplus funds to the reserve in 2012-13 and another \$1.25 million in 2013-14. The reserve balance of \$7.7 million is approximately four times the District’s average annual expenditures, which is within the District’s desired range. However, because the Board appropriated \$5.7 million but used less than 1 percent (0.62 percent) from the reserve between July 1, 2012 and June 30, 2015, we question whether maintaining four times the average annual expenditures is in the best interest of District residents.

Workers’ Compensation Reserve – District officials could not provide a Board resolution establishing the reserve, but did provide audited financial statements from the fiscal year ending June 30, 1988 showing when the reserve was first used. In August 2008, the Board, by resolution, set a maximum funding threshold of \$750,000. As of June 30, 2015 it had a balance of \$759,562, which was \$9,562 more than the threshold. No expenditures were paid using the reserve between fiscal years 2012-13 and 2014-15 and, with the exception of interest income, no funds were added to the reserve.

Unemployment Insurance Reserve – District officials could not provide a resolution establishing the reserve, but did provide audited financial statements from the fiscal year ending June 30, 1988 showing when the reserve was first used. In August 2008, the Board, by resolution, set a maximum funding threshold of \$252,341. As of June 30, 2015 the unemployment insurance reserve fund had a balance of \$346,844, \$94,503 more than the threshold set by the Board. No expenditures were paid using the reserve between fiscal years 2012-13 and 2014-15 and, with the exception of interest income, no funds were added to the reserve.

Without Board resolutions properly establishing District reserves, there is no assurance that the reserves meet statutory guidelines and are necessary. Funding reserves at greater than reasonable levels contributes to real property tax levies that are higher than necessary

because excessive reserve balances are not being used to fund operations.

Recommendations

The Board should:

1. Adopt budgets that realistically reflect the District's operating needs based on historical trends or other identified analyses.
2. Discontinue the practice of appropriating fund balance and reserve funds that are not needed and not used to fund District operations.
3. Update the fund balance policy to require compliance with statutory limits.
4. Ensure that reserve funds are established by resolution.

District officials should:

5. 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.

APPENDIX A

RESPONSE FROM DISTRICT OFFICIALS

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



**BELLMORE-MERRICK
CENTRAL HIGH SCHOOL DISTRICT**

**ADMINISTRATIVE OFFICES
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The Bellmore-Merrick Central High School District is in receipt of the Draft Audit Report – Financial Condition for the period July 1, 2012 – June 30, 2016. The Board of Education and District Administration thank the Office of the State Comptroller’s (OSC) staff for their professionalism and courtesy in conducting the audit. The District acknowledges and is pleased that the State Comptroller’s audit did not reveal any instances of fraud, waste or misuse, or operational improprieties.

The District prides itself in providing a high quality education to our students. The Board continually strives to balance the educational priorities of our students with our fiscal responsibility to the community.

Bellmore-Merrick is in excellent financial condition, as attested by Moody’s recent credit rating of Aa1. Moody’s credited the District with a ‘strong operating history with conservative budgeting and long-range planning’. This Aa1 rating enabled the District to garner an interest rate of 1.96% on its serial bonds issued in July 2016, saving the District \$10 million in interest over the life of its bond.

The Bellmore-Merrick CHSD adopts budgets that reflect its operating needs based on historical trends, contractual obligations and program costs. The District budgets conservatively for the uncontrollable elements: fluctuating energy, health insurance and retirement costs; unexpected special education costs; and since 2010, a \$4 million GEA state aid reduction. The District includes the use of Reserves and Fund Balance to mitigate the effects of these uncontrollable costs and to reduce the tax burden on the community. Fortunately, these resources were not needed to fund operations. The District anticipates continued appropriation of reserves and fund balance.

See
Note 1
Page 14

Bellmore • Merrick • North Bellmore • North Merrick

**BELLMORE-MERRICK
CENTRAL HIGH SCHOOL DISTRICT**

We do not agree with the Comptroller's 'Recalculated Unassigned Fund Balance' which combines the 4% Unassigned Fund Balance and Appropriated Fund Balance. By statute the District may retain 4% as Unassigned Fund Balance for unexpected expenses and cash flow purposes. Appropriated Fund Balance is another tool districts may utilize to reduce taxes and stabilize budgets and is separate and distinct from Unassigned Fund Balance. Combining the two distorts and exaggerates Unassigned Fund Balance.

See
Note 2
Page 14

The District acknowledges it was slightly above the 4% Unassigned Fund Balance in 2012-13 and 2013-14. The district intends to stay within the 4% statutory limit, as it has for the 2014-15 and 2015-16 school years. Administration will examine the District Fund Balance Policy and update as needed.

The District disagrees with the recommendation to remove interest earnings from the Workmen's Compensation Fund. General Municipal Law (GML) 6j states that any interest earned in Workmen's Compensation Reserve Fund "...shall become part of such fund". GML also does not set a maximum limit for reserves. The Board and Administration review reserves during the budget process and the Board has ascertained that they are at appropriate levels. The Board will revise the 2009 resolution which was intended to increase the funding level of the Unemployment Reserve to \$350,000. The Board will re-establish the 1988 Workers Compensation and Unemployment Reserves Resolutions which were not physically located.

See
Note 3
Page 14

In light of the State Comptroller's Office recent report of a potential \$5 billion State budget gap, the conservative budget approach used by Bellmore-Merrick will help in preparing future budgets with potentially shrinking revenues.

Sincerely,

John DeTommaso
Superintendent

Janet Goller
President, Board of Education

JD/mr

APPENDIX B

OSC COMMENTS ON THE DISTRICT'S RESPONSE

Note 1

District officials overestimated appropriations by \$21.3 million from fiscal years 2012-13 through 2014-15 and included \$24.4 million of fund balance and reserve funds in the budgets as financing sources. The practice of consistently 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.

Note 2

The District's reported year-end unrestricted fund balance essentially complied with the 4 percent statutory limit for fiscal years 2012-13 through 2014-15 because officials appropriated fund balance totaling \$17.4 million for that period, of which only \$218,108 was used. Fund balance that is needed to finance operations should be appropriated and excluded from the 4 percent calculation. However, fund balance that is not needed to finance the subsequent year should not be appropriated to make it appear as if the District is complying with the 4 percent statute. The practice of routinely appropriating fund balance in the budget but generally not using it distorts the true amount of unrestricted fund balance retained by the District. We recalculated the amount of unrestricted fund balance to show the actual unrestricted fund balance that the District should have reported if it had budgeted accurately.

Note 3

The Board established, by resolution, a maximum threshold of \$750,000 for the workers' compensation reserve. The balance of the reserve as of June 30, 2015 exceeded the threshold as established by the Board. We made no assertion that thresholds were established by GML nor did we recommend removing interest earnings from the reserve. We reported that the reserve fund exceeded the Board-authorized maximum threshold by \$9,562. We recommended that District officials ensure the reserve is funded in accordance with Board limits.

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 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 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 compared the general fund's budgeted appropriations and estimated revenues 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 obtain 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 reviewed Board resolutions, accounting records and audited financial statements to determine if reserves were legally established, funded and expended in accordance with Board authorizations and District policy. We also determined if the reserves had reasonable balances.
- We judgmentally selected four general fund expenditure codes with budget modifications between fiscal years 2012-13 and 2015-16 using the District's budget status reports and obtained and reviewed budget transfer request forms, budget transaction reports, Board minutes and supplementary reports to the Board to determine whether budget transfers were authorized and reports to the Board were in accordance with District policy.

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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