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March 19, 2018

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

Report Number: B18-1-1

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 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 deficit obligations and for each subsequent fiscal year during which the deficit obligations are outstanding, their tentative or proposed 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 its adoption or the last date on which the budget may be finally adopted, whichever is earlier. The State Comptroller must examine the proposed budget and make recommendations, as deemed appropriate, for any changes that are needed to bring the proposed budget into balance. Recommendations, if any, are made after the examination into the City's estimates of revenues and expenditures.

The Common Council (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 proposed budget consistent with those recommendations contained in this letter. All recommendations that the Council rejects must be explained in writing to our Office.

Our Office has recently completed a review of the City's proposed budget for the 2018-19 fiscal year. The objective of the review was to provide an independent evaluation of the proposed budget. Our review addressed the following questions related to the proposed budget:

- Are the significant revenue and expenditure projections in the proposed budget reasonable?
- Did the Council and City officials take appropriate action to implement or resolve recommendations contained in the budget review letter issued in March 2017?

To accomplish our objective in this review, we requested the proposed budget, salary and debt payment schedules and other pertinent information. We identified and reviewed 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 assess the nature of the items and to assess whether the estimates were realistic and reasonable. In addition, we inquired and evaluated whether written recommendations from our last budget review were implemented or resolved by the Council and City officials and, therefore, incorporated as part of the current year's proposed 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 proposed budget package submitted for review for the 2018-19 fiscal year consisted of the following:

- Cover Letter
- 2018-19 Proposed Budget
- Supplementary Information

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

Fund	Appropriations	Estimated Revenues^a	Appropriated Fund Balance	Real Property Taxes
General	\$16,612,591 ^b	\$9,395,068	\$0	\$7,217,523
Water	\$3,677,984 ^c	\$3,677,984	\$0	\$0
Sewer	\$3,956,210 ^d	\$3,956,210	\$0	\$0
Total	\$24,246,785	\$17,029,262	\$0	\$7,217,523
^a The proposed budget includes increases to the current water and sewer rates.				
^b This does not include \$45,000 for streets capital outlay requested by the department head.				
^c This does not include \$250,000 for water fund capital outlay requested by the department head.				
^d This does not include \$58,000 for sewer fund capital outlay requested by the department head.				

Based on the results of our review, except for the items discussed below, we found that the significant revenue and expenditure estimates contained in the proposed budget were reasonable. Further, while the Council submitted a corrective action plan (CAP) provided for in New York State General Municipal Law for the 2017-18 budget review and did implement certain corrective actions, the Council and City officials have not implemented certain other corrective actions that the Council indicated would be undertaken. Further, the Council decided to not implement certain other recommendations. Lastly, the Council did not address the remaining recommendations we

had included in the 2017-18 budget review letter. Consequently, the Council and City officials still have not completely implemented certain recommendations contained in our prior budget review letters issued from March 2009 through March 2017, which are addressed throughout this letter.

As of May 31, 2017, the City's audited financial statements reported that unrestricted fund balance in the general, water and sewer funds were approximately 15 percent, 19 percent and 58 percent, respectively, of the following year's appropriations. The City Auditor projects minimal operating surpluses in the general, water and sewer funds for 2017-18.

Based on our review, we make the following recommendations. The recommendations must be reviewed by the Council, with appropriate action taken as necessary in accordance with the requirements in Local Finance Law Section 10.10 as described above.

Unresolved Capital Expenditures

The City currently faces pending litigation relating to the North Union Street capital project that may require additional funds of approximately \$1.3 million, the City estimates, to cover projected costs. The City's proposed budget does not include any appropriations for these potential costs. Additionally, as of May 31, 2017, the City reported seven completed capital projects with deficit balances totaling approximately \$900,000 that may require money from the general fund to close out, which could result in a further reduction of general fund balance.

As of May 31, 2018, the City Auditor projects unrestricted general fund balance to be approximately \$2.5 million. Should the City require general fund money to cover the \$2.2 million of unresolved capital expenditures, virtually all of the general fund's \$2.5 million projected unrestricted fund balance would be depleted. As a result, the City would not have fund balance available to appropriate to cover the costs of unanticipated expenditures and revenue shortfalls. It is imperative that the Council and City officials properly evaluate the funding options available to the City for these potential costs and the long-term impact of those funding options on the City's fiscal health.

As a result, we recommend that the Council and City officials continue to consult with legal counsel regarding the funding options available to address these capital expenditures.

Contingency Appropriation

Local governments use contingency accounts to provide funding for unexpected events. Although the City Charter does not specifically address budgeting for contingencies, in our prior audit¹ and budget reviews² we commented on the Council and City officials' minimal contingency funding and recommended the Council budget 5 percent of an operating fund's budget (excluding appropriations for debt service and judgments). However, over the past several years, the Council consistently budgeted minimal amounts for contingencies and for this proposed budget continued this trend.

¹ *City of Olean: Financial Condition and Internal Controls Over Financial Operations, 2007M-6, March 2007*

² 2009-10, 2016-17, 2017-18 budget reviews

In the City's proposed budget, contingency appropriations are the same as 2017-18 levels: \$200,000 in the general fund and \$75,000 each in the water and sewer funds. This equates to approximately 1.3 percent of total appropriations excluding debt in the general fund, 2.9 percent of total appropriations excluding debt in the water fund and 2.7 percent of total appropriations excluding debt in the sewer fund. An insufficient amount in contingency appropriations limits the City's flexibility to address revenue shortfalls and/or unforeseen circumstances. This year, a sufficient contingency appropriation is particularly important because of the potential to use almost all available fund balance for the unresolved capital expenditures. Without the financial flexibility provided by fund balance, the contingency account is needed to provide for any unanticipated events. As a result, we recommend that the Council and City officials restore the contingency appropriation to at least the previously³ recommended levels.

Historically, the Council and City officials have consistently used contingency funds to fund recurring expenditures that should be incorporated into the respective departments' operating budgets. However, the Council has not budgeted for recurring expenditures such as vehicle replacement and street maintenance and has instead opted for a wait and see approach⁴ to determine whether funds are available at fiscal year-end for these items. 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 revenue sources.

In the CAP dated April 11, 2017, in response to our 2017-18 budget review, the Council indicated that it plans to continue with the wait and see approach. During our current budget review, officials indicated they anticipate purchasing equipment⁵ totaling \$125,000 with unused contingency funds at the end of 2017-18 and two police vehicles totaling \$75,000 from prior years' unused contingency funds that have been previously⁶ transferred to the capital projects fund. However, department head 2018-19 budget requests totaling \$353,000⁷ for capital improvements were not included in the City's proposed budget.

As previously⁸ recommended, we again recommend that the Council and City officials budget for recurring costs rather than taking the wait and see approach. Further, we recommend the Council and City officials ensure money transferred from the general, water and sewer funds to the capital projects fund is properly accounted for and used in accordance with Council authorizations.

³ 2009-10, 2016-17, 2017-18 budget reviews

⁴ Even though we recommended that items, such as replacement vehicles, be included in the operating budget, the Council and City officials have shown a pattern of transferring funds to the capital projects fund at the end of the year to use for vehicle replacement or other recurring expenditures. The transferred amounts are usually equal to unexpended contingency appropriations.

⁵ Lawn mower (\$40,000) from the general fund and a backhoe (\$85,000) split evenly from the general, water and sewer funds

⁶ Over the last five years, the Council and City officials have transferred \$4.6 million from the general fund and \$250,000 in 2013-14 from both the water and sewer funds.

⁷ General fund (\$45,000), water fund (\$250,000) and sewer fund (\$58,000)

⁸ 2009-10 through 2016-17 budget reviews

Multiyear Plans

A city's 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 plan⁹ and a multiyear financial/operational plan.¹⁰ These two documents can help project the effects of current and future budgets and policy assumptions on future years.

We previously¹¹ recommended that City officials create and the Council adopt multiyear plans and that these plans be used when developing and adopting the budget. However, these multiyear plans, again, were not prepared or used in the creation of the 2018-19 proposed budget. Had the Council and City officials developed, continually updated and used these plans when originally recommended approximately 12 years ago in our audit,¹² the financial impact of using fund balance and/or contingency funds to pay for recurring expenditures would have on future years' fund balances could be better evaluated.

Further, as part of the deficit financing legislation, the Council and City officials are required to prepare a three-year operational plan to address the City's financial problems. However, the Council and City officials have not done so, which we noted in our 2016-17 and 2017-18 budget reviews. The City's CAP stated that multiyear plans will be reviewed and updated. However, this did not happen. As a result, we again recommend that City officials create and the Council adopt and annually update both a multiyear capital plan and a multiyear financial/operational plan. Both plans should be used during the budget process to assist the Council and City officials in managing City finances.

Debt

The City's outstanding debt has grown by 36 percent in one year, increasing from approximately \$33.4 million as of May 31, 2016 to approximately \$45.3 million as of May 31, 2017. From June 1, 2012 through May 31, 2017, debt has grown by 59 percent, increasing a total of \$16.8 million.

The City's 2018-19 current debt service obligations are estimated to total approximately \$3.45 million (approximately 14 percent of the combined general, water and sewer operating budgets). A contributing factor for these increases is the Council's and City officials' continued practice of bonding (issuing long-term debt) for recurring expenditures¹³ – such as building repairs, vehicle and equipment replacement and street maintenance – rather than including them in budgeted appropriations and funding through recurring revenues.

⁹ A multiyear capital plan is a process of planning for and prioritizing potential future capital asset needs.

¹⁰ 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.

¹¹ 2009-10 through 2011-12 and 2013-14 through 2017-18 budget reviews

¹² See footnote 1

¹³ As discussed under the "Contingency Appropriation" section

Additionally, the proposed budget omitted approximately \$40,000 in general fund short-term debt that was included on the City's debt schedule. As a result, we recommend the Council add \$40,000 to the proposed general fund budget for this payment and routinely review budget estimates in comparison with the debt schedule to ensure all debt is accurately reflected.

Prior Recommendations

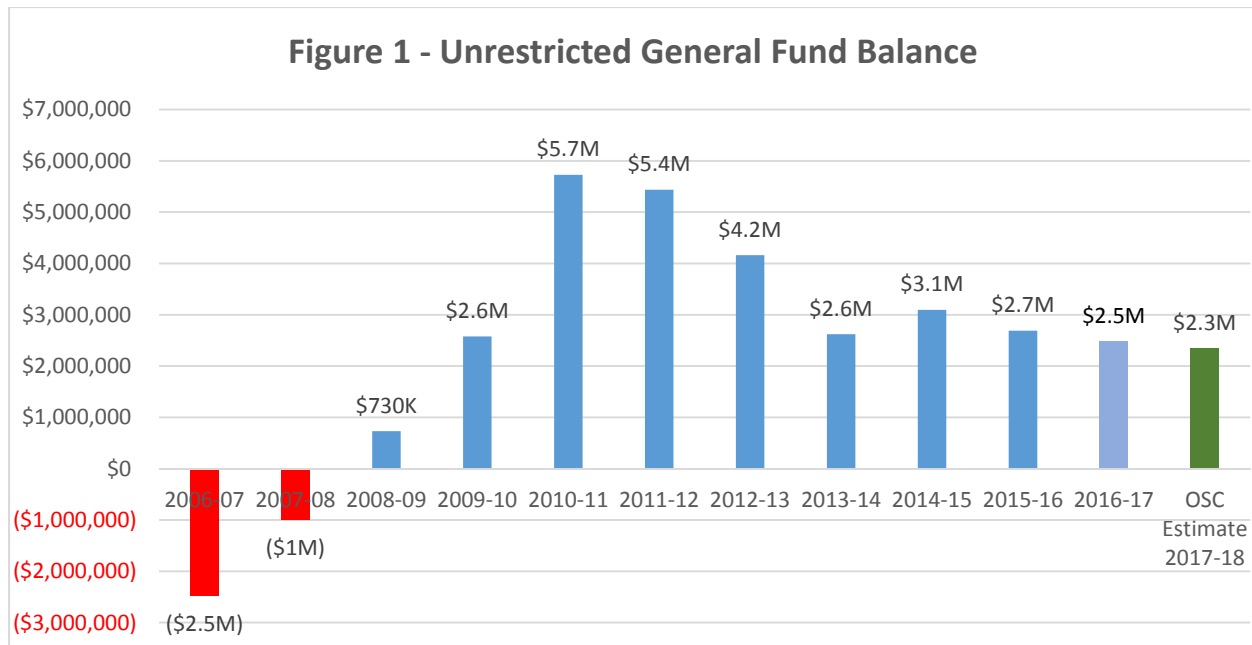
The Council and City officials did not fully comply with all of the recommendations contained in the 2017-18 budget review letter dated March 2017. In addition to those mentioned in the previous sections of this letter, we previously recommended the following:

- Projection reports – We recommended¹⁴ the City Auditor routinely provide the Council with year-end fund balance projections and cash flow reports for a rolling 12-month period for each fund to help aid the Council in its decision making and financial review responsibilities. The Council did not address either of these reports in its CAP. The City Auditor stated that he has not created and provided these reports to the Council because he feels the reports the Council currently receives are adequate. We again recommend the City Auditor routinely provide the Council year-end fund balance projections and cash flow reports for a 12-month period.
- Fund balance policy – We recommended¹⁵ the Council adopt a fund balance policy to guide the Council and City officials in its accumulation and use of fund balance. The Council indicated in its CAP that it had voted to create a fund balance policy and would design and implement the policy. However, the Council has not done so. We reviewed the City Auditor's projection of May 31, 2018 fund balance and agree with the projected amounts which, as a result of minimal operating surpluses, are anticipated to remain at levels similar to May 31, 2017: approximately \$2.5 million in the general fund, \$818,000 in the water fund and \$2.5 million in the sewer fund.

Although general fund balance levels are projected to remain at similar levels, as evidenced by Figure 1, general fund balance has declined since 2010-11. This is especially concerning given the Council has not adopted a fund balance policy to guide officials in determining the amount of fund balance it deems to be reasonable or under what specific circumstances or in which manner fund balance should be used. Without this plan guiding the Council and City officials and clearly communicating the Council's intent for the accumulation and use of these funds, continued decline and possible depletion of fund balance could occur. We again recommend that City officials develop and the Council adopt a fund balance policy to be used in the annual budget development process.

¹⁴ 2017-18 budget review

¹⁵ 2016-17 and 2017-18 budget reviews



Tax Cap Compliance

The State Legislature and the Governor 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 local governments and school districts from adopting a budget with a tax levy that exceeds the prior year tax levy by more than 2 percent or the rate of inflation, whichever is less, and certain exclusions permitted by law, unless the Council adopts a local law to override the tax levy limitation.

The City's proposed budget includes a tax levy of \$7,217,523. In adopting the 2018-19 budget, the Council should be mindful of the legal requirement to maintain the tax levy increase to no more than the tax levy limit as permitted by law, unless it obtains the proper voter approval to override the tax levy limit.

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

We hope that this information is useful as you adopt the upcoming 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 716-867-3647.

Sincerely,

Gabriel F. Deyo
Deputy Comptroller

cc: Alfred Saradin, City Auditor and Budget Officer
Tiffany Taylor, Clerk of the Common Council
Lens Martial, City Clerk
Catharine Young, State Senator and Chair, Senate Finance Committee
Helene E. Weinstein, Chair, Assembly Ways and Means Committee
Joseph Giglio, State Assembly Representative
Robert Mujica Jr., Director, Division of the Budget
Andrew A. SanFilippo, Executive Deputy Comptroller
Jeffrey D. Mazula, LGSA Regional Chief Examiner