Office of the New York State Comptroller

Division of Local Government & School Accountability

City of Poughkeepsie

Fiscal Stress and Council Oversight

Report of Examination

Period Covered:

January 1, 2011 — July 31, 2012

2013M-30

Thomas P. DiNapoli

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State of New York
Office of the State Comptroller

Division of Local Government
and School Accountability

May 2013

Dear City Officials:

A top priority of the Office of the State Comptroller is to help local government officials manage government resources efficiently and effectively and, by so doing, provide accountability for tax dollars spent to support government operations. The Comptroller oversees the fiscal affairs of local governments statewide, as well as compliance with relevant statutes and observance of good business practices. This fiscal oversight is accomplished, in part, through our audits, which identify opportunities for improving operations and City Council governance. Audits also can identify strategies to reduce costs and to strengthen controls intended to safeguard local government assets.

Following is a report of our audit of the City of Poughkeepsie, entitled Fiscal Stress and Council Oversight. This audit was conducted pursuant to Article V, Section 1 of the State Constitution and the State Comptroller's authority as set forth in Article 3 of the General Municipal Law.

This audit's results and recommendations are resources for local government officials to use in effectively managing operations and in meeting the expectations of their constituents. If you have questions about this report, please feel free to contact the local regional office for your county, as listed at the end of this report.

Respectfully submitted,

Office of the State Comptroller
Division of Local Government
and School Accountability

State of New York
Office of the State Comptroller

EXECUTIVE SUMMARY

The City of Poughkeepsie (City) is located in Dutchess County and has approximately 33,000 residents. The City is governed by an elected Mayor and an eight-member elected Common Council (Council). The City provides various services to its residents including general government support, police and fire protection, street maintenance, and refuse service. The City's total budgeted appropriations for the 2011 and 2012 fiscal years were approximately $67.2 million and $69.9 million, respectively.

The Commissioner of Finance (Commissioner) is responsible for compiling monthly financial reports. The Mayor is responsible for providing the Council with these monthly reports and other information necessary to properly monitor the City's financial activities. The Mayor, with the help of the City Administrator or Commissioner, is responsible for preparing realistic budgets and the City Council is responsible for approving and adopting the budget.

Scope and Objectives

The objectives of our audit were to review the City's financial condition and Council oversight for the period January 1, 2011, through July 31, 2012. We also reviewed selected financial information back to January 2007 to analyze financial trends. Our audit addressed the following related questions:

- Have City officials adequately monitored the City's fund balance, developed realistic and structurally balanced budgets, managed debt, and taken appropriate action to maintain the City's financial stability?

- Is the City Council providing adequate oversight of the City's financial operations?

Audit Results

From 2007 to 2011, the City's general fund balance declined by $12.8 million. As of December 31, 2011 the City had a general fund balance deficit of over $11.4 million.[1] This has occurred because the Council adopted budgets that were not based on prior year's actual results of operations. In addition, the City's debt service costs grew by 45 percent for the period and now are 12.9 percent of annual revenue. It appears that the Council was not aware of these negative financial trends because the Council did not require that the Commissioner prepare and present detailed and periodic financial reports to the Council. As a result, the City faces fiscal stress which, if not addressed, could affect the level of services that the City can provide.

[1] The 2011 figures used are preliminary, unaudited figures. However, we do not expect the finalized figures to change significantly, if at all.

Comments of Local Officials

The results of our audit and recommendations have been discussed with City officials and their comments, which appear in Appendix B, have been considered in preparing this report. Except as indicated in Appendix B, City officials generally agreed with our recommendations and indicated they would take corrective action.

Introduction and Fiscal Profile

Background

The City of Poughkeepsie (City) is located in Dutchess County and has approximately 33,000 residents. The eight-member Common Council (Council) is the City's legislative branch. The Mayor is the City's chief executive officer and has powers and duties conferred by law and the City Charter (Charter). The Commissioner of Finance (Commissioner) is in charge of the City's financial affairs. The Charter governs City operations and outlines the powers and duties of the Council, Mayor, City Administrator (Administrator) and Commissioner.

The City provides a variety of services to its residents, including general government support, police and fire protection, street maintenance, and refuse service. The City's total budgeted appropriations for the 2011 and 2012 fiscal years were approximately \$67.2 million and \$69.9 million, respectively. The City's 2012 general fund budget totaled \$43.2 million and was funded primarily by property taxes, sales tax and State aid.

Although there are a number of recent and planned City development projects, the City faces severe fiscal challenges. The City is experiencing severe budget pressures due, in part, to its recurring annual gaps between revenues and expenditures. The City has been filling budget gaps by using fund balance. Since 2009, the City's general fund has had a negative unexpended fund balance.[2] In 2009, the unexpended fund surplus was a negative \$1.12 million which grew to a negative \$11.4 million by the end of 2011. Budget pressures could intensify in 2013, as Dutchess County has instituted a cap on the sales tax revenue that will be distributed to cities and towns.

For 2011, the City had exhausted 34.7 percent of its constitutional debt limit of \$153.1 million. However, debt service as a percentage of total revenues is 12.9 percent, which is higher than the median of 8.4 percent for all cities, excluding New York City.

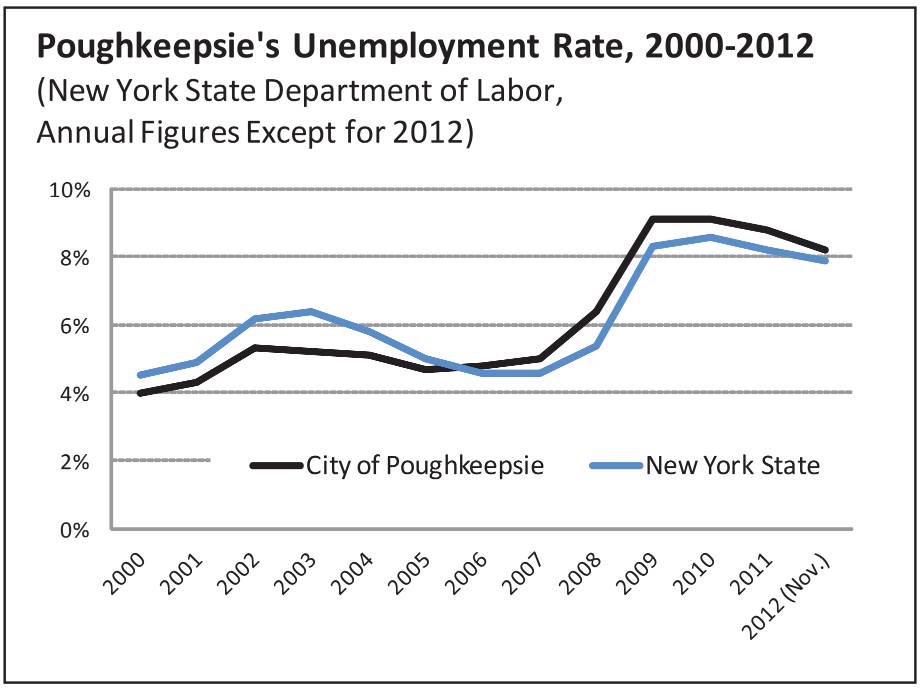
[2] The Governmental Accounting Standards Board (GASB) issued Statement 54, which replaces the fund balance classifications of reserved and unreserved with new classifications: nonspendable, restricted, and unrestricted (comprising committed, assigned, and unassigned funds). The requirements of Statement 54 are effective for fiscal years ending June 30, 2011 and beyond. To ease comparability between fiscal years ending before and after the implementation of Statement 54, we will use the term 'unexpended surplus funds' to refer to that portion of fund balance that was classified as unreserved, unappropriated (prior to Statement 54), and is now classified as unrestricted, less any amounts appropriated for the ensuing year's budget (after Statement 54).

Demographic and Economic Factors

The City experienced rapid population growth during the first half of the twentieth century, increasing by 70.7 percent from 24,029 in 1900 to over 41,000 by 1950. During the second half of the century, population declined by nearly 30 percent to 28,844 in 1990. Since then, the City's population has begun to grow again, with population growing by 9.6 percent from 2000 to 2010 to 32,736.

Although the growth in population is positive, the City is home to a relatively high-needs population. There is a mix of wealth and poverty in the City. Because of the City's close proximity to New York City, which has historically had higher property values, property values in the City are also relatively high. The City's median home value is $263,100 compared to $96,000 for cities Statewide [3] but below the $303,900 median home value in the State.

However, the City's rate of families in poverty is 22.6 percent — far above the median city rate of 13.7 percent. The unemployment rate of 8.2 percent in November 2012 was also higher than the Statewide rate of 7.9 percent and has been above the Statewide average since 2006.



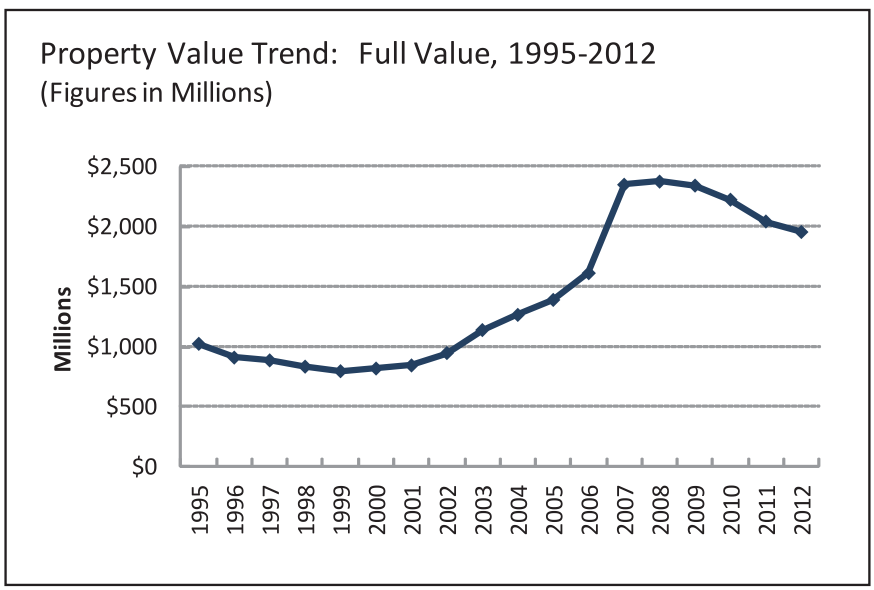
[3] Median city rates exclude New York City

Tax Base

The combination of modest incomes, high poverty rate and high property values contribute to the City's relatively low home ownership rate. Only 37.3 percent of housing units are owner-occupied compared to the median 49.5 percent rate for cities Statewide and the Statewide rate of 53.3 percent. In addition, over 11.3 percent of the housing units in the City are vacant, compared to a median of 9.2 percent for cities generally. Furthermore, only 28.8 percent of the City's property is tax-exempt, compared to the Statewide city median of 32 percent.

Housing Statistics		
	Poughkeepsie	Median New York Cities
Home Ownership	37.3%	49.5%
Median Home Value	$263,100	$96,000
Vacant Units	11.3%	9.2%
Tax Exempt Properties	28.8%	32.0%

The City benefitted from the rapid growth in the housing market between 2000 and 2008 and the City's full value assessment nearly tripled. Then, the housing collapse resulted in a decline of 17.7 percent. Recent and planned commercial and residential development on the Hudson Riverfront, in the downtown area, and around the Metro-North train station may help reverse this downward trend.



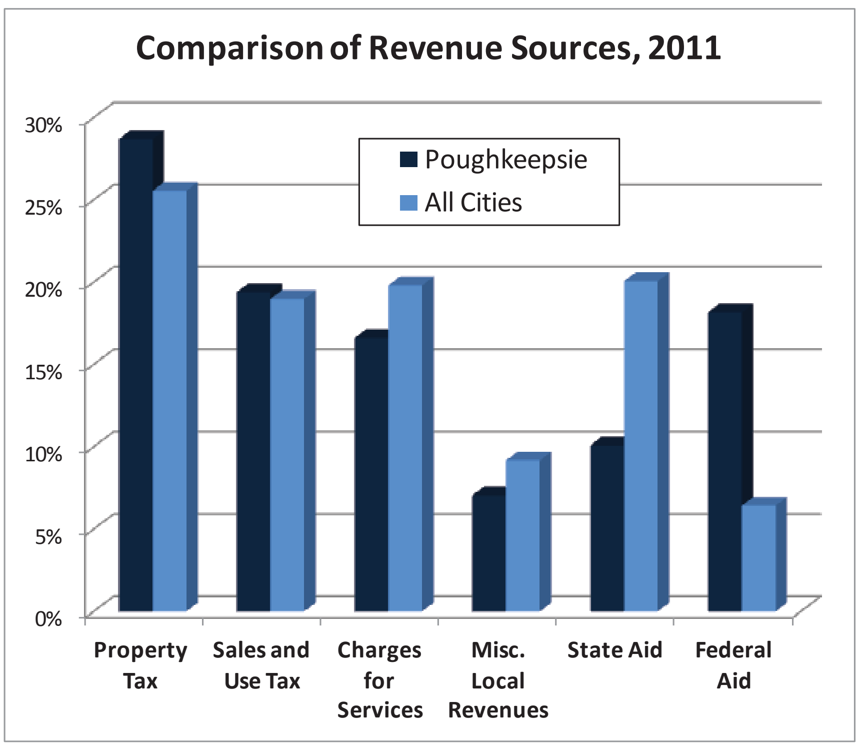
Because of its relatively high property values, the City has exhausted only 29 percent of its constitutional tax limit of $43.7 million, compared to the median for all cities of 44 percent.

Revenues and Expenditures

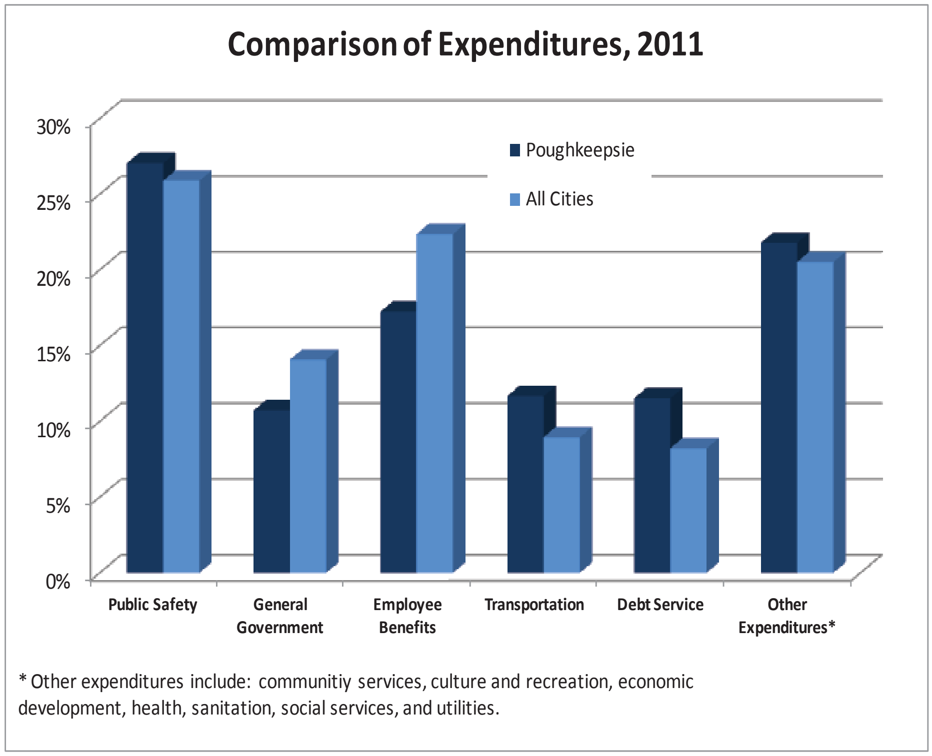
Like most city governments, the majority of City spending occurs in the areas of public safety and employee benefits. The share of public safety expenditures relative to total expenditures decreased from 29.3 percent in 2001 to 27.0 percent in 2011, but the share of employee benefit costs increased from 9.8 percent to 17.2 percent for the same period. During the past decade, spending for employee benefits, social services, and debt service grew most rapidly at annual growth rates of 10.0 percent, 8.4 percent, and 8.3 percent, respectively, while spending for cultural and recreation programs, community services, and sanitation decreased over the 10-year period.

In 2011, the City raised 28.7 percent of its revenues through property taxes and 19.4 percent from sales and use taxes. These shares as a percentage of total revenues have declined slightly since 2001. Compared to other New York cities, the City relies more heavily on Federal aid (18.2 percent of revenues in 2011 compared to 6.4 percent for all cities) and less on State aid (10.1 percent of revenues compared to 20.1 percent for all cities). The City's reliance on Federal aid has increased markedly over the last decade, growing from 11.7 percent of total revenues in 2001 to 18.2 percent in 2011.

The City received $130 per capita[4] in State aid through the Aid and Incentives for Municipalities (AIM) program in 2012-13, slightly less than the amount for the median city of $147 per capita.



[4] Per capita is based on the amount received in AIM divided by the entire population per the 2010 census.



Objectives

The objectives of our audit were to review the City's financial condition and Council oversight. Our audit addressed the following related questions:

- Have City officials adequately monitored the City's fund balance, developed realistic and structurally balanced budgets, managed debt, and taken appropriate action to maintain the City's financial stability?
- Is the City Council providing adequate oversight of the City's financial operations?

Scope and Methodology

We examined the City's financial condition and Council oversight for the period January 1, 2011, through July 31, 2012. We extended our scope period to January 2007 to analyze financial trends.

We conducted our audit in accordance with generally accepted government auditing standards (GAGAS). More information on such standards and the methodology used in performing this audit are included in Appendix D of this report.

Comments of Local Officials and Corrective Action

The results of our audit and recommendations have been discussed with City officials and their comments, which appear in Appendix B, have been considered in preparing this report. Except as indicated in Appendix B, City officials generally agreed with our recommendations and indicated they would take corrective action. Appendix C includes our comments on issues raised in the City's response

The Council 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 Council to make this plan available for public review in the City Clerk's office.

Fiscal Stress

Financial condition may be defined as the ability to balance recurring expenditure needs with recurring revenue sources, while providing desired services on a continuing basis. A city with good financial condition generally maintains adequate service levels during fiscal downturns and develops resources to meet future needs. Conversely, a city in fiscal stress usually struggles to balance its budget, suffers through disruptive service level declines, has limited resources to finance future needs, and has minimal cash available to pay current liabilities as they become due. A city in fiscal stress often experiences unplanned operating deficits. Persistent unplanned operating deficits are usually indicative of poor budgeting and can result in cash flow problems and/or deficits, and the need to borrow moneys to finance day-to-day operations.

From 2007 to 2011, the City's general fund balance declined by $12.8 million. As of December 31, 2011, the general fund had a deficit of over $11.4 million.[5] The Council did not adopt realistic budgets which resulted in recurring general fund operating deficits. In addition, the City's debt service costs grew by 45 percent for the period and now are 12.9 percent of annual revenue. As a result, the City faces fiscal stress which, if not addressed, will affect the City's ability to provide services and place an undue burden on taxpayers. Finally, the Council did not approve interfund loans and they were not repaid by the end of the fiscal year as required by law.

Fund Balance

A key measure of a local government's financial condition is the level of fund balance that it maintains. Fund balance is the difference between revenues and expenditures accumulated over time. City officials can legally set aside, or commit, portions of fund balance to finance future costs for a specified purpose, designate the unexpended surplus[6] portion of fund balance to help finance the next year's budget, and/or retain surplus fund balance for future use. It is the responsibility

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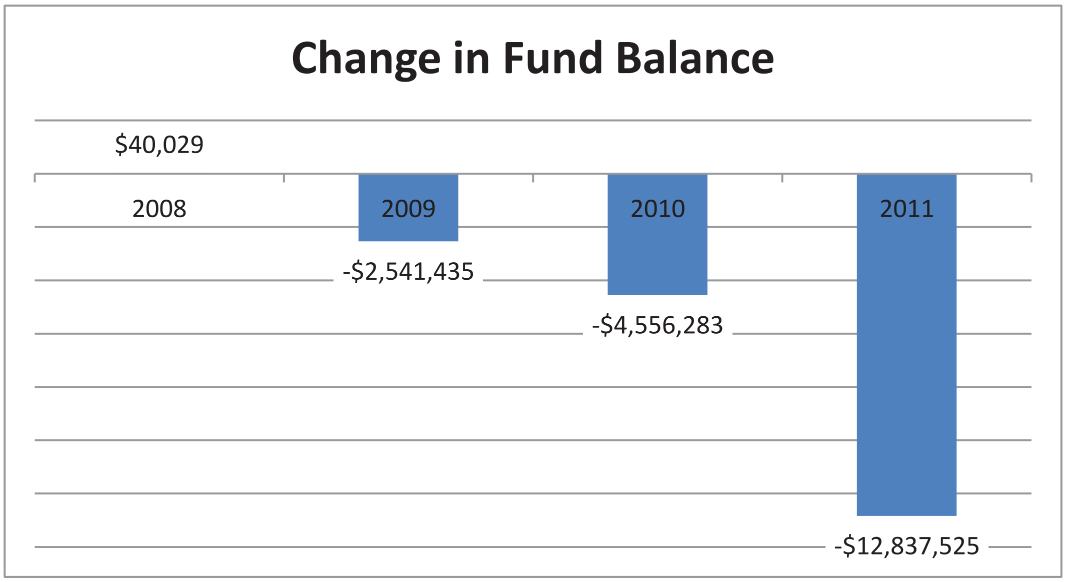
[5] The 2011 figures used are preliminary, unaudited figures. We do not expect the finalized figures to change significantly, if at all.

[6] The Governmental Accounting Standards Board (GASB) issued Statement 54, which replaces the fund balance classifications of reserved and unreserved with new classifications: nonspendable, restricted, and unrestricted (comprising committed, assigned, and unassigned funds). The requirements of Statement 54 are effective for fiscal years ending June 30, 2011, and beyond. To ease comparability between fiscal years ending before and after the implementation of Statement 54, we will use the term 'unexpended surplus funds' to refer to that portion of fund balance that was classified as unreserved, unappropriated (prior to Statement 54), and is now classified as unrestricted, less any amounts appropriated for the ensuing year's budget (after Statement 54).

of City officials to ensure that the level of fund balance maintained is sufficient to provide adequate cash flow, but not so excessive as to withhold funds that could be put to productive use. Fund balance can be used to manage unexpected occurrences, such as unanticipated shortfalls in revenues. Inadequate or deficit fund balance limits the ability of local government officials to manage emergencies and other unanticipated occurrences. A continuous decline in unexpended surplus funds indicates a deteriorating financial condition.

The City's general fund balance decreased by $12.8 million from the fiscal years 2007 through 2011, illustrated below, and ended the 2011 year with a $11.4 million deficit.



The City's negative general fund balance equates to 27.9 percent of the 2011 budget. The decline in fund balance occurred, in part, to the City's poor budgeting practices and large debt service payments. City officials avoided deficit financing and addressed the need for cash in the short-term by using interfund loans. However, if the Council does not take immediate actions to remedy the declining fund balance, the City will face even more debt than it has already incurred and possible disruptions in the services provided to residents.

Budgeting Practices

It is important that City officials develop realistic budgets for the Council to approve and monitor against actual revenues and expenditures regularly throughout the year. When estimating budgeted revenues and expenditures, City officials must have current and accurate information. They also should use historical data, such as prior years' actual results of operations, as guidance in determining whether revenues and expenditures are reasonable. Council members must ensure that there is a process to prepare, adopt and amend budgets based on reasonably accurate assessments of the resources to fund appropriations.

The annual budget is a plan that provides the Council with the information necessary to monitor and control spending and ensure revenue projections are being met during the year. To maintain good fiscal health, it is imperative that the Council approve realistic and structurally balanced budgets, identify and adjust to long-term changes, anticipate future problems, and plan for services and capital needs beyond the current year.

Revenues – We reviewed the City's 2010 and 2011 annual budgeted revenues and found that in both years the City overestimated revenues for individual budget line items.

Table 1: Budgeted vs. Actual Revenues

	2010			2011		
Budget Line Item	**Budget**	**Actual**	**Variance**	**Budget**	**Actual**	**Variance**
Utilities Gross Receipts	$490,000	$407,321	($82,679)	$450,000	$362,153	($87,847)
Interest/Penalties on Real Property Taxes	$350,000	$252,345	($97,655)	$350,000	$254,297	($95,703)
PILOTs	$700,000	$458,280	($241,720)	$800,000	$659,262	($140,738)
Lot Rentals	$527,600	$393,253	($134,347)	$607,300	$436,000	($171,300)
Interest Earnings	$420,000	$174,632	($245,368)	$370,000	$188,931	($181,069)
Over-Budgeted Revenues		**2010**	**($801,769)**		**2011**	**($676,657)**
					Total for 2010 and 2011	**($1,478,426)**

Although 2010's budgeted revenues were not achieved, the City continued to overestimate revenues for the 2011 budget. For example, for interest and penalties on real property taxes, the City budgeted $350,000 even though in 2010 it budgeted similar amounts and had come up short of that estimate. For lot rentals, the City budgeted $607,300 in 2011, an increase in estimate from the 2010 estimate, even though the 2010 budgeted revenue had not been achieved. By over-budgeting for these items, there was a revenue shortfall of approximately $1.5 million. If City officials had based the City's budgets on actual revenues received in prior years, current estimates would have been more accurate.

Expenditures — We reviewed the City's 2010 and 2011 annual budgeted appropriations and found that in both years the City under-budgeted certain appropriations related to employee benefits, resulting in a shortage of approximately $2.8 million.

Table 2: Budgeted vs. Actual Employee Benefit Expenditures						
	2010			2011		
Budget Line Item	**Budget**	**Actual**	**Variance**	**Budget**	**Actual**	**Variance**
Health Insurance Reimbursement	$56,000	$195,269	($139,269)	$130,620	$232,298	($101,678)
Accumulated Pay - Holiday	$87,743	$218,397	($130,654)	$92,300	$289,171	($196,871)
Accumulated Pay - Holiday - Fire	$155,120	$214,524	($59,404)	$176,190	$234,221	($58,031)
Sick Pay	$0	$212,100	($212,100)	$0	$168,654	($168,654)
Vacation Pay	$0	$162,643	($162,643)	$0	$204,741	($204,741)
Workers' Compensation	$830,000	$1,083,798	($253,798)	$750,000	$911,989	($161,989)
Health Insurance	$4,108,078	$4,255,316	($147,238)	$3,850,000	$4,647,262	($797,262)
Under-budgeted Appropriations		**2010**	**($1,105,106)**		**2011**	**($1,689,226)**
				Total for 2010 and 2011		**($2,794,332)**

City officials did not use the 2010 actual expenditures to develop the 2011 budget. For example, the City budgeted only $3.9 million for health insurance in 2011 when the actual cost incurred in 2010 was $4.3 million. Salaries and related benefits should be accurately projected because they are based on known facts. In addition, accumulated sick, vacation and holiday pay hours are known amounts and the total to be paid can be reasonably estimated. The City failed to include any appropriations for accumulated sick and vacation pay in the budget for both years, resulting in over-expending those budget line items by approximately $750,000. By not budgeting for known expenditures, the City is spending more than it has planned to, resulting in operating deficits.

Had City official used the 2010 actual expenditures when projecting the 2011 budget appropriations, the 2011 budget would have been more realistic. Under-budgeting appropriations for employee benefits contributed approximately $2.8 million to the budget shortfalls over the two-year period.

The Commissioner stated that the various department heads submit budgets for their respective departments. Although department heads have access to the financial system in order to review actual costs incurred by their departments, it does not appear that previous years' actual costs were considered when developing the 2011 budget. Although the Charter requires the budget to include the prior year's actual expenditures and current budget amounts, there is no evidence that a comparison of the prior year's actual expenditures were used in the budgeting process.

Operating Deficits — Overall, City revenues were over-budgeted by $3.2 million and appropriations were under-budgeted by $4.7 million, creating a combined operating deficit of more than $7.9 million for 2010 and 2011.

Table 3: Total Over-Estimated Revenues and Under-Estimated Expenditures - General Fund			
	2010	**2011**	**Total**
Revenues	$2,438,751	$797,927	$3,236,678
Expenditures	$1,187,394	$3,538,130	$4,725,524
Combined Operating Deficit for 2010 and 2011			**$7,962,202**

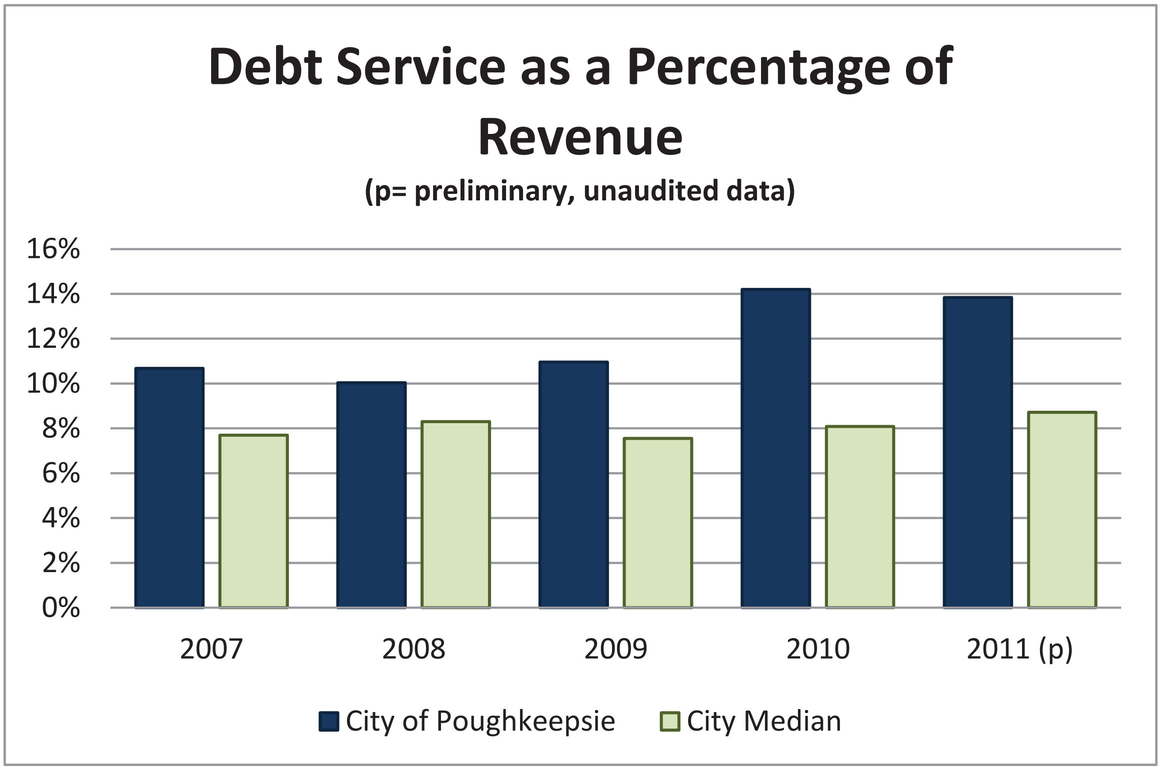
By not developing realistic budgets, City officials and the Council have placed the City in financial jeopardy. The City has amassed a deficit fund balance of approximately $11.4 million at the end of the 2011 fiscal year. Also, when City officials do not present accurate budget estimates to taxpayers, transparency and accountability are compromised. When budgets are inaccurate, taxpayers are not provided with a realistic portrayal of their local government's financial condition.

Debt

The issuance of debt allows a City to pay for capital infrastructure that is vital to economic development. However, if governments accumulate too much debt, their fiscal health can deteriorate.

Debt affordability is a measure of a local government's ability to repay its debt and still meet its current and future capital, operating, and other needs. Because debt is essentially a fixed cost, debt affordability affects the long-term fiscal health of the municipality. Since 2007, the City's debt service payments increased by about 45 percent. We compared the City's debt to 58 other cities[7] in the State and found that it ranked 11th highest as a percentage of debt service to revenue. The City's debt service for fiscal year 2011 was about 12.9 percent of the revenue it received. The median for all cities that we compared was about 9 percent. As the following chart shows, the City's debt as a percentage of revenue has consistently exceeded the Statewide median.

[7] There are 62 cities in NYS. We excluded NYC and three other cities which had not provided data.



The City's high amount of long-term debt requires debt service payments of approximately $8.5 million annually. This equates to approximately $261 per capita.[8] The City's total debt of $69.7 million is approximately $2,129 per capita.[9] The Council is placing an extra burden on its current and future taxpayers by acquiring excessive, long-term debt.

Interfund Loans

General Municipal Law (GML) allows the City to temporarily advance moneys from one fund to another to address budget shortfalls when available cash is not sufficient to pay current obligations. The advance must be authorized in the same manner as prescribed by law for making budgetary transfers between appropriations. Suitable records must be maintained, and the advance must be repaid no later than the end of the fiscal year in which the advance was made.

Under the Charter, the Commissioner, with the approval of the Mayor and the Administrator, is authorized to make transfers of unencumbered appropriations, except those for personal services, between general budget classifications of expenditures within the same department of the City. According to the Administrator,

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[8] Per capita is calculated based on the $8.5 million divided by the 2010 Census of the City's entire population.

[9] This per capita is calculated on the total debt of $69.7 million divided by the 2010 Census of the City's entire population.

transfers of budget appropriations between departments normally occur with Common Council approval. Since interfund advances must be authorized in the same manner as prescribed for making budgetary transfers between appropriations, any interfund advances would be subject to the same procedures as budget appropriation transfers, including any required Council approval.

The Commissioner advanced moneys from one fund to another without the Council's approval. The Commissioner also did not keep accurate records of interfund advances. For example, the general fund ledger has a balance of $2.4 million owed to the capital project fund; however, the capital project fund ledger has a balance of only $966,000 loaned to the general fund, a difference of $1.4 million. When we inquired about the discrepancy, we were provided a report of interfund balances which appeared to be balanced; however, several funds in the report showed that money was due to an unspecified fund. Because the City did not maintain accurate records of the interfund advances, it is highly unlikely that each fund will ever be repaid the correct amount. Furthermore, all advances were not paid back by the end of the fiscal year in which they were made.

Without maintaining accurate account records and obtaining any required Council approval for interfund advances between departments, the Council and other interested city officials cannot be assured and are not aware of the correct financial position of any of the City's funds. Also, the failure of a fund to reimburse another fund for advances by the end of the fiscal year is not in compliance with GML.

Recommendations

1. The Council should take steps to reduce the deficit in the general fund.

2. The Council should require the Mayor to prepare a realistic budget, based on prior years' actual results, for the Council to approve and monitor throughout the year.

3. The Council should evaluate the City's debt and develop a comprehensive plan to reduce the outstanding debt.

4. The Council should authorize all interfund loans prior to such transfers occurring, require that proper records are maintained for all interfund loans, and ensure that all interfund loans are repaid by the end of the fiscal year.

Council Oversight

The Council is responsible for managing and overseeing the City's overall fiscal affairs and safeguarding its resources. The Council is responsible for making sound financial decisions that are in the City's best interest and that of the taxpayers who fund its operations. To carry out its fiscal oversight responsibility effectively, the Council must ensure that the Mayor or Administrator provide the Council with the necessary financial information in order to monitor revenues and appropriations and timely and effectively address financial condition issues. The Council is also responsible for developing and adopting policies that guide officials and staff in carrying out the Council's directives.

The Council has not effectively managed the City's financial affairs. The Council did not obtain and review monthly financial reports and the City's audited financial statements, which are necessary to make informed financial decisions. In addition, the Council has not adopted policies related to financial activities such as using fund balance and interfund loans. The Council's failure to properly monitor the City's financial condition and develop needed policies has attributed to the City being put in an unsettled financial position.

Financial Records and Reports

The Council needs accurate and timely financial information to effectively manage the City's financial resources and properly oversee the City's financial condition. The Council cannot make informed decisions regarding the City's financial condition if the required information and other financial reports are not provided to them in a timely manner.

<u>Monthly Financial Reports</u> — The Charter requires the Mayor or City Administrator to present to the Council a monthly report of operations. The report is required to be filed as public record. However, we found that the Council did not receive monthly financial reports, and monthly reports were not filed as public records, as required by the Charter. The Chamberlain indicated she had no public record of monthly financial reports. The Council also was not provided a copy of the City's audited annual financial statements.

The Council's monthly meeting minutes did not show that monthly reports or audited financial statements were provided to or reviewed by the Council. We contacted all eight Council members and asked if they received financial information. Four members did not respond to our inquiries and the other four stated that they do not receive financial information such as monthly reports or audited financial statements. However, the Mayor stated that the Council did receive the 2010 audited financial statements in December 2011, a full year after the end of the fiscal year. One of the Council members, who was in office in 2011, stated that she had never seen the audited financial statements until we presented them to her.

Audited Financial Statements — Audited financial statements can help determine whether or not public money was spent and handled properly, can help identify conditions in need of improvement, and can be a useful tool in providing oversight and review of financial operations. The Commissioner did not engage an independent auditor to audit the City's books and records until the middle of the following year. Because the engagement was not arranged in a timely manner, the audited financial statements were not issued until the end of the next fiscal year. For the fiscal year ended December 31, 2010, the independent auditor was engaged in May 2011, almost halfway through the next fiscal year. Therefore, the 2010 audited financial statements were not available until December 2011. The same occurred for the 2011 engagement. As a result, crucial audited financial information was not available to be used as a budgeting tool or to monitor City operations.

Policies

A governing board should adopt policies to guide areas of operation, particularly in the areas concerning financial decisions. Every policy adopted by the governing board should be understood by all board members, customized to fit the unique needs of each local government, reviewed periodically, preferably annually (even when not required by law), and updated if needed. Adopted policies must be effectively communicated to those within the organization that the policy applies to.

The Council did not establish policies related to fund balance and interfund loans. A policy regarding the accumulation or reduction of fund balance and the optimum amount of fund balance the City should maintain would assist officials in planning for future needs and assist in establishing financial stability for the City. Additionally, an interfund loan policy should be developed which outlines the required level of Council approval. Council members did not provide us with an explanation as to why such policies were not developed.

Without adequate policies, officials and staff do not have the proper guidance to make financial decisions in accordance with the Council's directives and in the best interest of taxpayers.

Recommendations

5. The Council should require the Mayor and Commissioner to prepare periodic and timely reports for the Council. The Council should use such reports to assess the City's financial position in order to make informed financial decisions.

6. The Council should require the Commissioner to provide timely audited financial statements in order to assist in making informed financial decisions.

7. The Council should adopt financial policies pertaining to fund balance and interfund transfers.

APPENDIX A

DEMOGRAPHIC AND ECONOMIC INDICATORS

Poughkeepsie vs. All Cities and New York State				
Population 2010: 32,736	**City of Poughkeepsie**	**Median City (excl. NYC)**	**All Cities (excl. NYC)**	**New York State (inc. NYC)**
Demographic Indicators				
Percentage Change in Population, 1950-2010	-20%	-20%	-25%	31%
Median Household Income, 2011	$39,061	$38,699	N/A	$56,951
Percentage of Families in Poverty, 2011	21.8%	15.1%	17.5%	11.0%
Unemployment Rate, 2012	9.0%	9.2%	N/A	8.5%
Property Value Indicators				
Median Home Value, 2011	$253,200	$99,700	N/A	$301,000
Percentage Change in Full Value, 2007-2012	-16.8%	11.6%	-2.0%	5.4%
Owner-Occupied Housing Units, 2011	39.5%	50.5%	35.9%	54.8%
Property Vacancy Rate, 2011	13.1%	10.4%	10.0%	10.7%
Percentage of Property Value That Is Tax Exempt, 2011	27.1%	32.3%	35.4%	26.2%
Revenue and Tax Indicators				
State Revenue Sharing Aid (AIM) per Capita, SFY 2012-13	$129.77	$146.80	$289.50	N/A
Tax Limit Exhausted, 2012	29%	44%	N/A	N/A
GF Unreserved Fund Balance as a Percentage of Revenue, 2007	3.7%	13.4%	15.7%	N/A
GF Unreserved Fund Balance as a Percentage of Revenue, 2011	-28.0%	13.3%	12.9%	N/A

Source: U.S. Census Bureau, American Community Survey, five-year estimates, 2007-2011 and 2010 Census; Department of Taxation and Finance; New York State Labor Department; Office of the State Comptroller.

APPENDIX B

RESPONSE FROM LOCAL OFFICIALS

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

The City of Poughkeepsie
New York

John C. Tkazyik
Mayor

April 22, 2013

Tenneh Blamah
Chief Examiner of Local Government and
School Accountability
Newburgh Regional Office
33 Airport Center Drive, Suite 103
New Windsor, New York 12553

Dear Chief Examiner Blamah:

We wish to thank the Comptroller's office for its report on the City of Poughkeepsie. We'd also like to note that this report and audit was requested five years ago. Perhaps had it been done when it was requested some of the problems you noted would have been corrected sooner.

See Note 1 Page 28

We'd also like to note that the City of Poughkeepsie is not the only municipality in New York that is under financial stress. The unfunded mandates imposed on the city by the State of New York, skyrocketing health care and pension costs, coupled with reductions in state aid, on top of the recession that has been made worse by New York's anti-business climate have made life difficult for all New York municipal officials.

Fund Balance

We wish your report had noted that the City of Poughkeepsie has reduced its debt from $82 million to $53 million since 2008. Debt service as a percentage of the annual budget has been reduced from more than 13% to under 10%. While we do concede there are challenges facing the general fund balance, the anti-business climate in New York State continues to hamper our efforts to spur economic growth. Because New York has the nation's worst business climate and

See Note 2 Page 28

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the second highest state and local tax burden in the nation, record numbers of New Yorkers are leaving the state in search of economic opportunity. As of today, the City has over 300 abandoned or vacant properties. The assessment values have dropped by over $573 Million or 24.5% from 2008, a direct result of the recession and the sluggish response of the State to deal with it.

Unlike the State of New York, the City has resisted using "one-shots" to balance its budget.

Budgeting Practices

We do the best we can estimating revenue. It is not easy because it is hard to predict the number of homeowners and taxpayers who will abandon New York in any one given year because of the difficulty in finding opportunity here. Some who choose to leave abandon the homes and properties depriving the city of revenue needed to serve a high percentage of people living below the poverty line.

See Note 3 Page 28

Our budget challenges are compounded by the unfunded mandates imposed on the city by the State of New York, including heath care, pension costs and a dysfunctional workers compensation system.

Debt

The City's long term debt has been reduced from $82 million to $53 Million since 2008. The City's short term debts stand at $9.9 Million, down from $25 Million in 2010.

See Note 4 Page 28

At its height, the general fund debt service payments accounted for 13.25% of the budget. In 2013 the debt service represents 9.9% of the budget.

Inter-fund Advances

The use of inter-fund transfers and advances has always been part of the City's day to day operations. The City takes it guidance from the Administrative Code of the City Charter, section 7.05 (g) Control of Finances. "The commissioner of finance may at any time, with the approval of the mayor and city administrator, transfer any unencumbered appropriation balance, or portion thereof, except appropriations for personal services, from one general classification of expenditures to another such general classification within the same department, board, commission or agency of the city." The City further derives additional direction from the City's Charter, Section 5.03, Financial Procedures … "the method of transferring appropriation balances between or among classifications of expenditures, departments, offices or other units of city government … shall be provided in the administrative code."

See Note 5 Page 28

Responses to Recommendations:

1. The Council should take steps to reduce the deficit in the general fund.

   The Administration and the Common Council have and will continue to impose cost cutting measures as well as identifying new revenue enhancing opportunities to enable reduction in general fund deficits. The Common Council is reviewing the current monthly reports to discern additional cuts required to reduce the general fund deficit.

2. The Council should require the Mayor to prepare a realistic budget based on prior year's actual results for the Council to approve and monitor throughout the year.

   The 2013 budget was formulated by determining realistic revenue estimates based on prior period actual.

3. The Council should evaluate the City's debt and develop a comprehensive plan to reduce the outstanding debt.

   The City has reduced total debt (bonds and bans) from $ 76.6 Million down to $63.9 Million.

   See Note 6 Page 29

   The City has reduced outstanding short term debt from a high of $25.1 Million down to $ 9.9 Million.

4. The Council should authorize all inter-fund loans prior to such transfers occurring, require that proper records are maintained for all inter-fund loans, and ensure that all inter-fund loans are repaid by the end of the fiscal year.

   Most inter-fund transfers are a day to day operational process, covering the payment of bills. Inter-fund transfers are for specific reasons and properly documented. The City takes it guidance from the Administrative Code of the City Charter, section 7.05 (g) Control of Finances. "The commissioner of finance may at any time, with the approval of the mayor and city administrator, transfer any unencumbered appropriation balance, or portion thereof, except appropriations for personal services, from one general classification of expenditures to another such general classification within the same department, board, commission or agency of the city." Although stated in the report, the City Corporation Counsel has interpreted the role of the Common Council in regards to the inter-fund transfers to be subject to the same Administrative Code of the City Charter. Section 5.03 Financial Procedures of the Charter states ... "the method of transferring appropriation balances between or among classifications of expenditures, departments, offices or other units of city government ...

   See Note 7 Page 29

shall be provided in the administrative code." The City has been using the Administrative Code, Section 7.05 Control of City Finances as the guide stated in the City Charter. The City will develop a plan to re-pay inter-fund balances in a more timely fashion.

5. The Council should require the Mayor and Commissioner to prepare periodic and timely reports for the Council. The Council should use such reports to assess the City's financial position in order to make informed financial decisions.

   In 2013, the Common Council has received monthly budget performance reports. In accordance with the City Charter Administrative Code, financial reports have always been made available to the Common Council for their review. The Common Council is in the process of evaluating different presentation formats to better assess the City's financial position and make informed financial decisions.

6. The Council should require the Commissioner to provide timely audited financial statements in order to assist in making informed financial decisions.

   The Commissioner has engaged the external auditors to provide the 2012 audited financial reports prior to the beginning of the 2014 budget process.

7. The Council should adopt financial policies pertaining to fund balance and inter-fund transfers.

   In 2013, the Common Council adopted a policy on reviewing inter-fund transfers and is currently reviewing options for monitoring the fund balance.

Conclusion

The City of Poughkeepsie was already facing financial challenges before the start of the "great recession". It had no fund balance going into the 2008 budget year. The debt was climbing and peaked in 2009. The country's economic conditions compounded the City's challenges with dramatic revenue losses in property taxes, sales taxes, and mortgage taxes. The expenditures were highlighted with increased benefits primarily from rising health insurance costs, workmen's comp costs, and retirement costs.

We approached the 2013 budget process with one goal, to deliver a realistic budget that is attainable despite the economic challenges that we continue to face. Achieving our goal will help address our negative fund balance as well as continue the reduction in debt and debt service. It will be a challenge, but working with the Common Council, Department Heads, and City employees, we will deliver surplus operations for 2013 and begin our task of rebuilding our fund balance and continuing to dramatically reduce our debt.

We also hope the State of New York and those who serve in Albany will take some of the corrective actions needed to put its house in order, including the reform of a badly broken Workman's Compensation System, the unfunded mandates that are breaking the back of cities, counties and towns, including skyrocketing pension, health care and Medicaid costs. We would also suggest that the State of New York reduce the onerous state of local tax burden, now second highest in the nation, and improve the business climate in New York, considered the worst in the United States. Such corrective actions in Albany would go a long way toward alleviating the conditions that have caused fiscal stress in all of New York's cities, counties and towns.

Sincerely,

John C. Tkazyik
Mayor

APPENDIX C

OSC COMMENTS ON THE CITY'S RESPONSE

Note 1

It is the responsibility of the Mayor and City officials to develop and implement sound financial management practices, monitor the City's finances, and take corrective action when necessary to ensure the fiscal well being of the City. Such actions should occur regardless of whether an audit has been or will be conducted.

Note 2

The City's total debt increased from $65.9 million at the beginning of the 2008 fiscal year to $69.7 million at the end of 2011 fiscal year, an increase of $3.8 million. This included long-term debt of $58.2 million and short-term debt of $11.5 million. The $53 million referred to in the City's response relates to only the long-term portion of the debt for fiscal year ended 2012 and is an unaudited amount. Our calculation of debt service costs, as a percentage of actual revenue for the 2011 fiscal year is 12.9 percent, which is correct. The City's response calculates debt service as a percentage of its annual budget.

Note 3

City officials overstated revenues in both the 2010 and 2011 budgets. The City's real property tax collection estimates were accurate. Therefore, we did not identify them as one of the causes of the overestimated revenues. Our comparison was based on revenue items that could have been more accurately estimated had prior-year actual revenues been considered when preparing the budget.

Note 4

The $53 million of long-term debt and $9.9 million of short-term debt that officials are citing are year-end unaudited 2012 figures. Our audit period was from January 1, 2011, through July 31, 2012. Data for the 2012 fiscal year end was not available at the time of our audit. Debt service payments accounted for 14.2 percent of the City's revenue in 2010.

Note 5

As stated in the report, the Administrator told us that transfers of budget appropriations between departments normally occur with Council approval, and any interfund advances would be subject to the same procedures as budget appropriation transfers, including any required Council approval. To the extent the Charter and Code may be unclear with respect to whether or not Council approval is required for interfund transfers between and among departments, City officials may need to consider a clarifying amendment.

Note 6

The City is using unaudited amounts as of the end of the 2012 fiscal year, which were not available during our audit. Our report is based on audited amounts as of the end of the 2011 fiscal year.

Note 7

Interfund transfers should be limited and must be repaid to the fund from which the moneys were borrowed no later than the end of the fiscal year in which the transfer occurred. Such repayments did not occur.

APPENDIX D

AUDIT METHODOLOGY AND STANDARDS

Our overall goal was to assess the adequacy of the internal controls put in place by officials to safeguard City assets and monitor financial activities. To accomplish our audit objective and obtain relevant audit evidence, our procedures included the following:

- We reviewed Council minutes and formal policies to assess the City's control environment, including oversight of financial operations.

- We reviewed the Charter to determine the responsibilities of the Mayor, Commissioner, and Council.

- We interviewed management and staff involved with the City's financial operations to gain an understanding of operations and internal controls, and reviewed corroborative evidence.

- We interviewed and corresponded via email with Council members to gain an understanding of their level of involvement in City operations.

- We analyzed five-year data filed with the Office of the State Comptroller to evaluate fund balance trends.

- We reviewed debt schedules and bond prospectuses to gain an understanding of the City's debt.

- We reviewed audit reports, budgets, budget-to-actual reports, and interfund transfer schedules to assess the City's current financial position and prior-year trends in the City's financial position.

- We reviewed the financial information provided to the Council and inquired with Council officials and the Commissioner about the timing and usefulness of the information.

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 objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

APPENDIX E

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APPENDIX F

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DIVISION OF LOCAL GOVERNMENT AND SCHOOL ACCOUNTABILITY

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Nathaalie N. Carey, Assistant Comptroller

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