



LOCAL GOVERNMENT MANAGEMENT GUIDE

# Personal Service Cost Containment



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# Table of Contents

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Introduction .....	1
Overview .....	2
Containing Health Insurance Costs .....	3
Minimizing Unemployment Insurance Costs .....	9
Managing Workers' Compensation Costs.....	11
Overtime Planning and Management .....	14
Conclusion.....	15
Resources.....	16
Regional Office Directory .....	17
Central Office Directory .....	18



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# Personal Service Cost Containment

As a local official, you need the tools to do your job. The Office of the State Comptroller also recognizes that you need to be kept up-to-date on financial practices and developments. We have developed a publication entitled the *Local Government Management Guide*, sections of which will be released periodically. This guide includes technical information as well as suggested practices for local government operations.

*Personal Service Cost Containment*, the latest release of this guide, is now available. We believe that you will find this release and subsequent sections an easy-to-use tool and resource. The *Local Government Management Guide* is available in electronic format, including CD, so that it can be easily accessed. The publication is also available on our Web site, <http://www.osc.state.ny.us>.

On average, school districts and local governments spend nearly 57 percent of their annual budget on employee benefits and salaries.

## Introduction

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Employee benefits and salaries are significant expenditures for New York's local governments and school districts. On average, school districts and local governments spend nearly 57 percent of their annual budget on employee benefits and salaries. Employee benefit costs consist largely of retirement contributions, Social Security, workers' compensation, and health insurance costs.

With such a significant amount of your annual budget earmarked for employee benefits and salaries, it's important to realize that reducing costs by even the smallest percentage can amount to extensive dollar savings.

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The suggestions in this guide are ideas for you to consider and possibly utilize in the management of your operations and in the development of your annual budget.

## **Overview**

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This guide is designed to assist local governments and school districts contain certain personal service costs. It is broken down into the following sections:

- Containing Health Insurance Costs
- Minimizing Unemployment Insurance Costs
- Managing Workers' Compensation Costs
- Overtime Planning and Management

The suggestions in this guide are ideas for you to consider and possibly utilize in the management of your operations and in the development of your annual budget. You will need to tailor these cost savings opportunities to fit the requirements and needs of your local government or school district.

## **Who is Responsible for Personal Service Cost Containment?**

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Responsibility for cost containment generally is shared among a number of individuals and departments within each local government and school district. First and foremost, as a rule the governing board and various levels of management are responsible for taking a proactive approach by establishing appropriate policies for employee benefits and salaries, as well as monitoring adherence to such policies. The budget director usually plays a key role in cost containment because he or she must create a plan that provides adequate funding for all employee benefits and salaries. The governing board, management and the budget director should work hand-in-hand to assess whether salary and benefit levels are within the organization's (and the community's) ability to pay. In larger local governments, the human resources department is often involved in contract negotiations and in hiring new employees and can assist in developing salary and fringe benefit proposals that are reasonable and cost effective. Employees should also be encouraged to communicate their concerns and ideas for cost savings.

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## Containing Health Insurance Costs

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Health insurance is one of the most costly employee benefits offered and probably the most desired one too. The annual premium for a family of four averages nearly \$11,500 and the annual premium for single coverage averages over \$4,200. It's not hard to see how health insurance costs can affect your budget's bottom line, especially when they increase more than inflation year after year. The following are some common sense strategies for lowering health insurance costs.

### Seek Competition

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It is not uncommon to select a health insurance carrier and to stay with that vendor for many years. Even though you are not required to competitively bid for health insurance, it makes good business sense to periodically shop around and compare costs and coverage with other providers. Check your procurement policies and procedures and if they do not currently provide for the solicitation of proposals or quotations for insurance, consider amending the policies.

Bringing some competition into the mix may also help you negotiate better benefits or a lower price from your current vendor. A few simple phone calls to competing vendors and the New York State Health Insurance Program (NYSHIP) may be the catalyst for helping you hold the line or stabilize your health insurance costs. If your experience rating (history of losses) is good, along with other variables, you may find a comparable policy at a lower cost. Competition may enable you to obtain a better policy even if your experience rating is lower than average.

NYSHIP's Web site<sup>1</sup> contains information on the cost of their health plans which you can use as a benchmark for evaluating the services and affordability of other health insurance plans.

Even though you are not required to competitively bid for health insurance, it makes good business sense to periodically shop around and compare costs and coverage with other providers.

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<sup>1</sup> [www.cs.state.ny.us/ebd/ebdonlinecenter/pamarket/cost.cfm](http://www.cs.state.ny.us/ebd/ebdonlinecenter/pamarket/cost.cfm)

A popular cost savings strategy is to offer cash payments in lieu of health insurance.

### Offer Payments in Lieu of Health Insurance

A popular cost savings strategy is to offer cash payments in lieu of health insurance. Because some employees have health insurance available from a secondary source (usually under a spouse’s plan), offering a cash payment in lieu of health insurance can be mutually beneficial to both employer and employee. Employers can realize a savings, sometimes substantial, by paying employees an amount less than the annual cost of their health insurance premiums. At the same time, employees can increase their annual income by receiving a payment in lieu of health insurance. Such payments may be provided for by local law or pursuant to a collective bargaining agreement. A simple employee survey or discussion with labor union representatives can help you gauge employee interest in this type of alternate benefit.

To qualify for the payment, employees should demonstrate that they have appropriate coverage available from another source. Employers should advise their employees to compare their current plan with the alternative to weigh the benefits and risks of switching plans. You may also wish to contact the IRS (or a tax advisor) concerning the income tax consequences employees will have as a result of providing a payment in lieu of health insurance benefit option. Additionally, employees should be notified that payments in lieu of health insurance coverage are not reportable for retirement system purposes. Our office has conducted a study<sup>2</sup> in this area and has identified substantial savings that local governments can realize if this option is offered. Several school districts have offered this benefit to their employees with apparent success, and although we have not performed an audit on the practice in school districts, it has the potential to be a substantial cost saver.

Below is an example of the potential cost savings for five employees with family coverage and three employees with individual coverage who take advantage of cash payments in lieu of health insurance of \$5,000 and \$1,800, respectively. The potential annual cost savings generated by this example would be a total of \$39,700.

Number of Employees	Annual Premium	Total Opportunity Cost	Annual Cost of the Buyout	Net Annual Savings
5 With Family Coverage	\$11,500	\$57,500	\$25,000	\$32,500
3 With Individual Coverage	\$4,200	\$12,600	\$5,400	\$7,200

<sup>2</sup> OSC, *Rockland County Health Insurance Program*, 2003–MR–25.



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## Create a Self-Funded Health Plan

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Instead of paying periodic premiums to an insurance company for an established plan, you may pay for health care benefits directly under a self-insurance plan. A study<sup>3</sup> by the Office of the State Comptroller (OSC) found an average cost savings of 12 percent over a three-year period for the self-insured counties we examined.

Self-funded health plans are generally managed by a third-party administrator engaged by the local government or school district. These third-party administrators typically collect and review employees' health care bills, and may assist in negotiating rates with medical service providers and estimating the amount of funding required to pay the employees' health care costs. Third-party administrators can also look out for improper claims and perform a variety of other services. Contracts with third-party claims administrators must comply with the provisions of General Municipal Law Section 92-a(6).<sup>4</sup>

Self-insurance plans may be more cost-effective for those entities whose employees have relatively good claims histories and therefore such plans may not be suitable for all local governments and school districts. Although self-funded health plans appear to have significant benefits, there are some risks. To minimize year-to-year fluctuations and resulting financial risks, employers considering a self-insurance health plan should have 500 or more employees so that the administrators and risk managers can predict claims more easily. In addition, officials should consider purchasing a stop-loss policy from a private insurer to cover catastrophic health care costs above a certain amount.

Local governments and school districts should conduct a detailed cost-benefit projection to determine if cost savings would result from a self-funded plan. Officials may want to contact other entities that self-fund to review their plans. Also, be aware that these plans may be subject to collective bargaining with employee unions.

A study by the Office of the State Comptroller (OSC) found an average cost savings of 12 percent over a three-year period for the self-insured counties we examined.

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<sup>3</sup> OSC, *Containing the Cost of Employer Provided Health Insurance Benefits*, 2003–MR–5.

<sup>4</sup> General Municipal Law Section 92-a (6) authorizes governing boards that self fund for medical, surgical and hospital benefits to enter into agreements with duly qualified contact administrators or other service providers to receive, investigate, make recommendations on, audit, approve or make payment of claims for these benefits. Such agreements are required to be entered into pursuant to competitive bidding, or an RFP process in accordance with the local government's procurement policies and procedures. Section 92-a further provides that agreements entered into pursuant to this authority must contain certain minimum safeguards including, among other things, the furnishing of performance security, the maintenance and retention of proper books and records and an annual audit requirement.

**Section 125  
of the Internal  
Revenue Code  
makes it possible  
for employers  
to offer their  
employees a plan  
with the option of  
receiving certain  
health, dependent  
care and other  
qualifying benefits  
on a pre-tax basis.**

**Offer a Pre-Tax Benefit Plan**

Section 125 of the Internal Revenue Code makes it possible for employers to offer their employees a plan with the option of receiving certain health, dependent care and other qualifying benefits on a pre-tax basis. These “cafeteria plans” are a method for sheltering employee contributions for qualified expenses from federal income taxes and generally from Social Security (FICA) and Medicare taxes. This type of tax-sheltered plan can produce savings for both employees and employers.

Employee contributions to the cafeteria plan are usually made pursuant to salary reduction agreements between the employer and the employee, in which the employee agrees to contribute a portion of his or her salary on a pre-tax basis to pay for the qualified benefits. Those contributions are not considered wages for federal income tax purposes. In addition, those sums generally are not subject to FICA and Medicare taxes. Since your organization can also save on the employer’s share of FICA and Medicare of the amounts covered in a cafeteria plan, it can result in substantial savings.

Section 125 provides for another form of cafeteria plan benefit known as a flexible spending arrangement (FSA), which also can be advantageous to both employee and employer. Under an FSA, employees are reimbursed for out-of-pocket expenses incurred for medical care (such as deductibles, co-payments, office visits, prescription co-payments and over-the-counter drugs) and certain other qualified benefits, including dependent care assistance. The reimbursements are funded by salary reductions.

In the example below, the savings for one year totaled over \$10,000.

<b>Number of Participating Employees</b>	<b>Health Insurance Contributions</b>	<b>Health Care Spending Account</b>	<b>Dependent Care Account</b>	<b>Total Employer Savings on FICA and Medicare Taxes</b>
	Example: \$50 per month per employee	Example: \$2000 per year per employee	Example: \$3000 per year per employee	
<b>50</b>	\$30,000			<b>\$2,295</b>
<b>30</b>		\$60,000		<b>\$4,590</b>
<b>15</b>			\$45,000	<b>\$3,442</b>
<b>Total Savings</b>				<b>\$10,327</b>

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Some of the steps involved in establishing and maintaining a pre-tax benefit plan can be complex and may generate questions from your employees. To address these concerns, some organizations utilize consultants to present the plan to their employees and to assist in its establishment and in the maintenance of required records. This discussion provides only a basic overview of the Internal Revenue Code “Section 125” plans. To properly establish a pre-tax benefit plan, we recommend that you consult your attorney and/or a qualified tax professional. Note also that Section 125 provides only for the federal tax consequences of these plans. Each qualifying benefit offered must be properly authorized pursuant to State statute or local law and may be subject to collective bargaining agreements with employee unions.

To properly establish a pre-tax benefit plan, we recommend that you consult your attorney and/or a qualified tax professional.

### Other Ways to Trim Health Insurance Costs

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**Health and Wellness Programs** – Various studies of public and private employer health programs have demonstrated that they can improve employee health, nutrition, and behavior. Successful programs have generated noteworthy returns on employer investments by achieving:

- Reduction in health care costs
- Reductions in employees’ blood pressure, cholesterol, and weight
- Decreased absenteeism due to illness, depression, and stress
- Declines in on-the-job injuries
- Increased job satisfaction, morale, and productivity.

Some examples include walking programs and discounted health insurance premiums for nonsmokers. Helping your employees kick the habit by providing smoking cessation classes free or at a reduced cost can reduce the burden on your health insurance plan. Routine blood pressure checks can also detect symptom-less and often devastating conditions.

**Employee Awareness** – Encouraging employees to use health care services carefully and prudently is a cost effective way to contain health insurance premiums. Providing lists of participating providers at all work sites and posting reminders such as “Save Emergency Room Visits for Emergencies” can help control health care costs. In addition, reminding your employees to thoroughly review their medical bills to make sure that services billed were actually provided is an easy way to avoid paying unneeded expenses. Similarly, the monthly invoice received from your health insurance carrier should be examined for ineligible employees and other billing errors.

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A recent audit conducted by our office indicated that unnecessary costs are incurred when health insurance premiums are paid for deceased retirees or their dependents.

### Monitoring Retiree Eligibility

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Many local governments and school districts offer employees the option to receive health insurance coverage as part of their retirement package. Some also may have collective bargaining agreements that provide for continued coverage for spouses and/or dependents for a period of time after the eligible retiree passes away. A recent audit<sup>5</sup> conducted by our office indicated that unnecessary costs are incurred when health insurance premiums are paid for deceased retirees or their dependents.

To minimize paying unnecessary premiums, local governments and school districts should maintain continued communication with retirees. When retirees contribute to their health insurance plans, a communication process should already be in place through monthly insurance billing statements. For those that do not require retirees to contribute, communication can be accomplished through periodic questionnaires, postcards or letters to verify that the eligible person still needs insurance. This will also provide an opportunity to update any relevant personal information.

After your organization has verified the eligibility status of retirees, surviving spouses and/or dependents for health insurance benefits, it is important to make sure that they are the only persons included on the health insurance bill. Simply cross check the Social Security numbers listed on the bill to those already identified as eligible. Any ineligible individuals should be removed from the health insurance coverage. This procedure for verifying the accuracy of the monthly insurance bill should be applied to current employees as well as retirees.

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<sup>5</sup> OSC, *Health Insurance for Retirees: Are Payments Being Made for Deceased Retirees?*, 2006–MS–3.

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## **Minimizing Unemployment Insurance Costs**

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In New York State, qualifications for unemployment benefits are determined by the State Department of Labor (DOL), but individual employers are responsible for funding their own programs. A study by OSC<sup>6</sup> found there were significant differences in the cost of unemployment insurance among similar local governments. In many instances, local governments can take additional steps to minimize their unemployment insurance costs.

Local officials should take steps to ensure that they are keeping unemployment insurance costs as low as possible. Below are some suggestions and steps local government and school district officials can take to minimize unemployment insurance costs.

### **Select the Most Economical Funding Method**

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Local government and school employees in New York State are covered by the State Unemployment Insurance Program except for a few excluded positions. Unlike most private businesses, governmental entities can elect to fulfill their funding obligations in one of two ways—the Tax Contribution Method or the Benefit Reimbursement Method.

#### **Tax Contribution Method**

Generally, local governments and school districts are liable for unemployment insurance on a payroll tax contribution basis similar to that used by private sector employers. Under this basis, governments pay a quarterly tax based on a percentage of the first \$8,500 earned annually by each eligible employee. The employer's tax contribution rate is set annually by DOL.

A study by OSC found there were significant differences in the cost of unemployment insurance among similar local governments.

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<sup>6</sup> OSC, *A Study of Municipal Unemployment Insurance Costs*, 2002–MR–2.

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An OSC study comparing the two payment methods found potential savings if localities selected the reimbursement method instead of the tax contribution method.

### **Benefit Reimbursement Method**

The alternative to the tax contribution method is the benefit reimbursement option. Government and school employers electing this option must reimburse the Unemployment Insurance Fund for benefits paid to eligible employees. At the end of each calendar quarter, each government or school employer is billed for the total amount of benefits charged to their account for the quarter. Many local governments, with stable work forces, use this option and have little or no unemployment costs on an annual basis.

An OSC study<sup>7</sup> comparing the two payment methods found potential savings if localities selected the reimbursement method instead of the tax contribution method. The potential savings ranged from over \$3,000 for a town with 19 employees to more than \$59,000 for a town with 59 employees. In total, for the 10 towns reviewed, the average taxes paid during the three-year period exceeded average benefits paid out by \$8,345.

Although the OSC study found that the reimbursement method was generally less costly, you will want to make a comparison to verify that this method will result in savings for your locality before switching methods. The key factor to consider when selecting the method of funding your unemployment costs is the rate of employee turnover. DOL offers guidance on who is eligible for unemployment and your responsibilities under law.

Generally, local governments and school districts wishing to use the reimbursement method must submit a written request to DOL before the beginning of the calendar year. Further information can be found on the DOL Web site at [www.labor.state.ny.us/ui/ui\\_index.shtm](http://www.labor.state.ny.us/ui/ui_index.shtm).

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<sup>7</sup> See footnote 6.

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## Managing Workers' Compensation Costs

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Workers' Compensation coverage is a mandatory benefit that you must provide to your employees. A local government can obtain workers' compensation insurance in one of four different ways:

- Purchase a policy from a private sector insurance carrier
- Obtain coverage from the State Insurance Fund
- Become self-insured as authorized by the Workers' Compensation Law
- Participate in a county self-insurance plan as authorized by the Workers' Compensation Law.

### Seek Competition

Like health insurance, it is not uncommon for a local government or school district to select a workers' compensation carrier and then rarely compare its costs with other vendors or self-insured options. Such a major expenditure of funds warrants periodic review and cost comparison. If your experience rating and other factors are good, you may find comparable coverage at a lower cost. You may even be able to obtain better policy conditions or services regardless of experience rating. As with health insurance, if you use a private carrier, check your procurement policies and procedures and if they do not currently provide for the solicitation of proposals or quotations for insurance, consideration should be given to amending the policies. Also, county self-insurance plans may offer a cost-effective option for workers' compensation coverage to local governments located within a county that has established such a plan, and coverage through the State Insurance Fund may be financially advantageous.

Like health insurance, it is not uncommon for a local government or school district to select a workers' compensation carrier and then rarely compare its costs with other vendors or self-insured options.

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If your audit indicates that the employee's duties are not properly classified or that the positions are allocated among different categories of risk, you could be paying more in premiums than is warranted.

### **Monitor Your Bill**

If you purchase a policy from a vendor, your chief fiscal officer (or other appropriate official) should review the underlying factors that went into your bill to assess the accuracy of your job classifications and the apportionment of your gross wages and salaries to those job classifications.

If your local government is a participant in the State Insurance Fund or purchases a policy from a private insurance carrier, the premium that you pay, generally, is based on a number of factors, including wages paid to employees, level of risk for each job classification, and your experience rating. There is often a periodic audit of your payroll to determine the job classification and salary allocation for workers' compensation purposes; high risk tasks, such as snow plowing, generally carry more expensive premiums. You should request and review a copy of your payroll audit. If your audit indicates that the employee's duties are not properly classified or that the positions are allocated among different categories of risk, you could be paying more in premiums than is warranted.

If your local government is a participant in a county self-insurance plan, it is important to know the method of cost apportionment and make sure that your base numbers (i.e., full valuation of real property, salaries) are accurate.

### **Prevent Accidents**

Prevention is probably the best way to keep your employees safe and to save on workers' compensation costs. Many private sector entities manage their safety programs aggressively in order to save money. Your insurance carrier or a private consulting firm can help you develop policies and procedures to make safety and accident prevention top priorities for your local government or school districts.



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## Establish Claims Procedures

Regardless of whether you purchase insurance from a private insurance company, obtain coverage through the State Insurance Fund or are self-insured, once a claim is made, you must actively monitor and manage the claim, not only to make sure that the employee gets all the medical and financial benefits he or she is entitled to, but also to make sure that your organization is not paying for unnecessary costs.

**Assemble documentation**—It is important that employees and managers understand the importance of early documentation of a work-related accident, injury or illness. When an accident or occupational illness occurs at work, paperwork may be the last item on the minds of those involved. But often memories fade or witnesses become unavailable, so it is critical to document the incident as soon as possible. The employer should make sure that the procedures are in place so that incidents are documented immediately in order to ensure that only valid, work-related claims are being paid.

**Review documentation promptly**—Upon review of the original documentation, an assessment can be made as to whether to accept a claim and begin payments for medical expenses and/or compensation, or whether to dispute/deny a claim for various reasons. The standard reasons to dispute/deny a claim are that the employer does not believe that the injury or illness was incurred in the course of employment, there is no “prima facie” medical evidence to sustain a claim, or the employer did not receive notice of the injury or illness within the specified period of time. Missing a key piece of critical information can delay this process.

**Make sure your organization is represented**—If a claim is denied, there is a hearing before an administrative law judge at the State Workers’ Compensation Board for a determination of eligibility and, possibly, the amount to be indemnified. Your interests should be represented at this hearing generally by your attorney.

**Periodically verify eligibility for benefits**—With respect to injuries to certain body parts, if an employee is determined to have a permanent partial disability, he or she may be entitled to payment of compensation in an amount based on schedules contained in the Workers’ Compensation Law. In addition, with respect to injuries that result in a person being classified, the local government or school district has the right to periodically verify eligibility of the claimant.

The employer should make sure that the procedures are in place so that incidents are documented immediately in order to ensure that only valid, work-related claims are being paid.

There is growing interest in alternate work schedules due to their potential to improve productivity, relieve traffic congestion, expand hours of service, and reduce personal service costs.

## **Overtime Planning and Management**

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Overtime wages can increase personal service costs significantly. For example, eight to 30 percent of wages paid to highway employees in New York State are for overtime. Overtime generally accrues when regular full-time employees work additional hours beyond their normal work schedule. In controlling overtime costs, there should be a written plan to guide the assignment of overtime hours in the most efficient and effective manner. When the factors that create overtime are analyzed, management may be able to take alternative action to effectively cover noncritical posts without using overtime.<sup>8</sup>

### **Alternate Work Schedules**

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There is growing interest in alternate work schedules due to their potential to improve productivity, relieve traffic congestion, expand hours of service, and reduce personal service costs. Alternate work schedules should take into consideration operational needs, employee concerns, legal and regulatory requirements and terms negotiated in union contracts. Examples of alternate work schedules include the following:

- **The five-day flex schedule** has regular start and end times but allows for changes in these times to accommodate work demands. If employees are called in before their scheduled start time, they can be asked to leave early instead of working until the end of their normal work day, thereby decreasing the occurrence of overtime.
- **The eight-hour/five-day with alternate shifts schedule** allows a local government or school district to provide additional coverage during peak times by having different shifts for different groups of employees.
- **The four and a half day schedule** allows a local government or school district to reduce overtime by working an extra hour Monday through Thursday and a half-day on Friday.

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<sup>8</sup> In implementing actions relating to overtime, keep in mind that the provisions of the federal Fair Labor Standards Act (29 USC Section 201 et seq.) may come into play, as well as collective bargaining principles under the State's Taylor Law (Civil Service Law, article 14). Information concerning the provisions of the FLSA is available on the U.S. Department of Labor's Web site <http://www.dol.gov>.

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- **The four 10-hour day schedule** allows an organization to reduce overtime by working an hour earlier and later Monday through Thursday. Local governments and school districts using this schedule must consider that overtime averted on Monday through Thursday may only offset overtime incurred on the fifth work day.
  - **Four-day, split crew schedule** provides five-day coverage but splits the crew so that half the employees work 10-hour days Monday through Thursday and the other half work 10-hour days Tuesday through Friday.

An OSC audit<sup>9</sup> of overtime costs for highway employees compared the five alternate work schedules to the eight-hour/five-day schedule and found that the nine towns examined could have saved between \$15,000 and \$159,000 in overtime wages by using one of the alternate work schedules. In addition to the direct overtime wage savings, further saving for associated costs such as the employer's share of Social Security and Medicare payroll taxes, workers' compensation premiums, and retirement costs could increase cost savings an additional 20 percent, resulting in savings between \$18,000 to an estimated \$190,000 over the three-year period examined. These options were tested with local highway departments but may also be applicable to certain aspects of other local government and school district operations.

## Conclusion

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With such a significant portion of your annual budget dedicated to employee benefits and salaries, it is important to be proactive in your approach to managing these costs.

The Office of the State Comptroller would be pleased to assist you with any questions you may have regarding the information contained in this guide. The address and telephone numbers of our regional offices are located at the end of this publication.

With such a significant portion of your annual budget dedicated to employee benefits and salaries, it is important to be proactive in your approach to managing these costs.

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<sup>9</sup> OSC, *Reducing Winter Overtime Costs for Highway Employees*, 2005–MR–5.

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## **Resources**

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For more information, the following audit reports may be of interest:

**A Study of Municipal Unemployment Insurance Costs (2002-MR-2)**

**Containing the Cost of Employer Provided Health Insurance Benefits (2003-MR-5)**

**Health Insurance for Retirees: Are Payments Being Made for Deceased Retirees? (2006-MS-3)**

**Rockland County Correctional Center Managing Overtime (2004M-49)**

**Reducing Winter Overtime Costs for Highway Employees (2005-MR-5)**

Recent OSC audits can be found by visiting <http://www.osc.state.ny.us>.

Audit reports not available on the web can be obtained by calling 518-474-6975.

## **Other Useful Web Sites:**

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<http://www.labor.state.ny.us>

<http://ww3.nysif.com> (New York State Insurance Fund)

## Division of Local Government and School Accountability

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