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Report No. B1-6-12

The Honorable Norman L. Polanski and  
Members of the City Council  
City of Lackawanna  
714 Ridge Road  
Lackawanna, New York 14218

Dear Mayor Polanski and Members of the City Council:

Our Office has recently completed an audit of the City of Lackawanna (City) budget for the 2006-07 fiscal year. The objective of the audit was to provide an independent evaluation of the proposed budget. Our audit addressed the following questions related to the City's budget for the 2006-07 fiscal year:

Are the City's revenue and expenditure projections in the proposed budget reasonable?

Is the City's budget structurally balanced so that recurring costs are financed with recurring revenues?

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 were discussed with City officials and their comments have been considered in preparing this report. GAGAS require that we plan and perform our audit to adequately assess the estimates in the proposed 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 proposed budget.

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

The proposed budget package for the fiscal year ended July 31, 2007 submitted for audit consisted of the following:

- The proposed budget for 2006-07 submitted by the Mayor to the City Council
- Supplementary information

The City's proposed general fund budget submitted to our Office is summarized as follows:

<b>Appropriations</b>	<b>Estimated Revenues</b>	<b>Appropriated Fund Balance</b>	<b>Real Property Taxes</b>
\$20,681,876	\$11,616,418	\$0	\$9,065,458

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.

The City is on the brink of a severe financial crisis. It has no flexibility in its revenue structure as it has exhausted virtually all of its taxing power. The City's largest taxpayer is seeking a reduction in assessment from approximately \$40 million down to zero. Furthermore, we determined that expenditure estimates in the proposed 2006-07 budget are not reasonable. The contingency appropriation is not adequate, the amounts appropriated for certain personal service costs are inadequate, and appropriations for utility costs may be less than needed. Faced with a negligible tax margin, the potential loss of a substantial amount of taxable assessed valuation, and unreasonable expenditure estimates in the proposed 2006-07 budget, the City may not be able to sustain the current level of services provided to its citizens.

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.

### **Financial Condition**

The City's general fund reported an unreserved, undesignated fund balance of \$2,123,652 on July 31, 2005. This represented 11 percent of general fund appropriations included in the 2005-06 budget. Furthermore, the City Comptroller estimates that the City will end the 2005-06 fiscal year with an operating deficit of approximately \$350,000 and an unreserved undesignated general fund balance of \$1.77 million – which represents approximately 9 percent of proposed general fund appropriations for the 2006-07 fiscal year. No fund balance was appropriated as a financing source in the proposed 2006-07 budget.

The 2006-07 proposed budget includes a 4.44 percent real property tax increase (\$385,572) as compared to the previous fiscal year.<sup>1</sup> We reviewed the City Comptroller's draft 2006-07 Constitutional Tax Limit form, which he prepared based on the real property tax levy proposed in the 2006-07 budget. The proposed real property tax levy of \$9,065,458 results in a negligible tax margin of \$204,843, which leaves the City exhausting 97.6 percent of its constitutional tax limit. With such a negligible tax margin, the City has lost flexibility in its revenue structure and may not be able to sustain the current level of services provided to its citizens. Even normal cost increases will result in serious budget difficulties if there is no corresponding growth in revenues. In addition, the State Constitution and related statutes require the State Comptroller to withhold certain State aid payments from a local government if the taxes levied by that local government are in excess of its tax limit.

Moreover, the City is faced with the likelihood of a significant reduction in its assessed valuation. The City's largest taxpayer is currently seeking a reduction in its assessment from approximately \$40 million down to zero.<sup>2</sup> If this challenge is successful, the effect on City operations will be severe. The City will have to issue indebtedness to refund the taxes overpaid, because this tax certiorari was initiated several years ago. If the assessed value was reduced to zero for the entire period, this would result in a refund due to this taxpayer of more than \$7 million,<sup>3</sup> not including any interest that may be determined to be paid. Furthermore, the tax burden will shift significantly to the remaining businesses located in the City.<sup>4</sup> Finally, a reduction in the City's assessed value will result in the City exceeding its constitutional tax limit, as the formula on which the limit is based will be dramatically affected by the loss of such a substantial amount of assessed value.

Accordingly, City officials will need to explore substantial cost-savings strategies such as service consolidations (internally or with other local governments), and they must seek additional revenue sources. While this circumstance is, to a great extent, beyond the control of the City, it is imperative that City officials take whatever actions are presently available to them to expedite the resolution of this issue.

### **Contingency Appropriation**

In the 2006-07 proposed budget, the \$25,000 appropriation for contingencies is inadequate. Accordingly, this budget does not give the City the necessary flexibility to react to revenue shortfalls or insufficient appropriations when they occur. A conservative contingency account of 1 percent of appropriations, or \$207,000, would give the City greater flexibility in dealing with unexpected events.

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<sup>1</sup> This increase is a blended percentage that reflects homestead (residential) and non-homestead (business) tax rates.

<sup>2</sup> According to City officials, the taxpayer is seeking a reduction to zero because the site is polluted and may cost more to clean up than what it is worth.

<sup>3</sup> For taxes paid in the fiscal years 2000-01 through 2005-06.

<sup>4</sup> For perspective, the City's total taxable assessed valuation for the 2006-07 fiscal year is \$443,763,380. This increased by approximately \$62 million from fiscal year 2005-06 due to a revaluation performed in 2005-06. The \$40 million current assessment for this taxpayer represents approximately 9 percent of the total assessed valuation.

City officials should review the contingency appropriation and raise it to a more reasonable amount.

### **Personal Service Appropriations**

The amounts appropriated for personal service costs in the Police Department are not adequate. The table below compares actual and projected costs with the amounts proposed in the 2006-07 budget:

<b>Police Department</b>	<b>2002-03 Actual</b>	<b>2003-04 Actual</b>	<b>2004-05 Actual</b>	<b>2005-06 Projected by the City</b>	<b>2006-07 Proposed Budget</b>
<b>.102 Overtime</b>	\$246,253	\$187,671	\$218,514	\$221,502	\$160,000
<b>.103 Court Time</b>	\$71,246	\$65,064	\$120,640	\$121,971	\$88,000
<b>.106 Personal Services</b>	\$305,129	\$311,472	\$340,371	\$345,480	\$333,731
<b>Totals</b>	<b>\$622,628</b>	<b>\$564,207</b>	<b>\$679,525</b>	<b>\$688,953</b>	<b>\$581,731</b>

In addition to the above schedule of historical trends, our analysis of these accounts indicates that projected expenditures for the 2006-07 fiscal year could be as high as \$723,400, which is \$141,669 more than what is included in the 2006-07 proposed budget. Costs have generally been increasing in recent years and, therefore, without a plan to address these factors, personnel costs for 2006-07 cannot be reasonably expected to decline.

In addition, the collective bargaining agreement between the City and the union representing city firefighters expired on July 31, 2004. Furthermore, the collective bargaining agreements between the City and the remaining three unions (Police, Department of Public Works, and Clerical Staff) expire on July 31, 2006. City officials expect that they will be able to fully accrue a reasonable estimate for firefighter's back-pay on their financial statements at the conclusion of the current fiscal year, which is reflected in the City Comptroller's estimate of the general fund balance on July 31, 2006. However, the proposed 2006-07 budget includes only \$150,000 for employee pay raises. If City officials reach a settlement with the unions that provides for wage increases during the 2006-07 fiscal year, the \$150,000 currently proposed will likely not be sufficient. For example, if the City agreed to a 3 percent salary increase in the 2006-07 fiscal year for all four unions, we estimate that they would need approximately \$423,000, which is \$273,000 more than the budgeted amount.

City officials should review, and consider amending, the budget estimates for personal service costs. The failure to address issues affecting personnel costs puts the City at risk for incurring a significant over-expenditure of appropriations. This risk is significantly increased because the City has not included a reasonable appropriation for contingencies in the 2007 budget.

### **Utility Costs**

The amounts included in the 2006-07 proposed budget for utilities (natural gas, fuel, and electric) are inadequate. The City Comptroller projects that actual utility costs for the City's current fiscal year will total \$425,532. This amount is \$71,000 greater than the appropriations included for utilities (\$354,300) in the 2006-07 proposed budget. Given the present volatility in the energy market, it may be prudent for City officials to assume that energy rates will remain at their current high levels, and to ensure that adequate appropriations are available to fund these costs. Therefore, an appropriation that is at least as much as the cost projected for the present fiscal year would be more reasonable. City officials also should consider implementing energy conservation measures to reduce costs.

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 90 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 feel free to contact our Buffalo Regional Office at (716) 847-3647.

Very truly yours,

Chief Examiner of Local Government Services and  
Economic Development

cc: Mr. Robert Marciniak, City Comptroller  
Ms. Jacqueline Caferro, City Clerk  
Ms. Catherine Panczykowski, Secretary to the Council