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July 19, 2013

Mr. Salvatore A. Intagliata, Chairman
Members of the Board of Commissioners
Franklin Square Water District
895 Schroeter Avenue
Franklin Square, New York 11010

Report Number: 2013M-127

Dear Mr. Intagliata and Members of the Board of Commissioners:

One of the Office of the State Comptroller's primary objectives is to identify areas where local government officials can improve their operations and provide guidance and services that will assist them in making those improvements. Our goals are to develop and promote short-term and long-term strategies to enable and encourage local government officials to reduce costs, improve service delivery, and account for and protect their entity's assets.

In accordance with these goals, we conducted an audit of the Franklin Square Water District (District) for the period January 1, 2012, to February 28, 2013, which addressed the following question:

- Has the Board appropriately provided individual life insurance policies to the District's Commissioners and employees?

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

Background and Methodology

The District is located in the Town of Hempstead in Nassau County and serves the communities of Franklin Square and Elmont. The District's total revenue for the 2012 fiscal year was over \$2.5 million, generated primarily from water usage charges and real property taxes. The District's 2012 expenditures totaled almost \$ 2.4 million.

The District is governed by an elected three-member Board of Commissioners (Board), comprising a Chairman, a Secretary, and a Treasurer. The Business Manager is responsible for the general management of the District's operations under the direction of the Board. The Board is responsible for managing the District's investments and employee and Commissioner fringe benefits.

We interviewed District officials and reviewed State Comptroller's Office opinions and publications, District financial records, and District records regarding the life insurance policies. We conducted this performance audit in accordance with 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.

Audit Results

General Municipal Law (GML) and New York State Insurance Law provide authority for the Board of Commissioners of a water district, by resolution, to provide its officers and employees with group life insurance as a fringe benefit. There is no similar authority for the Board of Commissioners of a water district to provide, by resolution, individual life insurance policies for its officers or employees.

The District has inappropriately provided individual whole life insurance policies to its Commissioners and employees. The Board has adopted a personnel policy that includes a provision that any Commissioner or employee, except temporary and seasonal, will be provided with a life insurance policy that, after 10 years, will be transferred to them upon retirement. While GML expressly allows group life insurance, and the personnel policy is not specific, it has been the District's practice to purchase and pay the premiums for whole life insurance policies with a face value of \$50,000 for each Commissioner and full-time employee, and \$25,000 for each part-time employee. The policy values increase over time as premiums are paid and dividends accrue; however, each policy has a lower cash surrender value, which also increases over the life of the policy. If a Commissioner or employee retires after meeting the 10-year vesting requirement, ownership of the policy is transferred to the Commissioner or employee who can then either continue making premium payments, or redeem the policy for its cash surrender value. If a Commissioner or employee resigns before retirement, however, the District would redeem the policy for the cash surrender value. The District currently holds policies with face values totaling \$550,000 for three Commissioners and eight full-time employees; these policies had a cash surrender value of \$155,717 as of December 31, 2012. In addition to individual life insurance policies not being authorized under GML, the cash surrender feature of the whole life insurance policies may also constitute an unauthorized investment of District funds.

Recommendation

1. The Board should review the insurance policies it currently holds and consult with its counsel and insurance broker to take steps to ensure all insurance policies are in compliance with legal requirements.

The Board has the responsibility to initiate corrective action. A written corrective action plan (CAP) that addresses the findings and recommendations in this report should be prepared and forwarded to our office within 90 days, pursuant to Section 35 of the General Municipal Law. 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 of Commissioners to make this plan available for public review in the Secretary's office.

Sincerely,

Andrew A. SanFilippo
Executive Deputy Comptroller
Office of State and Local Government
Accountability

APPENDIX A

RESPONSE FROM DISTRICT OFFICIALS

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

BOARD OF WATER COMMISSIONERS

FRANKLIN SQUARE WATER DISTRICT

895 Schroeter Avenue / PO Box 177, Franklin Square, New York 11010
Phone: (516) 354-0780 Fax: (516) 775-2748



COMMISSIONERS: Salvatore A. Intagliata
Ralph D. Pugliese
Joseph V. Ra

BUSINESS MANAGER:
Carmen DiMartino

June 25, 2013

Ira McCracken, Chief Examiner
NYS Office of the Comptroller
NYS Office Building, Room 3A10
Veteran's Memorial Highway
Hauppauge, NY 11788-5533

Report Number: 2013M-127

Dear Mr. McCracken:

We have reviewed your draft audit findings regarding the group life insurance policies provided to Commissioners and employees. We respectfully disagree with your findings.

After reviewing the facts of this matter and the group insurance criteria set forth in General Municipal Law and New York State Insurance Law with our attorney and insurance broker, we believe that group life insurance policies are appropriate. General Municipal Law §93 authorizes municipal corporations to purchase group life insurance for its employees. Section 4216 of Insurance Law defines "group life insurance" as that form of life insurance, which covers any of the classes of employees and officers ("groups") that may be insured. The employees and Commissioners of the District are such a permitted group.

We found nothing in the law that restricted to term insurance, the group insurance policies authorized by General Municipal Law §93. The policies that the District purchased for its employees are issued as group insurance. These policies are issued to all employees and Commissioners without discrimination. There is no preference in the amount of the death benefit. Insurability is guaranteed to all employees. Each employee has the absolute right to designate the beneficiary. The employee life insurance is group life insurance, albeit whole life insurance rather than term insurance.

See
Note 1
Page 7

We also respectfully submit the assertion that the cash surrender value feature of the policies is an inappropriate investment, is also incorrect. The cash surrender value is not an "investment". The District purchased whole life insurance policies for its employees giving to them the additional benefit of having permanent rather than term life policies. That purchase was not an investment. The fact that whole life policies over the span of an employee's career are more cost effective for the District than the purchase of term life constitutes prudent purchasing, not investing. The life insurance policies are a contractual employee benefit. The District cannot surrender the policies at will to access the cash value.

See
Note 2
Page 7

See
Note 3
Page 7

Our opinion is that the group life insurance purchased by the District for its employees is authorized by law and in all respects proper. Therefore, we respectfully disagree with your findings.

Sincerely,

Salvatore Intagliata
Chairman

APPENDIX B

OSC COMMENTS ON THE DISTRICT'S RESPONSE

Note 1

According to the notes to the District's financial statements, "The District provides a group life insurance program for its employees which provides individual whole life insurance coverage." Furthermore, as we understand group life insurance provisions, there would usually be a single policy to cover all members of the group; however, the District instead has individual policies with a single-named insured in each. The cash surrender values attached to these policies are also indicative of these being individual whole life policies.

Note 2

While the District may not have intended its purchase of these policies as an investment, whole life policies do have an investment component. Where term insurance provides nothing more than a death benefit, whole life insurance is a type of investment as it pays dividends, and it also has an equity component where the policy's value grows over time. The whole life insurance policy owner can use the dividends to pay the policy's premiums, or roll the funds into the equity component. The owner can surrender the policy in its entirety and receive the value of the equity (cash surrender value); thus, whole life policies have both a death benefit portion and an actual cash value.

Note 3

We question the District's assertion that whole life policies over the span of an employee's career are more cost-effective than the purchase of term life insurance as whole life insurance is generally more costly than term insurance.