NASSAU COUNTY
OFFICE OF THE COMPTROLLER

REPORT ON THE COUNTY'S FINANCIAL CONDITION FOR THE FIRST SIX MONTHS OF FISCAL YEAR 2003

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NASSAU COUNTY
OFFICE OF THE COMPTROLLER

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Executive Summary

This report, which is mandated by Article IV § 402.9 of the Nassau County Charter, as modified by Local Law 3-2003, assesses the financial condition of the county for the first six months of the fiscal year 2003 (FY 03) and provides an opinion as to whether a surplus or deficit shall exist at year-end.

Our analysis of revenues and expenses through the end of June, coupled with our forecast for the remaining six months of the year, projects that the county will experience a small FY 03 budgetary surplus of approximately $15.3 million for its primary funds (General Fund, County Parks, Fire Safety, Police Headquarters and Police Districts). This surplus is primarily the result of conservative budgeting by the Suozzi administration and one-time pension relief, in the amount of $43 million, generated by pension system funding changes implemented by the New York State Comptroller. The year-end surplus is projected despite an anticipated $27 million sales tax shortfall and the payment of $40 million of retirement related obligations.

While the administration has made much progress towards improving Nassau County's financial position, the county still suffers from a structural deficit. As we have stated in several reports regarding the financial difficulties facing the county, the projected structural deficits are $150 million in 2004 and $300 million in 2005. We are pleased that this year's spending plan includes a number of measures aimed at increasing the county's long-term fiscal health and decreasing debt. Those measures will help close projected budget gaps in 2004 and beyond by using available 2003 funds to pay down certain non-recurring obligations. They included $21 million to pay for the county employee 2002 early retirement incentive program and $19.3 million to pay the balance of debt related to retirement. By paying these one-time retirement obligations this year, the administration is reducing the heavy deficits projected for 2004 and 2005. The county's decision to provide budgetary relief in future years by paying these obligations down now is prudent and sensible.

At this time, a number of unresolved major issues remain that may impact this year's projected surplus. The proposed labor agreement between the county administration and the Civil Service Employees Association was ratified by its membership on July 24, 2003. However, to become effective, it must be adopted by the County Legislature. The county's three police unions, the Police Benevolent Association (PBA), Detectives Association, Inc. (DAI) and Superior Officers Association (SOA), are all currently without labor contracts. NIFA has not yet approved the entire amount of restructuring of long-term county debt assumed in the FY 03 Adopted Budget. We understand that currently, only $40 million of the total $57 million budgeted, has been approved. Accordingly, we have not recognized the remaining $17 million. We understand that the State Legislature may convene a special session in the Fall to consider forgiving $155 million of State advances to counties for social services mental health programs. If enacted, the county will save $15.3 million, which is not included in our forecast. We do not yet know if the State will enact another early retirement incentive program, which, if adopted by the county, would further reduce current work force levels and increase future years' retirement related expenses.

The legislation mandating this report requires the Comptroller to express an opinion as to whether a surplus or deficit shall exist at the end of the current fiscal year. The legislation was intended to obtain a mid-year independent forecast of the projected year-end results. However, for the year ended December 31, 2002, the county complied with the new financial reporting standards, promulgated by the Governmental Accounting Standards Board (GASB Statement No. 34). Among other financial disclosures, GASB 34 requires a statement of net assets, which presents the county's net asset position (net worth). We believe a projection of the county's FY 03 net asset position is appropriate, and is included in this report. We expect the net asset deficit to grow to approximately $1.2 billion during 2003, due to the continued issuance of long-term debt for tax certiorari and other judgments. This net asset deficit will continue to grow until 2006, when the county moves to paying for these obligations from annual operating budgets instead of using long-term financing. This is based on the county's assumption that it will achieve its goal of reducing the annual level of property tax refunds from $150 million to $57 million by 2006.

Revenue and Expense Forecast for 2003*

($ millions)

	2003 Adopted Budget	2003 Projected Actual	Variance
Revenues:			
Sales Tax	$882.4	$855.0	($27.4)
Property Tax	738.8	742.9	4.1
State and Federal Aid	300.3	293.2	(7.1)
Other Revenues	373.2	387.7	14.5
Total Revenues	2,294.7	2,278.8	(15.9)
Expenses:			
Payroll and Fringe Benefits	1,044.8	972.7	72.1
Debt Service	289.1	289.3	(0.2)
Social Services	459.2	453.5	5.7
Other Expenses	501.6	507.7	(6.1)
Lump Sum Payment of 2002 Early Retirement Incentive		21.0	(21.0)
Defease Retirement Debt Service		19.3	(19.3)
Total Expenses	2,294.7	2,263.5	31.2
Total Projected Surplus	**$0.0**	**$15.3**	**$15.3**

*This forecast includes the following county funds: General, Parks and Recreation, Police Headquarters, Police Districts, and Fire Prevention, Safety, Communication and Education.

SIGNIFICANT VARIANCES - Obligations

Labor Costs

Employee salaries and fringe benefits constitute the largest portion of the county's expense budget. For its primary funds (General Fund, County Parks, Fire Safety, Police Headquarters and Police Districts) the FY 03 Adopted Budget for personnel costs equals approximately $1 billion, or about 43 percent of the total $2.3 billion budget. For 2003, the Comptroller's Office projects a $72.1 million year-end favorable variance to budget, for combined salaries and fringe benefits. Pursuant to the county's financial plan, this projected favorable variance will be reduced by the payment of $21 million for the FY 02 county employee early retirement incentive program and $19.3 million for the remaining balance of retirement debt issued in 1993.

Salaries

Proposed CSEA Agreement

The county's largest labor union, the Civil Service Employees Association (CSEA), has reached a tentative agreement with the county administration, which was ratified by its membership on July 24, 2003. The agreement must still be approved by the County Legislature in order to become effective. The prior contract with the CSEA expired on December 31, 2002.

The Comptroller's Office estimates that the proposed contract, if adopted, will cost approximately $3.4 million in fiscal 2003 for the county's primary funds, which is included in our projections. This represents an $8.6 million savings when compared to the 2003 adopted budget. While the budget did not anticipate any CSEA labor concessions to be achieved in 2003, estimated savings from the proposed CSEA agreement, are less than those projected in the multi-year plan for the out years.

Unresolved Police Labor Agreements

Police officers and other personnel represented by the county's three police unions still are without labor agreements. The contracts with the Police Benevolent Association (PBA) and the Detectives Association (DAI) expired on December 31, 2000, while the Superior Officers (SOA) agreement expired on December 31, 2001. The PBA and the DAI are currently engaged in binding arbitration with the county. The outcome of the arbitrations could have a significant impact on the county's financial position. Including retroactive payments for FY 01 and FY 02, each one-percent wage increase awarded annually to the police unions will cost approximately $17 million through 2003. Our projections are based on increases awarded to the Suffolk County PBA in its current contract.

Overtime

Overtime costs total $24.1 million through the end of June 2003. This amount is $8 million, or approximately 50 percent higher that the $16.1 million year-to-date June total a year ago. The Comptroller's Office projects that overtime for the county's primary funds could exceed the 2003 Adopted Budget by as much as $12.9 million, comprised of unfavorable variances in the General Fund of $5.6 million, $5.5 million in the Police Districts Fund and $1.7 million in the Police Headquarters Fund. The most significant portion of the forecasted variance in the General Fund is due to increased costs at the Correctional Center related to last Winter's snow storms, an increase in the number of required training days and raises included in the corrections officers' current labor agreement. The projected negative variance in the police funds is primarily due to overtime caused by the impact of minimum staffing requirements and the reduced number of police officers, and increased homeland security needs.

Termination Pay

Subject to the impact of finalized labor agreements with the county's police unions, FY 03 termination pay totals are expected to finish close to the adopted budget. Based on 125 police retirements, the Comptroller's Office is projecting a favorable variance in the police funds, totaling approximately $1.7 million. This positive variance will be substantially offset by a $1.2 million negative variance in the General Fund.

Fringe Benefits

Retirement System Contributions

Expenditures for employee retirement system contributions will be favorable to budget by approximately $28.4 million as a result of legislation proposed by New York State Comptroller Alan Hevesi. This legislation changed the methodology for funding the State's retirement systems and resulted in a one-time benefit of $43.3 million. Beginning in 2004, however, pension contributions are projected to increase dramatically.

Health Insurance

Employee health insurance costs continue to rise at an alarming rate, although we were pleased to see that a number of cost saving initiatives suggested in the Comptroller's report, "Providing Affordable Health Insurance for County Employees and Retirees in the Midst of a Fiscal Crisis: Some Suggested Solutions," are included in the proposed CSEA labor agreement. For 2003, the Comptroller's Office is projecting health insurance costs of $70.2 million for active employees and $63.9 million for retirees for the county's primary funds. This forecast reflects average increases of approximately 12 percent for active employees and 17 percent for retirees, and would result in a total $9.6 million favorable variance against the $143.7 million adopted budget.

SIGNIFICANT VARIANCES – Other than Personnel Services

Contractual Obligations

Contractual obligations are projected to be $8.9 million over the $154.1 million FY 03 Adopted Budget. This is primarily the result of obligations related to the county's continuing property reassessment project that are $7.1 million over the adopted budget, and higher than anticipated health care costs for services provided to Correctional Center inmates by the Nassau Health Care Corporation, projected to be $1.4 million over budget. In an audit report issued in 2002, we concluded –- and the State Comptroller in a separate audit concurred--that the Correctional Center's per capita health care costs were as much as three times higher than in neighboring Suffolk County. Nassau's administration is currently examining the high cost of these services.

Costs for Pre-NHCC Employee Benefits

Pursuant to the transfer agreement with the NHCC, the county is responsible for certain employee benefits, earned before the health care facilities were transferred from the county to the corporation. These costs are projected to be $3 million below budget due to lower than anticipated termination pay expenses for Corporation employees.

Social Services

Social Service expenses continue to rise, primarily due to the cost of Medicaid, which continues to experience double-digit annual increases. Accordingly, we joined the county executive in calling for a fundamental change in the relationship between the State and its counties as it relates to spiraling Medicaid costs. For 2003, the Comptroller's Office is projecting a positive social services variance of $5.7 million. The savings generated by modifications to the federal government's Federal Medical Assistance Participation Rate (FMAP) program is projected to provide a net $7.2 million of unanticipated cost savings. The revenues are projected to be more than offset, however, by the recognition of obligations related to a significant backlog of Medicaid applications.

Education of Handicapped Children

The education of handicapped children programs administered by the county's Department of Mental Health are projected to experience a negative variance of approximately $3 million due to increased caseload and costs, including retroactive rate adjustments for prior years. We anticipate actual FY 03 expense to be $76.8 million, against an adopted budget of $73.8 million. This variance will be partially offset by increased reimbursements from New York State.

OTPS Savings Imposed by the Administration

The administration has imposed a freeze on other than personnel service expenditures, stopping all non-emergency purchases during the reminder of 2003. This initiative is anticipated to save the county $4 million during the remainder of the year.

SIGNIFICANT VARIANCES – Revenues

Tax Revenues

Sales Tax

Our report last year included an overview of the national and local economies as they affected county finances, particularly sales tax revenues. Since then, however, the Office of Legislative Budget Review has begun producing monthly economic indicator reports. Accordingly, we have decided not to duplicate those reports' compilation of relevant statistics in this report. However, our estimates include the assumption that the weakened economy will remain relatively flat for the remainder of the year, with between a 1 to 2 percent growth for the next six months.

Through June 2003, sales tax collections have grown approximately one percent on a gross, unadjusted accrual basis. Based on previous collection history, collections to date and economic assumptions, and after adjustment for one-time prior-year increases generated by the US Golf Open at Bethpage State Park and the acceleration of electronic funds transfer collections, FY 03 sales tax revenues are projected to be $27.4 million less than the $882.4 million included in the 2003 Adopted Budget.

Non-Tax Revenues

Rents and Recoveries

Revenues in this category include tobacco settlement proceeds and budgetary recoveries from the reversal of unused prior-year encumbrances. FY 03 results are projected to be $13.8 million over the $46.3 million budget, primarily the result of increased administrative efforts to clean up the significant balance of prior-year encumbrances.

Debt Service from Capital

Unused proceeds from finalized capital projects are transferred to the operating funds to pay for related debt service. The Comptroller's Office is projecting a $5.5 million year-end FY 03 total in this unbudgeted funding source.

OTB Profits

During the first quarter of FY 03, the Nassau County Off-Track Betting Corporation (OTB) experienced a decrease in attendance, partially attributable to the inclement weather. Additionally, the corporation is obligated to pay $1 million in new taxes and fees to the State Racing and Wagering Association and must fund increased employee pension contributions. Accordingly, the Comptroller's Office is projecting a $2.1 million unfavorable variance from this revenue source against the $13.2 million budget, related to the contractual sharing of OTB profits.

Federal and State Aid

We are projecting unfavorable variances of $3.3 million against the $112.6 million federal aid budget and $3.8 million against the $202.7 million state aid budget. The federal aid variance is related to a reduction in reimbursements for lower than expected Social Service related salaries and DSS programs. We anticipate that state aid for Social Services will be $2 million below budget for reimbursement of the Family Health Plus Program and $800 thousand below budget for home relief. State aid for the reimbursement of Correctional Center costs related to holding state-ready prisoners is projected to be approximately $783 thousand, which is $1.3 million less than the $2.1 million adopted FY 03 budget. This is attributable to New York State accepting prisoners more quickly than in the past, thus avoiding the higher reimbursement rate required when inmates are held more than fifteen days.

Departmental Revenue

During the first six months of 2003, the County Department of Parks and Recreation collected $5.6 million, or 32 percent of its total budget. The FY 03 Adopted Budget is $17.5 million, or 19 percent over last year's actual. Based on the current level of revenues, a shortfall of $1.7 million could be experienced in FY 03. The primary cause of this shortfall has been the effect of inclement weather on golf fee collections.

Investment Income

Investment income earned during the first six months of FY 03 totaled $4.1 million, representing a decline of 33 percent under the same period a year ago. The decline is attributable to falling interest rates and a drop in daily average cash balances. The cash balance reduction is indicative of continued prudent cash management, which results in lower borrowing costs. The FY 03 budget included $8.5 million in investment income. Based on the level of earnings already achieved, full-year results adjusted for arbitrage rebate liability are projected to reach $5.1 million, which is $3.4 million under budget estimates.

Fines and Forfeitures

Fines collected by the Traffic and Parking Violations Agency are projected to fall short of budget expectations by approximately $2 million, due to a decline in the number of summons issued during 2003. While management has achieved improved collections of related fines, statistics obtained from the recently implemented County-Stat system reveal that when compared to last year, non-highway patrol summonses issued are down 32 percent and highway patrol summonses are down 3 percent.

Net Assets

The county's Comprehensive Annual Financial Report for the year ended December 31, 2002 was presented in compliance with Governmental Accounting Standards Board Statement No. 34 (GASB 34) – *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments.* The entirely new reporting format required by GASB 34 incorporates significant changes, including consolidated financial statements for all county operations, utilization of the full accrual basis of accounting and presentation of the county's cumulative net asset value.

The County Charter requires the County Comptroller to annually project a year-end budgetary surplus or deficit. In accordance with the new GASB 34 reporting requirements, we believe a forecast of the year-end net asset position is also appropriate.

As of December 31, 2002, the county's cumulative negative net worth was $992 million. Many municipalities have net asset deficits due to long-term liabilities, such as accrued termination pay for accumulated compensated absences. Nassau County's negative net worth has been primarily caused by its historical practice of issuing long-term debt to finance property tax refunds and other judgments. The actual dollar amount of the negative net worth is less significant than the trend, which is symptomatic of past poor borrowing practices. We believe the net asset deficit will increase to approximately $1.2 billion in FY 03, primarily due to the substantial amount of debt that again will be issued to finance property tax refunds and other judgments, estimated to be $250 million. The negative net worth will continue to grow until 2006, when the county moves to paying for these obligations from annual operating budgets instead of using long-term financing.

The updated Multi-Year Financial Plan (the "Plan") provides a strategy to gradually shift the funding for these liabilities to the operating budget, as the amount of long-term debt without corresponding assets is reduced. (If the Plan's assumptions of future tax certiorari claims are understated, the projected improvement in cumulative net assets could be negatively impacted.) Since the desired result will take place over time, the county net asset deficit will increase during 2003.

Nassau Health Care Corporation

The county has guaranteed $256 million in debt issued to finance the creation of the Health Care Corporation. Therefore, the financial position of the Corporation warrants our careful scrutiny. Each year since the Corporation began operating the health facilities acquired from Nassau County, the Corporation has incurred significant operating deficits and experienced an ongoing decline in cash and accumulated fund balance. Revenues have failed to keep pace with expenses, and future projections are inconclusive.

The Corporation has incurred net losses totaling $78.5 million from its inception in 1999 through December 31, 2002, and an additional $9 million for the first six months of 2003, calling into question its ability to meet its 2003 budgeted loss of $8.8 million. The cash balance has declined from $139.2 million at the end of 1999, to $42.4 million as of June 30, 2003. Unrestricted fund balance has also decreased, from $29.7 million at the end of FY 99, to a negative $30 million as of June 30, 2003. The Corporation's finances are further threatened by forecasted significant increases in pension contributions and the overall negative outlook for the health care industry.

The decline in the Corporation's financial position may limit its ability to continue to meet the health care needs of its patient population. Accordingly, the county is in the process of obtaining the assistance of health care experts to examine the county's current and future role in meeting the health care needs of its residents.