



CITY OF PHILADELPHIA

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ALAN BUTKOVITZ
City Controller
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August 8, 2012

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

Dear Ms. Burns:

In accordance with Section 12720.209(f)(1) of the Pennsylvania Intergovernmental Cooperation Authority Act, my office conducted an examination of the Forecasted General Fund Statements of Operations for the fiscal years ending June 30, 2013 through June 30, 2017 (the forecasted statements). The forecasted statements were prepared by the Office of the Director of Finance and submitted to the Pennsylvania Intergovernmental Cooperation Authority (PICA) on July 27, 2012.

My staff conducted its examination of the forecasted 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 statements. Attached is the independent auditor's report signed by my deputy who is a Certified Public Accountant.

The independent auditor's report indicates that certain management assumptions used in the Plan did not provide a reasonable basis for management's forecast. I urge PICA to reject the Plan for these reasons:

- The forecasted statements are based upon City of Philadelphia management's assumption of a favorable outcome of its latest appeal of the IAFF award, and do not include any potential changes in costs related to the appeal. The City's current appeal was filed in August 2012 after an arbitration panel rejected the City's initial appeal and reaffirmed the interest arbitration award granted to the IAFF in October 2010. The IAFF has filed a lawsuit seeking implementation of the arbitration award. City of Philadelphia

management asserts that the arbitrator's award imposes more than \$203 million in new wage and benefit costs over the life of the Plan, and has not included any provision for covering these costs in the event of an unfavorable outcome of the latest appeal. We do not believe the assumption that the City will prevail is reasonable.

- Based upon the City of Philadelphia management's assumption, the forecasted statements do not include any potential changes in costs resulting from ongoing negotiations with unions representing the city's non-uniformed workers. We do not believe this assumption provides a reasonable basis for management's forecast because recent awards between the city and other labor unions have resulted in employee salary increases.

In addition, the following questionable items, worthy of your attention, were noted during our review of the forecasted statements:

- The Plan overstates forecasted expenditures for debt service over the life of the Plan by approximately \$90 million, primarily because it includes debt service on two anticipated, but unissued and unapproved bond offerings of \$221 million and \$177 million.
- Forecasted FY13 revenue includes \$9 million requested from PICA for design work for a new Police Department headquarters, city morgue and health offices. Both the revenue and the corresponding expenditures for design work should be budgeted and recorded in the city's capital projects fund. Including this revenue in the city's general fund fails to restrict the use of these monies for capital purposes, and allows these funds to be spent for general governmental purposes.

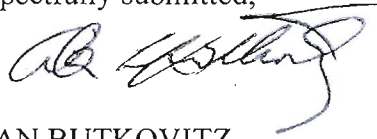
Furthermore, several uncertainties exist which could dramatically impact the Plan's effectiveness. These uncertainties, which PICA should also weigh when reviewing the Plan, include:

- The probability of additional, large funding requests by the School District (District) in future years. The District's current year deficit is estimated to be approximately \$282 million; a staggering amount which has it on the brink of insolvency. The District has no taxing authority and lacks the ability to borrow to finance its deficit. Adding to the District's fiscal woes, the Commonwealth has taken the position that it will not provide additional funding to the District. Although the city recently enacted increases in Real Estate and Use and Occupancy taxes to provide the District with \$40 million in additional contributions from its general fund in fiscal year 2013 and beyond, the District in all probability, will seek further sizable increases in city contributions in later years of the Plan. As City Controller, I again state the need for the District to prepare a Five Year Plan of its own, which would require the approval of an independent authority. I believe this additional level of oversight is necessary to halt the District's pattern of recurring fiscal crises of escalating proportions which we have witnessed in recent years. Unless the District takes the necessary steps to operate within its budgetary constraints and eliminate the uncertainty regarding its future funding requirements, the possibility of further financial shortfalls will remain, placing additional strains on the city's finances.

- The impact of any new union contract settlements. If the arbitrator's award to the IAFF is upheld, the city is facing a retroactive wage and benefit payment of approximately \$66 million in the current year. In addition, non-uniformed employees have been working under the terms of a labor agreement that expired more than four years ago. If the ongoing negotiations with the non-uniformed workers result in an agreement requiring additional retroactive wage and benefit payments, the city, under the Five Year Plan as presented, would lack the necessary funding to make that payment.

Finally, 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 Rhyhart, Budget Director