



State of New York
Financial Control Board

MEMORANDUM

TO: Mark Page
Deputy Director and General Counsel
Office of Management and Budget

James Snyder
Assistant Counsel to the Governor

Bernie Kabak
Counsel
Office of the State Deputy Comptroller

Roger Anderson
Bureau Chief for Debt Management and Counsel
Office of the City Comptroller

FROM: Cathy A. Bell **CAB**
General Counsel
Financial Control Board

RE: EXEMPTION OF THE TRANSIT AUTHORITY FROM THE FEA

DATED: February 12, 1992

I have drafted the attached memorandum for submission to the Executive Director of the Financial Control Board in support of a proposed staff recommendation to the Board that the Transit Authority be exempted by Board order from the provisions of the Financial Emergency Act. I would appreciate hearing your thoughts on this proposal, from your perspective as legal advisors to the respective public members of the Board.

As you may be aware, the TA is in violation of the Financial Emergency Act for its failure to balance its budget in accordance with GAAP. Despite closing its fiscal year 1991 in cash balance, the TA continues to project a deficit, on both a cash and a GAAP basis, in the January Modification to its financial plan for fiscal years 1992 through 1996.

In reviewing the fiscal operations of the TA, the staff of the Control Board has determined that the TA's operations have no material impact upon the City's ability to adopt and maintain a balanced budget, which is the standard for granting an exemption under the FEA. This conclusion is based on the changed status of the TA's relationship to the City, in that since enactment of the FEA, the TA has evolved into the functional

equivalent of a state agency, and the limited exposure that the City currently maintains for the TA's fiscal operations.

Please read the enclosed memorandum and give to me any comments you may have at your earliest convenience. If you have any questions, you can reach me at 417-5061.

cc: Lynette Kelly
Counsel
Municipal Assistance Corporation



State of New York
Financial Control Board

**DRAFT
MEMORANDUM**

TO: Allen J. Proctor
Executive Director

FROM: Cathy A. Bell
General Counsel

RE: Impact of the Transit Authority on the Ability of the City
to Adopt and Maintain a Balanced Budget Pursuant to the FEA

DATED: February 7, 1992

DRAFT

This memorandum sets forth the history of the Transit Authority's compliance with the GAAP preparation and balance requirements of the Financial Emergency Act and discusses the conclusions reached by the staff of the Financial Control Board in conducting its review of the Transit Authority's fiscal operations and its relationship to the City. These conclusions, based upon the reasoning and analysis set forth below, are that:

- (1) the purpose of the Financial Emergency Act's extension of the GAAP preparation and balance requirements to the covered organizations was to provide a mechanism of fiscal control over those agencies that operate independently of mayoral oversight and yet have the potential to impact upon the City's own fiscal affairs;
- (2) the Transit Authority has, since enactment of the Financial Emergency Act, evolved into the functional equivalent of a state agency;
- (3) the impact of the operations of the Transit Authority upon the fiscal affairs of the City is finite and limited to regular and fixed annual appropriations for certain specified purposes; and,
- (4) for such reasons, its continued violation of the Financial Emergency Act is not material to the fiscal stability of the City.

In addition, in view of the changed relationship between the City and Transit Authority, this memorandum sets forth the staff's recommendation that the Transit Authority be exempted from coverage under the Financial Emergency Act.

THE INTENT OF THE FEA'S APPLICATION TO THE COVERED ORGANIZATIONS

Section 2.5 of the Financial Emergency Act (the FEA or the Act) defines covered organizations as those agencies, public authorities and public benefit corporations that receive or may receive monies directly, indirectly or contingently from the City. The covered organizations presently consist of the Board of Education (BOE), the City University Construction Fund (CUCF), the Educational Construction Fund (ECF), the Health and Hospitals Corporation (HHC), the Housing Authority (HA), the Housing Development Corporation (HDC), the Housing Assistance Corporation (HAC), the Industrial Development Agency (IDA), the Off-Track Betting Corporation (OTB), the Rehabilitation Mortgage Insurance Corporation (REMIC), the Staten Island Rapid Transit Operating Authority (SIRTOA), and the Transit Authority (TA).¹

In constructing the scope of the financial planning process as set forth in the FEA, it can be inferred from the Act's findings, despite its rather limited legislative history, that the framers sought to create a mechanism that would provide for the assessment of actual liabilities of the city as well as reflect the potential for further financial exposure. Implicitly included under the Act in the City's financial planning process are departments, offices and City agencies under the Mayor's direct control such as the Human Resources Administration and the various criminal justice agencies. These mayoral agencies exist solely as a convenience to the City in compartmentalizing the provisions of services and are but an extension of City Hall.

On the other hand, in section 2.5 of the Act the framers explicitly sought to impose similar fiscal constraints upon the operations and budgets of agencies, authorities and public benefit corporations that operate with greater independence from

¹ Battery Park City Authority (BPCA) was exempted from coverage under the Act by resolution of the Board, dated June 26, 1980. Counsel to the Board determined that the Water Finance Authority (WFA) and the Water Board were not covered organizations within the meaning of section 2.5 of the Act as set forth in a letter opinion to the City, dated June 27, 1985. The Brooklyn Sports Center Authority, the New York City Sports Authority and the Convention and Exhibition Center Corporation are covered organizations within the meaning of section 2.5 but are not currently in operation.

the Mayor and that have their own separate boards of directors and independent budgetary systems. The FEA extends its coverage to these agencies to the extent that they receive monies directly, indirectly or contingently from the City and are, as a result, capable of impacting upon the City's ability to maintain budget balance. By extending the GAAP preparation and balance requirements to the covered organizations whereby their anticipated revenues must, like the City's, exceed or equal projected expenditures, the framers devised a mechanism to limit the City's exposure for the operations of these agencies in the absence of direct mayoral control.

Excluded under the Act from the definition of covered organizations are those agencies, authorities and public benefit corporations that are specifically exempted by the Financial Control Board (the Board) from coverage under the Act on the basis that such exemption does not materially affect the ability of the City to adopt and maintain a balanced budget. This exclusionary language, as set forth in section 2.5(1) of the Act, appears to contemplate agencies whose operations are fairly discrete from those of the City and receive only limited funding from the City without the potential of consuming a greater-than-anticipated share of the City's budgetary resources. For example, a rather clear distinction can be drawn in this regard between an agency such as the TA for which the City's funding liability is fixed and limited by annual appropriation and those agencies, such as HHC and SIRTOA, for which the City is legally obligated to subsidize any year-end deficit.² The potential for material impact upon the City's ability to maintain budget balance is shared only by those agencies falling into this latter category, given the virtual limitless exposure of the City for overspending by such agencies as compared to the determinate quality of its liability for the operations of the TA.

CHANGES IN TRANSIT AUTHORITY FUNDING SINCE 1975

Since the FEA's enactment in 1975, the TA has evolved into the functional equivalent of a state agency and, as operated today, bears no material impact upon the ability of the City to adopt and maintain a balanced budget. The TA was created in

² HHC's enabling legislation obligates the City to provide it with a general support subsidy, the parties, however, are currently negotiating a restructuring of their financial relationship. SIRTOA is a subsidiary of the MTA and is managed by the Transit Authority on behalf of the City under a contract which provides that the City fund SIRTOA's operating deficit.

1953 pursuant to state law for the purposes of, among other things, acquiring the transit facilities then operated by the City. Upon its establishment, the TA entered into a lease agreement with the City whereby it acquired all of the transit facilities then owned or thereafter to be acquired or constructed by the City. In 1968, the TA was placed under the control of the Metropolitan Transportation Authority (the MTA). Although the TA has its own management structure which is responsible for its day-to-day operations, the MTA approves the TA's budget and has sole authority to approve any increases in the transit fare.³

In 1981, the state expanded its role in funding the TA's capital program and, as a result, much of the TA's operations are overseen by various committees of the state Legislature. In 1982, the City's ability to terminate its lease arrangement with the TA, which was set to expire, was effectively limited to reflect the greater role assumed by the state in the financing, expansion and rehabilitation of the transit facilities covered therein. Then, in 1987, the state enacted several taxes that provide additional revenues for mass transit purposes, including assistance to the TA. The City, on the other hand, plays little role in the governance of TA operations other than partial funding through specific appropriations.⁴ Direct City funding of TA operations is currently limited to the provision of matching funds to the state's 18B Operating Assistance funding and the subsidizing of certain predetermined expenses.⁵

³ Pursuant to its enabling legislation and the financing agreement it entered into with the MTA, the Transit Authority is required to operate on a self-sustaining basis, i.e., revenues and operating subsidies must be sufficient to meet obligations, both debt and operating expenses, as they become due.

⁴ At a meeting of the MTA Board on December 31, 1991, the Board adopted a budget purporting to close the TA fiscal year 1992 operating gap. That budget provided for an increase of the transit fare to \$1.25, certain additional cash flow adjustments and a proposed transfer of about \$90.5 million from the commuter railroad's capital program or an alternative source. As part of the budget negotiations, in order to prevent the transit fare from rising above \$1.25 at this time, the City agreed to contribute an additional \$15 million to the TA in CY 1992 via the City's school fare subsidy. At its regularly scheduled monthly PEG monitoring meeting with the fiscal monitors on February 7, 1992, the City stated that its decision to provide additional assistance to the TA at this time is not the result of any ongoing commitment to fund gaps in the TA's operating budget nor the reflection of any change in overall funding policy towards the TA.

⁵ The City reimburses the TA for the costs of the Transit Police, its Car Overhaul Program and certain other capital expenses and provides subsidies to cover the costs of school children and senior citizen fare reductions programs. The City projects that its aggregate contributions to the TA's operating budget for CY 1992 will total \$536.7 million, which amounts to roughly twenty percent of total TA revenues for this fiscal year.

Accordingly, as a result of the changed relationship between the state, the City and the TA, the impact of TA operations on the City's budget is contained and controllable, quite aside from whether the TA complies with the circumscriptions of the FEA or not.

COMPLIANCE BY THE TRANSIT AUTHORITY WITH THE FEA

On February 12, 1991, official notification from the Board was submitted to the City and the TA that the GAAP Financial Plan submitted on behalf of the TA for calendar years 1991-1994 was in violation of section 8.1(a) of the Act.⁶ Section 8.1(a) requires that, beginning in City fiscal year 1989, the expense budgets of the covered organizations be prepared and balanced so that the results thereof would not show a deficit when reported in accordance with GAAP. The financial plan submitted on behalf of the TA as part of the City's January, 1991 Modification failed to project GAAP balance in any of the four years.⁷ Neither the City nor the TA responded in writing to this notification; however, as a result of certain actions, including the infusion of proceeds from a bond refunding undertaken by the MTA, the TA was able to close its fiscal year 1991 in balance on a cash basis.

On February 3, 1992, the City submitted to the Control Board its January Modification to the 1992-1996 Financial Plan. Despite a recent increase in the transit fare, the financial plan for the TA submitted as part of the January, 1992 Modification continues to project a deficit for the TA in fiscal years 1992 through 1996.⁸

⁶ The Transit Authority is on a calendar fiscal year.

⁷ Under GAAP, an enterprise fund such as the TA must report its revenues and expenses on an accrual basis. The accrual basis of accounting requires that certain large expenses, most notably those related to pension benefits and judgements and claims, must be reported in advance of the period in which associated cash disbursements occur. The reporting of these expenses prior to the associated payments has routinely contributed to a cumulative operating deficit in the audited financial statements of the TA, despite a generally positive cash position. The TA financial plan submitted as part of the City's January, 1992 Modification, however, reflects a deficit, on both a cash and a GAAP basis, in all years of the plan.

⁸ See footnote 4, above.

While the Act requires the Board to notify the City of this violation and authorizes it to take such other further action under the Act as it deems appropriate,⁹ it is the view of the Control Board staff that the failure on the part of the TA to comply with the requirements of the FEA is not material to the fiscal stability of the City and, in fact, will have no material impact upon the City's ability to balance its own budget. Furthermore, it is the opinion of the staff, including Counsel to the Board, that the continued violation of the Act by the TA becomes a material concern for the City only if and when a control period is reimposed at which time the Control Board will be unable to approve an otherwise acceptable financial plan submitted by the City as a result of the TA's inability or unwillingness to balance its budget.¹⁰

EXEMPTION FROM FEA COVERAGE

The Board can exempt a covered organization from coverage under the Act pursuant to section 2.5(i) of the Act where the Board determines that such exemption does not materially affect the ability of the City to adopt and maintain a balanced budget. Such an exemption can be made on the Board's own motion or pursuant to the application of a covered organization. Exemption under the Act does not relieve the affected agency from preparation of its financial statements in accordance with GAAP, but does effectively suspend the GAAP balance requirement.¹¹ Once the Board has granted an exemption, such exemption does not extend into perpetuity but terminates

⁹ Because the powers of the Board to approve the City's financial plan are suspended, the only action available to the Board to address the continued violation of the Act by the TA is to in order the TA to comply. The Board could not order the City to increase its funding of the TA in an amount sufficient to close the gap since the Act makes clear that it is for the City to determine the purposes for which its expenditures are to be made, within an aggregate amount consistent with the financial plan then in effect. In response to such an order, the TA could take only those actions which are solely within its control since the Board's orders are not binding upon the MTA, which would have to approve any additional fare increase, or upon the state legislature, which would have to authorize any increase in state funding. Given the size of the anticipated deficits, (projected to be at least \$84 million in 1992 and in excess of \$200 million in years 1993-1996) in order to balance its budget by taking actions solely within its control, the TA would have to implement significant expenditure reductions, possibly including severe service reductions. In 1991, during public hearings conducted by the TA on the prospect of certain proposed service reductions, a high level of public disapproval was expressed.

¹⁰ Under the Act, the Financial Plan is one document, covering the City and the covered organizations.

¹¹ The Act requires, at the time and during the period of exemption, that an annual audit of the covered organization's financial statements be performed in accordance with GAAP.

upon a determination by the Board that the circumstances warranting the exemption no longer exist.

The Board is mandated by law to enforce the provisions of the FEA. The Board's fiduciary obligations require, therefore, that the TA's violation of FEA be cured by either enforcing GAAP balance through appropriate orders of the Board or by exemption of the TA from the GAAP balance requirement. Given the changed relationship of the TA to the City, the TA would appear to qualify for an exemption from the Act's GAAP balance requirement under the standard discussed above. Because the TA's violation of the GAAP balance requirement is not material to the effectuation of the intent of the FEA that the City's budget exposure to the TA be circumscribed, we do not believe that the TA's violation warrants issuance of remedial Board orders. The staff therefore recommend that the Board exempt the TA from its status as a covered organization under the FEA. If an exemption were granted to the TA, the Board's continued review of annual audited financial statements of the TA, in addition to its routine monitoring of the City's fiscal affairs, should be sufficient to alert the Board to any significant modifications in the TA's fiscal practices that might present a potential for TA GAAP imbalance to impair the City's ability to adopt and maintain its own balanced budget. If such a change in practice occurred, the staff would recommend that the Board revoke the exemption.