

OFFICE OF THE NEW YORK STATE COMPTROLLER



DIVISION OF LOCAL GOVERNMENT
& SCHOOL ACCOUNTABILITY

City of Niagara Falls

Financial Management and Information Technology

Report of Examination

Period Covered:

January 1, 2009 — January 9, 2013

2013M- 47



Thomas P. DiNapoli

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State of New York Office of the State Comptroller

Division of Local Government and School Accountability

May 2013

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 Management and Information Technology. 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 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.

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



State of New York Office of the State Comptroller

EXECUTIVE SUMMARY

The City of Niagara Falls (City) is located in Niagara County and encompasses approximately 17 square miles. The City is governed by its Charters and other laws of the State of New York (State). The City Council (Council), consisting 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 chief fiscal officer of the City. The City's adopted general fund budget for 2012 was approximately \$86.3 million, and for 2013 was \$81.4 million, financed primarily with real property taxes, State aid, sales tax and fees for services. The City also has funds to account for tourism, parking, golf, risk retention, debt service, capital projects, community development, and tribal revenue, as well as funds associated with component units and internal service functions.

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 Nation was 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 was to pay a percentage of these funds (at least 25 percent) to the City. In 2009, a dispute arose between the State and the Nation regarding these exclusivity rights. The Nation suspended payments to the State and the State suspended payments to the City. City officials anticipated the dispute to be settled quickly and began to use fund balance to finance expenditures planned for the casino funds and certain general fund expenditures they deemed to be associated with the casino. The dispute has continued and the City has spent down its fund balance.

The City has approximately 400 personal computers and 100 laptop computers. The City uses a financial management system for its general ledger, accounts payable, payroll, human resources, and billing and collection functions. The City has an Information Technology (IT) Department with a Director of Management Information Systems, who supervises three other employees. In addition, the police department has a separate network administrator that oversees its IT systems. This individual does not report to the central IT Department.

Scope and Objective

The objective of our audit was to review the City's financial condition, the recording of financial activity, and the information technology environment for the period January 1, 2009, to January 9, 2013. We also obtained certain financial information subsequent to the end of field work. Our audit addressed the following related questions:

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

- Does the Controller properly record financial activity?
- Are City officials adequately safeguarding IT assets?

Audit Results

We found that the City has had a pattern of structural budget deficits, meaning recurring revenues were not sufficient to fund recurring expenditures. During our audit period the general fund's annual budget gap averaged \$12.4 million.

One cause of this structural deficit was that casino moneys have not been received since 2008, yet the City continued to budget for these revenues. When the dispute between the State and the Nation over the casino payments first occurred in 2009, it might have been prudent for the City to initially maintain established service levels while anticipating that the dispute might be quickly settled. However, as the dispute dragged on without a resolution, the City should have removed these revenues from its budget in order to protect the City's financial position.

The City has funded these structural deficits by relying on "one-shots" such as fund balance and surplus moneys remaining in the capital projects fund. This approach has negatively affected the general fund's financial condition. The City began 2009 with unassigned fund balance totaling \$16.4 million in the general fund. The Controller indicated that the general fund ended the 2012 fiscal year with an unassigned fund balance deficit of approximately \$5.2 million.¹ Therefore, over this four-year period, fund balance decreased by about \$21.6 million.

The Controller estimates that the City will need to issue short-term debt to address cash flow problems late in 2013. In addition, the City's credit rating, which was already downgraded in January 2013, may be reduced further, possibly resulting in the City being unable to issue debt at a reasonable cost or altogether.

The Controller has accounted for a substantial amount of unassigned fund balance in the capital projects and debt service funds. Since the general fund is expected to report a deficit as of December 31, 2012, these surplus funds should be used to improve the financial stability of the general fund.

Although City management has implemented policies and procedures for IT, including a computer use policy, they have not implemented adequate controls and restrictions over user access to the financial system. Further, City management has not developed adequate procedures for data backup and storage, or a comprehensive disaster recovery plan. As a result of these control weaknesses, the City's IT assets are at an increased risk of possible theft or compromise by intentional or unintentional manipulation or corruption. Without adequate and tested processes for backing up and restoring lost data in the event of a disaster, the City is also at risk of potentially costly disruptions to critical operations.

¹ These balances do not include incorrectly recorded capital projects fund balance that is discussed in the section of the report entitled Recording Financial Activity. Once the funds are transferred from the capital projects fund to the general fund, the reported deficit at December 31, 2012, will be reduced.

Comments of Local Officials

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. City officials generally agreed with the findings and indicated they either plan to initiate, or already have taken, corrective action. Appendix B includes our comments on issues raised in the City's response letter.

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 Charters² and other laws of the State of New York (State). The City Council (Council), consisting 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 chief fiscal officer of the City. The City's adopted general fund budget for 2012 was approximately \$86.3 million, and for 2013 was \$81.4 million, financed primarily with real property taxes, State aid, sales tax and fees for services. The City also has funds to account for tourism, parking, golf, risk retention, debt service, capital projects, community development, and tribal revenue, as well as funds associated with component units and internal service functions.

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 was 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 was to pay a percentage of these funds (at least 25 percent) to the City.

Section 99-h of State Finance Law regulates how casino revenue is to be used by local governments. The City may spend casino revenue on economic development, neighborhood revitalization, public health and safety, and infrastructure improvement in the City. During our audit period and prior, the City used anticipated casino revenue³ to fund certain general fund appropriations. These included increases in debt service payments since 2005, certain public safety costs, salaries of economic development employees, and an amount the City calculates as lost property taxes from parcels that are no longer taxable as Nation property.

In 2009, a dispute arose between the State and the Nation. The Nation contends that the State allowed prohibited gaming facilities within the Nation's exclusive geographic area. The Nation suspended payments

² The City has more than one Charter that governs operations.

³ The City did not receive casino revenue during our audit period. However it has maintained records accounting for the amounts due to the general fund from the tribal revenue fund, to be repaid if the City receives casino revenue.

to the State and the State suspended payments to the City. City officials anticipated the dispute to be settled quickly and began to use fund balance to finance expenditures planned for the casino funds and certain general fund expenditures they deemed to be associated with the casino. The dispute has continued and the City has spent down its fund balance.

The City has approximately 400 personal computers and 100 laptop computers. The City uses a financial management system for its general ledger, accounts payable, payroll, human resources, and billing and collection functions. The City has an Information Technology (IT) Department with a Director of Management Information Systems, who supervises three other employees. In addition, the police department has a separate network administrator that oversees its IT systems. This individual does not report to the central IT Department.

Objective

The objective of our audit was to review the City's financial condition, the recording of financial activity, and the IT environment. Our audit addressed the following related questions:

- Do the Mayor and Council ensure that budgets are realistic and structurally balanced?
- Does the Controller properly record financial activity?
- Are City officials adequately safeguarding IT assets?

Scope and Methodology

We examined the City's financial condition, the recording of financial activity, and the IT environment for the period January 1, 2009, to January 9, 2013. Information was obtained from prior years when necessary to complete our audit objective. We also obtained certain financial information subsequent to the end of field work. Our audit disclosed areas in need of improvement concerning IT controls. Because of the sensitivity of this information, certain vulnerabilities are not discussed in this report but have been communicated confidentially to City officials so they could take corrective action.

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 C of this report.

Comments of Local 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. City officials generally agreed with the findings and indicated they either plan to initiate,

or already have taken, corrective action. Appendix B includes our comments on issues raised in the City's response letter.

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 the 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 Board to make this plan available for public review in the City Clerk's office.

Financial Condition

Financial condition may be defined as a city's ability to balance recurring expenditures with recurring revenues, while providing desired services on a continuing basis. In order to maintain a city's financial health, it is essential that officials develop reasonable budgets and manage fund balance responsibly. City officials also should develop detailed multiyear plans to allow them to set long-term priorities and work toward goals, rather than making choices based solely on more immediate needs.

We found that the City has had a pattern of structural budget deficits, meaning recurring revenues were not sufficient to fund recurring expenditures. During our audit period (2009 through 2013 budgets) the general fund's budget gap averaged \$12.4 million. City officials balanced the budgets using fund balance and an estimate for casino revenue that averaged \$5.3 million annually.

One cause of this structural deficit was that casino moneys have not been received since 2008, yet the City continued to budget for these revenues. The Mayor stated that these revenue estimates remained in the budget to demonstrate confidence that the dispute between the State and the Nation would conclude and result in the City receiving its share of casino revenue. When the dispute first occurred in 2009, it might have been prudent for the City to initially maintain established service levels while anticipating that the dispute might be quickly settled. However, as the dispute dragged on without a resolution, the City should have removed these revenues from its budget in order to protect the City's financial position. Instead, as of December 31, 2012, the City incurred, in the aggregate, \$23.4 million⁴ in expenditures intended to have been funded with casino moneys that they have not received.

While the lack of casino revenues affected the City's structural deficits, it should be stressed that, even if the City had reduced its appropriations by over \$5 million to account for the lost casino payments, the City would still have a structural deficit of approximately \$7 million. This deficit equates to about 9 percent of the City's 2013 general fund budget of approximately \$81 million, which is a decrease from the 2012 spending plan.

⁴ This amount includes \$17.3 million from the general fund, \$150,000 from the tourism fund, and a \$5.9 million deficit fund balance in the tribal revenue fund. The Controller maintains a schedule, separate from the accounting records, to account for this activity.

The City has funded these structural deficits by relying on “one-shots” such as fund balance and surplus moneys remaining in the capital projects fund. This approach has significantly affected the general fund’s financial condition. The City began 2009 with unassigned fund balance totaling \$16.4 million in the general fund. The Controller indicated that the general fund ended the 2012 fiscal year with an unassigned fund balance deficit of approximately \$5.2 million.⁴ Therefore, over this four-year period, fund balance decreased by about \$21.6 million.

Although the City’s fund balance has been depleted, the City continued to budget for one-shot revenues. In the 2013 budget, in addition to \$2 million of unavailable appropriated fund balance, the City budgeted for the following one-shots: transfers from the capital projects fund of \$2.9 million, transfers from the debt service fund of \$850,000, and property sale revenue of \$1 million. The City’s adopted 2013 general fund budget has a structural deficit of \$12 million. Therefore, if the City does not receive any or an insufficient amount of casino revenue in 2013, it will have a revenue shortfall of approximately \$7.2 million, representing the budgeted casino revenues and the unavailable appropriated fund balance. Moreover, even with a resolution of the casino revenue impasse that would positively impact the City, the Council and Mayor will still need to take action to address the structural budget deficits affecting the City.

Due to these factors, we anticipate significant cash flow shortfalls in 2013. The Controller estimates that the City will need to issue short-term debt to address cash flow problems late in 2013. In addition, the City’s credit rating, which was already downgraded in January 2013, may be reduced further, possibly resulting in the City being unable to issue debt at a reasonable cost or altogether.

While the City has been significantly affected by the casino revenue impasse, its financial condition has worsened significantly due to its budgeting practices. The City also has not prepared a multi-year financial plan since the 2010 fiscal year. The Controller stated that the City stopped preparing multiyear financial plans when it was no longer a requirement to continue receiving State Aid for Municipalities (AIM). However, it is especially important for a city with financial difficulties to prepare such multiyear plans to develop a plan for eliminating accumulated deficits.

⁴ These balances do not include incorrectly recorded capital projects fund balance that is discussed in the section of the report entitled Recording Financial Activity. Once the funds are transferred from the capital projects fund to the general fund, the reported deficit at December 31, 2012, will be reduced.

Recommendations

1. The Mayor and Council must develop structurally sound and realistic budgets.
2. City officials should prepare and adopt a multiyear financial plan.

Recording Financial Activity

According to the City Charter, it is the responsibility of the Controller, as chief fiscal officer, to supervise the preparation of financial statements and to ensure that financial activity is accounted for correctly. The City's capital projects fund includes a significant amount of financial activity that must be accounted for and reported appropriately. Capital projects should be accounted for separately to ensure that the funds allocated by Council action are used only for the specified purpose. Once a project is completed, it should be closed and any unexpended balance disposed of, based upon the source of the project's funding. Unexpended funds originating from bonds or from multiple sources, which include debt proceeds, should be transferred to the debt service fund and used only for payments on the related debt. If all related debt is retired, any unexpended funds may be used for any lawful purpose and, as such, should be transferred out of the debt service or capital projects fund.

The Controller has accounted for a substantial amount of unassigned fund balance in the capital projects fund. As of December 31, 2012, the balance of these funds was \$7.1 million, of which \$2.9 million will be transferred to the general fund in 2013. The Controller indicated that this represents moneys remaining from completed capital projects where the related debt is retired. The Controller also stated that she was aware that these moneys should be returned to the general fund as unassigned, but was reluctant to do so, expecting that City officials would use these moneys in their entirety to reduce the tax levy or increase appropriations.

Beyond the amount reported as unassigned fund balance in the capital projects fund, additional funds may remain in other projects which should also be returned to the general fund. As of the end of our fieldwork, City officials were unable to demonstrate, and we were unable to definitively establish, the total amount of these other moneys. However, based on our review of the records, we conservatively estimate that the amount could range from \$1 million to \$1.4 million.

Furthermore, the City has maintained unassigned fund balance in the debt service fund, which should have been transferred to the general fund. The Controller stated that transfers were made to the debt service fund in error prior to her time as Controller. The City has appropriated these funds for the general fund budget over the past few years. As of December 31, 2012, after considering the amount appropriated in the adopted 2013 budget, the Controller estimates that no unassigned fund balance will remain in the debt service fund.

Since the general fund is expected to report a deficit as of December 31, 2012, these surplus funds should be used to improve the financial stability of the general fund.

Recommendation

3. The Mayor should ensure that the Controller determines the status of each capital project, whether open or complete, and dispose of any unexpended moneys in accordance with relevant statutory provisions.

Information Technology

City officials rely on the IT system to maintain financial data, process transactions, access the Internet, communicate by email, and report to State and Federal agencies and the general public. The potential consequences of a system failure can range from inconvenient to severe. Computerized personal data can also be a potential liability to the City if it is lost or improperly disclosed. Accordingly, City management (which includes the Council, Mayor, other officials, and department heads) is responsible for establishing policies and procedures and implementing internal controls to safeguard the City's valuable IT assets, including computer data, equipment, and systems.

Although City management has implemented IT policies and procedures, including a computer use policy, they have not implemented adequate controls and restrictions over user access to the financial system. Further, City management has not developed adequate procedures for data backup and storage, or a comprehensive disaster recovery plan. As a result of these control weaknesses, the City's IT assets are at an increased risk of possible theft, or compromise by intentional or unintentional manipulation or corruption. Without adequate and tested processes for backing up and restoring lost data in the event of a disaster, the City is also at risk of potentially costly disruptions to critical operations.

Financial System Access

Effective access controls prevent users from being involved in multiple aspects of financial transactions and from accessing unauthorized areas where they can intentionally or unintentionally change or destroy critical data. The proper segregation of payroll, human resources, and accounts payable duties within the IT environment is an essential internal control to ensure that no one employee performs key aspects of payment processing, such as adding new vendors or employees to the City's computer system, entering disbursements or payroll information, and processing checks. Compensating controls can limit the risks associated with inadequate segregation of duties. For example, someone independent of the payroll or accounts payable process can be designated to perform a review of all new employees and vendors added to the system. Audit logs also help to monitor system access.

Access Rights – While cross-training on certain applications is necessary, the ability to perform these functions should be assigned only in the absence of the person primarily responsible for each function. Furthermore, the granting of financial software permissions,

whether permanent or temporary, should be done only with the written consent of City department heads and carried out by a system administrator who is not directly involved with the financial operations of the City. City officials have not developed policies and procedures to safeguard against unauthorized access to the City's financial data. We interviewed City officials regarding the access rights and found that users had access to routines that were not necessary to perform their job duties. In addition, during our audit period, the Controller, a Senior Auditor, and the System Administrator had administrative access to the financial software. Although the System Administrator primarily added new users, the Senior Auditor assigned their access to specific account codes. The assignment of financial system access to numerous employees in excess of their job duties, without mitigating controls, increases the risk of unauthorized access and intentional or unintentional changes that could be detrimental to the City.

Audit Log – An audit log is a computer-generated monitoring tool that provides information such as the date and time a user accesses a program, the transaction or activity that occurred, and the time and date of the user's logoff. Maintaining and regularly reviewing audit logs for the financial software enables City officials to determine who is accessing the program and whether the transactions processed are appropriate, and to trace questionable system activity. City officials stated that the financial software did not create an audit log and, therefore, they had no means of detecting inappropriate transactions and identifying the users responsible.

Data Backup

A strong system of internal controls includes a system to back up (create a copy of) computer-processed data. Good business practices require City officials to run daily backups, keep the backup data as current as possible, and store the data at an environmentally and physically secure offsite location for retrieval in case of an emergency.

City management has not adopted comprehensive data backup policies and procedures for computer-processed data. Although City officials perform a daily backup of data files to a tape, they do not store the backup tape in a secure offsite location for retrieval in case of an emergency, but instead store the backup tapes on City premises in a vault on another floor of the building. While the vault provides a limited level of security, storing the backup tape on site subjects the backup data to the same risks (disasters) as the original data and does not appropriately address the purpose of a backup control procedure.

Disaster Recovery

A formal disaster recovery plan includes policies and procedures to help prevent or minimize the loss of computer equipment and data, and to guide recovery in the event of an actual loss. Even small disruptions in electronic data systems can require extensive effort

and cost to evaluate and repair. Therefore a disaster recovery plan should include precautions to minimize the effects of a disaster so that City officials can maintain or quickly resume critical functions. The plan may also include a significant focus on disaster prevention.

The Council has not adopted a comprehensive disaster recovery plan. In the event of a disaster, City personnel have no guidelines to follow to prevent the loss of equipment and data, and no procedures for data recovery. This could lead to the loss of important financial data and serious interruptions to City operations, such as not being able to process checks to pay vendors or employees.

Recommendations

4. City management should establish policies and procedures for access controls to restrict financial software permissions to only those functions that are necessary for employees' job duties.
5. City management should designate someone independent of the Controller's office operations as the City's financial system administrator.
6. City management should ensure that logs for the financial system are maintained and periodically reviewed.
7. City management should establish policies and procedures for data backup and storage, and comprehensive guidelines for disaster recovery.

APPENDIX A
RESPONSE FROM LOCAL OFFICIALS

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



City of Niagara Falls, New York

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Paul A. Dyster
Mayor

May 3, 2013

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Buffalo Regional Office
Division of Local Government and School Accountability
State of New York
Office of the State Comptroller

Dear

This letter is offered as comment to the preliminary draft findings presented to the City of Niagara Falls in the exit discussion of April 5, 2013 and in the document "City of Niagara Falls Financial Management and Information Technology Report of Examination 2013M-47 (the "Report")." It was prepared with input from the offices of the City Controller and Corporation Counsel.

We want to thank you for your hard work and insight on the issues covered in the draft report, and for your willingness to discuss its preparation and preliminary conclusions in the exit interview and subsequent conversations. As per your request, we have kept the information contained in the report confidential pending formal release of the report of examination from Albany. Given the pendency of certain matters related to the issue of delay in the receipt of casino revenues, we continue to have a strong concern about the timing of the release of the final report and possible unintended impacts on the ongoing processes of arbitration and/or negotiation of a settlement. We therefore ask that you continue to consult us as the date of release of final report is finalized.

As regards the section of the report dealing with Information Technology we are in general agreement with the thrust of the report and are in the process of drafting an appropriate action plan in response. We note that this report contains information on computer security that may be exempt from disclosure under the Freedom of Information Act, and will treat both the report and our response accordingly.

With respect to that portion of the Report dealing with "Financial Condition," we would like to note that much of the subject matter of the report deals with circumstances impacting the City's finances that are either direct or indirect consequences of the multi-year delay in the delivery of tens of millions of dollars owed the City as host of the Seneca Nation of Indians' Seneca Niagara

Casino. This situation is virtually unprecedented in the history of New York State, and almost entirely beyond the control of the City of Niagara Falls. The City has been forced to choose among largely bad options with little guidance as to what constitutes best practice under often unique circumstances. Given the State's degree of involvement and responsibility in this matter, we find it somewhat ironic that an agency of the State of New York would now find itself in a position to critique our attempts to deal with a crisis in which the State itself has been a central actor.

See
Note 1
Page 22

For example, we would like to note that the City felt it had little choice but to prepare its budgets factoring in Casino Revenues, in order to support the position of the State of New York that the dispute between the State and the Seneca Nation of Indians would conclude with a favorable decision for the State, causing the Senecas to release Casino Revenues to the State, with the State then remitting payment to the City. The City has been assured regularly by the State that the State will prevail in arbitration or settlement. To have done otherwise would have been to send the wrong message to anyone paying attention to this scenario, including rating agencies and the Seneca Nation itself. Although not currently booked as such, make no mistake: the City views the Casino Revenues as an account receivable.

The Report goes on to take issue with the City funding certain structural deficits by relying on "one-shots." The City's strategy should not be characterized in this way. Large fund balance surpluses remaining from Capital Projects, as well as from the General Fund, have been used time and again (year after year) in order to close deficits. Had the City not used those surpluses, they would have sat on the books and accomplished no purpose.

A large surplus in the General Fund was generated from certain activities that were not budgeted, such as increases in Aid and Incentives to Municipalities (AIM) and the sale of some City streets to the Seneca Casino. This large surplus was well above the recommended amount of 5% of budget that has been suggested as acceptable by the Office of the New York State Comptroller. Therefore, the City used those dollars to close deficits.

See
Note 2
Page 22

It should also be noted that the use of General Fund balance was done in accordance with one of the criteria in AIM that it be used for property tax relief, and this criteria was incorporated into budgets for the years 2010, 2011 and 2012. This was done for AIM's intended purpose and pursuant to a multi-year financial plan.

Use of both Capital and General Fund balance should not be characterized as a "one-shot" as it was projected over multiple years in decreasing amounts each year. A "one-shot" is normally referred to as a large revenue being placed in a budget without having that same recurring revenue in subsequent years. This is not what the City did, and therefore it should not be criticized for using "one-shots" to balance its budget.

With respect to multi-year financial plans, it should be pointed out that the City did develop its own multi-year financial plans. These plans may not have been in the AIM format (and were not required to be), but financial plans were developed and did address issues such as the utilization of Casino Revenues, General Fund balance and Capital Fund balance.

See
Note 3
Page 22

With respect to that portion of the Report dealing with "Recording Financial Activity," it was pointed out that surplus funds remaining from capital projects should be returned to the General Fund. This is precisely what the City did, and did pursuant to multi-year financial planning. The Report goes on to mention that City officials were unable to demonstrate the total amount of unassigned fund balance in capital projects which could be returned to the General Fund. It should be pointed out that the City Controller's office would have no knowledge of the status of various projects and whether they have been concluded and whether there are dollars to transfer. This information would be more the purview of the Engineering Department, which faced severe challenges in making such determinations. First, it should also be noted that the failure of the Seneca Nation of Indians to pay the City the Casino Revenues it is owed has caused the City a severe cash flow hardship. It was, therefore, necessary to be able to keep some capital cash resources available to provide funding for "related" capital emergencies. Surplus remaining from closed capital projects was one of few such cash resources. Second, there have been projects that have been unable to be concluded because of the lack of necessary and timely input from third parties, including State agencies. Excess funds in those situations would be required to be retained to deal with issues presented at the end of the process. Finally, some major capital projects underway during this period concluded or are likely to conclude with lawsuits between the City and contractors. Again, this makes it difficult to "close out" projects and determine when it is safe to return funds to the General Fund. For example, since the exit interview, the FBI, U.S. Department of Labor and U.S. Department of Transportation executed search warrants at the Buffalo and Salamanca offices of the contractor on the large Lewiston Road project; the result of this investigation is still pending, as is the result of the City's lawsuit against the contractor for damages totaling over \$4 million.

See
Note 4
Page 22

It should be pointed out that there is not appropriated fund balance in the 2013 budget from the debt service fund.

See
Note 5
Page 22

The Report states that the General Fund is expected to report a deficit as of December 31, 2012 and that surplus funds should be used to improve the financial stability of the General Fund. This did take place. There was a transfer that was made. The excess remaining fund balance in Capital Fund was transferred to the General Fund as of December 31, 2012 to decrease the operating deficit.

See
Note 6
Page 22

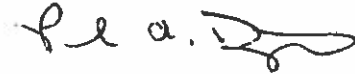
The Report recommends that "the Mayor should ensure that the Controller determines the status of each capital project, whether open or complete and dispose of any unexpended monies in accordance with relevant statutory provisions." It should be pointed out that the Controller provides the Mayor with reports every month, and provided copies of those reports to the State Comptroller's office when it was doing its field work. It should also be pointed out that the Controller is dependent upon input from the Engineering Department as to the status of capital projects. The Controller only knows when a project has been completed because of specific input or guidance from the Engineering Department.

See
Note 4
Page 22

We hope you will consider this input as you prepare your final version of the Report. Once again, thank you for your hard work under some difficult circumstances in preparing the draft report. We hope that early resolution of the casino revenues issue will put the City back into a

more normal state of fiscal affairs, and allow us to demonstrate once more that, given half a chance, we can manage our financial affairs intelligently and responsibly.

Sincerely,

A handwritten signature in black ink, appearing to read "P. A. Dyster", with a stylized flourish at the end.

Paul A. Dyster
Mayor, City of Niagara Falls

cc: Ms. Maria Brown, City Controller
Mr. Glenn Choolokian, City Council Chairman
Ms. Donna Owens, City Administrator
Mr. Craig Johnson, Corporation Counsel

APPENDIX B

OSC COMMENTS ON THE CITY'S RESPONSE

Note 1

We acknowledge the significant financial problems facing the City, attributable in large part to the casino moneys not being received, as well as the limited options available to the Mayor and Council to address the City's fiscal stress. It is important to note however that even if the City had received casino payments, as budgeted, the structural deficit remains at approximately \$7 million annually. To put this in perspective – of the approximately \$81 million in general fund costs expected to be incurred in the 2013 fiscal year, which is a decrease from the 2012 spending plan, the City will not have recurring resources sufficient to cover as much as 9 percent of its costs, and that assumes it will receive the \$5.2 million that was budgeted for casino moneys in 2013.

Note 2

OSC does not recommend a minimum level of fund balance for local governments. The Government Finance Officers Association recommends that local governments, at a minimum, maintain unrestricted fund balance of no less than two months (approximately 17 percent) of regular expenditures or revenues. However, the desired level of unrestricted fund balance should be assessed based upon a local government's specific circumstances.

Note 3

City officials should develop comprehensive multiyear financial plans including revenue and expenditure projections, not merely the anticipated use of casino revenues and fund balance.

Note 4

The Mayor should ensure that City department heads collaborate to determine the status of capital projects and close completed or unapproved capital projects in a timely manner.

Note 5

The City's adopted 2013 budget includes a transfer to the general fund from the debt service fund of \$850,000. These funds would then be 'appropriated' as a financing source in the general fund.

Note 6

The transfer occurred subsequent to the completion of field work.

APPENDIX C

AUDIT METHODOLOGY AND STANDARDS

The Office of the State Comptroller's Fiscal Stress Monitoring System evaluates local governments based on both financial and environmental indicators. These indicators are calculated using the local government's annual update document, and information from the United States Census Bureau, the New York State Department of Labor, and the New York State Education Department, among other sources. The City has demonstrated signs of fiscal stress in several areas, which were discussed in a fiscal profile released in December 2012, available at <http://www.osc.state.ny.us/localgov/pubs/fiscalprofiles/niagarafalls.pdf>. Due in part to these fiscal stress indicators, we selected the City for audit.

Our overall goal was to assess the City's financial condition and to identify areas where the City could realize efficiencies and protect assets from loss or misuse. To accomplish this, our initial assessment included a comprehensive review of financial condition, after which we conducted a secondary assessment of payroll, human resources, purchasing, billing and collection, IT, and various departments.

During the secondary assessment, we interviewed appropriate City officials, performed limited tests of transactions, and reviewed pertinent documents, such as the City Charters, City policies and procedures, Council minutes, financial records, and reports.

In addition, we reviewed the City's internal controls and procedures over its computerized financial systems to help ensure that the information produced by such systems was reliable. After reviewing the information gathered during our initial assessment, we determined where weaknesses existed and evaluated those weaknesses for the risk of potential fraud, theft, and/or professional misconduct. We then decided on the reported objective and scope by selecting those areas most at risk. We selected financial condition, recording financial activity, and IT for further audit testing.

To achieve our financial condition and recording financial activity objectives and obtain valid audit evidence, we performed the following audit procedures:

- We reviewed the City Charters, City Code, and any policies and procedures for information relevant to financial and budgeting activities, including the responsibilities of certain City officials.
- 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 the City's financial records and reports for all funds, including balance sheets, budget reports, and statements of revenues and expenditures.
- We reviewed the use of casino revenue to determine how much was received and if it was used in accordance with Section 99-h of State Finance Law.
- We reviewed the City's multiyear financial plan to determine if it was up-to-date.

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

- We reviewed the City Charters, City Code, and any relevant policies and procedures relating to IT.
- We interviewed IT staff and the financial system administrator to determine what internal controls were in place.

We conducted this performance audit in accordance with generally accepted government auditing standards (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 D

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