



**THOMAS P. DiNAPOLI**  
COMPTROLLER

STATE OF NEW YORK  
**OFFICE OF THE STATE COMPTROLLER**  
110 STATE STREET  
ALBANY, NEW YORK 12236

**STEVEN J. HANCOX**  
DEPUTY COMPTROLLER  
DIVISION OF LOCAL GOVERNMENT  
AND SCHOOL ACCOUNTABILITY  
Tel: (518) 474-4037 Fax: (518) 486-6479

March 24, 2010

Nicholas Valentine, Mayor  
Members of the City Council  
City of Newburgh  
83 Broadway  
Newburgh, NY 12550

Report Number: 2010M-019

Dear Mayor Valentine and Members of the City Council:

We have recently audited the City of Newburgh's (City) adopted budget for the 2010 fiscal year at the request of the Acting City Manager and members of the City Council (Council). The City has experienced significant turnover in its administration in the last fiscal year. There have been five acting City Managers, the Comptroller resigned in August 2009, and the Corporation Counsel resigned in November 2009. The last audited financial statements were for the fiscal year which ended December 31, 2007, which the City Council did not receive until October 2009.

The City's financial problems are significant. Near the end of the City's 2009 fiscal year, the State advanced the City a portion of its scheduled Aid and Incentive to Municipalities (AIM) funding to help the City meet its payroll obligations. The City Council and Acting Manager have engaged a CPA firm on a consulting basis to gain an understanding of the City's financial status, help analyze the financial issues, provide a cash flow analysis, and help the Acting City Manager prepare the 2010 proposed budget for the Council's review.

In October, the City issued a bond anticipation note for \$5.2 million to repay the general fund for the capital costs of constructing the City's new courthouse. In December, the City issued a second bond anticipation note for \$17 million for construction overage costs on the courthouse facility (\$3.2 million), a legal settlement (\$2.3 million), and future capital projects (\$11.5 million). It also issued a tax anticipation note for \$5.6 million to improve cash flow.

The objective of our audit was to provide an independent evaluation of the City's adopted budget. Our audit addressed the following question related to the City's budget for the 2010 fiscal year:

- Are the significant revenue and expenditure projections in the City’s adopted budget reasonable?

We conducted this performance audit in accordance with generally accepted government auditing standards (GAGAS), with the exception of reporting views of responsible officials. GAGAS 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 regarding the estimates in the adopted budget.

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

The adopted budget package submitted for audit for the 2010 fiscal year consisted of the following:

- Adopted budget
- Supplementary information

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

<b>Fund</b>	<b>Appropriation and Provisions for Other Uses</b>	<b>Estimated Revenues</b>	<b>Appropriated Fund Balance</b>	<b>Real Property Taxes</b>
General	\$43,126,027	\$24,422,753	\$5,500,000	\$13,203,274
Water	\$5,254,548	\$5,254,548	\$0	\$0
Sewer	\$4,911,914	\$4,911,914	\$0	\$0

Based on the results of our audit, we found that the significant revenue and expenditure projections in the proposed budget are not reasonable. As a result of the City’s incorrect projections, the City’s budget shortfall this year could be \$6.3 million or more if no action is taken to address the problems.

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. At the time of our review, audited financial statements for the year ended December 31, 2008, had not been issued, and the City’s accounting records for the year ended December 31, 2009 were incomplete. As a result, our conclusions are based on data that is not comprehensive.

Our audit disclosed the following findings which should be reviewed by the 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.

## **Fund Balance Appropriation**

The City's 2010 budget includes an appropriation of \$5.5 million of fund balance, which is a non-recurring funding source. Because this is a one-shot funding source, the City will face a shortfall of at least this amount when it prepares its 2011 budget.

City officials believe that \$5.5 million is available because the City issued debt to repay the general fund for a total of \$5.5 million that was already paid from the general fund for construction overage and legal settlement costs. However, City officials could document that they had paid only \$2.9 million of these costs. Therefore, only \$2.9 million of the debt proceeds would be repaid to the general fund and be potentially available for appropriation.

However, the larger concern is that City officials do not know whether \$5.5 million – or any amount of fund balance – is available at all. The City could not provide evidence of its fund balance amount for the fiscal year ended December 31, 2009 because its 2009 accounting records are not complete or reliable. In fact, the City's accounting records for fiscal year 2008 have not been audited, and are only now being reviewed by the City's accounting consultants. We believe it was imprudent for the Council to appropriate fund balance when there was no evidence that it existed.

## **Revenues**

City officials over-estimated revenues from payments in lieu of taxes (PILOT), sewer rents, and water facility charges in the adopted 2010 budget by a total of approximately \$601,000, as follows:

- PILOTs – The 2010 general fund budget includes estimated revenues of \$700,000 for PILOT payments. However, City officials erroneously included the Orange County and Newburgh City School District portion of the PILOT in their revenue projections. Therefore, budgeted revenues are over-estimated by approximately \$300,000.
- Sewer rents – The adopted 2010 sewer fund budget estimates revenues of \$4.2 million, which is an increase of \$1 million over last year's budget. City officials told us that the Council adopted an increase in sewer rents on February 8, 2010. Because the increase will not be assessed until March 1, 2010, the City has forgone two months of this estimated revenue, or approximately \$167,000, for fiscal year 2010.
- Water facility charges – The adopted 2010 water fund budget includes new estimated revenue of \$800,000 for a water facility charge. This charge, which was adopted by the Council February 8, 2010, amounts to \$7.30 per unit for each single-family dwelling, \$12.78 per unit for each two-family dwelling, \$18.25 per unit for each three-family dwelling and \$23.73 per unit for each four-family dwelling. All other properties within the City are assigned a \$7.30 charge for every \$30,000 of their total assessed value. However, the new charge will not be assessed until March 1, 2010. Therefore, the City

has forgone two months of this estimated revenue, or approximately \$134,000, for fiscal year 2010.

### **Appropriations**

Our review of the amounts appropriated in the City's budget for 2010 shows that City officials underestimated appropriations for debt service payments by \$227,000. The budget also made no provision for general fund contingencies.

- Debt service payments – The 2010 budget includes an appropriation of \$3.9 million for debt principal and interest payments. However, the City has not budgeted for all of its debt service payments. We reviewed the debt payment schedules for the City's long-term debt and found that the total amount due the City must pay is \$4.1 million. This creates a budget shortfall of \$227,000.
- General fund contingencies – The budget originally included an appropriation of \$317,455 for general fund contingencies, but the Council voted in December 2009, prior to the new fiscal year, to use this appropriation to increase the amount budgeted for police salaries. This action leaves the City with no provision for general fund contingencies, which could be very problematic in the light of current economic conditions and the City's financial condition. Without a general fund contingency fund, the City has virtually no cushion available should it incur any kind of unexpected costs or if its revenues are lower than anticipated.

### **Write-Off of Receivables**

City officials told us that their external auditor is recommending that they write off approximately \$3 million of miscellaneous receivables outstanding from 2008 and prior years. The write off will reduce the City's currently undetermined fund balance by \$3 million.

We recommend that City officials review the items identified in this report and take appropriate action to correct the imbalances in the 2010 budget. If City officials determine there are deficits in the City's fund balances, they should seek approval for deficit financing through State Legislation.

The Council has the responsibility to initiate corrective action. 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 adopt a budget for the City. If you have any questions on the scope of our work, please feel free to contact Christopher Ellis at (845) 567-0858.

Sincerely,

Steven J. Hancox  
Deputy Comptroller  
Office of the State Comptroller  
Division of Local Government and  
School Accountability

cc: Richard Herbek, Acting City Manager and Budget Officer  
Christine Mitchell, City Comptroller  
Lorene Vitek, City Clerk

## **APPENDIX A**

### **RESPONSE OF LOCAL OFFICIALS**

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



# CITY OF NEWBURGH

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OFFICE OF THE CITY MANAGER  
City Hall - 83 Broadway, Newburgh, New York 12550  
[www.cityofnewburgh-ny.gov](http://www.cityofnewburgh-ny.gov)

[citymanager@cityofnewburgh-ny.gov](mailto:citymanager@cityofnewburgh-ny.gov)

Phone: (845) 569-7301

Fax: (845) 569-7370

Richard F. Herbek  
Acting City Manager

March 11, 2010

Christopher J. Ellis  
Chief Examiner  
Office of the State Comptroller  
Newburgh Regional Office  
33 Airport Central Drive, Suite 103  
New Windsor, NY 12553

Dear Mr. Ellis:

We are in receipt of your March 3, 2010 letter and the preliminary draft report regarding your recent examination of the City of Newburgh. The draft report has been shared with the Mayor and members of the City Council. They have been informed about the financial stress the City is currently experiencing.

The City is moving forward to quickly finalize its financial statement audits for the years ending 2008 and 2009. The City has hired a new Comptroller, Christine Mitchell, CPA, and has engaged the services of J. Dwight Hadley, CPA to help expedite the process. The City Council is aware that it's 2010 budget is out-of-balance and will likely cause the 2010 year to end with a deficit in the General Fund.

The City Council at its March 8<sup>th</sup> meeting passed a resolution authorizing the City Manager to request the City's State Representatives to introduce deficit financing legislation to fund any accumulated deficit the City may have occurred through the end of 2010.

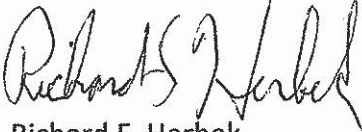
The City is also aware that it faces a large challenge to balance its 2011 operating budget. Toward that goal, the City will begin preparing its 2011 budget in the very near future.

Christopher Ellis, Chief Examiner  
Office of the State Comptroller

March 11, 2010

We thank you in advance for any assistance the Comptroller's Office can provide in monitoring or assisting our efforts to strengthen the City's financial position.

Sincerely,



Richard F. Herbek  
Acting City Manager

RFH/ee

Cc: Nicholas Valentine, Mayor  
Councilwoman Regina Angelo  
Councilwoman Marge Bell  
Councilwoman Christine Bello  
Councilman Curlie Dillard  
Christine Mitchell, City Comptroller  
Dwight Hadley, CPA