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March 14, 2016

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

Report Number: B1-16-2

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 totaling \$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 local governments 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 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 for any changes that are needed to bring the proposed 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 proposed 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 proposed budget for the 2016-17 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 City's budget for 2016-17:

- Are the significant revenue and expenditure projections in the City's proposed 2016-17 budget reasonable?
- Did the City take appropriate action to implement or resolve recommendations contained in our budget review report letter issued in March 2015?

To accomplish our objectives in this review, we requested your proposed 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 proposed budget to be used as a financing source and determined if 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 proposed budget package submitted for review for the fiscal year ending May 31, 2017 consisted of the following:

- Cover Letter
- 2016-17 Proposed Budget
- Supplementary Information

The proposed 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	\$17,161,402	\$9,433,890	\$680,000	\$7,047,512
Water	\$3,958,000	\$3,958,000	\$0	\$0
Sewer	\$3,552,661	\$3,552,661	\$0	\$0
Total	\$24,672,063	\$16,944,551	\$680,000	\$7,047,512
^a The Mayor's proposed 2016-17 budget did not include increases to the current water and sewer rates.				

Based on the results of our review, except for the matters described in this letter, we found that the significant revenue and expenditure projections in the proposed budget appear reasonable. Although the City has made significant progress in improving its financial condition, it did not completely implement recommendations contained in our budget review report letter issued in March 2015. The City's proposed budget complies with the property tax levy limit set by statute.

As of May 31, 2015, the City's audited financial statements reported that unrestricted fund balance in the general, water and sewer funds were approximately 20 percent, 17 percent, and 44 percent, respectively, of the following year's total appropriations. The City also projects operating surpluses for all three funds for 2015-16.

Our review disclosed the following findings which should be reviewed by the Common Council for appropriate action. City officials should take prompt action concerning our recommendations.

Appropriated Fund Balance

Fund balance represents money left over from previous years' operations that may be appropriated in the ensuing 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.

The City has a projected unrestricted general fund balance of approximately \$3.8 million at the end of 2015-16. The City has appropriated \$680,000, or approximately 18 percent, of the projected fund balance to offset certain general fund expenditures in the 2016-17 proposed budget. We caution the City in appropriating fund balance as the use of it to close gaps in the general fund budget decreases the fund balance that is available to cover unforeseen shortfalls in revenue.¹ Additionally, using fund balance to fund recurring expenditures that should be regularly incorporated into the budget can lead to future budget shortfalls. Of the \$680,000² in appropriated fund balance included in the proposed budget, \$310,000³ will be used for recurring expenditures. Therefore, we recommend these costs should be incorporated into the annual operating budget and funded using recurring revenue sources rather than appropriated fund balance. We also recommend that City officials develop and adopt a fund balance policy to guide the City in its accumulation and use of fund balance.

Contingency

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 audit⁴ and prior budget reviews we commented on the City's minimal contingency funding and recommended the City budget 5 percent of the operating fund's budget (excluding appropriations for debt service and judgments). However, the 2016-17 proposed budget includes contingency appropriations of \$250,000⁵ in the general fund and \$75,000 each in the water and sewer funds. This is approximately 1.5 percent, 2.6 percent and 2.7 percent of proposed appropriations⁶ in the general, water and sewer funds, respectively. This provides the City with a limited amount of flexibility in the event of unforeseen circumstances that may require additional funds.

¹ The depletion of fund balance through annual appropriations over the course of five years (2000-01 through 2004-05) was a contributing factor that led the City into fiscal stress prior to obtaining deficit financing.

² Other proposed uses of fund balance include: City Hall emergency generator (\$175,000), accessibility improvements (\$75,000) and alarm system upgrades (\$10,000); fire department roof (\$70,000); and boiler replacement (\$40,000).

³ These purchases include Department of Public Works snowplow (\$185,000) and Police Department vehicles (\$75,000) and radios (\$50,000).

⁴ *City of Olean Financial Condition and Internal Controls Over Financial Operations (2007M-6)*

⁵ The amount included in the proposed general fund budget reviewed and determined to be reasonable for the 2015-16 budget was \$500,000. This amount was reduced by 50 percent, or \$250,000, when the Common Council adopted the final budget for 2015-16.

⁶ Excluding appropriations for debt service and judgments.

In addition, all four of the City's collective bargaining agreements have expired or will expire by the end of 2015-16, and the City is still in contract arbitration with one negotiating unit affecting two previous fiscal years. However, the 2016-17 proposed budget does not contain provisions for any potential increased costs associated with settling these agreements. As wages and salaries account for over \$7.5 million, or 44 percent of the general fund budget, any increases could have a significant impact on the 2016-17 budget. By underfunding contingency appropriations, the City's ability to pay any liabilities which may arise from contract agreements settled during 2016-17 is diminished. We recommend that City officials either include potential salary increases within the department line items or restore the contingency appropriation to previously recommended levels.

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 plan⁷ and a multiyear financial plan.⁸ These two documents can help project the effects of the current budget, and future budget and policy assumptions, on future years. For example, the 2016-17 proposed budget includes an appropriation from the debt service fund totaling approximately \$345,000 for certain debt principal and interest payments. The City has determined it has a total of approximately \$892,000⁹ in available fund balance that it can use towards these related debt payments. However, by appropriating 39 percent of these funds in 2016-17 and given tax cap restrictions, we are concerned the City may face the future risk of not being able to maintain a structurally balanced budget after the remaining available funds in the debt service fund have been appropriated and instead must be absorbed in the operating budget.¹⁰

We previously recommended the City create and use multiyear plans in its budget creation process. However, these plans were not prepared or used in the creation of the 2016-17 proposed budget. 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 mitigate the risk of unbalanced future budgets.

Prior Recommendations

The City did not take appropriate action to implement all of the recommendations contained in our budget review report letter issued in March 2015. We previously recommended that anticipated water and sewer rate increases included in the 2015-16 budget be adopted by the Common Council prior to the adoption of the budget. According to Common Council minutes, the anticipated water and sewer rate increases were both adopted by the Common Council on April 28, 2015, two weeks after the adoption of the budget on April 14, 2015. In addition, we recommended that the City

⁷ A multiyear capital plan is a process of planning for and prioritizing potential future capital asset needs.

⁸ 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.

⁹ The City asserted these funds are unused proceeds from recently completed capital projects.

¹⁰ Not having updated multiyear capital and financial plans were contributing factors that lead the City into fiscal stress prior to obtaining deficit financing.

update and use the multiyear capital plan in the budget development process; however, the City did not follow this recommendation.

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 proposed budget complies with the tax levy limit because it includes a proposed tax levy of \$7,047,512, which decreases the 2016-17 tax levy by approximately \$40,940. In adopting the 2016-17 budget, the Common Council should be mindful of the legal requirement to maintain the tax levy increase to no more than the statutory limit.

As noted above, the Common Council has the responsibility to initiate corrective action to address the recommendations in this report. 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) 847-3647.

Sincerely,

Andrew A. SanFilippo
Executive Deputy Comptroller

cc: Fred Saradin, City of Olean Auditor and Budget Officer
Tiffany Taylor, Clerk of the Common Council
Hon. Catherine M. Young, Chair, Senate Finance Committee
Hon. Herman Farrell, Jr., Chair, Assembly Ways and Means Committee
Hon. Joe Giglio, NYS Assembly
Robert F. Mujica, Jr., Director, Division of the Budget
Gabriel F. Deyo, Deputy Comptroller
Jeffrey Mazula, Chief Examiner