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November 20, 2006

The Honorable Vincenzo Anello, Mayor
And Members of the City Council
City of Niagara Falls
P.O. Box 69
Niagara Falls, New York 14302-0069

Dear Mayor Anello and Members of the City Council:

Our office has recently completed an audit of the City's tentative budget for the 2007 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 tentative budget for the 2007 fiscal year:

- Are the significant revenue and expenditure projections in the City's 2007 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 omitted from 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 objective 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 December 31, 2007 submitted for audit consisted of the following:

- Cover Letter
- 2007 Tentative Budget

- 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 Fund	\$ 73,099,565	\$ 44,018,614	\$ -	\$ 29,080,951
Parking-Surface Lots	\$ 421,542	\$ 421,542	\$ -	\$ -
Parking-Ramps	\$ 1,218,491	\$ 1,218,491	\$ -	\$ -
Golf Course	\$ 991,848	\$ 991,848	\$ -	\$ -
Library	\$ 1,619,665	\$ 1,619,665	\$ -	\$ -
Tourism	\$ 1,250,000	\$ 1,250,000	\$ -	\$ -
Debt Service	\$ 7,498,878	\$ 7,498,878	\$ -	\$ -
Total	\$ 86,099,989	\$ 57,019,038	\$ -	\$ 29,080,951

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 as noted below, we found the significant revenue and expenditure projections in the tentative 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.

General Fund Balance

The City's general fund had a reported unreserved, unappropriated fund balance of \$3.26 million at December 31, 2005, which equates to approximately 4.9 percent of 2006 appropriations¹. The City will likely realize a \$4.25 million operating surplus in the general fund for the fiscal year ended December 31, 2006. As a result, the City's general fund will end the 2006 fiscal year with an unreserved, unappropriated fund balance of approximately \$7.5 million, which is 10.3 percent of general fund appropriations included in the 2007 tentative budget. The tentative budget does not include any appropriation of fund balance to reduce the 2007 tax levy.

The operating surplus in 2006 is primarily the result of State aid for the AIM program exceeding the City's 2006 budget estimate by \$4.5 million. The State's funding of this program was not finalized until after the City adopted its 2006 spending plan. The City's 2007 tentative budget reflects the higher funding level for AIM that was realized in 2006.

¹ This positive fund balance was mainly due to favorable budget variances in revenue accounts that occurred during the 2005 fiscal year. For example, actual State aid revenues exceeded budget estimates by nearly \$1.7 million, and real property tax items, such as sales of in rem properties, exceeded budget estimates by over \$1 million.

The improvement in the City's financial condition led rating agencies to recently upgrade the City's bond rating. These agencies cited the City's modest positive tax base growth over the past three years and increased economic activity driven by the December 31, 2002 opening of the Seneca Casino, which has stimulated development within the downtown area, as reasons for the upgrade. The increase in the City's bond rating should lead to lower borrowing costs for new debt issuances.

Although the general fund has sufficient unappropriated fund balance, as stated below, the City is close to its constitutional tax limit and its 2007 tentative budget contains appropriation deficiencies that can reduce this amount of accumulated fund balance.

Constitutional Tax Limit

Despite the improvement in the City's financial condition, the City remains dangerously close to its constitutional tax limit. We reviewed the City Comptroller's draft 2007 Constitutional Tax Limit form, which she prepared based on the real property tax levy in the 2007 tentative budget. The proposed 2007 levy of \$29,080,951, which is an increase of \$1.0 million above the 2006 levy, leaves the City with a negligible tax margin of \$260,225, or within 1.03 percent of its taxing 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. Although the modest growth in tax base will increase the tax limit slightly, it is unlikely to provide a meaningful increase in budget flexibility. Any significant 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.

Although the City has accumulated general fund balance that can be used to reduce future years' tax levies, we recommend that the City develop a long-term strategy to address either containing expenditures or increasing revenues other than real property taxes.

Contingency Appropriations

The City has a budgeted appropriation of \$486,000 for contingencies. However, this does not represent a contingent appropriation per se, as the entire amount is intended for police and fire retirement buyouts. As a result, if an unanticipated expenditure or revenue shortfall occurs, the only funding source available would be to appropriate fund balance². A minimal undesignated contingency account of 1 percent of appropriations (\$731,000) would give the City some minimal flexibility in dealing with unexpected events. We recommend that the City provide for an undesignated contingency account.

² This assumes that all other revenue estimates and appropriations closely mirror reality. For example, if an appropriation for a particular purpose was well in excess of anticipated expenditures for the balance of the fiscal year, such surplus could be transferred to other appropriations where expenditures are expected to exceed the budgeted amount.

Collective Bargaining Agreements

The collective bargaining agreements between the City and its eight unions representing various employees expired in either 2003 or 2004 and have not been renewed. The 2007 tentative budget does not include any provision for pay raises for employees represented by these unions. Therefore, fund balance may be the only available resource to finance any pay raises. For perspective, each increase of one percent for pay raises in the 2007 fiscal year for all union employees whose costs are budgeted in the general fund would cost the City over \$270,000³. We recommend that the City make provisions in the 2007 budget for increases in personal service costs.

Non-Recurring Revenue

The State provides aid as an incentive to promote certain cooperative ventures between local governments. In August 2006, the City entered into a shared service agreement for a coordinated assessment program (CAP) with the Town of Wilson. Accordingly, the City expects to receive a one-time State aid payment of \$240,000 for entering into the CAP. They included this estimated revenue in the 2007 tentative budget. This revenue source is not expected to recur beyond the 2007 fiscal year. Although this is not a large revenue source in relation to the general fund budget, the fact that the City is so close to its constitutional tax limit requires that the City find another revenue source to make up for this shortfall in 2008.

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.

Very truly yours,

Steven J. Hancox
Assistant Comptroller

cc: Ms. Maria Brown, City Comptroller
Ms. Carol Antonucci, City Clerk
Ms. Geri Mondri, Secretary to the Council
Mr. Daniel Bristol, City Administrator
Robert Meller, Chief Examiner

³ A one percent pay raise applied to budgeted 2007 personal service costs of \$27,285,100 would cost \$272,285.