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March 17, 2017

The Honorable William Aiello
Members of the Common Council
City of Olean
101 East State Street
Olean, New York 14760-0668

Report Number: B17-1-3

Dear Mayor Aiello and Members of the Common Council:

Chapter 331 of the Laws of 2007 authorizes the City of Olean (City) to issue debt not to exceed \$4,300,000 to liquidate the accumulated deficit in the City's general, water and sewer funds as of May 31, 2007. New York State Local Finance Law (LFL) Section 10.10 requires all municipalities and school districts that have been authorized to issue obligations to fund operating deficits to submit to the State Comptroller each year, starting with the fiscal year during which the local government is authorized to issue obligations and for each subsequent fiscal year during which the deficit obligations are outstanding, their tentative or preliminary budget for the next succeeding fiscal year.

The budget must be submitted no later than 30 days before the date scheduled for the governing board's vote on the adoption of the budget or the last date on which the budget may be finally adopted, whichever is sooner. The State Comptroller must examine the preliminary budget and make recommendations for any changes that are needed to bring the preliminary budget into balance. Such recommendations are made after the examination into the estimates of revenues and expenditures of the City.

The Common Council, no later than five days prior to the adoption of the budget, must review all recommendations made by the State Comptroller and may make adjustments to its preliminary budget consistent with those recommendations contained in this report. All recommendations that the Common Council rejects must be explained in writing to our Office.

Our Office has recently completed a review of the City's preliminary budget for the 2017-18 fiscal year. The objective of the review was to provide an independent evaluation of the preliminary budget. Our review addressed the following questions related to the City's budget for 2017-18:

- Are the significant revenue and expenditure projections in the City's preliminary 2017-18 budget reasonable?

- Did the City take appropriate action to implement or resolve recommendations contained in our budget review letter issued in March 2016?

To accomplish our objectives in this review, we requested your preliminary budget, salary schedules, debt payment schedules and other pertinent information. We identified and examined significant estimated revenues and expenditures for reasonableness with emphasis on significant and/or unrealistic increases or decreases. We analyzed, verified and/or corroborated trend data and estimates, where appropriate. We identified any significant new or unusually high revenue or expenditure estimates, made appropriate inquiries and reviewed supporting documentation to determine the nature of the items and to assess whether the estimates were realistic and reasonable. We also evaluated the amount of fund balance appropriated in the preliminary budget to be used as a financing source and determined whether the amount of fund balance was available, sufficient and reasonable for that purpose. In addition, we inquired and evaluated whether written recommendations from our last budget review were implemented or resolved and, therefore, incorporated as part of the current year's budget.

The scope of our review does not constitute an audit under generally accepted government auditing standards (GAGAS). We do not offer comments or make specific recommendations on public policy decisions, such as the type and level of services under consideration to be provided.

The preliminary budget package submitted for review for the fiscal year ended May 31, 2018 consisted of the following:

- Cover Letter
- 2017-18 Preliminary Budget
- Supplementary Information

The preliminary budget submitted to our Office is summarized as follows:

Fund	Appropriations and Provisions for Other Uses	Estimated Revenues^a	Appropriated Fund Balance	Real Property Taxes
General	\$16,936,219 ^b	\$9,251,290	\$600,000	\$7,084,929
Water	\$4,049,940	\$4,026,960	\$22,980	\$0
Sewer ^c	\$4,183,520	\$3,814,294	\$369,226	\$0
Total	\$25,169,679	\$17,092,544	\$992,206	\$7,084,929

^a The City's preliminary 2017-18 budget includes proposed increases to the current water and sewer rates.
^b This amount does not include approximately \$630,000 department heads requested for nine vehicle replacements and approximately \$700,000 department heads requested for various capital improvements.
^c We adjusted sewer appropriations and appropriated fund balance to correct for mathematical errors in the City's preliminary budget.

We determined that certain sources of revenue and expenditure categories in the preliminary budget are not reasonable and, at current rates, could potentially contribute to a depletion of the general fund balance within three to five years. Furthermore, the City did not submit a corrective action plan provided for in New York State General Municipal Law (GML) for the 2015-16 and 2016-17 budget reviews. The City also has not completely implemented recommendations

contained in our prior budget review letters issued from March 2009 through March 2016. The City's preliminary budget complies with the property tax levy limit set by statute.

We identified mathematical errors in the preliminary budget for the sewer fund's appropriations and appropriated fund balance. Additionally, both the proposed water and sewer rate increases were omitted from the respective fund's rate history sheet contained within the preliminary budget, resulting in diminished transparency regarding proposed rate increases. We recommend the schedules supporting the preliminary budget be reviewed for errors prior to presentation to the Common Council.

As of May 31, 2016, the City's audited financial statements reported that unrestricted fund balances in the general, water and sewer funds were approximately 16 percent, 19 percent and 45 percent, respectively, of the following year's appropriations. The City projects an operating deficit in the general fund and operating surpluses in the water and sewer funds for 2016-17.

Our review disclosed the following findings which should be reviewed by the Common Council for appropriate action. Good management practices require that City officials take prompt action concerning our recommendations. We believe that prompt action by City officials will help improve the City's financial condition.

Fund Balance

Fund balance represents money left over from previous years' operations that may be appropriated in the subsequent year's budget to reduce the tax levy. Because fund balance is affected by the results of the City's financial operations, it may not be available on a recurring basis and should be used cautiously. While it is normal and acceptable to use accumulated fund balance, it is best to use it for one-time purposes such as debt reduction, capital expenditures or to help cover a one-time budget shortfall.

We are concerned that the City has again¹ proposed to rely on \$600,000 in fund balance to balance its general fund budget. The City appropriated \$602,000, or approximately 17 percent, of its fund balance as of May 31, 2016 to close the gap in its 2016-17 budget. We estimate that if current plans remain in place, nearly all \$602,000 of the appropriated fund balance will be used to offset the general fund's operating deficit in 2016-17. This deficit is projected to occur, in part, because the City did not include any of the department heads' requests for vehicle replacements or capital improvements, which totaled approximately \$1.3 million, in the preliminary 2017-18 budget. Instead, the City initially proposed that approximately \$240,000 of these items be purchased during the current fiscal year, further increasing the projected 2016-17 operating deficit. As a result, we estimate that general fund unrestricted fund balance could decrease to approximately \$2.9 million as of May 31, 2017.

All \$600,000 in appropriated general fund balance included in the preliminary budget will be used towards recurring expenditures. We recommend recurring costs be funded using recurring revenues rather than appropriated fund balance. Using fund balance to fund recurring expenditures that should instead be regularly incorporated into the budget can lead to future budget shortfalls.

¹ The 2016-17 adopted budget also relied on appropriated fund balance.

We estimate² that if the City continues to budget for the use of fund balance to finance recurring expenditures, as well as taking into consideration certain other factors affecting the City's financial condition, unrestricted general fund balance could be depleted within the next three to five years.

We included this same recommendation regarding the use of appropriated fund balance and the adoption³ of a fund balance policy in our 2016-17 budget review letter dated March 14, 2016. To further assist City officials, we recommend the City Auditor routinely provide the Common Council year-end fund balance projections and cash flow reports for a rolling 12-month period for each fund.

Contingency Appropriation

Local governments use contingency appropriations to provide funding for unexpected events. Although the City Charter does not specifically address budgeting for contingencies, in our prior budget reviews, we commented on the City's minimal contingency funding and recommended the City budget 5 percent of an operating fund's budget (excluding appropriations for debt service and judgments). However, over the past several years, City officials consistently budgeted minimal amounts for contingencies, and this trend continues.

The City's preliminary budget includes contingency appropriations of \$200,000 in the general⁴ fund and \$75,000 each in the water and sewer funds. This equates to approximately 1.2 percent of total appropriations excluding debt in the general fund and 2.5 percent of total appropriations excluding debt in both the water and sewer funds. This provides the City with a limited amount of flexibility in the event of unforeseen circumstances that may require additional funds.

We reviewed the last five years of contingency appropriation use and determined that approximately \$1.3 million has been used for recurring expenditures such as street paving, building repairs and vehicle replacement. These are examples of known recurring costs that should be adequately planned for and incorporated in the respective department's operating budget and financed with recurring revenues. Such practices contribute to the increasing amounts of fund balance being appropriated to fill budget gaps and fund operations.

Additionally, all four⁵ of the City's collective bargaining agreements (CBAs) have expired, or will expire, by the end of 2016-17. However, the 2017-18 preliminary general fund budget does not contain provisions for any potential increased costs associated with settling these agreements.

² This estimate includes the assumption that the Mayor will follow through with his initial plan to purchase vehicles requested for 2017-18 during 2016-17 and the annually occurring assumptions of appropriated general fund balance totaling \$600,000, 1 percent real property tax increases, 1 percent decreases in sales tax revenue, 2 percent increases in operating expenditures and encumbrances averaging \$270,000.

³ In February 2017, the Council has agreed that the concept of a fund balance policy, as we recommended in March 2016, is important. However, it has not adopted a comprehensive policy since we made this recommendation over a year ago.

⁴ This is a \$50,000 decrease from the 2016-17 budget and a \$565,000 decrease from the 2012-13 adopted budget.

⁵ The Police Command (Olean Police Local 967C and New York State Law Enforcement Officers Union, Council 82 of the American Federation of State, County and Municipal Employees, AFL-CIO) and the Police Patrol (Olean Police Local 967 and New York State Law Enforcement Officers Union Council 82 of the American Federation of State, County and Municipal Employees, AFL-CIO, I.A.F.F. Local 1796) CBAs expired on May 31, 2015. The Olean Professional Fire Fighters Association, I.A.F.F. Local 1796 expired on May 31, 2016. The City of Olean Unit 6202 Cattaraugus County Local 805 Civil Service Employees Association CBA expires on May 31, 2017.

The expired CBAs cover the salary and wage costs of approximately 140 of the City's 260 full- and part-time employees. Wages and salaries account for over \$7.5 million, or 45 percent, of the preliminary general fund budget.

We estimate that any negotiated increases taking effect during 2017-18 could have a significant impact on the City's budgeted operations. For example, if the City settled all four CBAs with a range of approximately 1 to 3 percent increase (\$150,000 and \$450,000, respectively), the 2017-18 contingency appropriation included in the preliminary budget could be depleted and leave no provisions for unanticipated expenditures or revenue shortfalls and further erode fund balance. In the past, City officials have budgeted for similar potential cost increases with additions to the contingency line item. However, by underfunding contingency appropriations, the City's ability to pay liabilities which may arise from contract negotiations settled in 2017-18 is diminished.

We recommend that City officials be cognizant of the potential financial impact of the settlement of the expired CBAs and be prepared to fund the resulting costs in the event they are settled in 2017-18. We recommend that City officials should either include potential salary increases within the department line items or restore the contingency appropriations to previously recommended levels. We included this same recommendation regarding the level of contingency funding in our previous 2016-17 budget review letter dated March 14, 2016.

Multiyear Plans

A budget is a financial plan that details the projected revenues and expenditures for a defined period of time. An integral part of any successful budget process is the integration of both a multiyear capital plan⁶ and a multiyear financial plan.⁷ These two documents can help project the effects of the current and future budgets and policy assumptions on future years.

We recommended that the City create and use both these multiyear plans in its budget creation in our previous 2016-17 budget review letter. We note that Section 5(d) of Chapter 331 of the Laws of 2007 requires the City to annually prepare a three-year financial plan (see also LFL §10.10[e]). However, these plans were not prepared or used in the creation of the 2017-18 preliminary budget.

It is important to note, the City's outstanding debt has grown by more than 17 percent over the last five years, increasing from approximately \$28.5 million as of May 31, 2012 to approximately \$33.4 million as of May 31, 2016. The City's 2017-18 debt service obligations are estimated to total approximately \$3.4 million (approximately 13.5 percent of the combined general, water and sewer operating budgets). A contributing factor is the City's continued practice of bonding for recurring expenditures, such as building repairs, equipment upgrades and street maintenance, rather than including them in budgeted appropriations and funding through recurring revenues.

⁶ A multiyear capital plan is a process of planning for and prioritizing potential future capital asset needs.

⁷ A multiyear financial plan projects revenues and expenditures for several years into the future. Unlike a multiyear budget, it does not authorize expenditures (although it should be linked to the current budget). Instead, it illustrates what will happen to a government's ability to pay for and provide services, given a set of policy and economic assumptions. These projections help policy makers assess expenditure commitments, revenue trends, financial risks and the affordability of new services and capital investments.

Had the City developed and continually updated and used these plans when originally recommended approximately 10 years ago in our audit,⁸ the financial impact of using fund balance, contingency funds and/or issuing debt to pay for recurring expenditures would have had on future years could be evaluated. We continue to recommend that City officials create, adopt, use and annually update both a multiyear capital plan and a multiyear financial plan and that both plans become an integral part of the budget process to reduce the risk of unbalanced future budgets.

Water and Sewer Funds

The 2017-18 preliminary budget estimate of \$4,026,960 for water fund revenue includes an anticipated 2 percent increase in water rates, which equates to approximately \$80,000 more than the 2016-17 estimate. This estimate assumes the anticipated water rate increase is adopted by the Common Council. We recommend that the Common Council authorize the potential water rate increase prior to the budget's adoption. If the water rate increase is not authorized, or is authorized at a different rate, the revenue estimate should be modified accordingly.

The 2017-18 preliminary budget estimate of \$3,814,294 for sewer fund revenue includes an anticipated 5 percent increase in rates, which equates to approximately \$164,000 more than the 2016-17 estimate. This estimate is approximately \$33,000 less than the previous year's budget and is more in line with current usage trends. We recommend that the Common Council authorize the potential sewer rate increase prior to the budget's adoption. If the sewer rate increase is not authorized, or is authorized at a different rate, the revenue estimate should be modified accordingly.

Tax Cap Compliance

The State Legislature enacted Chapter 97 of the Laws of 2011 that established a tax levy limit on all local governments and school districts, which was effective beginning in the 2012 fiscal year. The law precludes a local government from adopting a budget that requires a tax levy that exceeds the prior year's tax levy by more than 2 percent or the rate of inflation, whichever is less, and certain exclusions permitted by law, unless the governing board adopts a local law to override the tax levy limitation.

The City's preliminary budget complies with the tax levy limit because it includes a proposed tax levy of \$7,084,929, which increases the 2017-18 tax levy by approximately \$37,800. In adopting the 2017-18 budget, the Common Council should be mindful of the legal requirement to maintain the tax levy increase to no more than the statutory limit.

The Common Council has the responsibility to initiate corrective action. Pursuant to Section 35 of GML, the Common Council should prepare a plan of action that addresses the recommendations in this report and forward the plan to our office within 90 days. We encourage the Common Council to make this plan available for public review in the City Clerk's office. For guidance in preparing your plan of action and filing this report, please refer to the attached documents.

We request that you provide us with a copy of the adopted budget.

⁸ *City of Olean: Financial Condition and internal Controls Over Financial Operations, 2007M-6, March 2007*

We hope that this information is useful as you adopt a budget for the City. If you have any questions on the scope of our work, please feel free to contact Jeffrey D. Mazula, Chief Examiner of the Buffalo Regional Office, at (716) 847-3647.

Sincerely,

Gabriel F. Deyo
Deputy Comptroller

cc: Fred Saradin, City Auditor and Budget Officer
Alexander Utecht, City Clerk
Tiffany Taylor, Clerk
Hon. Catherine M. Young, Chair, Senate Finance Committee
Hon. Herman Farrell, Jr., Chair, Assembly Ways and Means Committee
Hon. Joe Giglio, New York State Assembly
Robert F. Mujica, Jr., Director, Division of the Budget
Andrew A. SanFilippo, Executive Deputy Comptroller
Jeffrey D. Mazula, Chief Examiner