

**City of Niagara Falls
Financial Condition**

Report of Examination

**Period Covered:
January 1, 2015 – June 30, 2017**

2017M-170

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State of New York Office of the State Comptroller

Division of Local Government and School Accountability

August 2017

Dear City Officials:

A top priority of the Office of the State Comptroller is to help local government officials manage government resources efficiently and effectively and, by so doing, provide accountability for tax dollars spent to support government operations. The Comptroller oversees the fiscal affairs of local governments statewide, as well as compliance with relevant statutes and observance of good business practices. This fiscal oversight is accomplished, in part, through our audits, which identify opportunities for improving operations and City Council governance. Audits also can identify strategies to reduce costs and to strengthen controls intended to safeguard local government assets.

Following is a report of our audit of the City of Niagara Falls, entitled Financial Condition. This audit was conducted pursuant to Article V, Section 1 of the State Constitution and the State Comptroller's authority as set forth in Article 3 of the New York State General Municipal Law.

This audit's results and recommendations are resources for local government officials to use in effectively managing operations and in meeting the expectations of their constituents. If you have questions about this report, please feel free to contact the local regional office for your county, as listed at the end of this report.

Respectfully submitted,

*Office of the State Comptroller
Division of Local Government
and School Accountability*

Introduction

Background

The City of Niagara Falls (City) is located in Niagara County and encompasses approximately 17 square miles. The City is governed by its Charter, State statutes and local laws. The City Council (Council), composed of five elected members, has legislative responsibility for the City's operations. The Mayor, along with the City Administrator and department heads, is responsible for managing City operations. The appointed City Controller (Controller) is the City's chief fiscal officer. The City's adopted general fund budget for 2017 was approximately \$93 million, financed primarily with real property taxes (\$33 million), sales tax (\$20.9 million), State aid (\$19 million) and casino revenue (\$11 million).

In 2002, the State entered into a compact with the Seneca Nation of Indians (Nation) for the Nation to establish three gaming facilities in western New York, including a facility in the City. The compact stated that the Nation would have exclusive rights over gaming devices, including slot machines, within a specified geographic area. The initial term was for 14 years, with an option to renew. The Nation agreed to pay the State 18 to 25 percent of the proceeds from the gaming devices, depending on the year of the compact. In turn, the State agreed to pay a percentage of these funds (at least 25 percent) to the City. The City accounts for these proceeds in a separate fund.

In 2013, the compact was extended to 2023. However, the compact's section concerning the revenue sharing requirements was left unchanged. In 2017, the Nation announced that it would no longer make casino revenue payments to the State after the initial 14-year term expired. While the Governor's office contends that the Nation has a financial obligation to continue making these payments, an agreement has not been reached.

Objective

The objective of our audit was to review the City's financial condition. Our audit addressed the following related question:

- Do the Mayor and Council ensure that budgets are realistic and balanced?

Scope and Methodology

We examined the City's financial condition for the period January 1, 2015 through June 30, 2017. We also determined whether City officials took corrective action¹ in response to our prior audit report from 2013,² and we evaluated operating results for 2013 and 2014.

¹ As it related to our current audit objective.

² 2013M-47-*Financial Management and Information Technology*, May 2013

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We conducted our audit in accordance with generally accepted government auditing standards (GAGAS). More information on such standards and the methodology used in performing this audit are included in Appendix B of this report.

Comments of City Officials and Corrective Action

The results of our audit and recommendations have been discussed with City officials, and their comments, which appear in Appendix A, have been considered in preparing this report.

The Council has the responsibility to initiate corrective action. A written corrective action plan (CAP) that addresses the findings and recommendations in this report should be prepared and forwarded to our office within 90 days, pursuant to Section 35 of General Municipal Law. For more information on preparing and filing your CAP, please refer to our brochure, *Responding to an OSC Audit Report*, which you received with the draft audit report. We encourage the Council to make this plan available for public review in the City Clerk's office.

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Financial Condition

The Mayor, Council and City Controller have a shared responsibility for managing and maintaining the City's fiscal health. To do so, City officials must develop and adopt accurate and reasonable budgets in which recurring revenues are able to fund recurring expenditures. Additionally, officials should actively monitor available fund balance and cash balances to ensure neither is depleted to dangerously low levels. By policy, the City's goal is to maintain unrestricted fund balance of 5 percent of budgeted general fund appropriations.

In our prior audit,³ we recommended the Mayor and Council develop realistic budgets and adopt a multiyear financial plan. Our prior audit also discussed the use of casino revenue to balance the budget. However, the City did not maintain a multiyear financial plan and has continued to rely on unreliable revenues and one-time funding sources. From fiscal years 2014 through 2017, City officials balanced the budget using primarily casino revenue, averaging \$9 million, and fund balance, averaging \$2.9 million. By the end of 2017, the City will deplete available fund balance. This, combined with the loss of casino revenue, could result in a general fund budget gap of \$12 million for the 2019 fiscal year. If the current dispute with the Nation is not resolved positively for the City, City officials will have to make difficult choices to achieve some combination of reduced expenditures and increased revenues.

Operating Results and Fund Balance

Sound budgeting practices ensure that appropriations are funded with recurring revenues and that fund balance serves as a financial cushion for unexpected events and maintaining cash flow. City officials must also ensure that the level of fund balance maintained is sufficient to provide adequate cash flow and hedge against unanticipated expenditures and revenue shortfalls. A continuous decline in fund balance may indicate a deteriorating financial condition. While fund balance can be appropriated in the budget to help finance operations, consistently doing so – instead of planning to use recurring revenue sources – can deplete fund balance to levels that are not sufficient for contingencies and cash flow.

During fiscal years 2014 through 2017, the City's general fund expenditures⁴ ranged from \$90.8 million (2015) to \$96.2 million (2017-projected) and averaged almost \$94 million annually. Over the same period, recurring revenues have been averaging \$79 million annually, leaving a gap between revenues and expenditures of approximately \$15 million annually. The City funded this gap by using casino revenue and fund balance. The Controller accounts for casino revenue in a separate fund. Each year, City officials budget and transfer a portion of casino revenue from this fund to the general fund.⁵ Since 2013, the amount of casino money in this fund has decreased 42

³ 2013M-47-*Financial Management and Information Technology, May 2013*

⁴ Includes risk retention, tourism and grant fund expenditures, as these funds are combined under the general fund for reporting purposes in the City's audited financial statements.

⁵ The Controller also makes disbursements to other funds and entities as needed or required.

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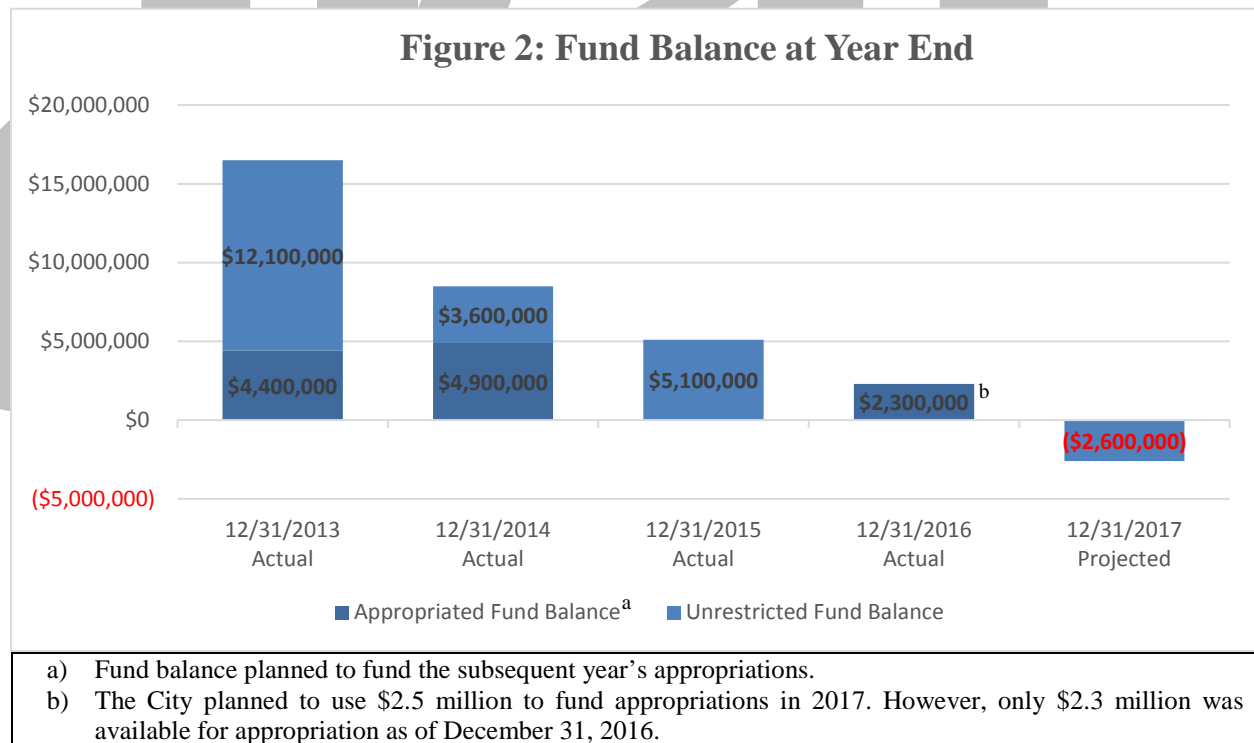
percent, from \$43.9 million to \$25.4 million as of May 31, 2017. Moreover, by appropriating fund balance, City officials planned to have an operating deficit in the general fund (Figure 1).

Figure 1: General Fund Operating Results and Use of Casino Revenue

	2014 Actual	2015 Actual	2016 Actual	2017 Projected
Real Property Taxes	\$31,100,000	\$33,000,000	\$31,200,000	\$33,000,000
Other Revenues	\$47,900,000	\$46,500,000	\$47,700,000	\$47,200,000
Total Recurring Revenues	\$79,000,000	\$79,500,000	\$78,900,000	\$80,200,000
Total Expenditures	\$93,100,000	\$90,800,000	\$92,700,000	\$96,200,000
Funding Gap	(\$14,100,000)	(\$11,300,000)	(\$13,800,000)	(\$16,000,000)
Casino Revenue – Interfund Transfer	\$6,600,000	\$7,500,000	\$12,300,000	\$11,100,000
Reduction in Fund Balance ^b	(\$7,500,000)	(\$3,800,000)	(\$3,300,000) ^a	(\$4,900,000)

a) Includes a general fund interfund receivable of \$1.8 million due from the community development fund that was written off in 2016.
b) Includes restricted and nonspendable fund balance

By the end of 2017, the City will deplete unrestricted fund balance.⁶ The annual operating deficits have reduced fund balance available for appropriation as a financing source in the annual budget from \$16.5 million at the start of 2014 to \$2.3 million at the end of 2016, a reduction of \$14.2 million (86 percent). We estimate that unrestricted fund balance will be a deficit of \$2.6 million as of December 31, 2017 (Figure 2).



⁶ Excluding nonspendable fund balance (averaging \$2 million) and restricted fund balance (averaging \$3.3 million).

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The failure to identify additional recurring revenue sources to fund operations resulted in a reduction in fund balance to an amount well below the City policy's 5 percent goal. Also, the City could lose the ability to balance the budget with casino revenue if the current dispute is not resolved positively.

Casino Revenue Used to Finance Operations

The City's casino revenue is an unreliable financing source. Previously, in 2009, there was an impasse with the Nation regarding exclusivity rights which was not resolved until 2013. During this time, the Nation suspended payments to the State and the State suspended payments to the City. This led to an unrestricted fund balance deficit. Given the prior impasse with the Nation, City officials should have reduced the amount of casino revenue used to fund routine appropriations, instead of increasing reliance on it to balance the budget.

The amount of casino revenue the City received annually has declined from \$14.2 million in 2013 to \$12.3 million in 2016 (13 percent).⁷ However, the City has used increasing amounts of casino revenue to finance general fund operations rather than develop other recurring revenue sources. From fiscal years 2014 through 2017, the City's use of casino revenue to help balance the general fund's budget increased from \$6.6 million in 2014 to a projected \$11.1 million in 2017. The highest amount of casino revenue used was \$12.3 million in 2016. City officials budgeted additional casino revenue in 2016 (\$6.5 million) and 2017 (\$5.2 million), which allowed them to avoid a significant tax levy increase. The additional use of casino revenue coincided with the elimination of appropriated fund balance from the 2016 budget.

Due to the current impasse with the Nation, it is uncertain whether the City will receive any future casino revenue. Therefore, it is imperative that City officials take immediate action to address the City's fiscal problems.

Current Balance and Projected Use of Casino Revenue

As of May 31, 2017, the City had \$25.4 million of casino revenue available. The City budgeted approximately \$11.1 million of this amount to finance 2017 general fund appropriations. The City also designated \$3.3 million for various other projects and purchases. We estimate that by December 31, 2017, the City will have \$11 million of casino revenue remaining. City officials do not anticipate receiving any additional money under the current compact.

Due primarily to recently negotiated collective bargaining agreements, we conservatively project that 2017 general fund expenditures will be at least \$2 million over the adopted budget. This will deplete unrestricted fund balance by year end. City officials indicated that they plan to use casino revenue in the 2018 budget. However, the actual amount will be determined during the budget process. If the City includes at least the \$9 million average, it will nearly deplete the remaining casino revenue by the end of the 2018 fiscal year. City officials have not developed a plan to

⁷ This amount excludes non-discretionary expenses that the City must pay from casino revenues received.

transition away from using casino revenue to balance the budget. In fact, instead of cutting back, City officials increased the amounts of casino revenue to balance the budgets in recent years. Therefore, unless the City makes significant reductions to budgeted appropriations and/or finds additional recurring revenue sources, we anticipate a budget gap totaling approximately \$12 million in 2019 and subsequent years.

The City's ability to generate additional revenue from its major sources is limited. The City exhausted 81 percent of its constitutional tax limit⁸ in 2017 and can only increase the annual levy by \$5.5 million before it reaches the limit. This increase will not be sufficient to fund the budget gap. Also, the amount of State aid and sales tax revenue the City receives is largely dependent on factors beyond officials' control, and increases in these revenues over the last four fiscal years have been negligible.

Multiyear Financial Plan

As recommended in our prior audit, multiyear financial planning is a tool City officials can use to improve the budget development process. Comprehensive multiyear financial planning should consider operating and capital needs and financing sources over an extended period. Planning on a multiyear basis enables officials to identify developing revenue and expenditure trends, establish long-term priorities and goals, and consider the impact of one-time financing sources or other short-term budgeting decisions on future fiscal years. Any long-term financial plan must be monitored and updated on a continuing basis to provide a reliable framework for preparing budgets and to ensure that information used to guide decisions is current and accurate.

City officials did not develop a multiyear financial plan. Had such plans been developed, City officials would have had a valuable resource that would have allowed them to make more informed financial decisions. For example, such a plan would have shown the magnitude of the impact of the loss of the casino revenue and provided a tool to assess the impact of different approaches to using the balance of the funds on hand. This may have mitigated the City's declining financial condition. Going forward, developing a financial plan would be a useful tool for the officials to ensure that recurring revenue sources are sufficient to finance operations. This will help to rebuild fund balance and subsequently maintain a reasonable level of unrestricted fund balance at year end.

Recommendations

City officials should:

1. Adopt realistic budgets in which recurring expenditures are funded by recurring revenues.
2. Rebuild unrestricted fund balance in accordance with the City's policy.

⁸ The constitutional tax limit is the maximum amount of real property tax that may be levied in any fiscal year. It is computed by multiplying the value of taxable real property by a certain percentage enumerated in the State Constitution.

3. Develop and regularly update a comprehensive written multiyear financial plan that includes realistic measures for rebuilding fund balance levels.

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APPENDIX A

RESPONSE FROM CITY OFFICIALS

The City officials' response to this audit can be found on the following page(s).

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APPENDIX B

AUDIT METHODOLOGY AND STANDARDS

To achieve our audit objective and obtain valid evidence, we performed the following procedures:

- We reviewed the City Charter, City Code and any policies and procedures for information relevant to financial and budgeting activities, including certain City officials' responsibilities.
- We interviewed City officials to determine what processes were in place and gain an understanding of the City's financial situation and budget.
- We reviewed and analyzed financial records and reports for all funds, including balance sheets, budget reports, and statements of revenues and expenditures.
- We requested to review the City's multiyear financial plan to determine whether it was adequate.

We conducted this performance audit in accordance with GAGAS. Those standards 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 objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

APPENDIX C

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APPENDIX D
OFFICE OF THE STATE COMPTROLLER
DIVISION OF LOCAL GOVERNMENT
AND SCHOOL ACCOUNTABILITY

Andrew A. SanFilippo, Executive Deputy Comptroller
Gabriel F. Deyo, Deputy Comptroller
Tracey Hitchen Boyd, Assistant Comptroller

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