



Merrick Union Free School District

Financial Management

2024M-64 | September 2024

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Report Highlights

Merrick Union Free School District

Audit Objective

Determine whether the Merrick Union Free School District (District) Board of Education (Board) and District officials properly managed fund balance and reserves.

Key Findings

The Board and District officials did not properly manage fund balance and reserves. Although the Board and District officials reduced surplus fund balance from 19 percent at June 30, 2015 to 8 percent as of June 30, 2023, they consistently appropriated fund balance that was not needed and overfunded reserves, primarily through transfers of surplus fund balance. These practices lack transparency, circumvent the statutory limit on surplus fund balance and can result in taxpayers being taxed more than necessary.

Specifically, the Board and District officials:

- Overestimated appropriations by an annual average of \$1.7 million (3.3 percent) and, as a result,
- Consistently appropriated an average of \$1.6 million of fund balance that was not needed.
- Could not demonstrate that the unemployment insurance and repair reserves, with balances totaling \$2.9 million, were reasonably funded.

Key Recommendations

- Continue reducing surplus fund balance to comply with the statutory limit.
- Adopt budgets that contain reasonable estimates of appropriations and fund balance that will be used to fund operations.
- Maintain reserves at reasonable levels.

Except as noted in Appendix A, District officials generally agreed with our findings. Appendix B includes our comments on the District's response.

Audit Period

July 1, 2019 – November 30, 2023.
We extended our audit back to June 30, 2015 to analyze surplus fund balance trends.

Background

The District is located in the Town of Hempstead in Nassau County.

The elected seven-member Board is responsible for managing and controlling the District's financial and educational affairs. The Superintendent of Schools (Superintendent) is the chief executive officer and is responsible for the District's day-to-day management under the direction of the Board.

The Board, Superintendent and Assistant Superintendent for Business (ASB) are responsible for developing the annual budget.

Quick Facts

2022-23 Appropriations	\$55.6 million
2022-23 Property Tax Levy	\$43.9 million
Overestimated Appropriations	
2019-20	\$2.7 million
2020-21	\$276,031
2021-22	\$2.2 million
2022-23	\$1.7 million
Total Reserves as of June 30, 2023	
Six Reserves	\$12.2 million

Financial Management

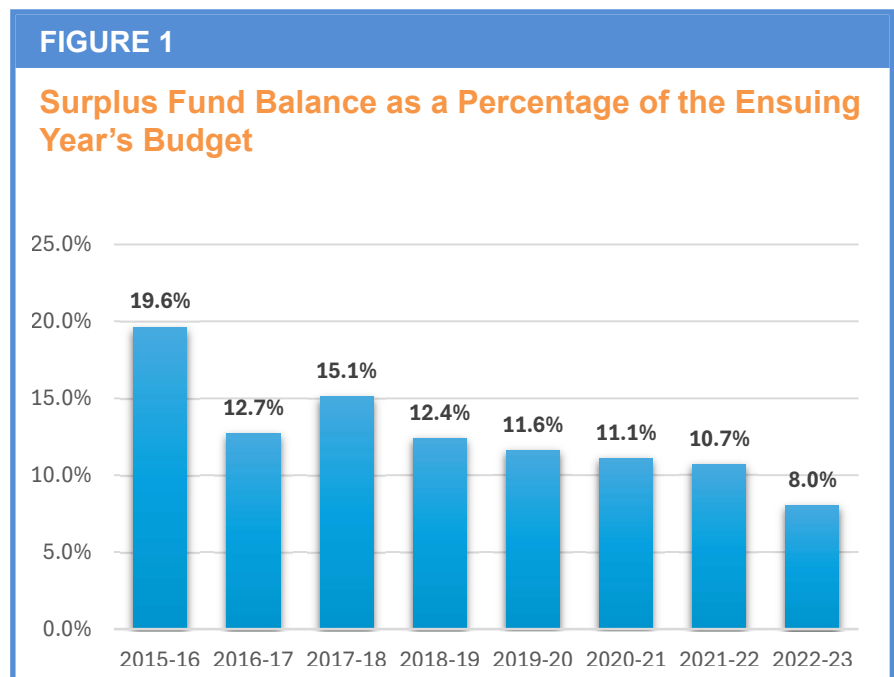
How Should Fund Balance Be Properly Managed?

Fund balance is the difference between revenues and expenditures accumulated over time. School districts may retain a portion of surplus fund balance¹ for unexpected occurrences and fluctuations in cash flow. However, a school district board (board) and officials must comply with New York State Real Property Tax Law Section 1318, which limits the amount of surplus funds that a school district can retain to no more than 4 percent of the budget. Officials must apply any surplus fund balance in excess of the 4 percent limit to reduce the upcoming year's real property tax levy or appropriately fund needed reserves.

To properly manage fund balance, the board and school district officials should develop and 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, the board must estimate the amounts the school district will spend and receive, the amount of fund balance that will be available at fiscal year-end to use toward the upcoming year's budget, and the expected real property tax levy. Accurate and reasonable budget estimates help ensure that the tax levy is not greater than necessary, the budget is presented transparently to the public, and surplus fund balance does not exceed the legal limit. During the course of the fiscal year, as school district officials have a better understanding of the results of financial operations, they should consider using anticipated surplus fund balance to finance one-time expenditures, fund needed reserves or pay off debt.

The Board and District Officials Did Not Properly Manage Fund Balance

In our prior audit report² released in October 2016, we reported that the District's fund balance was approximately \$9 million or 19.3 percent of the ensuing year's budget as of June 30, 2015, exceeding the statutory 4 percent limit by more than 15 percentage points. Since that time, the District reported year-end surplus fund balances that had decreased to 8 percent of the ensuing year's budget at June 30, 2023 (see Figure 1), primarily by transferring from the surplus fund balance



1 For guidance on fund balance classification and reporting see <https://www.osc.ny.gov/files/local-government/publications/pdf/gasb54.pdf>
2 See Merrick Union Free School District – Financial Condition (2016M-240).

to increase the reserve funds. However, the fund balance was still double the 4 percent statutory limit at the end of the 2022-23 fiscal year. The Board President and another Trustee stated that the Board is aware that the District's surplus fund balance still exceeds the 4 percent statutory limit and needs to be reduced. They explained that, because the District's balance had been so high during our previous audit, it is taking considerable time to get to the balance down to 4 percent. The Board and District officials, however, have not adopted a written plan to reduce the District's surplus fund balance to legal limits, nor have they revised the District's fund balance policy to require compliance, as we recommended in our October 2016 report.

Moreover, we compared budgeted revenues and appropriations with actual operating results from July 1, 2019 through June 30, 2023 and noted that, while revenue estimates were generally reasonable, appropriations were overestimated by an average of approximately \$1.7 million annually (3.3 percent), or a cumulative total of \$6.9 million (see Figure 2). While the total overestimation of appropriations was not materially significant

Figure 2: Overestimated Appropriations

	2019-20	2020-21	2021-22	2022-23
Appropriations	\$51,475,143	\$53,262,135	\$54,502,486	\$55,618,754
Less Actual Expenditures	\$48,745,129	\$52,986,104	\$52,244,130	\$53,956,575
Variance	\$2,730,014	\$276,031	\$2,258,356	\$1,662,179
Percentage Overestimated	5.6%	0.5%	4.3%	3.1%

in any of the reviewed years, the consistent practice of overestimating appropriations can cause the District to raise more money in real property taxes than what is needed to finance the District's operations. For the

appropriations that we identified as having the most significant overestimations, the ASB explained that the District must consider the following when developing its budgets:

- Students with Disabilities Related Services at Private Schools – The ASB stated that estimating the cost of services for students with disabilities is difficult to predict because it depends on the number of new students who may qualify and enroll for these services, and because outside service providers could increase their rates. However, the District overestimated this appropriation by an average of \$296,875 annually (149 percent) for the last four years or a cumulative total of approximately \$1.2 million.
- Employee Retirement System Contributions – According to the ASB, the employer contribution rate for the employee retirement system is unknown for April, May and June at the time the budget is prepared and, therefore, the District has to estimate the contribution rate for these months. However, the District overestimated this appropriation by an average of \$223,737 (58 percent) over the last four years or a cumulative total of \$894,948, while the average employer contribution rate did not increase by more than 2 percentage points in any of the last four years.
- Health Insurance – This appropriation was overestimated by an average of \$341,840 annually or a total of nearly \$1.4 million (7 percent) over the last four years. The ASB said that health insurance costs for the second half of the school year are unknown when preparing the budget, so the District budgets to keep sufficient funding to cover premium increases, which the Assistant Superintendent for Business told us can range between 10 and 15 percent.

The ASB further explained that the District routinely appropriates fund balance as a contingency, should they receive less State foundation aid than projected. However, the appropriation of fund balance for contingencies is not appropriate. Appropriated fund balance is intended as a one-time financing source to reduce the tax levy needed; surplus fund balance is what should be used to absorb any shortfalls in projected revenues. In addition, when appropriated fund balance is not used, the budget is misleading because it indicated that the fund balance would be used to finance operations; therefore, the tax levy could be higher than necessary.

In fiscal years 2019-20 through 2022-23, the Board appropriated \$6.5 million of fund balance, or an average of \$1.6 million each year. However, the District's actual annual revenues were more than sufficient to cover annual expenditures, which were less than budgeted appropriations. Consequently, the District experienced operating surpluses totaling nearly \$5.5 million in three of the last four fiscal years, using only \$253,352 of the amount appropriated in 2020-21 and, as of June 30, 2023, surplus fund balance totaled approximately \$4.7 million and continued to exceed the statutory limit by 4 percentage points or \$2.4 million.

The Board and District officials' practice of appropriating fund balance that is not needed is, in effect, a reservation of fund balance that is not provided for by statute and is impeding the Board and District officials' ability to reduce surplus fund balance to within the statutory limit. Appropriating fund balance that is not needed artificially reduces the amount of surplus fund balance subject to the statutory limit, giving the appearance that surplus fund balance is within or closer to the statutory limit. For perspective, when unused appropriated fund balance is included in surplus fund balance, the District's surplus fund balance as of June 30, 2023 would have totaled \$6.2 million and exceeded the statutory limit by \$3.9 million, or 7 percentage points.

Over the four-year period, the District's tax levy increased by an average of nearly \$1 million or more than 2 percent each year. The officials' budgeting practices artificially inflated the total budget and resulted in a real property tax levy that was higher than needed to finance actual expenditures. Furthermore, by continually overestimating appropriations year after year, and appropriating fund balance that was intended as a contingency instead of a reduction of the taxpayers' burden, District officials did not present the District's spending plan in a transparent and meaningful manner to taxpayers.

How Should a School Board Properly Manage Reserve Funds?

A school board should appropriately allocate funds to specific reserves for the reserves' intended purposes. To help ensure that reserve balances do not exceed the amount necessary to address long-term obligations or planned expenditures, a school board should adopt a comprehensive written policy clearly stating its rationale for establishing reserve funds and the objectives for each reserve, reasonable maximum funding levels, how and when the reserves will be used and a periodic review of reserve balances to assess reasonableness. Reserve funds should not be merely a location to accumulate unneeded excess cash or fund balance.

A school board should balance the intent for accumulating funds for identified future needs with the obligation to ensure real property taxes are not higher than necessary. School districts are allowed to

establish reserves and accumulate funds for certain future purposes (e.g., unemployment or retirement expenditures). While school districts are generally not limited to the amount of funds that can be held in reserves, a board should ensure reserve balances are reasonable.

Reserves Were Not Properly Managed, Were Overfunded and Not Being Used

Our October 2016 audit report included findings that the District overfunded its employee benefit accrued liability reserve (EBALR) and retained an excessive balance in its unemployment insurance reserve. On our current audit, we determined that the District continues to maintain excessive reserve balances. Since our 2016 audit, reserve balances have grown from three reserves with balances totaling approximately \$1.9 million to six reserves with balances totaling approximately \$12.2 million, or an increase of three reserves and \$10.3 million. These balances were achieved primarily through transfers from surplus fund balance. The Board did not adopt a comprehensive reserve fund policy to clearly identify a reasonable rationale for maintaining reserves at their targeted levels and how and when the reserves would be used.

While the reserves were properly established, they were generally not used. As of June 30, 2023, four of six reserves were reasonably funded:

- The employee retirement contribution reserve had a balance of \$1,037,365,
- The teachers' retirement contribution reserve had a balance of \$1,054,873,
- The EBALR had a balance of \$1,058,531, and
- The capital reserve had a balance of \$6,130,249.

However, District officials could not demonstrate that the repair reserve with a balance of \$2,566,065 and the unemployment insurance reserve with a balance of \$373,502 were reasonable and necessary. These two reserves were overfunded based on a review of eligible liabilities, a historical cost trend analysis and their use.

Unemployment Insurance Reserve – The purpose of an unemployment insurance reserve is to reimburse the New York State Unemployment Fund for payments made to claimants on the District's behalf. As of June 30, 2023, the unemployment insurance reserve had a balance of \$373,502. We compared this balance to the District's average annual unemployment insurance cost during the last four years and found that the current reserve balance could pay the average annual expense of \$21,097 for more than 17 years. Furthermore, the District paid for unemployment insurance costs, totaling \$84,390 by including appropriations in each of the last four budgets instead of using money from the reserve fund.

Repair Reserve – The purpose of a repair reserve is to pay expenditures for the purpose of keeping the property in an ordinarily efficient operating condition. Repairs do not add to the value of the property, nor do they appreciably prolong its life; they keep the property in an operating condition over the probable useful life for the uses for which it was acquired. The Board established this reserve in April 2019; however, the establishing resolution did not identify the purpose of the reserve or the optimal funding level. The repair reserve increased \$1,548,559, or more than 152 percent during the last

three fiscal years from \$1,017,506 as of June 30, 2020, to \$2,566,065 as of June 30, 2023. The ASB could not provide support for the current funding level. Instead, the ASB explained that District officials originally planned to use the repair reserve for projects related to a 2016 bond issue that was reduced from \$40 million to \$19.9 million. However, after discussions with their attorneys, District officials became aware that the repair reserve has very limited uses, such as minor sidewalk, window and roof repairs, and that the projects originally planned by District officials were more appropriately funded with a capital reserve.

Because the Board did not adopt a comprehensive written reserve fund policy, District officials could not demonstrate that the balances in these reserves were needed or reasonable. Funding reserves at levels higher than necessary for operations and/or needs creates an undue burden on taxpayers and withholds funds that may have been used in a way that was more beneficial to current District residents and taxpayers.

What Do We Recommend?

The Board and District officials should:

1. Adopt a plan to continue reducing surplus fund balance to comply with the statutory limit. Surplus funds may be used for:
 - Reducing District property taxes
 - Funding one-time expenditures,
 - Funding needed reserves that are not already adequately funded, and
 - Paying off debt.
2. Develop and adopt budgets that include reasonable estimates for appropriations and the amount of fund balance that will be appropriated and used to fund operations.
3. Develop, adopt and periodically update a comprehensive written reserve fund policy that addresses the objective of each reserve, rationale for funding levels and conditions under which reserves will be used and replenished.
4. Review all reserve balances to determine whether the amounts reserved are necessary and reasonable. Reduce overfunded reserves to reasonable levels in accordance with applicable statutes. Refer to our publication *Reserve Funds* available at: <https://www.osc.ny.gov/files/local-government/publications/pdf/reserve-funds.pdf>

Appendix A: Response From District Officials



MERRICK UNION FREE SCHOOL DISTRICT

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www.merrick.k12.ny.us
rbutler@merrick.k12.ny.us

DOMINICK PALMA, Ph.D.
Superintendent of Schools

Ryan Butler
*Assistant Superintendent
for Business*

September 12, 2024

Mr. Ira McCracken, Chief of Municipal Audits
NYS Office building, Room 3A10
250 Veterans Memorial Highway
Hauppauge, NY 11788

Dear Mr. McCracken:

The Merrick Union Free School District is in receipt of your audit report on Financial Management. We would like to thank your audit team for their professionalism both during their on-site fieldwork and subsequent correspondence.

Since your office's previous audit in 2016, the district initiated steps to reduce the unassigned fund balance which, as noted in your report, has seen the balance trending towards the statutory limit. In accordance with your recommendations, the district reallocated the available fund balance to appropriate, and authorized, reserves for specific expenditures. Furthermore, additional fund balance was, and continues to be, appropriated into fiscal budgets for one-time (non-recurring) capital and facilities upgrades and repairs. While still pending final audit review, our anticipated unassigned fund balance as of June 30, 2024, is approximately 4.3%.

The Comptroller's report highlights three key findings. The report does not adequately explain that two of these items, "overestimated appropriation" and "consistently appropriated and average of fund balance that was not needed" are in essence the same item. The district explained to the audit team that annually, an appropriation of \$1.5 million was included in the budget estimate on the expenditure side to be used for urgent, unpredictable costs (e.g. additional special education costs, increased cost due to late Fall release of NYSHIP rates, unexpected capital expenditures). This was funded with an appropriation in the same amount from the district's "savings account". When unused the funds remained in the "savings account". As a reminder, the district stayed within the annual tax levy limit each year referenced in your audit report.

It should also be noted that if the "overestimate" of \$6,926,580 indicated on page 5 of your report is reduced by the \$6,000,000 (\$1,500,000 x 4) contingency appropriation over the four audited annual budgets the result is a \$926,580 surplus or 0.4% of the \$214,858,518 total four-year appropriations. Further in one of the four years under audit, these contingent funds were expended, leaving the district with a 0.5% surplus that year, inclusive of this appropriation.

See
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Note 3
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Note 4
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The application of these contingent funds is transparently discussed publicly during budget presentations at Board meetings during the annual budget development. The district acknowledges that the Comptroller’s auditors would prefer that such a contingent application of funds not be utilized.

See
Note 3
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It should be noted that during the early days of this audit, the administration informed the auditors that we discovered that our repair reserve could not be utilized for the type of capital repairs that were being planned for the upcoming school year and beyond. The district funded a repair reserve with the intent to use it for repairs to facilities and infrastructure. After discussions with district counsel (while the auditor’s fieldwork was in progress), the repair reserve was deemed too restrictive in nature for the needed work. In response to this limitation, the district proposed transferring \$2.0 million from the repair reserve to the capital reserve. This proposition was accepted by the Board of Education and supported by the Merrick community at the May 2024 budget vote. Remaining repair reserve funds were then appropriated to sidewalk and asphalt repairs in the 2024-25 budget. The district acknowledges the surplus balance in the unemployment insurance reserve and, like the steps above, will look to transfer an amount to another acceptable reserve fund.

One final note, the report indicates that: “The Board and District officials, however, have not developed a written plan to reduce the district’s surplus fund balance to legal limits...” This is inaccurate. The Assistant Superintendent for Business presented an updated reserve and fund balance plan to the Board of Education at their public meeting on November 14, 2023. This report details each current reserve, ideal balances and future recommendations. A copy was provided to your audit team during fieldwork. This plan will be updated annually at the conclusion of each financial audit. The district will seek Board adoption of this plan at the November 2024 meeting.

See
Note 5
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In conclusion, it was a pleasure working with your audit team. The district will submit a formal Corrective Action Plan within the timeframe required. Through the continued support of the community, the Merrick Union Free School District maintains a healthy financial position per our annual external audits, a stable bond rating, and a lack of fiscal stress as per Comptroller reporting.

Sincerely,

Dr. Dominick Palma
Superintendent of Schools

Cc: Jill Levine, President – Merrick Board of Education
Merrick Board of Education Trustees
Ryan Butler, Assistant Superintendent for Business

Appendix B: OSC Comments on the District's Response

Note 1

The Report Highlights page is intended as a summary to introduce the topics that will be discussed in detail in the body of the report.

Note 2

The District is using “savings account” to refer to the surplus funds retained.

Note 3

As explained in our report, the appropriation of fund balance for contingencies is not appropriate. Further, there is no requirement that the same amount of fund balance be appropriated each year. Had the District used the \$1,500,000 appropriated in any given year, the District could have adjusted the subsequent appropriation to an appropriate amount based on the level of surplus funds the District wished to maintain.

Note 4

In 2020-21, the District used \$253,352 of the \$1,500,000 of fund balance appropriated. This means that the District ended 2020-21 with a 0.5 percent operating deficit. However, even with this single operating deficit, the District had surplus funds equivalent to 11.1 percent of the budget at June 30, 2021.

Note 5

We modified our report to reflect the plan was not adopted, as agreed at our exit discussion.

Appendix C: Audit Methodology and Standards

We conducted this audit pursuant to Article V, Section 1 of the State Constitution and the State Comptroller's authority as set forth in Article 3 of the New York State General Municipal Law. We obtained an understanding of internal controls that we deemed significant within the context of the audit objective and assessed those controls. Information related to the scope of our work on internal controls, as well as the work performed in our audit procedures to achieve the audit objective and obtain valid audit evidence, included the following:

- We interviewed Board members and District officials and reviewed District policies to gain an understanding of the District's financial condition and budgeting process.
- We analyzed the District's fund balance for June 30, 2015 through June 30, 2023 to identify trends and calculated surplus fund balance as a percentage of the upcoming year's budgeted appropriations to determine whether it was within the statutory limit. For fiscal years 2019-20 through 2022-23, we recalculated surplus fund balance as a percentage of the upcoming year's budgeted appropriations after adding back unused appropriated fund balance.
- We compared estimated revenues to actual revenues and budgeted appropriations to actual expenditures for fiscal years 2019-20 through 2022-23.
- We reviewed Board resolutions establishing District reserves.
- We reviewed reserve balances as of June 30, 2023 to determine whether they were reasonably funded.

We conducted this performance audit in accordance with generally accepted government auditing standards (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.

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

The Board has the responsibility to initiate corrective action. 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-a (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 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 CAP should be posted on the District's website for public review.

Appendix D: Resources and Services

Regional Office Directory

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

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

www.osc.ny.gov/local-government/publications

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

www.osc.ny.gov/local-government/fiscal-monitoring

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

www.osc.ny.gov/local-government/publications

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

www.osc.ny.gov/local-government/resources/planning-resources

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

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

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

www.osc.ny.gov/local-government/required-reporting

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

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Contact

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