



CITY OF PHILADELPHIA

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ALAN BUTKOVITZ
City Controller
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August 23, 2012

Ms. Fran Burns
Executive Director
Pennsylvania Intergovernmental Cooperation Authority
1500 Walnut Street, Suite 1600
Philadelphia, PA 19102

Dear Ms. Burns:

This correspondence is a follow-up to my August 8, 2012 letter issued in conjunction with the examination of the city's Five Year Plan conducted by the City Controller's Office. In that letter I stated that management's assumptions used in the Plan did not provide a reasonable basis for the forecast, and I urged the Pennsylvania Intergovernmental Cooperation Authority (PICA) to reject the Plan. As submitted, the Plan did not include funding for the \$203 million interest arbitration award to the International Association of Fire Fighters (IAFF) or provide for any potential changes in costs resulting from ongoing negotiations with unions representing the city's non-uniformed workers.

I personally believe it is unrealistic for management to assume it will prevail in its current appeal of the arbitrated IAFF award after the same arbitration panel denied the city's previous appeal. Moreover, because it may take several years before a decision on the current appeal will be rendered, management is needlessly assuming the risk that it will be required to make a very substantial retroactive payment if the city loses on appeal. It is short-sighted of management to not anticipate the long-term damaging effect a sizable retroactive payment would have on the city's budget because it would not be surprising if the amount of the retroactive payment in future years eventually dwarfs the \$66 million retroactive payment that would be due currently if the city dropped its appeal and implemented the terms of the IAFF award.

Likewise, I believe management's inability to reach a settlement in its ongoing negotiations with its non-uniformed workers may have a similar, devastating effect on the city's budget. The Five Year Plan with its supplemental projected expenditure reductions addresses only the \$203 million in additional costs for the IAFF award, and makes no provision for increases for the city's non-uniformed workers. Because these employees have been working under the terms of an agreement that expired more than four years ago, the terms of any future settlement may include additional retroactive wage and benefit payments which the city has not planned for and may not be able to afford without large tax increases or further expenditure reductions.

With respect to your request of August 10, 2012, my office conducted an examination of the Forecasted and Supplemental Projected General Fund Statements of Operations for the fiscal years ending June 30, 2013 through June 30, 2017 (the forecasted and supplemental projected statements). The forecasted and supplemental projected statements within the Five Year Plan were prepared by the Office of the Director of Finance to reflect the financial impact of the addendum submitted to PICA on August 9, 2012. The supplemental projected statements assume hypothetical levels of expenditure reductions that would be necessary to fund the IAFF award if an outcome unfavorable to the city should occur.

My staff conducted its examination of the forecasted and supplemental projected statements in accordance with attestation standards established by the American Institute of Certified Public Accountants. Those standards require that we evaluate whether the assumptions used by the City of Philadelphia's management at the time the Plan was submitted provide a reasonable basis for management's forecasted and supplemental projected statements. Attached is the independent accountant's report signed by my deputy who is a Certified Public Accountant.

The independent accountant's report indicates that the assumptions used in the plan provide reasonable bases for City of Philadelphia management's forecast and for the City of Philadelphia management's supplemental projections assuming the implementation of the IAFF award and the reduction of expenditures. However, the forecasted statements include particularly sensitive assumptions which PICA should consider when assessing the plan. These particularly sensitive assumptions include:

- The forecasted statements do not include any of the potential new costs of more than \$203 million associated with the IAFF interest arbitration award since the city expects a favorable outcome on appeal. Accordingly, this assumption is considered particularly sensitive.
- The forecasted statements do not include any potential changes in costs or achieved savings resulting from ongoing negotiations with unions representing the city's non-uniformed workers. Accordingly, this assumption is considered particularly sensitive.

Additionally, our review of the supplemental projected statements with hypothetical levels of expenditure reductions that would be necessary to fund the IAFF award disclosed the following areas of concern which, I believe, warrant PICA's attention:

- The possible deactivation or brownout of full- and/or part-time Fire Department Medic Units as well as Engine and Ladder companies to reduce forecasted expenditures by \$3.4 million to \$8.4 million. I have repeatedly commented in prior audit reports that the city's Emergency Medical Services are strained at the current staffing level and paramedics are frequently unable to respond in a timely manner. To propose a further reduction in the number of paramedics is unreasonable, and will only serve to increase the response time and unnecessarily jeopardize the health and safety of the citizens.
- The reduction of certain classes of expenditures for the Philadelphia Prisons System to reduce costs by \$1.9 million to \$3.6 million. These proposed expenditure reductions are based upon a decrease in the city's prison population; a factor which is clearly beyond the city's ability to control. Therefore, it is unlikely that the projected reduction of expenditures related to providing food and incarcerating fewer inmates will be possible.

- The elimination of nine to seventeen Public Defender positions to reduce forecasted expenditures by \$0.5 million to \$1.3 million. It is impractical to assume the elimination of these positions while the District Attorney's Office, which will prosecute these cases, continues to receive sufficient funding to maintain its current staffing levels. Eliminating these positions may result in the need to provide defense attorneys by contracting with outside agencies which could increase the overall cost of providing this service.

Additionally, as I wrote to you in my August 8, 2012 letter, I believe there are several questionable items in the forecasted statements that could dramatically impact its effectiveness. These include:

- The Plan assumes \$90 million in forecasted expenditures for debt service over the life of the Plan that may never materialize.
- Forecasted FY13 revenue includes an assumption that the city will receive \$9 million requested from PICA for construction-related purposes which should be budgeted and recorded in the city's capital projects fund to prevent its use for general purposes.
- The Plan does not provide for increases in funding for the School District whose estimated \$282 million current year deficit has it bordering on insolvency. It remains my belief that the School District will seek further sizable increases in city contributions in the later years of the Plan.

To date, the above uncertainties remain unresolved. I again urge PICA to strongly consider the potential effect of these uncertainties when evaluating the Plan.

I would like to express our thanks to the management and staff of the city's Office of Budget and Program Evaluation for their courtesy and cooperation in the conduct of our examination.

Respectfully submitted,



ALAN BUTKOVITZ
City Controller

cc: Chair and Board Members of the
Pennsylvania Intergovernmental Cooperation Authority
Michael A. Nutter, Mayor
Rob Dubow, Director of Finance
Rebecca Rhynhart, Budget Director