Comptroller's Comments
On The Proposed Nassau County
FY 2004 Budget and Multi-Year Financial Plan

Howard S. Weitzman
Nassau County Comptroller

October 15, 2003

This report appears on the comptroller's website @www.co.nassau.ny.us/comptroller
For more information call (516) 571-2386

NASSAU COUNTY
OFFICE OF THE COMPTROLLER

Howard S. Weitzman
Comptroller

Jane R. Levine
Chief Deputy Comptroller

Manuel Mosquera
Deputy Comptroller
for Audits and Special Projects

Randolph Ghisone
Deputy Comptroller for Accounting

Judy Bejarano
Assistant Director of Accounting

Accounting Staff
Julie Hennel
Kathy Kugler
Camille Thompson

Susan D. Wagner
Deputy Comptroller
for Operations

Allen Morrison
Director of Communications

Ana Sousa
Special Projects

Chuck Lott
Accounting Executive

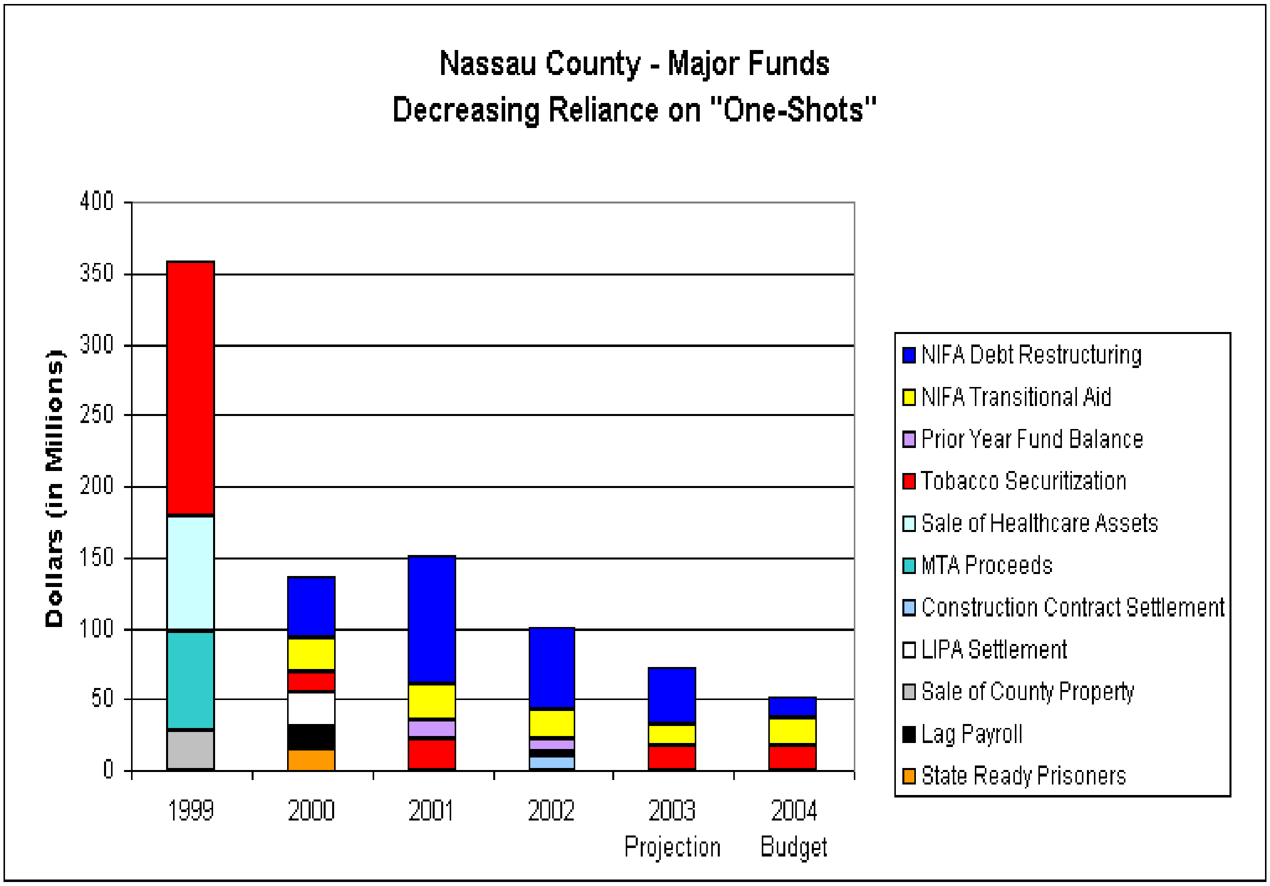
Comptroller's Comments On The Proposed Nassau County FY 2004 Budget and Multi-Year Financial Plan

October 15, 2003

On September 15, 2003, Nassau County Executive Thomas R. Suozzi presented to the County Legislature his proposed Fiscal 2004 (FY 04) Budget ("proposed budget") and Multi-Year Financial Plan (the "financial plan") for the years 2004 through 2007, as required by the Nassau Interim Finance Authority (NIFA).

The Comptroller's office analyzed the underlying assumptions and financial estimates contained in the proposed budget and financial plan. The proposed budget is balanced and incorporates assumptions about revenue and expense growth rates that are appropriately conservative. A conservative fiscal strategy is especially warranted given the uncertain economic times and projected out-year structural deficits. This strategy was incorporated in the FY 03 adopted budget and is projected to result in surplus funds at the end of fiscal 2003. The administration plans to use these funds to provide budgetary relief over the next several years by paying for a number of liabilities that otherwise would have been financed over an extended period.

As presented in the table below, the proposed budget includes $52 million of non-recurring revenues or "one-shots." This is the lowest level since 1998. During 1999 the county avoided a deficit of $330 million through the use of $358 million of such one-time revenues. While the use of non-recurring revenues is appropriate under certain circumstances, such revenues do not contribute to closing ongoing budgetary structural deficits.



The out-year projections in the financial plan show that expenses will rise sharply, with little or no growth in revenues. As with most counties across New York State, Nassau County is saddled with dramatic annual cost increases for state and federally mandated expenses, as well as for contractual employee fringe benefits. These cost increases cannot be sufficiently funded by normal revenue increases and are the cause of the projected increase in the structural deficit. In the plan, the county indicates that New York State and its counties must redefine their relationship as it relates to mandated Medicaid responsibility. The Comptroller's office is on record as agreeing with this position. If, however, budgetary relief is not forthcoming from the State, the plan advocates dedicating a portion of the county's property tax to Medicaid.

A number of the plan's out-year gap closing measures and revenue opportunities are subject to significant risk. Additionally, the financial challenges faced by the Nassau Health Care Corporation expose the county to large potential liabilities, as do future property assessment challenges. Consequently, the county may have to take additional measures in the future to maintain fiscal health.

The Proposed 2004 Budget

The proposed budget includes funding for employee pension contribution rates of between 17.4 and 29.4 percent of earnings for police personnel and between 11.3 and 19.5 percent for non-police, depending upon employee retirement system tier designations; increases for employee and retiree health insurance costs of 15 and 18 percent respectively; and a 13.5 percent increase in mandated Medicaid expenditures. Sales tax revenues are projected to rise 2.7 percent over the administration's $878.2 million FY 03 estimate.

Pensions

The schedules below present our projections for employee pension contribution expense for the county's five primary funds (General, Police Headquarters, Police Districts, Parks and Fire Safety). Annual pension-related expenditures are projected to increase from approximately $29 million in fiscal 2003 to $116.6 million in 2007, an increase of 302 percent. Since the county is on a calendar year and the State retirement systems are on a March fiscal year, the county will benefit from the recently adopted New York State Retirement System funding formulas for the last nine months of FY 03 and the first three months of FY 04.

Schedule A

Employees' Retirement System Projected Expense
Five Primary Funds
($ Millions)

	2003 Estimate*	2004 Projected**	2005 Projected	2006 Projected	2007 Projected
Retirement Expense	$ 14.5	$ 41.8	$ 51.8	$ 53.4	$ 55.2
Percent Increase Over Prior Year	178.8%	188.3%	23.9%	3.1%	3.4%

Schedule B

Police and Fire Retirement System Projected Expense
Five Primary Funds
($ Millions)

	2003 Estimate*	2004 Projected**	2005 Projected	2006 Projected	2007 Projected
Retirement Expense	$ 14.8	$ 44.4	$ 54.7	$ 57.7	$ 61.4
Percent Increase Over Prior Year	78.3%	200.0%	23.2%	5.5%	6.4%

Schedule C

Total Projected Retirement Expense
Five Primary Funds
($ Millions)

	2003 Estimate*	2004 Projected**	2005 Projected	2006 Projected	2007 Projected
Retirement Expense	$ 29.3	$ 86.2	$ 106.5	$ 111.1	$ 116.6
Percent Increase Over Prior Year	117.0%	194.2%	23.5%	4.3%	5.0%

* Based on the Preliminary Annual Contribution Statement dated August 1, 2003 from the New York Retirement System.

** Based on retirement rates and inflators provided by the New York State Retirement System

Note:
Projections for years 2005-2007 are based on retirement rates remaining stable for the Employees Retirement System, with a 1% increase a year in the rates for the Police and Fire Retirement System, as per direction from the NYS Retirement System Chief Actuary.

Health Insurance

The schedules below present our projections for increases in employee and retiree health insurance costs for the county's five primary funds. Total costs are forecast to increase from approximately $134 million this year to $251 million in fiscal 2007, an increase of 87 percent.

Schedule D

Health Insurance for Active Employees
Five Primary Funds
($ Millions)

	2003 Projected	2004 Projected	2005 Projected	2006 Projected	2007 Projected
Expense	$ 70.1	$ 82.4	$ 94.8	$ 109.0	$ 125.4
Percent Increase Over Prior Year	5.1%	17.5%	15.0%	15.0%	15.0%

Schedule E

Health Insurance for Retired Employees
Five Primary Funds
($ Millions)

	2003 Projected	2004 Projected	2005 Projected	2006 Projected	2007 Projected
Expense	$ 63.9	$ 76.5	$ 90.3	$ 106.6	$ 125.8
Percent Increase Over Prior Year	19.9%	19.7%	18.0%	18.1%	18.0%

Schedule F

Total Health Insurance Expense
Five Primary Funds
($ Millions)

	2003 Projected	2004 Projected	2005 Projected	2006 Projected	2007 Projected
Expense	$ 134.0	$ 158.9	$ 185.1	$ 215.6	$ 251.2
Percent Increase Over Prior Year	11.7%	18.6%	16.5%	16.5%	16.5%

Medicaid

The schedule below presents our baseline projections for Medicaid growth over the next four years. Total costs are forecast to increase from approximately $240 million this year, to $409 million in fiscal 2007, a cumulative increase of over 70%. The crushing burden represented by the county share of Medicaid costs under existing state formulas represents a serious threat to the future solvency of every county in the state (see page 9).

Schedule G

Medicaid Expense
(Net of IGT)
($ Millions)

	2003 Projected*	2004 Projected*	2005 Projected	2006 Projected	2007 Projected
Expense	$ 239.8	$ 264.1	$ 322.8	$ 363.9	$ 408.6
Percent Increase Over Prior Year	12.5%	10.1%	22.2%	12.7%	12.3%

* 2003 is inflated due to costs associated with the Medicaid application backlog reduction

Other Issues

Our latest sales tax projection indicates a potential 2003 shortfall of $8 million, which would bring total FY 03 collections to $874.4 million, slightly less than the $878.2 million estimated by the administration. A shortfall greater than that forecast by the administration will reduce the baseline used to project the proposed sales tax budget and may necessitate future budgetary adjustments. Actual results will be subject to developments in the local economy, which are difficult to predict.

The proposed budget appropriates sufficient amounts to fund the recent Civil Service Employees Association (CSEA) collective bargaining agreement and the Police Benevolent Association (PBA) arbitration award. The police arbitration award reduced termination pay for police officers retiring after December 31, 2004. Accordingly, the county's police force may experience retirements in excess of historical levels. The proposed budget contains sufficient funding for approximately 100 PBA retirements. The administration plans to use $18 million to $26 million of surplus 2003 appropriations in the Police Headquarters Fund and Police Districts Fund to establish a reserve to be used for any additional police retirements during FY 04.

The FY 04 budget submission includes a commendable proposal for the use of $19.9 million of accumulated fund balance to support important technology projects that will yield ongoing benefits to the county.

The county's declining subsidy to MTA Long Island Bus is reduced further in the proposed budget to $3.6 million from $8.3 million in 2003 ($11.3 million in 2001). This is inconsistent with the County Executive's call for Long Islanders to reduce their reliance on automobiles and increase their use of public transportation. We are additionally concerned that these cutbacks will impact the ability to provide transportation to the disabled. If the subsidy is reduced, the MTA and the county will need to work together to find alternative funding sources.

As a result of the recent agreement on the terms of Sewer and Storm Water Authority legislation, the proposed budget includes a new fund, the Sewer and Storm Water District Fund. The Sewer and Storm Water Finance Authority will be created to facilitate financing for Nassau County's sewer funds. It will have the ability to issue bonds and finance the operation and construction of sewer and storm water facilities. As part of the legislation that establishes the Authority, a consolidated Sewer and Storm Water District will be created to consolidate the various sewer disposal and collection funds. The enabling legislation for the Sewer and Storm Water Finance Authority is not yet finalized.

The administration anticipates that NIFA will borrow $55 million in 2003 for advance refunding bonds. It also anticipates issuance of notes and bonds of $16.8 million in July 2004. The Authority will assume the county's debt service payments for existing storm water and unrestuctured, unrefunded sewer debt.

The proposed budget contains charge-backs to agencies for certain services provided to them by other agencies. These charge-backs, to be implemented through internal service agreements, are intended to motivate analysis of the costs of various county-provided functions. We believe that these charge-backs are an important tool in analyzing costs. We do not believe, however, that they should be utilized as part of the budget process, since the agencies being charged have no significant control over these costs or access to alternative, non-county contractors.

Several items in the proposed budget require technical corrections. These corrections have been discussed with the administration, which has indicated it will make the necessary modifications to the budget submission. The corrections include adding the police headquarters-to-districts charge-back, which is booked annually to account for police district services performed by and initially charged to police headquarters. This charge results in additional Police Headquarters Fund revenue that is offset by Police District Fund expense. Accordingly, the correction has no net impact on the proposed budget. The property tax budget must also be corrected, primarily to properly account for prior year excess sales tax receipts. This will result in a $4.1 million reduction in budgeted revenue, which must be offset with additional cost reductions and/or revenue increases.

The administration indicates that an additional change is being made to the proposed budget with respect to the transfer of approximately $3 million of charges for 49 public works employees. Although these employees perform work related to the county's sewer functions, they have been charged historically to the General Fund. The proposed budget initially transferred related personnel costs to the Sewer and Storm Water District Fund. We understand that the budget is now being modified to move the expenses back to the General Fund. If these employees specifically perform work related to sewer projects, then the related salaries and fringes should be charged to the Sewer Fund.

The Multi-Year Financial Plan – Fiscal Years 2005 through 2007

For the out years of the proposed financial plan, the county's exposure to structural budget deficits increases significantly. The financial plan includes revised baseline structural deficits that reach $121.8 million in FY 05, $288.2 million in FY 06, and $395.1 million in FY 07. In the plan, each of these projected future budgetary gaps is closed by new revenue-generating and cost-cutting initiatives, and revenue opportunities.

Based on our forecasts of future expenses and revenues, as well as a review of the assumptions and projections included in the Proposed Multi-Year Financial Plan, the growth in the projected structural deficit results primarily from dramatic increases in pension contributions, health insurance premiums for employees and an increasing number of retirees, and mandated Medicaid expenses. The projected growth in these expenses cannot be funded by revenues that are growing at a much slower pace.

We are concerned that the Plan may understate future budget gaps. Most significantly, projected Medicaid expenses may be understated by over $25 million per year, from 2005 through 2007. While we agree with the estimated growth rate of 13.5 percent annually for basic Medicaid local share payments, the increases were applied to an understated FY 04 base. In addition, the revenue generated by charge-backs to capital project funds, for services provided by and charged to the General Fund, are overstated by approximately $6 million per year from 2005 through 2007. Estimated annual increases were applied to an FY 04 baseline, which was artificially inflated due to a one-time accounting adjustment.

Unlike the Suozzi administration's past financial plans, the current plan does not discount the value of individual gap-closing actions. A number of these measures are subject to unknown factors, and accordingly, are not without risk. If the actions identified do not achieve expected results, the county will have to take other actions to ensure the county's future fiscal balance.

The revised baseline growth of the Proposed Multi-Year Financial Plan includes pension contribution costs of between 17.4 and 29.4 percent of eligible earnings for police personnel and between 11.3 and 19.5 percent for non-police employees, depending upon retirement system tier designations. These contribution rates are based on information provided by the State retirement systems, and are held constant through the future years of the Plan which assumes no further decline in pension system investment performance.

Health insurance expenses are estimated to grow 15 percent annually for active employees, and 18 percent annually for retirees. These projected increases are based on information provided by the New York State Health Insurance Plan (NYSHIP).

The proposed financial plan includes mandated basic Medicaid costs that are expected to grow 13.5 percent annually. In the plan, the administration presents the value of potential relief from New York State for capping this expense. This action is estimated to save $35.9 million in 2006 and $81.1 million in 2007. This office often has stated the critical need to restructure the relationship between counties and the state to fund Medicaid, which was never intended to be funded by local property taxpayers. If, however, relief is not provided by the State, the plan presents the alternative of a dedicated property tax to fund future increases in Medicaid expenditures.

The financial plan's baseline includes sales tax revenues that increase 2.7 percent annually. While this growth rate is conservative, the plan includes a contingency for sales tax revenue growth that parallels historical averages. If achieved, the growth in sales tax collections would increase 3.6 percent in each of the fiscal years 2005 through 2007. Additionally, the plan includes the implementation of either a residential energy tax or a ¼-cent sales tax increase, which will generate approximately $50 million in each year, 2005 through 2007.

While property tax rates are held constant in the proposed financial plan, with the possible exception of the potential increase to fund Medicaid discussed above, a gap-closing measure related to greater tax revenues associated with increased property values is projected to generate $32.9 million in FY 06 and $58.5 million in FY 07. This source of revenue, however, may be inadequate if property values are flat or decrease. In that event, other budgetary actions will be required to the close the gap.

Health and human services expenditures other than Medicaid are projected to grow 4.4 percent annually. Costs for other than personal services, such as equipment and office supplies, are expected to grow 2.5 percent per year. Since the county controls this expense, we believe the forecast increase is realistic. The annual growth for state and federal aid reimbursements is forecast to be approximately 2.45 percent, while other revenues are projected to remain flat. Health and human services reimbursements from the state and federal governments have grown an average of 2.7 percent and 3.3 percent respectively, over the last five years. Accordingly, the Plan's projected increase of 2.45 percent appears reasonable and parallels the projected increases in related reimbursable expenses.

The budget and financial plan propose an additional workforce reduction of 298 positions by the end of 2007. When complete, this initiative is projected to save $28.1 million per year. While the county must cut costs and keep staffing levels to a minimum, the ultimate impact on essential services must be carefully monitored.

The costs arising from the recently settled CSEA and PBA labor contracts are included in the financial plan's baseline. The plan includes gap-closing concessions from new contracts to be negotiated with the Detectives Association (DAI), Superior Officers Association (SOA) and Sheriff Officers Association (SHOA). The value of these concessions is estimated to range between $10 million in 2004 to $34.5 million in 2007. Given the relative size of the projected labor costs for these remaining unions, the concession targets may be difficult to achieve, especially in FY 06 and FY 07.

The Proposed Multi-Year Financial Plan includes new "smart government initiatives" valued at $90.2 million by FY 07. This number may be difficult to achieve. We did not perform an in-depth analysis of the initiatives; some of them, however, are subject to uncertainty and risk. These include:

- The annual recovery of $1.5 million from correcting billing errors on invoices related to contractual services;
- $1.7 million of annual savings generated by automating the county's time and leave systems;
- $1.5 to $2 million annually for unrecorded revenue receivables; and
- $2 million annually to pass down charges to the towns and cities for county residents who attend out-of-county community colleges.

One of the most significant factors that will affect the multi-year plan and the County's financial recovery will be the outcome of future property assessment challenges. The county projects that future tax certiorari liabilities will be $39 million in 2006 and $29 million in 2007. The county has historically borrowed over $100 million each year to fund these liabilities. The success of assessment challenges and their cost implications to the county will depend on the accuracy of the reassessment project and the effectiveness of the Assessment Review Commission. Our concerns about the efficacy of some of the mass appraisal techniques employed by the county's reassessment contractor were stated in our audit report of May 14, 2003.

This office remains concerned about the financial viability of the Nassau Health Care Corporation, its ability to continue to deliver health care assistance to the population it serves, and the effect that developments at the Corporation will have on the future finances of the county. We recently released an audit report describing the corporation's decreasing cash balances. As a result, the Corporation has agreed that the Comptroller's office will monitor the corporation's cash balances on a monthly basis.

Outside health care experts retained by the county are reviewing the County's provision of health care services, its relationship with the NHCC, and future options.

For the first time, the county's Comprehensive Annual Financial Report produced for the year ended December 31, 2002 included financial statements calculating the county's net worth, as required by the Governmental Accounting Standards Board (GASB). The county was found to have a *negative* net worth of $1 billion, primarily due to the county's previous practice of bonding settlements for property tax assessment challenges and other judgments against the county. A growing concern is the future value of health insurance benefits for retirees (determined according to actuarial tables), which GASB requires the county to include beginning in 2006. While the required analysis has not yet been performed, the calculated amount will increase the county's negative net worth significantly and highlights the dramatic impact retiree health benefits will have on future county budgets.