

THOMAS P. DINAPOLI
STATE COMPTROLLER



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ALBANY, NEW YORK 12236

STATE OF NEW YORK
OFFICE OF THE STATE COMPTROLLER

March 5, 2007

Jason Molino, City Manager
and members of the City Council
City of Batavia
One Batavia City Centre
Batavia, New York, 14020

Dear Mr. Molino and members of the City Council:

Our office has recently completed an audit of the City's budget for the 2007-08 fiscal year. The objective of the audit was to provide an independent evaluation of the tentative budget. Our audit addressed the following question related to the City's budget for the 2007-08 fiscal year:

- Are the significant revenue and expenditure projections in the City's tentative budget reasonable?

We conducted our audit in accordance with generally accepted government auditing standards (GAGAS) with the exception of reporting views of responsible officials, which were not solicited for this report due to the necessity of providing the City with this time-sensitive information. However, the results of this audit have been discussed with City officials and their comments have been considered in preparing this report. GAGAS requires that we plan and perform our audit to adequately assess the estimates in the tentative budget. Further, those standards require that we understand the City's management controls and those laws, rules and regulations that are relevant to preparing estimates for the tentative budget.

To accomplish our objectives in this audit, we requested your tentative budget along with other pertinent information. We analyzed the composition of revenues and expenditures in order to determine if the revenue and expenditure estimates are reasonable. It was not our intent and we do not offer comments on public policy decisions, such as the type and level of services to be provided.

The tentative budget package for the fiscal year ended March 31, 2008, submitted for audit consisted of the following:

- Budget Message
- 2007-08 Proposed Budget, submitted January 15, 2007 by the City Manager to the City Council
- Supplementary Information

The tentative budget submitted to our office is summarized as follows:

Fund	Appropriations and Provisions for Other Uses	Estimated Revenues	Appropriated Fund Balance	Real Property Taxes
General	\$13,798,721	\$9,062,819	-0-	\$4,735,902
Water	4,191,478	4,191,478		
Ambulance	2,587,891	2,587,891		
Sewer	2,547,469	2,547,469		
Mall Maintenance	210,188	180,000		
Worker's Compensation	200,000	200,000		
Business Improvement District	161,300	161,300		
Total	\$23,697,047	\$18,930,957	\$30,188	\$4,735,902

The observations and recommendations resulting from our audit are, to a great extent, influenced by the quality and quantity of materials submitted, and the time between submission and budget adoption.

Based on the results of our audit, except for the findings noted below, we found the significant revenue and expenditure projections in the proposed budget to be reasonable.

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

Fiscal Condition

The City's financial condition has been marked by recurring deficits in the major operating funds, as shown in the table below.

Schedule of Operating Results¹

Operating Surplus/(Deficit)	General Fund	Water Fund	Sewer Fund	Ambulance Fund
2001-02	\$ (481,912)	\$ (343,150)	\$ (166,814)	
2002-03	\$ 748,050	\$ (11,326)	\$ 97,395	
2003-04	\$ (931,609)	\$ 139,119	\$ (977,449)	\$ (77,074)
2004-05	\$ (1,071,321)	\$ (229,023)	\$ (937,046)	\$ (310,989)
2005 -06	\$ (1,007,514)	\$ (382,550)	\$ (1,136,092)	\$ (354,441)
Operating Surplus/(Deficit) for Five Year Period	\$ (2,744,306)	\$ (826,930)	\$ (3,120,006)	\$ (742,504)

At March 31, 2006, the City's audited financial statements reported an unreserved, unappropriated accumulated fund deficit in the general fund of (\$2,228,320).

The water, sewer and ambulance fund balance sheets at March 31, 2006 showed the following:

	Water	Sewer	Ambulance
Current Assets	\$1,933,670	\$842,491	\$416,801
Current Liabilities	\$1,048,305	\$1,839,376	\$1,187,159
Working Capital ²	\$855,366	(\$996,885)	(\$770,358)

It should also be noted that among the current liabilities, the water, sewer and ambulance funds reported interfund liabilities of \$409,272, \$1,007,121 and \$1,058,794 respectively, which represent cash advances from other funds. The extent to which such amounts cannot reasonably be expected to be repaid impacts the financial condition of the fund from which these resources came. Given that these three funds reported March 31, 2006 cash balances of \$372, \$357 and \$39, respectively, these interfund advances could not be repaid at that date. The amount reported on the general fund balance sheet as due from

¹ Source – Annual Update Documents filed with the Office of the State Comptroller

The general fund is reported on a modified accrual basis. The water and sewer funds were reported on a modified accrual basis for the first two years, and were converted to full accrual enterprise accounting for the most recent three years. The ambulance operation was included in the general fund for the first two years, and separated out as an enterprise fund for the most recent three years.

² The difference between current assets and current liabilities is referred to as working capital, the amount of money that would be available after current liabilities are satisfied.

other funds at March 31, 2006 is \$1,843,224. Therefore, this general fund asset was essentially uncollectible at that date, which, if reported as such, would have increased the general fund deficit to \$4,071,544.

These deficits are the result of an accumulation of recurring operating deficits, which occurred from over-expenditures, unrealized revenues, unsupported interfund transfers and the appropriation of fund balance to finance operations.

City officials have recently taken a series of actions to increase the City's revenue stream to address its poor fiscal condition. City officials have increased water and sewer rates and certain ambulance fees. They also expect to realize increased ambulance revenues by contracting with billing and collection agencies.

Tax Increase

The City Manager's proposed budget includes a 23.5 percent tax increase in the general fund, a level of taxation that is well within the City's constitutional tax limit. For the 2006-07 fiscal year, the City exhausted only 30 percent of its constitutional tax limit. The proposed tax levy will increase that amount to approximately 38 percent.

The City's tax levy had been essentially flat for five years, until the City Council adopted the 2006-07 budget, which increased the tax levy by 12 percent. The City Manager's proposed budget for the 2007-08 fiscal year has addressed a wide array of significant budgetary discrepancies that existed in prior years' budgets, including certain revenues which had been significantly over-estimated in the past, and certain expenditures, such as overtime for the police, fire and ambulance departments, which were significantly under-estimated in prior budgets.

In its deliberations on the tentative budget and the substantial tax increase it contains, the City Council should ensure that any reductions in the proposed tax levy are fully supported by increases to other revenue sources or reductions in expenditure commitments, cost structures and/or service levels. Otherwise, unsupported reductions in the levy could significantly worsen the City's financial condition, as has occurred in previous years.

Contingency Appropriation

Contingency accounts are utilized by local governments as a means of providing funding for unexpected events. For the first time since 2001, the City Manager has included in the general fund budget an appropriation for contingencies, in the amount of \$300,000. This amount is approximately 2.3 percent of total appropriations and provides the City with some flexibility to deal with revenue shortfalls or insufficient appropriations. The City Charter does not address budgeting for contingencies. New York State statutes for other classes of local government set the maximum for such accounts at 10 percent of the general fund budget (excluding debt service and judgments). If the City were required to observe such a limit, the contingency appropriation could not exceed \$1.3 million.

This account is particularly important because the general fund is in a deficit position, and therefore has no fund balance to provide resources for contingencies, as they occur. In effect, the City should appropriate sufficient moneys in the contingency account to fund both unexpected costs as well as reasonably foreseeable contingencies.

Unexpected costs include things such as adverse weather events, unexpected machinery breakdowns, unexpected overtime, litigation costs, and increases in health insurance, fuel and utility costs. Considering the lack of fund balance to act as a cushion, we suggest providing \$500,000 for such unforeseeable events.

The City also has reasonably foreseeable contingencies for which an estimate should be made and included in the contingency account. Included are potential payments for retroactive salary increases for two years, which may result from police and fire/ambulance contract settlements or arbitration awards during the 2007-08 fiscal year.

To adequately address foreseeable as well as unexpected events, we recommend the City consider increasing its contingency account to \$1,000,000.

Real Property Tax Overlay

The City enforces real property taxes for itself, as well as Genesee County and the Batavia City School District for taxable real property within the City, yet the budget does not provide for a tax overlay. A tax overlay is designed to provide additional funding to compensate for taxes that may be delinquent or not collected.

In preparing the annual budget, the City should analyze the amount of unpaid City, County and School taxes that will not be collectible during the upcoming year, and provide for this shortfall in funding by increasing the tax levy. To add perspective, the City consistently collects about 98 percent of its tax levy during the year. Thus, about 2 percent of the proposed tax levy (approximately \$95,000), as well as an additional \$65,000 for miscellaneous City levies and penalties, will likely not be collected during the 2007-08 fiscal year. In addition, based on historical tax collection data, we estimate the amount of the required payments to the County and School for their unpaid taxes during the 2007-08 fiscal year will total more than \$375,000. This total of \$535,000 in unpaid taxes, reduced by the collection of prior year taxes in 2007-08, which we estimate to be \$330,000, would result in a tax overlay amount of approximately \$205,000.

Ambulance Fund

The tentative budget includes a 14 percent increase (\$286,000) in ambulance revenues, to \$2,275,000. This increase is anticipated to reflect rate changes and enhanced revenue collection efforts. Based on the revenue shortfalls that this fund has experienced in previous years, reliance on this level of additional revenues may be premature. It should be noted that the budgeting and accounting for the ambulance operation has changed in recent years. The City has used varying methods to allocate fire department payroll costs to the ambulance fund, since certain firefighters provide ambulance services during their

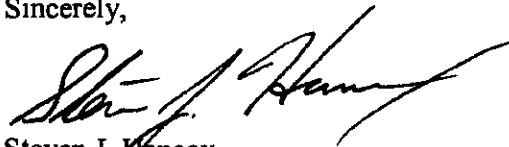
shifts. However, ambulance revenues have historically not been sufficient to fund these costs. Thus, the shift in costs from the general fund has resulted in significant operating deficits in the ambulance fund, and prompted interfund advances from the general fund to provide funding to sustain ambulance operations. The 2007-08 budget, notwithstanding the expected increase in ambulance revenues, includes a \$267,000 interfund transfer from the general fund to subsidize a portion of the costs re-allocated from the general fund to the ambulance fund.

City officials should consider more realistic options for allocating fire department payroll costs, recognizing the need to fund them with or without an ambulance service or ambulance enterprise fund.

The City Council has the responsibility to initiate corrective action. Pursuant to Section 35 of the General Municipal Law, the City Council should prepare a plan of action that addresses the recommendations in this report and forward the plan to our office within ninety days. We encourage the City 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 also request that you provide us with a copy of the adopted budget.

We hope that this information is useful as you adopt a budget for your City. If you have any questions on the scope of our work, please contact the Buffalo regional office at 716-847-3647.

Sincerely,



Steven J. Hancox
Assistant Comptroller
Local Government Services and
Economic Development

cc: Ms. Heidi Parker, City Clerk-Treasurer