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November 18, 2013

Honorable Lou Rosamilia, Mayor  
Members of the City Council  
City of Troy  
City Hall  
Troy, NY 12180

Report Number: B5-13-20

Dear Mayor Rosamilia and Members of the City Council:

Chapter 721 of the Laws of 1994, as amended, authorizes the City of Troy (City) to issue debt totaling \$21,630,000 to liquidate cumulative deficits in the City's general fund for the years ending December 31, 1993, 1994 and 1995. 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 City Council'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 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 of the City's revenue and expenditure estimates.

The City 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 report. All recommendations that the Council rejects must be explained in writing to our Office.

The Council adopted the City's 2014 budget on November 14, 2013, without taking our budget review findings and recommendations into account. Based on the date the budget was adopted, the City was to have provided our Office a copy of its proposed budget and related supporting documentation by October 15, 2013. While the City provided the proposed budget to us on October 7, 2013, we were not provided with all related supporting documents until November 13, 2013.

The City's failure to provide us with the requested budget documents timely precluded us from completing our review and providing this budget letter prior to the Council adopting the budget. As a result, City officials could not consider our findings and recommendations prior to adopting the 2014 budget. Furthermore, since the supporting documentation was not made available to us in a timely manner, we cannot be sure that it was made available to the Council to review prior to adopting the budget. The Council should obtain and review all relevant documentation prior to adopting the City's annual budget. This documentation should include, but is not limited to, our Office's budget review findings and recommendations and documents supporting significant revenue and appropriation estimates.

Our Office recently completed a review of the City's budget for the 2014 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 City budget for the 2014 fiscal year:

- Are the significant revenue and expenditure projections in the City's proposed budget reasonable?
- Did the City take appropriate action to implement or resolve recommendations in our review of the proposed 2013 fiscal year budget?

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 and sufficient for that purpose. In addition, we checked whether written recommendations from the prior year's 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. 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 ended 2014 consisted of the following:

- Cover Letter (October 7, 2013)
- 2014 Proposed Budget (October 7, 2013)

- Supplementary Information (Various<sup>1</sup>)

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

<b>Fund</b>	<b>Appropriations and Provisions for Other Uses</b>	<b>Estimated Revenues</b>	<b>Appropriated Reserved Fund Balance</b>	<b>Real Property Taxes</b>
General	\$66,479,829	\$45,864,713	\$1,325,000	\$19,290,116
Water	\$13,408,489	\$13,408,489	\$0	\$0
Sewer	\$3,507,088	\$3,507,088	\$0	\$0

The City's proposed budget, while generally reasonable, needs improvement to make it a better tool for prudently managing the City's resources. For example, the water and sewer funds have displayed a trend of weakening financial position and must be monitored to ensure the declining trends are reversed. In addition, the City's 2014 proposed budget does not appropriate enough money for contingencies to provide adequate flexibility to pay for unanticipated costs, and it provides only minimal funding for capital improvements: the capital plans in the general and water funds are underfunded by a total of \$3.2 million.

We found that the City's proposed budget is in compliance with the tax levy limit.

The following findings have been discussed with the City Comptroller and should be reviewed by the Mayor and Council. Good management practices require that City officials take prompt action concerning our recommendations, which we believe will improve the City's financial condition.

### **Sewer Fund**

The fiscal stability of the sewer fund has declined over the past several years. As noted in our review of the 2013 proposed budget, the fund has displayed continuing trends of declining financial condition. Total fund balance decreased from \$658,128 in 2008 to \$91,619 in 2012. Furthermore, the fund's unrestricted, unappropriated fund balance decreased from \$301,288 in 2008 to a deficit of \$615,356 in 2012. During the same period, the sewer fund's assigned fund balance<sup>2</sup> (for which the City has an intended purpose) increased from \$384,051 in 2008 to \$706,975 in 2012, primarily because of an encumbrance of moneys related to the City's participation in the Combined Sewer Overflows Long Term Control Plan (Plan). The Plan<sup>3</sup> is designed to help the City meet Federal Clean Water Act goals by preventing untreated effluent from entering the Hudson River. However, participation in the Plan without developing the

<sup>1</sup> The City provided us with supplementary information between October 15, 2013 and November 13, 2013. This information included quarterly budget status reports for the period ending September 30, 2013, documentation of encumbrances and interfund loans as of December 31, 2013, debt schedules, a schedule of reserve activity and information related to the Combined Sewer Overflows Long Term Control Plan.

<sup>2</sup> Previously classified as reserve for encumbrances

<sup>3</sup> The City uses combined sewer systems that collect storm water runoff, domestic sewage, and industrial wastewater in the same pipe. During heavy rain and snow events, the capacity of the sewer system can be exceeded and the combined sewer overflow will be discharged directly into the river.

means to pay for it could significantly impact the sewer fund's short-term and long-term fiscal health.

The 2013 adopted budget contained sewer fund appropriations totaling \$3.4 million, of which \$3.2 million was to be financed with sewer rents. As of September 30, 2013, the City modified the sewer fund budget, increasing appropriations to \$4.1 million, in effect carrying over prior year encumbrances associated with the Plan. The City funded this increase through an appropriation of fund balance without having a sufficient amount of fund balance available to cover this appropriation. City officials indicated that they are unsure whether these encumbrances will be expended in 2013.

As a result of our reviews of the 2012 and 2013 proposed budgets which cautioned the City against adopting budgets that do not contain provisions to adequately fund tentative Plan expenditures, City officials increased sewer rates in 2013. However, it appears that this rate increase was not sufficient to generate the \$3.2 million of revenues included in the 2013 adopted budget. We project that the City will realize \$2.9 million of the \$3.2 million sewer rent revenues included in the 2013 proposed budget. This projected revenue shortfall may be offset if the City does not expend the entire amount appropriated in the 2013 budget, which City officials indicated is likely. However, if the City expends the entire amount appropriated, even without expending any of the moneys encumbered, the sewer fund will realize an operating deficit which could cause the fund to have a deficit unrestricted fund balance.

Due to the sewer fund's declining financial condition, it is imperative that the City adopt a reasonable 2014 budget for the sewer fund and develop a strategy to finance the short-term and long-term liabilities related to the Plan. The 2014 proposed sewer fund budget includes an \$80,000 increase in the water rent revenue estimate from the 2013 adopted budget based on an increase in water consumption.<sup>4</sup> This increase in revenue does not appear reasonable based on our projection of total 2013 revenues.

Furthermore, the City's 2014 proposed budget includes appropriations totaling \$1 million for costs associated with the Plan which is \$475,000 less than the total plan costs for 2014 outlined in the Plan Implementation Schedule (Schedule). As a result, this appropriation also does not appear reasonable. According to the Schedule, the Plan will have a \$32.8 million cost to the City over the next 15 years. To ensure fiscal stability in the sewer fund, the City must develop a long-term plan to fund these costs.

City Officials should amend the 2014 budget to align budgeted revenues and expenditures.

## **Water Fund**

The City has historically budgeted for and transferred moneys from the water fund to the general fund. Over the past several years, the amount of this transfer has increased from \$1.5 million to \$2 million and the 2014 budget includes another increase to nearly \$2.5 million. In addition, the City has increasingly relied on the appropriation of fund balance to fund capital costs in the water fund. In 2013 the City amended the adopted budget to appropriate \$4.4 million of fund

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<sup>4</sup> Sewer billings are calculated by applying sewer rates to water consumption.

balance to fund capital costs and transferred the \$4.4 million to the capital projects fund. In addition, the City plans to transfer approximately \$2 million to the general fund, which will result in \$6.4 million of interfund transfers out of the water fund. While we project the water fund will realize a \$2.4 million operating surplus in 2013, the net change in fund balance will be a \$4 million decline due to the transfers out of the water fund. Fund balance will decrease from \$9.2 million at the beginning of 2013 to \$5.2 million at the end of the fiscal year.

In addition, the fund reported a \$2.2 million balance of cash at the end of 2012 and an interfund loan receivable from the general fund for \$2.5 million.<sup>5</sup> According to the City Comptroller, this interfund loan was repaid in the beginning of 2013 resulting in a cash balance of approximately \$4.7 million at the beginning of 2013. However, the \$4 million decrease in fund balance will likely cause a corresponding \$4 million decrease in cash, which will result in a cash balance at the end of 2013 of only \$730,000 or an 84 percent decrease in cash during one fiscal year.

During the past three fiscal years, the fund has realized significant operating surpluses (\$2.2 million in 2011, \$2 million in 2012 and projected \$2.4 million in 2013). However these surpluses have been offset by \$2 million transfers to the general fund. If the fund realizes similar results of operations in 2014, but transfers \$2.5 million to the general fund, the result will likely be a decrease in the water fund balance. Due to the likely fiscal decline in the water fund during 2013, we caution the City against increasing the transfer to the general fund from \$2 million to \$2.5 million and encourage the City to develop a plan to mitigate any potential future declines in the water fund.

### **Contingency Account**

Local governments use contingency accounts to provide funding for unexpected events. Although the City Charter does not specifically address budgeting for contingencies, New York State statutes for certain other classes of local government set the maximum for such accounts at 10 percent of the general fund budget (excluding appropriations for debt service and judgments), which can serve as a general guideline for the City. The City's proposed general fund budget includes a \$580,032 contingency appropriation, an increase of more than \$250,000 from the 2013 adopted budget. However this amount represents less than 1 percent of total anticipated general fund expenditures. This amount provides the City with a limited amount of flexibility in the event of unforeseen circumstances that require additional funds.

Furthermore, according to City officials, five of the City's six collective bargaining agreements are expired. The 2013 budget does not contain provisions for any potential increased costs associated with settling these collective bargaining agreements. By underfunding the contingency appropriation, the City's ability to pay any liabilities which may arise from contract negotiations in 2014 will be limited.

Given the contract negotiations, the volatility of certain City revenues and expenditures, and current economic conditions, we do not believe that less than 1 percent of appropriations provides a sufficient safeguard against unforeseen events. Over the past several years, the City

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<sup>5</sup> According to the City Comptroller, this interfund loan was made because the general fund did not receive state aid in a timely manner, which caused cash flow problems in the general fund.

has consistently budgeted minimal amounts for contingencies. In previous budget review letters we have criticized this practice and the City has not taken corrective action on our recommendations. This year, given the risks, noted herein, associated with the water and sewer fund budgets it is even more of a concern that the City has not built any flexibility into its budget. We again caution the City that an insufficient contingency appropriation will provide the City with limited flexibility to address revenue shortfalls or unforeseen expenditures.

## **Capital Expenditures**

In past years, we have reported, and City officials have acknowledged, that the City's budget provides only minimal funding for capital expenditures. This continues to be the case with the City's 2014 proposed general fund budget. The City's capital plan calls for approximately \$2.1 million in capital-related expenditures in 2014, but the proposed budget contains an appropriation of only \$57,720 in the general fund for equipment and capital improvements. Although the budget also includes a \$725,000 interfund transfer to the capital projects fund, this still leaves the capital plan underfunded by over \$1.4 million in the proposed budget. According to City officials, the City intends to begin issuing debt to fund capital projects. This shift in the method of financing capital costs from using traditional budget appropriations to issuing debt indicates potential cash flow issues and fiscal stress and was likely caused, in part, by the City's depletion of the capital reserve.

Because the City has continuously relied on the capital reserve to fund various capital expenditures over the past several years, it has significantly depleted the balance in this reserve. In our 2012 and 2013 budget reviews, we noted the balance in the capital reserve decreased from \$6.5 million in 2006 to \$2.5 million in 2011. The reserve has decreased further to \$2.1 million in 2012. Although the City's 2013 adopted budget does not contain provisions to use any of the capital reserve, the City modified the 2013 budget to appropriate more than \$700,000 from the capital reserve and transferred it to the capital projects fund to pay for street paving in 2013. This occurred because the City failed to adequately fund their capital plan in the 2013 budget, as we noted in our 2013 budget review. Furthermore, based on this information, the capital reserve will finish 2013 with a balance of \$1.4 million. The 2014 proposed budget contains provisions to use \$725,000 of this balance to fund capital purchases. If the City uses the entire amount included in the budget, the reserve will have a balance of only about \$680,000 at the end of 2014 for future capital plans.

Similarly, in the water fund, the City's capital plan provides for \$2 million of capital expenditures in 2014; however, the 2014 proposed water fund budget contains capital appropriations totaling only \$127,250. Traditionally, the City does not include sufficient appropriations in water fund budgets to fully fund the water fund capital plans. Instead, the City later amends the budgets to appropriate fund balance during the year to fund the capital plan. As noted above, in 2013, the City modified the budget and appropriated \$4.4 million of fund balance in the water fund to finance capital costs and transferred these funds to the capital projects fund. This has limited the financial flexibility of the water fund and it appears that in 2014 the water fund may not have sufficient resources available to appropriate fund balance during the year to finance capital costs.

Although the City has established a multiyear capital plan, given that the City is rapidly drawing down its general fund capital reserve and water fund unrestricted fund balance, we encourage City officials to identify reliable funding sources for capital expenditures and to include these funding sources in their operating budgets.

In previous budget review letters, we have expressed concern that the City was not including funding for capital expenditures in its adopted budget, and was deferring capital costs. We continue to be concerned that the City is deferring certain capital expenditures that it may be forced to incur in the future, likely at a higher cost, at a time when the City is inadequately prepared to fund such costs because the capital reserve has been depleted.

### **Tax Cap Compliance**

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

The City's proposed budget complies with the tax levy limit because it includes a tax levy of \$20,117,736,<sup>6</sup> which increases the 2014 tax levy by 1.6 percent over the 2013 tax levy of \$19,811,014.<sup>7</sup> In adopting the 2014 budget, the City 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 adopts a local law to override the cap.

The City Council has the responsibility to initiate corrective action. Pursuant to Section 10.10 of Local Finance Law, the Council shall review the recommendations in this report and may make adjustments to its proposed budget. The Council must explain in writing to our office any recommendations that it has rejected. In addition, pursuant to Section 35 of General Municipal Law, the 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 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 hope that this information is useful as you monitor your budget during the upcoming fiscal year. If you have any questions on the scope of our work, please feel free to contact Jeffrey Leonard, Chief Examiner in the Glens Falls Regional Office, at (518) 793-0057.

Sincerely,

Gabriel F. Deyo

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<sup>6</sup> This amount includes the proposed budget City's tax levy as well a projected tax levy for the Troy Business Improvement District and projected omitted taxes.

<sup>7</sup> This amount includes the City's actual 2013 tax levy, the Troy Business Improvement District tax levy and total omitted taxes.

cc: Joseph Mazzariello, Acting City Comptroller  
Karla Guereri, Clerk  
Hon. John A. DeFrancisco, Chair, Senate Finance Committee  
Hon. Herman D. Farrell, Jr., Chair, Assembly Ways and Means Committee  
Hon. Steven F. McLaughlin, State Assembly  
Hon. John T. McDonald III, State Assembly  
Hon. Neil D. Breslin, State Senate  
Hon. Kathleen A. Marchione, State Senate  
Mr. Robert L. Megna, Director, Division of the Budget  
City of Troy Supervisory Board Members  
Jeffrey Leonard, Regional Chief Examiner