CITY OF CRANSTON

Fiscal 2007 Budget Review

April 2007

Ernest A. Almonte, CPA, CFE
Auditor General

Office of the Auditor General
General Assembly
State of Rhode Island

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April 27, 2007

Honorable Michael T. Napolitano
Mayor of the City of Cranston

Honorable Aram G. Garabedian
Cranston City Council President

At your request, we have completed a review of the status of the City of Cranston's fiscal 2007 budget. Our review is a natural extension of our oversight responsibilities with respect to Rhode Island municipalities.

Our report is included herein as outlined in the Table of Contents and includes recommendations to enhance budget preparation and monitoring and other financial related issues impacting the City that we observed during our review.

Sincerely,

Ernest A. Almonte

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Auditor General

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OBJECTIVES

The newly elected Mayor of Cranston, upon taking office, requested that the Office of the Auditor General review the status of the City of Cranston's fiscal 2007 budget to assist in projecting actual operating results for the fiscal year ending June 30, 2007. This request was made, in part, due to concerns over the impact of an error made in preparing the fiscal 2007 budget which was estimated to result in a $2.5 million shortfall in tax collections.

We reviewed the status of the City's fiscal 2007 budget as adopted by the City Council on May 9, 2006. Our review included actual expenditures reported by the City through February 28, 2007 and expenditures estimated by the City for the remainder of the fiscal year. We did not perform an audit of the City and we have not performed independent tests of the data provided to us by the City which became the basis for our analysis.

Our goals were to (1) assess the reasonableness of the City's current estimate of fiscal 2007 operating results; (2) assess current year shortfalls, if any; and (3) offer recommendations to enhance budget preparation and monitoring, or address other financial related issues impacting the City.

FISCAL 2007 BUDGET PROJECTION – OBSERVATIONS AND CONCLUSION

OVERVIEW

The City has projected that it will essentially break even for the fiscal year ending June 30, 2007 and, based upon our limited budget review, we concur with that assessment. Although there are projected variances in specific budgetary line items, these variances offset to the extent that, overall, the City is not likely to experience either a material operating surplus or deficit within the General Fund for the year ending June 30, 2007.

The principal cause for concern regarding the City's fiscal 2007 budget was the $2.5 million revenue shortfall caused by errors in budgeting revenue from the fiscal 2007 tax levy. This shortfall has been alleviated with motor vehicle excise tax phase-out revenues from the State that were more than budgeted amounts and investment earnings that are projected to be significantly more than budgeted amounts. We observed a potential inconsistency between a provision of the City Charter which requires investment earnings to remain in specific funds and a recently adopted accounting policy which directs interest earnings to the General Fund. Since approximately $875,000 of the City's projected fiscal 2007 budget gap is expected to be closed through non-General Fund interest earnings, we believe this inconsistency should be addressed promptly to ensure these interest earnings can be used to solve the current fiscal 2007 budget gap.

While the City is likely to complete fiscal 2007 without any significant budget deficit, we did observe trends that are indicative of future budgetary challenges not only in fiscal 2008 but future years as well. These include:

- The City has not adequately defined the funding mechanism, desired target balance and permissible uses of funds accumulated within the Budget Stabilization Fund. The Budget Stabilization Fund has been used for current operating expenditures or replacement of capital items that are not unusual or extraordinary in nature and therefore should be built into the base operating expenditures to be supported by tax and other revenues. Structural budgetary issues will become increasingly obvious when normal operating expenditures can no longer be funded through budget stabilization accounts. Although the City had a $4.3 million fund balance in the Budget Stabilization Fund, and a $5.1 million fund balance in the Health Care Budget Stabilization Fund at June 30, 2006, a significant portion of these balances were used to support fiscal 2007 expenditures.

- The City's Police and Fire Pension plan continues to be severely underfunded and utilizes a disproportionate amount of the City's annual budgetary resources considering the relatively small number of employees and retirees covered by the plan. Failure to fund 100% of annual required contributions, both in the past and currently, weakens the City's overall financial health and increases future costs to the City.

- The City's tax rate is already considered high relative to other Rhode Island communities. This may impact its ability to continue to generate sufficient revenue to meet normal growth in operating expenditures and remain within the State's statutory limits on property tax increases.

Analyses on pages 4 and 5 summarize the growth in tax levy over the period 2002 - 2007 and the trends in City revenues and expenditures over the same time period. Beginning in fiscal 2008, the previous cap of 5.5% is reduced to 5.25% with continued reductions through fiscal 2013 when the maximum increase in property taxes is limited to 4% each year.

The City of Cranston has experienced a steady increase in its property tax levy for residential and commercial real estate over the past six years as demonstrated in Schedule 1 on page 4 of this report. In fiscal 2003, the year of the $12.8 million supplemental levy, the increase was most dramatic. Some of this can be attributed to growth. However the primary reason has been an increase in the property tax burden as evidenced by data received through reports from the State Office of Municipal Affairs and the Rhode Island Public Expenditure Council (RIPEC). These reports show Cranston's rank as compared to the other 39 municipalities as increasing from the ninth highest based on a 2002 RIPEC report to the second highest as reported in 2006. In addition the equity index for Cranston during this same period, which related the City's tax effort to its tax capacity, dropped from .75 to .62. In general, communities that have an equity index of 1.00 or less are considered to evidence some level of fiscal stress relative to the rest of the state because of their relative fiscal capacity and tax effort. We were advised that 2007 data regarding these indices is not yet available for publication.

As demonstrated in Schedule 2 on page 5, expenditures as reported in the 2008 budget document have grown steadily increasing an estimated $60 million (over 35%) from 2002 to 2007. This excludes expenditures from the Budget Stabilization Fund which are not included in the General Fund budget. These expenditures approximated $2.5 million in 2006 and are projected to total $3.5 million in 2007. During this six-year period City expenses grew by approximately $32 million with $12 million representing increased contributions to the police and fire pension plan, and School expenses grew by approximately $28 million.

During the course of our review we made observations concerning the City's budgetary practices and budget preparation, accounting practices and accounting information systems, and the pension plans covering its employees.

City of Cranston - Tax Levy - Fiscal Years 2002 - 2007

<u>Schedule 1</u>

Property Tax Levy [1]	2002	2003 [3]	% change	2004	% change	2005	% change	2006	% change	2007	% change
Residential	63,880,519	$ 84,394,389	32%	$ 88,299,004	5%	$ 92,353,263	5%	$ 93,476,637	1%	$ 95,357,713	2% (4)
Commercial	21,126,379	22,957,543	9%	27,431,185	19%	28,983,461	6%	29,251,640	1%	30,963,049	6%
Motor Vehicles	11,459,043	10,585,266	-8%	11,022,137	4%	11,010,192	0%	12,518,889	14%	11,378,120	-9%
Tangible Personal	7,841,357	10,081,384	29%	8,968,785	-11%	9,474,139	6%	9,449,475	0%	6,009,093	-36%
Wholesale Inventory	1,337,203	1,161,185	-13%	1,035,083	-11%	873,146	-16%	640,814	-27%	447,124	-30%
Total Net Tax Levy	$ 105,644,501	$ 129,179,767	22%	$ 136,756,194	6%	$ 142,694,201	4%	$ 145,337,455	2%	$ 144,155,099	-1%
Effective Tax Rate [2]	$ 24.25							$ 19.18			
Rank (out of 39 municipalities) [2]	9							2			
Equity Index Tax capacity/tax effort) [2]	0.75							0.62			

Sources/ Notes:

1 City of Cranston - Assessor's Statement of Assessed Values and Tax Levy (represents current year tax levy)

2 Rhode Island Public Expenditure Council Reports and data from the State Office of Municipal Affairs
The **effective tax rate** provides a tool to compare the overall property tax burden in each community. Effective tax rates include the effects of local assessment practices and statutory provisions so more meaningful cross-jurisdictional comparisons can be made within property classifications.

The **Equity Index** calculated by the State Office of Municipal Affairs considers the property tax base and levy of each municipality relative to the State average. In general, those communities that have an Equity Index of 1.00 or less are considered to evidence some level of fiscal stress relative to the rest of the State because of their relative fiscal capacity and tax effort.

3 Includes supplemental tax levy

4 For fiscal 2007 we analyzed the residential property tax levy using the tax assessor's electronic data files and determined the effect of the 2007 levy on single and multi-family units when compared to 2006.

	<u>single family units</u>	<u>all residential units</u>
Increase in property tax	60.7%	64.4%
Decrease in property tax	39.1%	35.4%
No change in property tax	0.2%	0.2%

City of Cranston - Summary of General Fund Revenues and Expenditures - Fiscal Years 2002-2007

Schedule 2

(UNAUDITED)

	2002 (actual)		2003 (actual) [1]			2004 (actual)			2005 (actual)			2006 (actual)			2007 (budget)		
		% of total		% of total	% increase		% of total	% increase		% of total	% increase		% of total	% increase		% of total	% increase
Revenues																	
Property taxes[2]	$104,646,645	62%	$ 126,946,330	64%	21%	$ 137,896,968	64%	9%	$ 142,076,318	66%	3%	$ 141,429,673	65%	-0.5%	$ 144,145,860	64%	2%
State Aid and other revenues	19,559,385	12%	24,935,825	13%	27.5%	25,569,775	12%	3%	24,850,177	12%	-3%	27,173,884	12%	9.4%	30,856,420	14%	14%
State Aid for Education and Other School Revenues	36,408,376	22%	38,235,925	19%	5%	37,008,694	17%	-3%	36,723,207	17%	-1%	37,691,639	17%	2.6%	39,357,420	17%	4%
Departmental Revenues	7,087,237	4%	8,727,121	4%	23%	13,648,204	7%	56%	10,881,146	5%	-20%	12,040,988	6%	10.7%	11,986,351	5%	0%
Total revenues	$167,701,643	100%	$ 198,845,201	100%	19%	$ 214,123,641	100%	8%	$ 214,530,848	100%	0.2%	$ 218,336,184	100%	1.8%	$ 226,346,051	100%	4%

	2002 (actual)		2003 (actual) [1]			2004 (actual)			2005 (actual)			2006 (actual)			2007 (budget)		
Expenditures		% of total		% of total	% increase		% of total	% increase		% of total	% increase		% of total	% increase		% of total	% increase
City Services	$ 60,219,268	36%	$ 78,402,205	41%	30%	$ 73,378,469	36%	-6%	$ 79,775,430	38%	9%	$ 79,910,001	37%	0.2%	$ 80,751,973	36%	1%
Schools	96,071,831	58%	98,036,998	51%	2%	106,447,419	52%	9%	111,229,947	53%	4%	116,753,389	53%	5.0%	123,871,057	55%	6%
Police and Fire Pensions - City Administered Plan	9,482,990	6%	14,949,999	8%	58%	23,876,568	12%	60%	20,024,158	9%	-16%	21,339,873	10%	6.6%	21,723,021	9%	2%
Total	$ 165,774,089	100%	$ 191,389,202	100%	15%	$ 203,702,456	100%	6%	$ 211,029,535	100%	4%	$ 218,003,263	100%	3.3%	$ 226,346,051	100%	4%

(1) Includes supplemental tax levy
(2) Represents current and delinquent taxes, net of abatements

Source: Data derived from the City of Cranston - Fiscal 2008 Budget Document

FISCAL 2007 REVENUE

The 2007 budget includes an estimated $2.5 million overstatement of tax revenue. This anticipated shortfall in tax revenue is a net amount (gross tax revenue after exemptions) for several categories of taxes and is partially offset by $637,000 of additional state aid (from motor vehicle excise tax phase-out reimbursement) not budgeted by the City. City officials anticipate that $1.8 million of interest earnings in excess of budget will offset the remaining shortfall as shown below.

Estimated Shortfall in Fiscal 2007 Tax Revenue and Projected Unbudgeted Revenue to Offset Shortfall	
Estimated Shortfall in Tax Revenue:	
Motor Vehicle Excise Tax	($ 1,634,154)
Real Property Tax – Commercial/Industrial/Mixed Use	($ 1,114,012)
Other Taxes (Residential, Tangible Property and Inventory)	$ 268,465
Net Estimated Shortfall in Tax Revenue	($ 2,479,701)
Projected Unbudgeted Revenue	
Additional State Aid - Motor Vehicle Excise Tax Phase-out	$ 637,000
Interest Earnings in Excess of Budget	$ 1,800,000
Total	$ 2,437,000

Cranston had a city-wide property revaluation which resulted in new assessed values for taxable property as of December 31, 2005. The net shortfall in tax revenue of $2,479,701 (per above Schedule) is the difference between budgeted tax revenue totaling $143,895,860 and billed tax revenue based on the certified levy totaling $141,416,159. The budget was not amended to reflect these changes.

The $2.5 million tax revenue shortfall resulted from multiple errors in budgeting revenue from the fiscal 2007 tax levy as follows:

1) When calculating tax revenue from the motor vehicle excise tax for the 2007 budget, the City used *estimated* assessed values because *certified* assessed values had not been determined. Subsequently, in June 2006, certified assessed values were determined to be $508,600 more than the budgeted estimate. In addition, the City made an error in calculating the total value of motor vehicle excise tax exemptions for all motor vehicles, i.e., it used an exemption amount of $5,000 per vehicle rather than $5,500 which was the amount then authorized by state law. Subsequently, the RI General assembly, in its 2006 session, voted to increase the exemption amount from $5,500 to $6,000. The net result was that the tax revenue billed was $1,634,154 less than the tax revenue budgeted.

2) The city over-estimated the total assessed value for the Real Property – Commercial/Industrial/ Mixed Use category by $15 million when calculating budgeted tax revenue. This error translated into a tax revenue shortfall of $1,114,012.

3) The *certified* values for certain other tax categories were *more* than the budgeted *estimates* which resulted in tax revenue per the tax bills that was $268,465 more than budgeted tax revenue.

We were advised that the City did not detect the $2.5 million shortfall until the fall of 2006 when it reviewed budgeted and billed tax revenue.

An additional fiscal 2007 shortfall of $1.5 million results from the sale of the existing police station that will not be realized before June 30, 2007. The anticipated proceeds of this sale were budgeted in fiscal 2007 as a required offset to debt service expenditures. This shortfall is expected to be addressed through a $1.5 million withdrawal from the City's Budget Stabilization Fund.

RECOMMENDATIONS

1. Enhance oversight of the City's tax revenue estimation process when preparing the annual budget to ensure it is based upon accurate and reliable revenue estimates.

2. Reconcile budget estimates for current property taxes to the certified levy promptly to identify any significant variances. This will enable the City to take any necessary corrective action to ensure that the budget remains balanced.

INVESTMENT EARNINGS

Investment income is generated by investing the available cash balances of the City's various funds. During fiscal 2007, two significant sources of funds available for investment (exclusive of the pension fund) resulted from the General Fund surplus and unexpended bond proceeds.

As part of the budget process, the City projects interest earnings prior to each fiscal year. An analysis of the budget to actual interest earned for fiscal years 2005, 2006 and 2007 (through February 28, 2007) indicates that the City has consistently under-projected interest earnings. In fiscal 2005, interest was budgeted at $185,000 while actual interest earned exceeded $840,000. This variance was repeated in fiscal 2006 with budgeted interest revenue of $805,000 and $1,500,000 in actual earnings. For fiscal 2007 the variance is expected to be even larger, with budgeted interest of $1.3 million and actual investment earnings expected to be over $3 million by fiscal year end.

For fiscal 2007, higher than expected interest earnings are being heavily relied upon to close the budget gap. By January 2007, the City estimated that approximately $1.8 million of excess interest would be available by the end of the fiscal year to offset anticipated budget shortfalls. As part of our consideration of the reliability of the City's projected financial position at June 30, 2007, we calculated our own projection for interest revenue for fiscal year 2007 utilizing actual interest earnings figures through February 28, 2007 and the City's projections of expenditures of bond funds for the remainder of fiscal 2007. The projection assumed no material changes in the City's investment policy or budget surplus amount and utilized an average interest rate of 5%, approximating the average interest yield on the City's liquid investment accounts for the first 8 months of the fiscal year.

The City's total budgeted interest revenue projection for fiscal 2007 was $1.3 million. At February 28, 2007, after eight months of operating activity, the City's accounting system reflected actual interest earned of $2,076,493. Based on these accounting system amounts and additional information provided by the City regarding expected capital project expenditures, we projected interest earnings through June 30, 2007 to be approximately $3,050,000. Of this projected interest amount, approximately $875,000 is related to unexpended bond proceeds, with the remaining portion attributable to General Fund sources. This amount approximates the City's projected final interest earnings; as a result, we consider the City's expectation of excess interest of $1.8 million for fiscal 2007 to be reasonable.

The City Controller and Internal Auditor for the City Council indicated that the large budget variances for investment income have been driven primarily by overly conservative interest rate assumptions and the growth of the General Fund surplus, along with the recent addition of higher yielding certificates of deposit as an investment vehicle for certain General and Bond Funds. Although the anticipated positive budget variance in investment income for fiscal 2007 partly offsets an unfavorable variance in property tax revenue caused by an error, these understated investment earning projections limit the effectiveness of the overall budget as a reliable planning tool.

Use of investment income earned from non-General Fund sources

The City's projection of fiscal 2007 investment earnings available to offset other budgetary shortfalls includes investment income in the General Fund as well as certain other special funds (budget stabilization funds) and capital funds. Whether investment income from these non-General Fund sources is appropriately available is unclear. The City Charter – Section 7.05 – *Powers and duties of city treasurer* (as amended by the voters November 2006) states that interest or dividends earned from the investment of "surplus moneys" shall be credited to the fund concerned. Conversely, an interest policy instituted by the City's Finance Director on July 1, 2006 directs staff "to return all interest earned on investments in the Capital Funds and Stabilization Funds to the General Fund". We were informed that this interest policy had not been ratified by the City Council. As a result we advised the City to obtain a legal opinion as to whether Council approval is required. Whether the change in policy requires Council approval remains unclear. Approximately $875,000 of investment income from non-General fund sources is being used to resolve the fiscal 2007 budget gap. The City should clarify the permissible uses of investment income earned outside the City's General Fund to be sure that it can appropriately be used to offset the property tax revenue shortfall.

Potential arbitrage rebate liability

As noted previously, part of the City's fiscal 2007 investment income is derived from the investment of unexpended bond proceeds. Because the City may earn yields higher than the expected yield on the bond issue, the City is exposed to potential liability for rebate of some portion of the excess interest earned above the yield on the bonds. Although this potential arbitrage rebate is payable on the fifth anniversary of the bond issuance, issuers generally make an annual determination of potential arbitrage rebate liabilities in order to properly accrue any potential obligation. As the City is relying, in part, on bond proceed interest earnings to balance the budget for fiscal 2007, it is critical that the City consider any potential arbitrage rebate obligation and the possible need to set aside funds, before appropriating interest earnings for other purposes.

RECOMMENDATIONS

3. Ensure budget estimates of investment income are reasonable and reflective of expected amounts available for investment at projected investment yields.

4. Clarify permissible uses of investment income earned from non-General Fund sources.

5. Consider the City's potential arbitrage rebate liability in connection with investment of unexpended bond proceeds.

STRUCTURAL BUDGET ISSUES

The City may have certain structural budget issues that could adversely impact the City's future budgets and its ability to comply with State mandated limits on property tax increases. A structural budget gap is a mismatch between expenditures and revenue streams. Some of the City's budgeting practices have created these structural imbalances.

The fiscal 2007 shortfall in tax revenue of $2.5 million is anticipated to be offset by an increase of $636,645 in state aid from the motor vehicle excise tax phase-out in excess of budget and $1.8 million of interest earnings in excess of budget. The latter amount includes $875,000 of interest earned on bond funds. However, the bond funds will eventually be spent on projects and therefore will not be available to generate interest in fiscal 2008 and future years. In addition, the City must address whether the City's policy of using interest earnings on bond funds is consistent with limitations included in the City Charter.

Funding normal, recurring operating expenditures of the City from one-time revenues creates structural budget issues. These recurring expenditures are no longer matched to a recurring revenue source. Normal revenue growth is typically insufficient to fund these expenditures when the one-time source of funds or the budget reserve account is no longer available. Additionally, State mandated caps on property tax increases limit the City's ability to raise taxes to cover these items and also fund normal expenditure growth.

The City has utilized its Budget Stabilization Fund and Health Care Budget Stabilization Fund for certain expenditures that are more recurring rather than extraordinary in nature. Continual use of budget reserve funds for regular and recurring budget items limits their availability for unpredicted one-time expenditures or revenue shortfalls and gives rise to structural budget imbalances

Budget Stabilization Fund

The Budget Stabilization Fund has been used to an increasing extent to fund expenditures that are more recurring in nature rather than one-time extraordinary type items. For example, police severance pay was paid during fiscal years 2005, 2006 and 2007. Fire severance pay was paid during fiscal years 2006 and 2007. The purchase of textbooks for schools has been funded from the Budget Stabilization Fund in both fiscal 2006 and 2007.

Debt service of $1.5 million is also being funded with budget stabilization funds in 2007. The fiscal 2007 budget includes $1.5 million of estimated revenue from the planned sale of the old police station which is earmarked to pay an equal amount of debt service. (The City Charter requires that proceeds from the sale of public buildings be used to retire municipal debt.) The building is to be sold when the Police Department moves to a new station that is currently under construction. Although the City anticipates moving to the new station by the end of fiscal 2007, the old station will not be sold during fiscal 2007. Accordingly, as a contingency, the City will use $1.5 million from the Budget Stabilization Fund which has been authorized by City ordinance.

Fiscal 2007 expenditures in the Budget Stabilization Fund through February 28, 2007 totaled approximately $1.5 million with an additional $2.0 million projected to be expended before June 30, 2007.

Health Care Stabilization Fund

In fiscal 2005, the City established a Health Care Stabilization Fund. It was funded by transfers of the excess of funds appropriated over actual health care expenditures. The purpose of the fund was to cover deficits in the event that health care expenditures exceeded the budgeted appropriations.

In fiscal 2007, the City funded its contribution to a newly created Other Post-employment Benefits (OPEB) trust fund by appropriating $3 million from the Health Care Budget Stabilization Fund. The contribution to the OPEB trust fund is in response to new accounting guidelines which require an actuarial determination of the costs of retiree health benefits and recognition and disclosure of these costs in the City's annual financial statements. The actuarial amount required to fund these benefits for fiscal 2007 was $3.2 million which was only $300,000 more than the $2.9 million expended in fiscal 2006 on a pay-as-you-go basis from the General Fund. Delaying funding of this cost is not feasible since actual cash outlays for claims are projected to exceed the actual contribution amount for fiscal 2007 (see related finding on page 22). In essence, a current budget expenditure item is now being temporarily funded from a reserve account (Health Care Stabilization Fund) rather than the current operating budget as it had been in previous years. The Mayor's fiscal 2008 budget again proposes using $1.75 million from the Health Care Budget Stabilization Fund to fund, in part, the fiscal 2008 annual required contribution for retiree health care.

Use of budget stabilization funds in this manner creates budgetary structural imbalances -- when the stabilization funds are exhausted and the item must be funded from the current operating budget, there may be insufficient revenues to support the expenditure item.

Structure of the Budget Stabilization and Health Care Stabilization Funds

In 2002, we recommended that the City create a budget reserve account after resolution of the City's immediate fiscal crisis and progress was made in funding the City's pension obligations. The long-term goal of such a reserve was to prevent a recurrence of a significant fiscal crisis and to enable the City to achieve sufficient fiscal stability such that it could weather fiscal problems without resorting to deficit financing. As recommended, a portion of each year's estimated revenues should be directed to a reserve account until a sufficient balance is achieved. Once the reserve account was fully funded, "excess" contributions to the reserve account could be directed to funding capital items without long-term borrowing, reducing existing bonded debt, and reducing unfunded pension liabilities. Creation of such reserves is an integral component of a sound financial plan for the City and would demonstrate a commitment to preventing recurrence of a fiscal crisis. Additionally, creation of a "rainy day" fund would enhance the City's cash position and allow it to fund its temporary cash needs internally without short-term borrowing.

The City established two budget stabilization accounts in fiscal 2005 -- the Budget Stabilization Fund and Health Care Budget Stabilization Fund. In establishing the budget reserve accounts, the City did not earmark a specific annual contribution or a target balance to be maintained (e.g., percentage of annual operating budget). Additionally, permissible uses of each fund are not specified, just that approval of the City Council must be obtained. Adopting a budget reserve policy which includes these criteria by amending the charter and/or enacting an ordinance would impose additional controls and fiscal discipline on the use of the budget stabilization funds.

Recommended Budget Practices, A Framework for Improved State and Local Government Budgeting, published by the Government Finance Officers Association, provides best practices guidance for state and local budgeting. It states that governments should develop a policy on stabilization funds and maintain a prudent level of financial resources to protect against reducing service levels or raising taxes and fees because of *temporary revenue shortfalls or unpredicted one-time expenditures*.

RECOMMENDATIONS

6. Limit the use of budget stabilization funds to avert an unexpected revenue shortfall or to fund unpredicted one-time expenditures. Define the specific permissible uses of the budget reserve account within the City Charter and/or City ordinances.

7. Establish a specific annual contribution and a target balance to be maintained for each budget stabilization fund.

OTHER FINDINGS AND RECOMMENDATIONS

PENSION PLANS

City of Cranston (the City) employees are eligible for pension benefits provided under various pension plans. In general:

- Teachers are covered by the Rhode Island Employees' Retirement System which is administered by the State. The employee, City and State are each required to make contributions to this plan.

- Certain other City employees, including non-certified school employees and police and fire personnel hired subsequent to July 1, 1995, are covered by the Municipal Employees' Retirement System which is also administered by the State. The employee and City are each required to make contributions to the plan – the State is only the administrator and has no funding obligation for future benefits.

- Certain public works' employees and all school bus drivers are eligible to participate in the National (Industrial) Pension Plan which is administered by the Laborers' National (Industrial) Pension Fund. The City, but not the participating employee, is required to make contributions to the plan.

- Certain other City employees, mostly workers within City Hall and other clerical staff are eligible to participate in the New England Teamsters & Trucking Industry Pension Plan which is administered by the New England Teamsters & Trucking Industry Pension Fund. The City, but not the participating employee, is required to make contributions to the plan.

- Police and fire personnel hired before July 1, 1995 are covered under the Police and Fire Employees' Pension Plan of the City of Cranston (PFERS). The PFERS was established to provide benefits to Cranston's retired municipal police and fire personnel hired prior to July 1, 1995. The employee and City are each required to make contributions to this plan. The City is solely responsible for the administration and funding of pension benefits provided under this plan.

For all but the PFERS, the City's primary obligation is to make the annual required employer contributions to the plans. For the PFERS, the City has the responsibility for not only making required employer contributions but also for administering the plan, investing plan assets, obtaining periodic actuarial valuations and funding all future benefits.

Except for the PFERS, the City has made required contributions to pension plans covering its employees. Annual contributions to the PFERS have increased in recent years but are still short of 100% of the annual required contribution amount. At July 1, 2006, only $40 million of assets had been accumulated to fund plan liabilities of $257 million. By any measure the plan remains severely underfunded.

The PFERS has been historically underfunded. In 2002, the fiscal problems of the City of Cranston received much public scrutiny and the Office of the Auditor General issued a report including recommendations for ameliorating the City's fiscal challenges. One of the key factors impacting the City's deteriorating fiscal condition was the funding status of the City administered PFERS. At that time, assets accumulated for future benefits were significantly less than the actuarially required amounts. The Unfunded Actuarial Accrued Liability (UAAL) was $237 million and the City's auditors raised doubts about PFERS ability to continue as a going concern.

With the intent of assessing the progress made in improving the overall financial health of the PFERS plan, we reviewed the Cranston Police and Fire Pension Trust for the fiscal year ended June 30, 2006 and the previous four years (2002 through 2005). We utilized the actuarial valuations performed by the City's actuary and the information provided in the City's audited financial statements to perform our analyses. We focused on five common measures used to assess the "fiscal health" of a pension plan:

Annual required contribution (ARC)	The amount required to be contributed to the plan as determined by an actuary in accordance with the plan's actuarial funding methodology and assumptions. Any contribution amount less than 100% of the ARC warrants concern.
Net pension obligation (NPO)	When a government contributes 100% of the ARC no liability is required to be presented on the face of the government's financial statements. When less than 100% of the ARC is contributed, the difference between the ARC and the actual contribution is reflected as a liability on the government's government-wide financial statements and is referred to as the net pension obligation. When an NPO exists on a government's financial statements, this amount represents the cumulative effect of contributions that should have been, but were not, made to a pension plan.
Unfunded actuarial accrued liability (UAAL)	The Actuarial Accrued Liability (AAL) is the present value of fully projected benefits attributable to service credit that has been earned. The Unfunded Actuarial Accrued Liability (UAAL) is the difference between the AAL and the actuarial value of assets available to pay benefits.
Funded ratio – overall funding status of the plan	The funded ratio of a pension plan is the relative value of the plan's assets and liabilities. The Plan's funded ratio is determined by dividing the actuarial value of assets by the actuarial value of liabilities.
Investment Performance	In addition to contributions, investment income is another source of funds to provide current and future pension benefits. Investment performance can be measured against the actuarial assumed rate of return and investment returns obtained by other similar investors.

Annual Required Contribution

While the City has made progress in making required contributions to the PFERS, the City has not contributed 100% of the Annual Required Contribution (ARC), except for one fiscal year when unexpected revenues were applied to the PFERS pension obligation. Making 100% of the annual required contribution is generally considered a minimum baseline for responsible funding of a pension plan.

The PFERS' annual required contribution (ARC), as determined by the actuary, increased 14% from $18,996,537 in fiscal year 2002 (based on the 2001 valuation) to $21,723,021 in fiscal year 2006 (based on the 2005 valuation). The percentage of the ARC that the City funded during the period ranged from 50% in 2002 to 109% in 2004. For fiscal year 2006, the City funded 98% of the ARC with a contribution of $21 million. The following table illustrates the ARC and the funding percentages over the last five years.

	2002	2003	2004	2005	2006
Annual Required Contribution (ARC)	$ 18,996,537	$ 24,945,408	$ 21,877,449	$ 22,147,958	$ 21,723,021
Amount Actually Funded	$ 9,482,990	$ 14,949,999	$ 23,876,569	$ 20,024,158	$ 21,339,876
% Funded	49.92%	59.93%	109.14%	90.41%	98.24%

The annual required contribution for the PFERS, which is in excess of $20 million each year, is a significant component of the City's annual budget of approximately $220 million. The City's annual required contributions remain significant because of chronic underfunding of the plan including failure to make 100% of annual required contributions, and an increasing number of retirees and decreasing number of active members since the plan is now closed to new members.

The cumulative difference between the ARC and the amounts the City actually contributed to the PFERS in just the last five years is approximately $20 million. Had the City fully made the annual required contributions, the PFERS would not only have had those amounts available to provide benefits to retirees but could have realized investment earnings over the period, thereby reducing future contributions. In the last five fiscal years (2002-2006), funding 100% of the annual required contribution in each of those years would have resulted in $22 million of additional contributions to the PFERS and more than $2.5 million of additional investment income. We estimated that had these contributions been made, assets available in the plan would have been nearly $62 million rather than $39.6 million and the funded ratio would have been nearly 24% rather than 15.4%. As discussed in the next section, Net Pension Obligation, the cumulative effect of the City's failure to make the annual required contribution to the PFERS over many years is nearly $89 million.

The City has budgeted, in fiscal 2007, a contribution to the PFERS that is equal to 100% of the annual required contribution; however, the fiscal 2008 budget as submitted by the Mayor provides for a contribution to the PFERS that is approximately $1.7 million less than 100% of the annual required contribution.

Net Pension Obligation

The City's Net Pension Obligation (NPO) increased approximately 9% from $81 million in 2002 to $89 million in 2006. This increase results from continued failure to fund 100% of the annual required contribution.

The net pension obligation had a significant impact on the financial position of the governmental activities as reported in the City's Comprehensive Annual Financial Report for the fiscal year ended June 30, 2006. The net pension obligation of $89 million was 47% of all general long-term obligations of the City which totaled $189 million at June 30, 2006. Consequently, the NPO is a primary cause for the fact that the City's liabilities (governmental activities) exceed assets at June 30, 2006 by more than $20 million.

Unfunded Actuarial Accrued Liability

The Actuarially Accrued Liability (AAL) increased approximately 19% from $212 million as reported in the 2001 actuarial valuation to $257 million as reported in the 2006 valuation. Despite an increase in the actuarial value of the plan's assets which increased 52% from $19 million to $39.6 million, the Unfunded Actuarially Accrued Liability (UAAL) increased 15% from $191 million to $218 million over the same period.

Actuarial Valuation Date	Actuarial Value of Assets (000's) (a)	Actuarial Accrued Liability (AAL) (000's) (b)	Unfunded Actuarial Accrued Liability (UAAL) (000's) (b) – (a)	Funded Ratio (a)/(b)
July 1, 2001	$ 20,805	$ 211,799	$ 190,994	9.8 %
July 1, 2002	$ 19,237	$ 256,292	$ 237,055	7.5 %
July 1, 2003	$ 17,960	$ 218,407	$ 200,447	8.2 %
July 1, 2004	$ 27,622	$ 242,850	$ 215,228	11.4 %
July 1, 2005	$ 31,641	$ 252,222	$ 220,581	12.5 %
July 1, 2006	$ 39,606	$ 257,475	$ 217,869	15.4 %

Because membership in the plan is closed, the number of active members and the amount of employee contributions continues to decline, while the number of retirees and related pension benefits continues to increase.

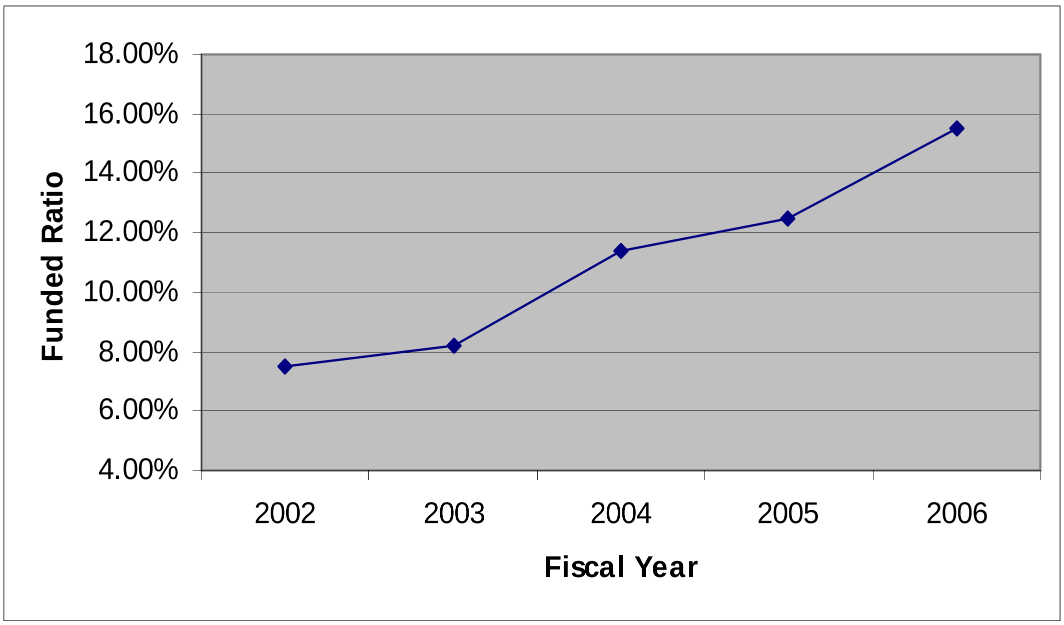
There were 192 active contributing members per the July 1, 2001 actuarial valuation. Annual covered payroll for these employees was $11 million. At July 1, 2006, there were 98 active members with annual covered payroll of $7 million. Conversely, the number of retirees and beneficiaries at July 1, 2001 was 336 and increased 21% to 407 at July 1, 2006. Pension benefits paid as reported in the fiscal year

2002 audited financial statements were $13.2 million and increased 36% to $18 million in 2006. The actuarial valuation at July 1, 2006 forecasts further pension benefit expense increases through fiscal year 2024.

In addition to the increase in projected benefits and contributions to the plan, the other factor that has significant impact on the UAAL is the performance of the plan's investments which is discussed in the Investment Performance section.

Funded Ratio

The Plan's funded ratio increased from 7.5% in 2002 to 15.5% in 2006. However, even with this increase the plan is seriously underfunded. The following graph illustrates the increase in the Plan's funded ratio from 2002 through 2006.

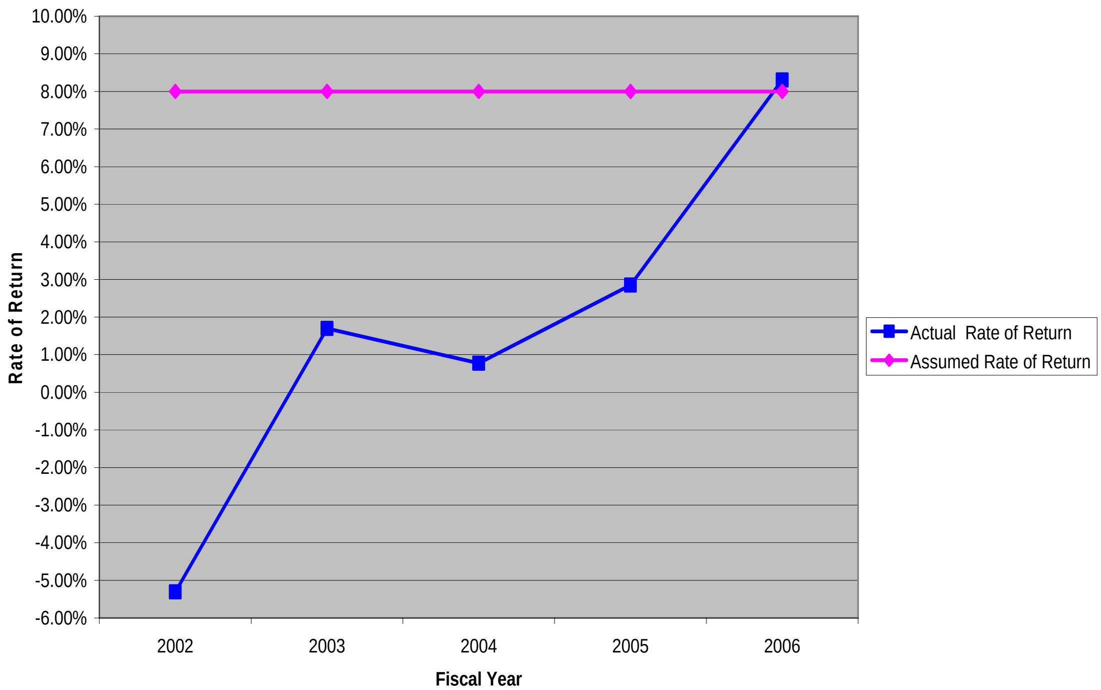


Wilshire Consulting published a report on the funding levels of 125 state retirement systems in March 2006. Wilshire estimated the funded ratio of pension assets to liabilities for all 125 systems surveyed was 87% in 2005. Recent initiatives in other states to identify pension plans at risk have targeted any plan with a funding ratio of less than 80% to 90%. By this measure, Cranston's PFERS with a funded ratio of only 15% remains a plan at risk.

Investment Performance

The market value of the Plan's investments increased 106% from $19.2 million in 2002 to $39.6 million in 2006. The Plan's investments realized a return of approximately 8% for the fiscal year ended June 30, 2006. However, prior to fiscal year 2006, investment returns were significantly less than the plan's assumed rate of return of 8% and averaged just 1.6% over the five years ending June 30, 2006.

We calculated the PFERS actual rate of return on investments for fiscal years 2002 through 2006 by averaging the beginning and ending balances and dividing by investment income as reported in the City's audited financial statements. The following graph illustrates actual investment returns as compared to the assumed investment rate over the last five years.



In comparison to the PFERS' investment return performance, the Employees' Retirement System of RI (ERSRI) had investment returns of 19.5%, 12.2% and 12.6 % for the fiscal years ended June 30, 2004, 2005, and 2006, respectively.

To demonstrate the impact of actual investment performance on the plan's funding status, we estimated investment income had the plan achieved the assumed rate of return of 8%. Over the five fiscal years 2002 - 2006, we estimated the plan would have realized more than $8 million in additional investment income. We also estimated investment income over the same five-year period if the plan had achieved the same rate of return as the Employees' Retirement System of the State of Rhode Island. Under this scenario, the plan would have realized approximately $9 million in additional investment income over the five-year period.

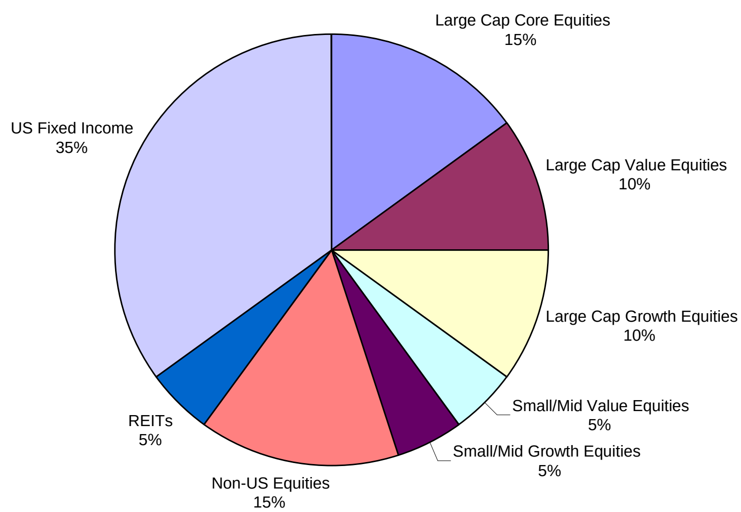
In December 2004, the City formulated an investment policy for the Plan's assets. The plan established an investment committee consisting of the City Council President, the City Solicitor and the Finance Director. The City Treasurer is the Investment Officer and all investment decisions are subject to a majority vote of the Committee. The Committee hired an investment consultant and set a return objective of 8% over a full market cycle, defined as approximately five to seven years. The schedule on page 15 illustrates the changes in market value of the Plan's investments over fiscal years 2002-2006.

Prior to implementation of the investment policy and asset allocation guidelines for PFERS investments, a significant portion of plan assets were invested in short-term cash equivalent type investments and were not broadly diversified as required by the current asset allocation model. Investing a significant portion of plan assets in short-term cash equivalent type investments likely had a negative impact on investment returns in those years.

The investment policy also established specific asset allocation guidelines for the Plan's investments. Permissible investments include (but are not limited to) obligations of U.S. and non-U.S. corporations such as mortgage bonds, convertible and non-convertible notes and debentures, preferred stock, commercial paper, certificates of deposits, and obligations guaranteed or insured by the U.S. Government and its agencies. If upon review the actual asset allocation differs from the established allocation, the asset class will be rebalanced to its target.

The following represents the Plan's asset allocation guidelines.

Asset Allocation Guideline – Cranston PFERS



The City has taken positive steps to implement diversified asset allocation guidelines with the intent of increasing investment performance and spreading risk over a variety of assets types for investments held within the PFERS. Smaller plans, such as PFERS, typically have difficulty achieving the overall investment performance of larger plans because they have fewer opportunities to spread risk, cannot invest as efficiently (higher costs) and may not have access to all types of potentially higher yielding investments.

Summary

Although not as dire as July 2002, when the City's auditors questioned the ability of the plan to continue as a going concern, the City's PFERS remains significantly underfunded and continues to negatively impact the City's overall financial health. Nearly one-half of the City's general long-term debt stems from the chronic failure to contribute actuarially determined amounts to fund the PFERS. If no further contributions were made to the plan, assets available within the plan would only be sufficient to make pension benefit payments to retirees for approximately two years.

Even when rating agencies upgraded the City's bond rating in 2006, they continued to cite the unfunded pension liability as an important factor.

> *"Moody's believes that the retirement system is a key component of the city's overall credit quality and continued reduction of the unfunded pension liability will be an integral part of any future rating analysis." - Moody's Investors Service*

> *"Although Cranston has made significant strides in restoring fiscal balance, its very large $220 million unfunded police and fire pension plan liability remains a credit weakness … this significant liability will continue to be a burden for years to come." – Standard & Poors Ratings Service*

In identifying issues that could cause a ratings downgrade, Moody's cited " failure to reduce the city's unfunded pension liability".

Progress has been made through fiscal 2007 in approaching the benchmark of contributing 100% of the annual required contribution but that baseline target has still not been consistently met. Consequently, the fiscal 2008 budget proposal to fund $1.7 million less than 100% of the annual required contribution is of particular concern.

Assets are starting to accumulate within the plan and a more appropriate investment policy and asset allocation guideline has been recently implemented; however, average investment returns for invested assets have not come close to the assumed rate of return used by the PFERS actuary in valuing liabilities of the plan.

The City's actuary uses an assumed rate of return of 8% in valuing the liabilities of the PFERS. Actual investment performance over the last five years averaged only 1.6% which fell far short of the target. Only in fiscal 2006, did actual investment performance approximate the assumed rate of return. The assumed rate of return should be realistic and attainable over the long-term otherwise the plan's liabilities for future benefits are understated and therefore misleading. In the last five fiscal years (2002-2006), we estimated that the plan would have generated $8 million more in investment income if the assumed rate of return of 8% had been consistently achieved.

The PFERS covers only 4% of the City's total employees (98 active members out of 2,309 total City employees) yet has a disproportionate negative impact on the City's annual budget and overall fiscal condition. As stated previously, the City is making 100% of annual required contributions to the other four pension plans that cover City employees. In these instances, the City must fund required amounts;

however, the same fiscal discipline is not forced upon the City administered PFERS. For many reasons, most notably the flexibility to avoid making required contributions, locally administered pension plans can be problematic.

While the PFERS is closed to new members, the City should again examine the possibility of moving additional active employees still covered by PFERS to the State administered Municipal Employees' Retirement System (MERS). This could result in lower overall pension expense to the City since investment returns of the State system have been consistently higher than those earned by PFERS and the benefit structure of MERS is more conservative.

In addition to contributing 100% of the annual required contribution in future years, the City should earmark any unexpected revenues and/or budget surpluses for making supplemental contributions to the PFERS. This would serve to accelerate the amortization of the City's net pension obligation and reduce future annual required contributions to the plan.

RECOMMENDATIONS

8. Contribute no less than 100% of the annual required contributions to the PFERS.

9. Earmark any unexpected revenues and/or budget surpluses for making supplemental contributions to the PFERS.

10. Examine the possibility of moving additional active members now covered by the PFERS to the State administered Municipal Employees Retirement System.

BUDGET MONITORING

In assessing the status of the City's fiscal 2007 budget, we requested that the City Finance Department prepare, for each department, a detailed comparison of budget and actual expenditures-to-date for fiscal 2007 including a projection of expenditures through year-end and an explanation of significant budget variances. Such a comparison is a necessary and useful tool to monitor the budget and highlight potential problems on a timely basis to allow for appropriate corrective action. The City advised us that the projections it prepares to comply with the provision of General Law section 45-12-22 are computer generated and had not been adjusted by the finance department for input by Department heads.

We requested a comparison, to be prepared by each department, of budget to actual expenditures-to-date for fiscal 2007, and a projection of expenditures through June 30, 2007. Significant budget variances (over/under) were to be explained along with a corrective action plan so that the department would complete the fiscal year without exceeding the budgeted appropriation.

Based on the submissions we received and our subsequent follow-up with departments, we found that some department heads were unclear about their budget monitoring responsibilities and communication could be improved between the central finance department and the individual city departments. For example, the Finance Department projected a fiscal 2007 surplus of $350,000 for the Fire Department. In contrast, the Fire Department projected a deficit of ($171,000) for the same period.

Both departments made good faith projections based on the information available to them. But neither was in a position to make a complete and accurate projection.

Accordingly, the budget preparation process is fragmented. This is due, in part, to the City computer system being the driving force for parts of the budget preparation process. The City uses the budget program to prepare the salary and benefit requirements for the budget. As a result, the computer performs all the calculations internally and produces final reports. However, Department personnel are required to complete certain remaining budget line items which are not calculated by the computer, including overtime pay, part-time pay or differential pay, hospitalization buyback pay and extra vacation pay after 10 years.

Department personnel advised us that they do not have access to the detail information calculated by the computer program and therefore it is difficult to project payroll expenditures. Conversely, it is also difficult for the finance department to project other line items (non-payroll) which requires knowledge of what is occurring at the department level. This makes it difficult to monitor budget results, and can easily lead to error in the budget process.

The Finance Department, with input from appropriate personnel in each department, should routinely prepare budget-to-actual comparisons with projections through June 30, and investigate significant budget variances. Corrective action should be taken so that the department will complete the fiscal year without exceeding the budgeted appropriation.

RECOMMENDATIONS

11. Require departments to continually monitor the adopted budgets and provide input to the Finance Department regarding projected variances and propose corrective action when warranted.

12. Coordinate budget preparation and monitoring between the Finance Department and other department personnel to ensure that projected expenditures and revenues are determined and monitored effectively.

OVERTIME EXPENDITURES

Actual overtime expenditures for the six months ended December 31, 2006 totaled more than $2.7 million. Total overtime expenditures for the year are projected to be $4.5 million, with the Fire Department being the largest component at $3.2 million. Total budgeted overtime for fiscal 2007 (all departments) was $2.3 million.

Ordinarily, actual overtime expenditures that were nearly 100% over budget would constitute a serious budget shortfall. The budgetary shortfall does not materialize because, in the case of the Fire Department, the fiscal 2007 budget included funding for 12 additional firefighters that have not been hired. The 12 budgeted positions that remain unfilled offset the unbudgeted overtime costs.

For the purpose of preparing annual budgets and monitoring overtime expenditures, the City should complete a cost benefit analysis that highlights the point where additional hires are more cost effective than incurring excessive overtime costs.

RECOMMENDATION

13. Perform a cost benefit analysis comparing the cost of hiring additional firefighters versus the cost of continuing to pay overtime.

OTHER POST-EMPLOYMENT BENEFIT TRUST FUND

The City created an Other Post-Employment Benefit (OPEB) Trust Fund in fiscal 2007 in response to new accounting standards issued by the Governmental Accounting Standards Board (GASB). GASB Statement No. 43 *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans* and GASB Statement No. 45 *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions* impact the City's accounting for retiree health care costs and the recognition and disclosure of those costs in the City's financial statements. In general, the standards are similar to those governing the accounting for pension plans and require an actuarial determination of the future costs of providing retiree health care benefits to employees.

The City's OPEB Trust Fund was created during fiscal 2007 to serve two purposes: to pay current costs of health care claims for the City's retirees and to build a reserve for future payments for retiree health care. The City employed the use of an actuary to calculate the annual required contribution the City is to make to the Trust Fund, in accordance with the provisions of GASB 45. This contribution amount for fiscal 2007 was calculated by the actuary as approximately $3.2 million. The actuary estimated approximately $2.6 million in current year benefit payments for health insurance claims for current retirees, theoretically leaving almost $600,000 in the Fund towards the reserve for future retiree health care claims.

We compared the amounts projected in the actuarial analysis to the actual expenditures from the OPEB Trust Fund to date in the current fiscal year. As of March 31, there were approximately $2.7 million in health insurance claims paid from the fund, exceeding the actuarial estimate by $100,000 with three months remaining in the fiscal year. Based on data from the first nine months of the fiscal year, we projected that total benefit payments from the OPEB Trust could total $3.3 million for the entire fiscal year. In this instance, this could result in a potential shortfall in the OPEB Trust Fund, with no funds remaining toward a reserve for future health care claims.

Based on projected actual results for fiscal 2007, the City may not have achieved its goal of beginning to fund, on an actuarial basis, the projected costs of health care costs for certain retirees. The City should review, with assistance from its actuary, current healthcare claims estimates and cost projections to ensure that actuarial valuations are reasonable and assets begin to be accumulated for future retiree healthcare costs.

RECOMMENDATION

14. Periodically review OPEB Trust Fund activity to determine whether revisions should be made to required contributions to further the accumulation of a reserve for future retiree health care claims.

CITY ACCOUNTING SYSTEM

The City uses a proprietary computer system for accounting, tax collection, accounts payable, procurement, payroll, fixed assets and budgeting (excluding the School Department). The system is outdated utilizing more than 20 year-old software, a ten-year-old server and a tape back-up system that must be repaired using 'refurbished' components. The City no longer has a maintenance and support agreement with the computer system vendor, and instead, hires the vendor for maintenance and support on an as needed basis.

The computer system crashed in September 2006 due to a lack of available disk storage space. To compound this problem the back-up system failed, requiring extensive manual efforts to recover the data. The director of the City's Information Technology Department (IT) advised us that the back-up system is not reliable.

In its effort to recover from the system's crash, the City's vendor restored the general ledger and certain other files and transactions. Subsequently, the City determined that the data restoration process resulted in many erroneous duplicate debit transactions. This required the City to post offsetting adjustments.

The City's IT Department Director indicated that various problems/issues exist with the computer system including:

- system capacity and processing concerns when within the same time period, the accounting system is maintaining data for a new fiscal year, as well as processing data for the old fiscal year;
- lack of resources to perform required integrity testing and validation of accounting system back-up data;
- unsuccessful postings to the general ledger;
- difficulty in producing trial balances, and
- posting of duplicate transactions.

Our July 2002 report identified these same conditions and we recommended that the City perform a citywide information systems needs analysis.

Considering budgetary constraints and the significant costs associated with implementing a new accounting system, the City has opted to continue with the existing system. As a result it must take appropriate steps to ensure that system "problems" are anticipated and corrected promptly.

The City performs a complete back-up of the accounting system each day; however, there is no validation of the back-up data to ensure readability and completeness of the back-up data. Procedures must be established that mandate testing and validation of the accounting system's back-up data on a scheduled basis.

The City should explore other available means of securing the accounting system's data. One possible solution would require that the systems back-up data be electronically transmitted to data storage equipment found within other City departments. Current plans call for the new Police Department's system to back up its data to new high speed, high capacity data storage equipment. A review should be performed to determine if this planned back-up system has enough storage capacity to include the accounting systems back-up data.

The City should perform a city-wide information systems needs analysis. This needs analysis would be designed to identify gaps between the existing system services and future needs, which may be required to meet projected city-wide information technology demands. The final product of such a review would be a formal plan that the City could use to help build or restructure the IT infrastructure using emerging technologies that have higher levels of performance and availability, yet are flexible to handle any future operational demands and anticipated growth.

RECOMMENDATIONS

15. Improve the operation and integrity of the accounting system's back-up procedures. Establish procedures that require testing and validation of the data on a scheduled basis.

16. Perform a city-wide information systems needs analysis. A primary goal of this review is to develop recommendations regarding the acquisition of a new accounting system package capable of handling all existing and future needs of the City.

TRAVEL EXPENSES

The City does not utilize a separate travel line item to budget and account for travel costs within the departments. City personnel stated that travel is included in the budget for each department but not in an exclusive travel account. Travel expenses are incurred in a variety of departments; however, the more significant dollars are expended by Police, Fire, Public Library, Administrative and Executive personnel to attend training, meetings and seminars out of state.

We noted that each department uses different expense line items within the accounting system to record travel expenses (expenses, miscellaneous). The accounting department stated that there is no uniform policy and procedure to guide where travel expenses should be appropriately charged. However, the "Budget to Actual" schedule from the accounting system does provide a line item "Travel Expenses" referred by object code 54095. The IT department stated the accounting system has the functionality to provide the breakdown of itemized travel but management does not utilize the object code either for budgeting or recording actual expenditures.

Accountability over travel related expenditures would be enhanced by segregating such amounts for budgeting and accounting purposes.

RECOMMENDATION

17. Adopt a policy to budget travel expenses as a separate line item in each department. Consistently record travel expenditures in the appropriate object code within the accounting system.

CONSULTANTS – ACCOUNTING SERVICES

We noted payments for accounting services to an accounting firm other than the firm engaged to perform the annual Single Audit of the City. The annual expenditures ranged from $18,690 in fiscal 2004, to $11,100 in fiscal 2007 and totaled $63,277 for the four-year period. The services provided, as indicated on vendor invoices, included:

- preparation of workpapers of various general ledger accounts for year end reporting purposes;
- initial preparation of transmittal letter for Comprehensive Annual Financial Report (CAFR);
- assistance with preparation of the CAFR;
- preparation of statistical tables required for the CAFR;
- preparation of the Schedule of Expenditures of Federal Awards;
- preparation of Management's Discussion and Analysis for inclusion in the CAFR; and
- preparation of budget documentation for submission to the Government Finance Officers Association Budget Awards Program

These services appear to be for recurring functions that would usually be performed by the City's Finance Department. As a cost saving measure, the City should determine whether these functions could be performed internally with existing staff rather than hiring an outside consultant.

RECOMMENDATION

18. Reassess whether certain fiscal closing and financial reporting tasks previously performed by a consultant to the City could be performed by existing staff of the Finance Department.