

BUFFALO FISCAL STABILITY AUTHORITY

FINANCIAL STATEMENTS

JUNE 30, 2006

BUFFALO FISCAL STABILITY AUTHORITY

Table of Contents

June 30, 2006

Independent Auditors' Report

Management's Discussion and Analysis

Basic Financial Statements

Statement of Net Assets

Statement of Activities and Changes in Net Assets

Balance Sheet – Governmental Funds

Reconciliation of Governmental Funds Balance Sheet to the Statement of Net Assets

Statement of Revenues, Expenditures, and Changes in Fund Balances – Governmental Funds

Reconciliation of the Governmental Funds Statement of Revenues, Expenditures, and Changes in Fund Balances to the Statement of Activities and Changes in Net Assets

Statement of Fiduciary Net Assets

Notes to Basic Financial Statements

Supplementary Information

Schedule of Administrative Expenditures - General Fund

Compliance Reports

Report on Internal Control over Financial Reporting and Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*

Independent Auditors' Report on Compliance with Section 2925(3)(f) of the New York State Public Authorities Law



Independent Auditors' Report

The Board of Directors
Buffalo Fiscal Stability Authority
Buffalo, New York

We have audited the accompanying financial statements of the governmental activities and each major fund of Buffalo Fiscal Stability Authority (the Authority) as of June 30, 2006, and for the year then ended, which collectively comprise the Authority's basic financial statements as listed in the foregoing table of contents. These financial statements are the responsibility of the Authority's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities and each major fund of the Authority as of June 30, 2006, and the respective changes in financial position thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated September 18, 2006, on our consideration of the Authority's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, grant agreements, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The management's discussion and analysis preceding the financial statements is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Authority's basic financial statements. The accompanying supplementary information as listed in the table of contents is presented for purposes of additional analysis and is not a required part of the basic financial statements of the Authority. The accompanying supplementary information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

Lumsden & McCormick, LLP

September 18, 2006

BUFFALO FISCAL STABILITY AUTHORITY

MANAGEMENT'S DISCUSSION AND ANALYSIS YEAR ENDED JUNE 30, 2006 (UNAUDITED)

Introduction

The Buffalo Fiscal Stability Authority ("BFSA", the "Authority") is a corporate governmental agency and instrumentality of the State of New York constituting a public benefit corporation created by the BFSA Act (the Act) – Chapter 122 of the Laws of 2003, as amended, signed by the Governor on July 3, 2003. BFSA has a broad range of financial control and oversight powers over the City of Buffalo (the City), the Buffalo Public School District (the School District), the Buffalo Municipal Housing Authority, the Joint Schools Construction Board, and other covered organizations as defined by the Act. Among BFSA's explicit powers is the power to issue bonds and notes for various City capital and operating purposes. The Act provides for the Authority to be in existence until its oversight, control or other responsibilities and its liabilities (including the payment in full of Authority bonds and notes) have been met or discharged, which in no event may be later than June 30, 2037. The Act provides the Authority different financial control and oversight powers depending upon whether the City's financial condition causes it to be in a "control period" (which, under the current Authority-approved financial plan, would end no earlier than the City's fiscal year ending June 30, 2013) or an "advisory period." During a control period the Authority possesses significantly expanded powers, including the power to impose a wage and/or hiring freeze. Under the Act, the Authority began its existence during a City control period, which means that the Authority commenced operation with its maximum authorized complement of financial control and oversight powers. In the event that the City's finances improve sufficiently in the future to cause the Authority to determine that an advisory period should be in effect, the Authority would operate with a reduced set of financial oversight powers and responsibilities.

The Act empowers BFSA to finance a declining percentage of the yearly deficits of the City and covered organizations which are part of an approved budget and 4-year financial plan. There was no deficit financing required for the fiscal year 2006. This power expires in fiscal year 2007.

In its capacity to issue bonds and notes on behalf of the City, the Authority has funded deficits, capital projects and certain working capital needs of the City and has issued bonds to refund City debt. Revenues to pay Authority debt service and to fund Authority operations are provided by the City's State aid, and the City's and School District's share of Erie County sales tax, on which the Authority has a first lien. BFSA became entitled to the City's share of Erie County sales tax revenues and state aid on July 3, 2003, the effective date of the Act. BFSA became entitled to the School District's share of Erie County sales tax revenues on July 1, 2004 as provided in Chapter 86 of the Laws of 2004, which amended the Act. Pursuant to the Act, the City and the School District have no right, title or interest in these revenues until transferred to the City and the School District by the Authority. The Authority has no independent operating income or taxing power.

Overview of the Financial Statements

The annual financial statements of the Authority consist of the following components: management's discussion and analysis (this section), financial statements, and notes to the financial statements.

Management's discussion and analysis of the Authority's financial performance provides an overview of the Authority's financial activities for the fiscal year ended June 30, 2006. The overview, which covers the most important financial events of the period, should be read in conjunction with the Authority's financial statements, including the notes to the financial statements.

Government-wide financial statements of the Authority are in accordance with Governmental Accounting Standards Board ("GASB") Statement No. 34, "Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments." The government-wide financial statements use the economic resource measurement focus and accrual basis of accounting. These statements are presented to display information about the reporting entity as a whole. The statement of net assets presents information on all the Authority's assets and liabilities, with the difference between the two reported as net assets. The statement of activities and changes in net assets presents

information showing how the Authority's net assets changed during the fiscal year. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of timing of the related cash flows.

Governmental fund financial statements are presented using the current financial resources measurement focus and the modified accrual basis of accounting. These statements are the *balance sheet* and the *statement of revenues, expenditures and changes in fund balance*. They recognize revenue when it becomes susceptible to accrual, which is when it becomes both measurable and available to finance expenditures in the current fiscal period.

In addition to these two types of statements, the financial statements include reconciliations between the government-wide and governmental fund statements. Accompanying notes to the financial statements are an integral part of the financial statements.

Financial Highlights and Overall Analysis

The most critical factors in the Authority's financial position are its revenues derived from the City's sales tax revenue, (since July 1, 2003), the School District's (beginning July 1, 2004) share of Erie County sales tax revenues, and the City state aid, which together provided close to 100% of the Authority's 2006 revenue. The Act granted the Authority a first lien and perfected security interest in net collections from sales and use taxes authorized by the State and imposed by Erie County (the County). Sales taxes are imposed by the County, collected by the State and remitted to the Authority, usually several times each month. After provision for Authority debt service deposits and operating expenses, the remaining funds are remitted immediately to the City or the School District. The State legislation also provided that all state aid appropriated as local government assistance for the benefit of the City is payable to the Authority to use for debt service requirements and operating expenses, with the remaining funds to be remitted to the City.

The amount of BFSAs sales tax revenues to be collected depends upon various factors, including the economic conditions in the County, which has experienced numerous cycles of growth and recession. In addition, in the past the State has enacted amendments to the Tax Law to exempt specific goods and services from the imposition of sales tax. The Act requires the County to impose the local sales tax at a rate of no less than 3% for the period ending June 30, 2037. Pursuant to State statutory authority, Erie County currently imposes sales tax at the rate of 4 3/4%. New York State has reauthorized the additional 1% sales tax rate, in Erie County every year since January 1978 above the general State authorization, but is under no obligation to continue to do so. Effective July 1, 2005, the County was authorized by the State to increase the Local Sales Tax rate by an additional .25%, to 4.25%, and effective January 10, 2006, the County was authorized by the State to increase the Local Sales Tax by another .50%, to 4.75%. However, during the period beginning January 1, 2007, and ending February 29, 2008, the County will be required to allocate to the cities and towns within the County the first \$12.5 million of any net collections from the additional 1% of sales and compensating use taxes authorized by Section 1210(i)(4) of the State Tax Law, which allocation would result in additional City Tax Revenues of up to approximately \$5.9 million.

Sales tax revenue for the year ended June 30, 2006 was \$95,908,772. The Authority also received state aid for the year ended June 30, 2006 in the amount of \$121,876,026. Investment income, which accounts for the remaining Authority revenue, totaled \$4,388,472 of which \$3,728,573 was derived from interest on the City's general obligation bonds described below.

The other significant element in the Authority's financial position is its long-term debt. During 2004 and 2005, the Authority issued a total of \$53,775,000 long-term bonds (Series 2004A and 2005A) to finance the City's cost of various City of Buffalo and the School District capital projects. The City of Buffalo in return issued a series of its own general obligation long term bonds, privately placed with the Authority, evidencing the obligations of the City. In July 2005 the Authority refunded \$47,065,000 of City of Buffalo serial bonds by issuing \$46,705,000 in 14-year bonds, (the 2005B series), and \$360,000 in 2-year taxable bonds (the 2005C Series). The City of Buffalo issued its own 13 1/2-year premium bonds privately placed with the Authority in the amount \$48,157,000. Net interest cost of the issue was 3.91%. Issuance costs were \$836,855. Refunding provided net cash flow savings after costs of \$1,830,000 and present value savings of \$1,596,000.

The Authority issued its 2005A-1 premium Bond Anticipation Notes in the amount of \$90,000,000 on July 28, 2005 to finance cash flow needs of the City. A \$50,000,000 note matured on May 15, 2006 and a \$40,000,000 matured August 15, 2006. Both maturities were paid from the Authority's revenues from State aid to the City. Net interest cost of the issue was 2.98% and issuance costs were \$244,237. On April 20, 2006, the Authority issued \$27,270,000 long-term bonds

(Series 2006A) to finance the cost of various City of Buffalo capital projects. Net interest cost of the issue was 4.42% and issuance costs were \$447,543. The City of Buffalo in return issued a series of its own general obligation long term bonds, privately placed with the Authority evidencing the obligations of the City.

The statement of net assets shows a total net deficit of \$20,072,064. The deficit results largely from Authority debt issuance which is backed by securitization of future sales tax revenue and State aid to the City. The debt is reported as a long-term liability, but the future revenues are not reportable. In some instances, the City issues its own general obligation bonds and places them with the Authority. As of June 30, 2006, the Authority had bonds payable of \$126,075,000 and long term receivables from the City of \$101,220,245. In any year where the Authority issues more long-term debt than it retires without a corresponding issuance from the City, the deficit is likely to increase. The reconciliation on page 7 of these financial statements provides additional detail on the determination of the net deficit amount.

Cash and investments were \$48,489,907 at June 30, 2006. This amount primarily includes monies set aside for debt and note repayment.

Operating expenses for the Authority totaled \$1,076,637 under the fund basis of accounting, which includes capital asset purchases of \$1,334 as expenditures. The Authority employed 7 salaried staff members at June 30, 2006. Staff members worked an extensive amount of overtime totaling 1,778 uncompensated hours during the fiscal year.

Staff Expenses

Wages	\$491,438
Other staff related expenses	11,598
Total Direct Staff expenses	\$503,036
Staff Benefits	
NYS Employees Retirement System contribution	\$51,068
Payroll taxes, workers' comp and NYS disability	37,899
Health Insurance (net of employee contributions)	50,060
Total Staff Benefits	\$139,027
Total Staff Expenses	\$642,063

The next largest category of expenses was for professional fees, of which \$263,277 was legal fees and \$31,291 was for other professional consultants and advisors. Legal fees included general counsel work as well as labor and litigation expenses. The Authority contracted an outside consultant to review the City of Buffalo's energy procurement process and was approved to receive a grant from NYSEDA to cover approximately 45% of the cost of the engagement. Payments to the consultant through the end of the fiscal year were \$44,490 before application of the grant proceeds.

Directors of the Authority do not receive any compensation for their services but are reimbursed for any Authority-related expenses, primarily travel expense for those attending meetings from outside the Buffalo area. Lunch is provided for the Board and staff on meeting days. The following chart details expenses connected with Authority meetings and Directors' travel.

Meeting Expenses

Facilities Expenses – Public Board Meetings	\$8,612
Directors' travel reimbursements	6,199
Public Forum Expenses	4,085
Total Meeting Expenses	\$18,896

Other expenses include various items necessary for the running of the Authority's offices, as follows:

Other Expenses

Office services including postage and delivery	\$7,735
Rent	32,946
Telephone and data processing	16,887
Office Supplies	5,470
Staff travel	7,847
Other	2,969
Total Other Expenses	\$73,854

The Authority's rental payments are made to the Buffalo Economic Renaissance Corporation, the economic development arm of the City, where they can be used toward the City's economic development efforts. As stated before, the Authority also purchased \$1,334 in capital assets, primarily telecommunications and computing equipment. Furniture of the Authority was primarily donated by New York State from used surplus furniture.

Debt Service Fund

The Authority issued its 2006A 20-year serial premium bonds in the amount of \$27,270,000 for capital projects of the City in April 2006. Net interest cost of the issue was 4.42%. Issuance costs were \$447,543. The Authority issued its 2005A-1 premium Bond Anticipation Notes in the amount of \$90,000,000 in July, 2005 to finance cash flow needs of the City. A \$50,000,000 note matured on May 16, 2005 and \$40,000,000 matured on August 15, 2005. Both maturities were paid from the Authority's revenues from State aid to the City Net interest cost of the issue 2.98 %. Issuance costs were \$247,237

Subsequent Events

The Authority issued its 2006A-1 premium Bond Anticipation Notes in the amount of \$60,000,000 on September 13, 2006 to finance cash flow needs of the City. A \$30,000,000 note matures on May 15, 2007 and a \$30,000,000 matures August 14, 2007. Both maturities are expected to be paid from Authority's revenues from State Aid to the City. Net interest cost of the issue was 3.72 % and issuance costs were \$188,250.

Contacting the Authority's Financial Management

This financial report is designed to provide, taxpayers, investors, and creditors with a general overview of the Authority's finances and to demonstrate its accountability for the money it receives. If you have questions about this report or need additional financial information, contact Bertha H. Mitchell, Chief Financial Officer, Buffalo Fiscal Stability Authority, Market Arcade Building - Suite 400, Buffalo, New York 14203.

BUFFALO FISCAL STABILITY AUTHORITY

Statement of Net Assets

June 30, 2006

(With comparative totals as of June 30, 2005)

	2006	2005
Assets		
Cash and cash equivalents	\$ 269,087	\$ 152,253
Investments	48,220,820	2,797,738
Notes receivable - City of Buffalo due within one year	5,507,623	34,022,387
Due from other governments	31,035,843	30,861,526
Prepaid expenses	7,633	73,503
Notes receivable - City of Buffalo	98,505,775	29,715,838
Bond issuance costs, net	2,413,020	1,345,513
Capital assets	75,633	74,299
Accumulated depreciation	(33,859)	(18,860)
Total assets	186,001,575	99,024,197
Liabilities		
Accounts payable	94,538	189,528
Accrued liabilities	3,406,620	1,628,902
Bond anticipation note payable	40,055,968	34,079,526
Due to the City of Buffalo		
Sales tax	8,846,524	9,901,080
General purpose aid	19,165,879	19,165,879
Bonds payable		
Bonds due within one year	3,460,000	2,035,000
Bonds due beyond one year	131,044,110	55,725,654
Total liabilities	206,073,639	122,725,569
Net Assets		
Invested in capital assets, net of related debt	41,774	55,439
Restricted for debt service	6,494,039	2,797,738
Unrestricted	(26,607,877)	(26,554,549)
Total net assets (deficit)	\$ (20,072,064)	\$ (23,701,372)

See accompanying notes.

BUFFALO FISCAL STABILITY AUTHORITY

Statement of Activities and Changes in Net Assets

For the year ended June 30, 2006

(With comparative totals for June 30, 2005)

	2006	2005
Expenses		
General and administrative	\$ 1,551,431	\$ 1,342,039
Distributions to City of Buffalo - financeable costs	90,706,150	50,213,765
Distributions to City of Buffalo - general operations	87,656,340	146,781,580
Distributions to City of Buffalo School District	32,243,205	32,297,004
Interest expense	6,602,702	2,706,675
Total expenses	218,759,828	233,341,063
General revenues		
Sales tax	95,908,772	97,317,692
State aid	121,876,026	137,538,408
Interest and other income	4,604,338	1,181,302
Total general revenues	222,389,136	236,037,402
Change in net assets	3,629,308	2,696,339
Net assets - beginning	(23,701,372)	(26,397,711)
Net assets (deficit) - ending	\$ (20,072,064)	\$ (23,701,372)

See accompanying notes.

BUFFALO FISCAL STABILITY AUTHORITY

Balance Sheet - Governmental Funds

June 30, 2006

(With summarized comparative totals as of June 30, 2005)

	General	Debt Service	Total Governmental Funds 2006	2005
Assets				
Cash and cash equivalents	\$ 269,087	\$ -	\$ 269,087	\$ 152,253
Investments	41,726,781	6,494,039	48,220,820	2,797,738
Due from other governments	29,138,418	105,694,958	134,833,376	94,577,364
Prepaid expenses	7,633	-	7,633	73,503
Total assets	\$ 71,141,919	\$ 112,188,997	\$ 183,330,916	\$ 97,600,858
Liabilities and Fund Balances				
Accounts payable	\$ 35,189	\$ 59,349	\$ 94,538	\$ 189,528
Accrued liabilities	1,495,378	1,911,242	3,406,620	860,993
Due to the City of Buffalo	28,012,403	-	28,012,403	29,066,959
Bond anticipation note payable	40,000,000	-	40,000,000	34,000,000
Total liabilities	69,542,970	1,970,591	71,513,561	64,117,480
Fund Balances				
Designated for debt service	-	6,494,039	6,494,039	2,797,738
Undesignated	1,598,949	103,724,367	105,323,316	30,685,640
Total fund balances	1,598,949	110,218,406	111,817,355	33,483,378
Total liabilities and fund balances	\$ 71,141,919	\$ 112,188,997	\$ 183,330,916	\$ 97,600,858

See accompanying notes.

BUFFALO FISCAL STABILITY AUTHORITY

Reconciliation of Governmental Funds Balance Sheet to the Statement of Net Assets

June 30, 2006

Total fund balances - governmental funds	\$ 111,817,355
--	----------------

Amounts reported for governmental activities in the statement of net assets are different because:

Capital assets used in governmental activities are not financial resources and therefore are not reported as assets in governmental funds. The cost of the assets is \$75,633 and accumulated depreciation is \$33,859

41,774

Interest receivable is recognized when earned in the government-wide statements, but in the governmental fund statements income is accrued only if it will be received within sixty days of year end. This is the difference in interest receivable between the government-wide and funds statements.

215,865

In the government-wide statements, bond and BAN premiums are deferred and recognized ratably over the related terms of the debt. In the fund statements these amounts are recognized as revenue when received. This is the amount remaining at June 30, 2006

(55,968)

Certain liabilities, including bonds payable, are not due and payable currently and therefore are not reported as liabilities of the governmental funds. These liabilities consist of:

Bonds net of premiums

(134,504,110)

Costs associated with the issuance of bonds are capitalized in the statement of net assets and are expensed in the governmental funds in the year the bonds are issued. The costs amounted to \$2,921,689 net of accumulated amortization of \$508,669

2,413,020

Net assets (deficit) - governmental activities	\$ (20,072,064)
--	-----------------

BUFFALO FISCAL STABILITY AUTHORITY

Statement of Revenues, Expenditures, and Changes in Fund Balances - Governmental Funds

For the year ended June 30, 2006

(With summarized comparative totals for June 30, 2005)

	General	Debt Service	Total Governmental Funds	
			2006	2005
Revenues				
State aid	\$ 121,876,026	\$ -	\$ 121,876,026	\$ 137,538,408
Sales tax	95,908,772	-	95,908,772	97,317,692
Interest income	659,899	3,728,573	4,388,472	1,181,302
Total revenues	218,444,697	3,728,573	222,173,270	236,037,402
Expenditures				
General and administrative	937,610	-	937,610	914,372
Distributions				
City of Buffalo - financeable costs	90,706,150	-	90,706,150	50,213,765
City of Buffalo - general operations	87,656,340	-	87,656,340	146,781,580
City of Buffalo School District	32,243,205	-	32,243,205	32,297,004
Cost of bond issuance	244,237	1,284,398	1,528,635	747,400
Employee benefits	139,027	-	139,027	110,895
Debt service				
Principal	-	2,035,000	2,035,000	-
Interest	3,176,035	5,719,366	8,895,401	2,595,066
Total expenditures	215,102,604	9,038,764	224,141,368	233,660,082
Excess revenues (expenditures)	3,342,093	(5,310,191)	(1,968,098)	2,377,320
Other financing sources (uses)				
Operating transfers in (out), net	(3,666,846)	3,666,846	-	-
Proceeds from the issuance of bonds	-	74,335,000	74,335,000	28,030,000
Premiums on BAN/bond obligations	953,900	5,013,175	5,967,075	2,655,829
Other financing sources (uses)	(2,712,946)	83,015,021	80,302,075	30,685,829
Net change in fund balances	629,147	77,704,830	78,333,977	33,063,149
Fund balances - beginning	969,802	32,513,576	33,483,378	420,229
Fund balances - ending	\$ 1,598,949	\$ 110,218,406	\$ 111,817,355	\$ 33,483,378

See accompanying notes.

BUFFALO FISCAL STABILITY AUTHORITY

Reconciliation of the Governmental Funds Statement of Revenues, Expenditures, and Change in Fund Balances to the Statement of Activities and Changes in Net Assets

For year ended June 30, 2006

Total net change in fund balances - governmental funds \$ 78,333,977

Amounts reported for governmental activities in the statement of activities are different because:

Capital outlays are reported in governmental funds as expenditures. However in the statement of activities, the cost of those assets is allocated over their estimated useful lives as depreciation expense. This is the amount by which depreciation expense (\$14,999) exceeds equipment cost (\$1,334) in the period (13,665)

Interest on long-term debt is reported as an expenditure in the governmental funds when it is paid as it requires the use of current financial resources. In the statement of activities, interest expense is recognized when it is earned. This amount represents the difference in interest expense. 745,521

Accrued interest income will not be collected until several months after fiscal year end, are considered "available" resources and are not recognized in the governmental funds. This is the difference in interest income between the government-wide and funds statements. 215,865

Payments of long-term liabilities are reported as an expenditure in governmental funds, and reduce such liabilities in the statement of net assets. In the current year there were principal payments of the following amounts which are not on the statement of activities: 2,035,000

In the governmental fund statements, bond proceeds and premiums are reflected as other financing sources measured by the net cash flows received and bond issuance costs are expensed as paid. In the statement of activities, bonds are reflected as a liability, bond issuance costs are capitalized and bond premiums are deferred and recognized over the life of the bonds. The following summarizes these differences:

Bond proceeds	(74,335,000)	
Bond issuance costs	1,528,635	
Bond and BAN premiums received in the current period	(5,967,075)	
Amortization of bond and BAN premiums	1,547,178	
Amortization of bond issuance costs	(461,128)	(77,687,390)

Change in net assets - governmental activities \$ 3,629,308

BUFFALO FISCAL STABILITY AUTHORITY

Statement of Fiduciary Net Assets

June 30, 2006

	<u>Agency</u>
Assets	
Cash and cash equivalents	<u>\$ 6,804,029</u>
Liabilities	
Due to the City of Buffalo	<u>\$ 6,804,029</u>

See accompanying notes.

BUFFALO FISCAL STABILITY AUTHORITY

Notes to Basic Financial Statements

1. Summary of Significant Accounting Policies

Reporting Entity

Buffalo Fiscal Stability Authority (the Authority) is a corporate governmental agency and instrumentality of the State of New York (the State) constituting a public benefit corporation created by the Buffalo Fiscal Stability Authority Act (the Act), Chapter 122 of the Laws of 2003, as amended by Chapter 86 of the Laws of 2004 and as may be amended from time to time. Although legally separate and independent of the City of Buffalo (the City), the Authority is a component unit of the City for financial reporting purposes and, accordingly, is included in the City's financial statements.

The Authority is governed by nine directors, with seven appointed by the Governor. One of the seven must be a resident of the City. One director is appointed following the recommendation of the State Comptroller; one director is appointed on the joint recommendation of the temporary president of the Senate and the Speaker of the Assembly. The Mayor of the City and the County Executive of Erie County, New York serve as ex-officio. The Governor also designates the chairperson and vice-chairperson from among the directors.

The Authority has power under the Act to monitor and oversee the finances of the City and "covered organizations" - City of Buffalo School District (the District), the Joint Schools Construction Board, Buffalo Municipal Housing Authority, and any governmental agency, public authority, or public benefit corporation which receives or may receive money directly, indirectly, or contingently from the City. The Authority is empowered to issue bonds and notes for various City purposes, defined in the Act as "Financeable Costs." The Act authorizes the issuance of bonds, notes, or other obligations in amounts necessary to pay any financeable costs and to fund reserves to secure such bonds. The aggregate principal amounts of such bonds, notes, or other obligations outstanding at any one time can not exceed \$175,000,000. The Authority may also issue bonds, notes or other obligations to pay the cost of issuance of such borrowings, to establish debt service reserves, to refund or advance refund any outstanding notes of the City. The Authority may issue cash flow borrowings which do not count toward the above limit, but are limited to \$145,000,000 of aggregate principal amounts outstanding at any one time.

A "control period," as defined in the Act became effective as of the date of the Act and will continue until conditions have been met regarding the stability of the City's finances, but, under the current financial plan, no sooner than the fiscal year ending June 30 2013. Thereafter an advisory period commences, and the Act permits a control period to be reestablished as determined by the Directors should conditions warrant. The Act provides for the continuing existence of the Authority through June 30, 2037.

The Act provides broad monitoring responsibility over the City's finances including the requirements for the City to provide an annual financial plan for four years to be approved by the Authority. The Act also allows the Authority to establish a maximum level of spending, impose a wage or hiring freeze, review and approve or disapprove any collective bargaining agreement entered into by the City or covered organization, and may require the City to explore certain actions regarding merger of services with the County of Erie.

The Authority receives all sales tax revenues designated for the City and the District, and State aid to be paid to the City. State aid includes all general purpose local government aid, emergency financial assistance to certain cities, emergency financial assistance to eligible municipalities, supplemental municipal aid, and any successor or new aid appropriated by the State as local government assistance for the benefit of the City. The Authority is also entitled to receive all other aid, rents, fees, charges, payments and other income to the extent such amounts are pledged to bondholders of the City. The Authority maintains amounts it deems necessary for its operations and debt service requirements with the excess transferred to the City as frequently as practicable.

Basis of Presentation

Government-wide Statements: The statement of net assets and the statement of activities and changes in net assets display financial activities of the overall Authority. These statements are required to distinguish between *governmental* and *business-type* activities. Governmental activities generally are financed through taxes, intergovernmental revenues, and other nonexchange transactions. Business-type activities are financed in whole or in part by fees charged to external parties. The Authority does not maintain any business-type activities.

The statement of activities and changes in net assets is designed to present a comparison between direct expenses and program revenues for each function of the Authority's governmental activities. Given the specific nature of the Authority's purpose, its only function is displayed as monitoring of City finances.

Fund Financial Statements: The Fund financial statements provide information about the Authority's funds. The emphasis of the fund financial statements is on major governmental funds, each displayed in a separate column.

The Authority reports the following major funds:

- *General fund.* This is the Authority's primary operating fund. It accounts for all financial resources except those required to be accounted for in another fund.
- *Debt service fund.* This fund accounts for resources accumulated and payments made for principal and interest on long-term debt obligations of governmental activities on behalf of the City.

The Authority reports the following fiduciary fund:

- *Agency fund.* This fund accounts for assets held by the Authority as agent for others. The agency fund is custodial in nature and does not involve measurement of results of operations. The agency fund holds proceeds from State spin-up aid at request of the City to be used for debt service on the 2004 deficit bonds and the Authority's operating expenses.

The basic financial statements include certain prior year summarized comparative information in total but not by separate governmental activities and major funds. Such information does not include sufficient detail to constitute a presentation in conformity with generally accepted accounting principles. Accordingly, such information should be read in conjunction with the Authority's financial statements for the year ended June 30, 2005, from which the summarized information was derived.

Basis of Accounting and Measurement Focus

The government-wide and fiduciary fund financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded at the time liabilities are incurred, regardless of when the related cash flows take place. Nonexchange transactions, in which the Authority receives value directly without giving equal value in exchange, include State aid and sales taxes. On an accrual basis, revenue is recognized in the fiscal year for which taxes and State aid are earned or designated. Revenue from grants and

donations is recognized in the fiscal year in which all eligibility requirements have been satisfied.

Governmental funds are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Under this method, revenues are recognized when measurable and available. The Authority considers all revenues reported in the governmental funds to be available if they are collected within sixty days after year end, with the exception of amounts determined by statute as state general purpose aid. By law, although designated for the current fiscal year the amount is paid by the State in December. In 2005, both the amount paid in December 2004 as well as the amount to be received in December 2005 were included in State aid and distributions to the City. In 2006, the amount applicable to the current fiscal year has been recognized.

Expenditures are recorded when the related fund liability is incurred, except for principal and interest on general long-term debt and claims and judgments, which are recognized as expenditures to the extent that they have matured. Capital asset purchases are reported as expenditures in governmental funds. Proceeds of long-term liabilities and acquisitions under capital leases are reported as other financing sources.

Interest expense is recognized on the accrual basis in the government-wide financial statements. In the governmental fund statements, interest expenditures are recognized when funds are deposited in the debt service fund.

The Authority receives sales tax revenues several times each month, and receives interest earnings from time to time as investments mature. Funds for debt service are required to be set aside from revenues on a monthly basis, and the Authority also deducts, as necessary, amounts which in its judgment are required for Authority's operations and operating reserves. Residual sales tax revenues and investment earnings are then transferred to the City.

No revenues are generated from operating activities of the Authority; therefore, all revenues are defined by the Authority as non-operating revenues. Revenues are received in the general fund and debt service fund. Expenses of the Authority that arise in the course of providing the Authority's oversight and debt issuance services, such as payroll and administrative expenses are considered operating expenses and are accounted for in the general fund. Expenditures related to debt issuance are considered non-operating expenses and are accounted for in the debt service fund.

Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

Cash and Cash Equivalents

Cash and cash equivalents include cash on hand, demand deposits and commercial paper with original maturities of three months or less.

Capital Assets

Assets are capitalized at historical cost if their value is greater than \$500 and have a useful benefit in excess of one year. Contributed assets are recorded at fair value at the time received. Depreciation is provided in the government-wide statements over estimated useful lives of five years using the straight-line method. Maintenance and repairs are expensed as incurred, significant improvements are capitalized.

Inventory and Prepaid Expenses

The Authority holds no inventory beyond small amounts of office supplies. Prepaid expense accruals are minor and are adjusted at the close of each fiscal year.

Other Assets

Bond issuance costs are expensed and recognized in the period issued in the governmental funds. Within the government-wide statements, bond issuance costs are capitalized and amortized over the life of the related debt issue.

Bond Premiums

In the government-wide statements, proceeds from the issuance of bonds received in excess of face value (premiums) are deferred and added to the bonded liability. These amounts are subsequently amortized on a straight-line basis as a component of interest expense over the life of the bond. In the fund statements, these amounts are recognized currently as other financing sources.

Equity Classifications

Government-wide statements

- *Invested in capital assets, net of related debt* - consists of net capital assets reduced by outstanding balances of any related debt obligations attributable to the acquisition, construction, or improvement of those assets.
- *Restricted net assets* - net assets are considered restricted if their use is constrained to a particular purpose. Restrictions are imposed by external organizations such as federal or state laws or buyer's of the Authority's bonds.
- *Unrestricted net assets* - consists of all other net assets that do not meet the definition of the above two components and are available for general use by the Authority.

When an expense is incurred for purposes for which both restricted and unrestricted net assets are available, the Authority's policy concerning which to apply first varies with the intended use, and with associated legal requirements. Debt service requirements are satisfied with resources restricted for that purpose.

Interfund Transfers

The operations of the Authority include transactions between funds. These transactions may be temporary in nature, such as with interfund borrowings. Permanent transfers of funds include the transfer of expenditure and revenues to provide resources for required debt service payments.

In the government-wide statements, the amounts reported on the statement of net assets for interfund receivables and payables, if any, would represent amounts due between different fund types (governmental activities and fiduciary funds). Eliminations would be made for all interfund receivables and payables between the funds, with the exception of those due from or to the fiduciary funds.

Governmental fund statements

Designations of fund balances are established to preserve resources for future expenditures as required by bond instruments or as determined by the Authority's Board of Directors. The debt service designation is used to accumulate resources for a sinking fund in connection with the requirements of the related bond agreements.

Contributed Services

No amounts have been reflected in the financial statements for donated services. The Board of Directors serves the Authority without compensation. Additionally, certain Directors utilize resources of their organizations to provide numerous hours of contributed services in the form of specialized public relations assistance and human resource matters.

2. Transactions with and on Behalf of the City

The Act and other legal documents of the Authority establish various financial relationships between the Authority, the City, and the District. The resulting financial transactions between the Authority, the City, and the District include the receipt and use of revenues as well as Authority debt issuances to fund financeable costs of the City.

The receipt and remittance of revenues in 2006 include:

- The receipt and remittance to the City of sales tax revenues. Revenues of \$95,908,772 were received, of which \$53,319,797 was or will be paid to the City and \$32,243,205 was designated for the District. The balance was retained for Authority operations and to provide for a debt service sinking fund.
- The receipt of State aid for the City of \$121,876,026 with \$28,620,998 transferred to the City and \$93,255,028 was used to pay bond anticipation notes (BANs) including interest. Of this amount, \$19,165,879 was accrued as revenue in fiscal 2005 and transferred to the City when it is received in December 2005, with a similar amount for 2006.

Authority debt issuance to fund financeable costs of the City encompassed the following:

- The issuance of Series 2005A-1 in the amount of \$90,000,000 in BANs with \$90,706,150 (including allocable BAN premium, net of issuance costs) distributed to the City. Of this amount, a \$50,000,000 BAN was repaid in May 2006 with applicable State aid, and \$40,000,000 plus accrued interest was transferred from the City to the Authority for the BAN payments due August 14, 2006.
- Series 2005B&C bonds in the amount of \$47,065,000 by the Authority for refunding existing City debt. The bond included a premium of \$3,818,367. The Authority received a mirror-note from the City in the amount of \$49,691,411 with \$1,533,953 allocated to the premium.
- Series 2006A bond in the amount of \$27,270,000 by the Authority for \$25,450,000 in City and \$2,500,000 in District capital projects. The bond included a premium of \$1,194,808. The Authority received a mirror-note from the City in the amount of \$27,758,917 with \$247,054 allocated to the premium.

3. Cash and Investments

Investment policies are governed by New York State laws in accordance with the Act and as established in the Authority's written policies. Cash resources must be deposited in FDIC-insured commercial banks or trust companies located within the State. The Executive Director is authorized to use demand accounts and certificates of deposit. Permissible investments include obligations of the United States Treasury and its Agencies, repurchase agreements, obligations of State or its localities, and commercial paper of any bank or corporation provided it has the highest rating of two independent rating agencies.

Collateral is required for demand and time deposits and certificates of deposit not covered by Federal Deposit Insurance. Obligations that may be pledged as collateral are obligations of the United States and its agencies and obligations of the state and its municipalities and school districts.

Custodial credit risk is the risk that in the event of a bank failure the Authority's deposits may not be returned to it. At June 30, 2006, the Authority's bank deposits were fully collateralized by FDIC coverage and securities held by the pledging institution's trust in the Authority's name.

The Authority's cash and investments at June 30, 2006 consist of the following:

	Carrying Value	Fair Value
Governmental activities:		
Cash	\$ 55,419	\$ 55,419
Certificates of deposit	225,000	225,000
U.S. Treasury Slugs	1,274,797	1,274,797
U. S. Treasury Bills	101,540	101,540
Fed'l Home Loan Mortg Corp. Disc. Paper	3,777,685	3,778,801
Fed'l Farm Credit Bank Disc. Paper	417,366	417,366
Fed'l National Mortg. Assn. Disc. Notes	20,548,469	20,548,469
GE Credit Corp. Commercial Paper	9,999,707	9,999,707
Fed'l Home Loan Bank Discount Paper	331,562	332,086
CitiCorp Commercial Paper	11,670,414	11,670,414
Accrued interest	87,948	87,948
	<u>\$ 48,489,907</u>	<u>\$ 48,491,547</u>
Fiduciary activities:		
Cash	\$ 5,968	\$ 5,968
Fed'l Home Loan Mortg Corp. Disc. Paper	6,774,359	6,774,359
Accrued interest	23,702	23,702
	<u>\$ 6,804,029</u>	<u>\$ 6,804,029</u>

The risk and type of investments presented above generally indicate activity and positions held throughout the year. Maturities are generally short term with certificates of deposits issued with 30 day maturities and U.S. Treasuries and commercial paper due within 45 days of purchase.

4. Due from Other Governments

Due from New York State:		
May and June sales tax receipts	\$	9,950,293
June 2006 general purpose local aid		19,165,879
Due from the City:		
Mirror bond 2005A (1/15/2025) interest at 5.0% inclusive of premium of \$1,117,144		28,848,472
Mirror bond 2005B&C (1/15/2019) interest at 5.0% inclusive of unamortized premium of \$1,431,690		47,161,690
Mirror bond 2006A (1/15/2020) interest at 5.0% inclusive of premium of \$244,319		28,003,236
Accrued interest		1,897,425
Energy consultant grant		22,246
	<u>\$</u>	<u>135,049,241</u>

Amounts to be received from the City on the mirror bonds are as follows:

Year ending June 30,	Principal	Interest
2007	\$ 5,658,623	\$ 4,671,616
2008	7,622,037	4,778,171
2009	7,787,840	4,396,979
2010	10,253,506	4,007,587
2011	11,236,181	3,494,912
2012-2016	40,643,589	10,104,781
2017-2021	16,897,618	2,391,850
2022-2025	1,120,851	143,564
	<u>\$ 101,220,245</u>	<u>\$ 33,989,460</u>

5. Capital Assets

	2006	2005
Furniture, fixtures, and computers	\$ 75,633	\$ 74,299
Accumulated depreciation	(33,859)	(18,860)
	<u>\$ 41,774</u>	<u>\$ 55,439</u>

Capital assets increased by \$1,334 in fiscal 2006 and depreciation expense amounted to \$14,999.

6. Short-Term Debt

Aggregate BANs outstanding at June 30, 2006 amounted to \$40,000,000 and carry interest at 4.0% (\$34,000,000 at June 30, 2005 at 3.0%). In 2006, \$90,000,000 of BANs were issued and \$84,000,000 were redeemed. The BANs mature August 14, 2006. The carrying amount on the accompanying statement of net assets includes the unamortized portion of a premium on the BAN of \$55,968.

7. Long-Term Liabilities

	July 1, 2005	Increases	Decreases	June 30, 2006	Amounts Due in One Year
Series 2004A Bond, maturing \$ August 2014 with interest ranging from 4.0% to 5.25% over the life of the bond.	25,745,000	\$ -	\$ 2,035,000	\$ 23,710,000	\$ 2,125,000
Series 2005A bond maturing September 2025 with interest ranging from 4.0% to 5.0% over the life of the bond.	28,030,000	-	-	28,030,000	-
Series 2005B&C bond maturing September 2019 with interest at 5.0% over the life of the bond.	-	47,065,000	-	47,065,000	1,335,000
Series 2006A bond maturing September 2020 with interest ranging from 4.0% to 5.0% over the life of the bond.	-	27,270,000	-	27,270,000	-
Premiums:					
2004A	1,834,601	-	203,807	1,630,794	-
2005A	2,151,053	-	97,776	2,053,277	-
2005B&C	-	3,818,367	254,558	3,563,809	-
2006A	-	1,194,808	13,578	1,181,230	-
	<u>\$ 57,760,654</u>	<u>\$ 79,348,175</u>	<u>\$ 2,604,719</u>	<u>\$ 134,504,110</u>	<u>\$ 3,460,000</u>

Debt service requirements:

Year ending June 30,	Principal	Interest
2007	\$ 3,460,000	\$ 5,878,659
2008	7,225,000	5,774,819
2009	10,080,000	5,404,918
2010	10,350,000	4,897,643
2011	12,925,000	4,426,593
2012-2016	58,015,000	12,642,417
2017-2021	22,615,000	2,752,645
2022-2026	1,405,000	96,142
	<u>\$ 126,075,000</u>	<u>\$ 41,873,836</u>

Lease obligations:

The Authority leases its office space from a City related entity under the terms of an operating lease. Rental expense amounted to for \$32,946 the year ended June 30, 2006. The lease expires in May 2007 with the minimum future rentals expected to be paid of \$28,600.

8. Contributions to Pension Plans

The Authority participates in the New York State and Local Employees' Retirement System (ERS), which is a cost-sharing multiple employer, public employee retirement system. ERS offers a wide range of plans and benefits which are related to years of service and final average salary, vesting of retirement benefits, death and disability.

ERS provides retirement benefits as well as death and disability benefits. The New York State Retirement and Social Security Law govern obligations of employers and employees to contribute and provide benefits to employees. ERS issues a publicly available financial report that includes financial statements and required supplementary information. This report may be obtained by writing to the New York State and Local Retirement System, Gov. Alfred E. Smith State Office Building, Albany, NY 12244.

ERS requires contributions of 3% of salary except for employees who joined prior to July 27, 1976 or have greater than 10 years of service. The Comptroller annually certifies the required contribution rate expressed as a percentage of participants' wages for contributions to the pension accumulation fund. The Authority made 100% of its required contributions. For the years ended June 30, 2006, 2005, and 2004 ERS expense amounted to \$51,068, \$42,544, and \$31,419, respectively.

9. Commitments and Contingencies

The Authority is involved in various legal proceedings, which, in the opinion of management, will not have a material adverse effect upon the financial position of the Authority. These proceedings result from the Authority being named as a party to various suits initiated by bargaining units representing many of the City's workers challenging articles of the Act relative to wage freeze. No damages have been specified.

10. Subsequent Event

The Authority issued its 2006A-1 premium BANs in the amount of \$60,000,000 on July 13, 2006 to finance cash flow needs of the City. A \$30,000,000 note matures on May 15, 2007 and a \$30,000,000 matures August 15, 2007. Both maturities are expected to be paid from the Authority's revenues from State aid to the City. The notes carry coupon rates of 4.25% and were priced to yield 3.50% and 3.52%, respectively.

BUFFALO FISCAL STABILITY AUTHORITY

Supplementary Information Schedule of Administrative Expenditures - General Fund

For the years ended June 30, 2006 and 2005

See Independent Auditors' Report

2006

2005

General and Administrative

Board functions

Public meeting expenses

\$ 8,612 \$ 10,915

Public forums

4,085 9,520

Directors travel reimbursement

6,199 6,312

18,896 26,747

Staff expenses

Wages

491,438 435,100

Professional development

6,338 3,064

Parking

4,645 3,479

Payroll processing fees

615 609

503,036 442,252

Central services

Postage, printing and dues

7,735 5,088

Rent

32,946 32,073

Telephone and data processing

16,887 15,166

Repairs and maintenance

2,324 1,202

Insurance

645 631

Office supplies

5,470 4,965

66,007 59,125

Administrative

Travel

7,847 8,110

Professional fees and consultants

31,291 44,150

Legal fees

263,277 313,664

Equipment

2,766 20,324

305,181 386,248

Grant expenditures

City of Buffalo energy consultant

44,490 -

Total General and Administrative

937,610 914,372

Employee Benefits

New York State Employees' Retirement System contributions

51,068 42,544

Social security and Medicare taxes

35,380 31,336

Workers' compensation and disability insurance

2,519 2,394

Medical insurance net of employee contributions

50,060 34,621

Total Employee Benefits

139,027 110,895

Total administrative expenditures - general fund

\$ 1,076,637 \$ 1,025,267



**Report on Internal Control over Financial Reporting and Compliance and Other Matters
Based on an Audit of Financial Statements Performed in Accordance with
*Government Auditing Standards***

The Board of Directors
Buffalo Fiscal Stability Authority
Buffalo, New York

We have audited the financial statements of the governmental activities and each major fund of Buffalo Fiscal Stability Authority (the Authority), as of and for the year then ended June 30, 2006, which collectively comprise the Authority's basic financial statements and have issued our report thereon dated September 18, 2006. We conducted our audit in accordance with auditing standards generally accepted in the United States of America, and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States.

Internal Control over Financial Reporting

In planning and performing our audit, we considered the Authority's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Authority's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of the Board of Directors, management, officials of the City of Buffalo, and the Office of the State Comptroller of the State of New York. It is not intended to be and should not be used by anyone other than these specified parties.

Lumsden & McCormick, LLP

September 18, 2006



Independent Accountants' Report

The Board of Directors
Buffalo Fiscal Stability Authority
Buffalo, New York

We have examined Buffalo Fiscal Stability Authority's (the Authority) compliance with Section 2925(3)f of the New York State Public Authorities Law and Part 201 of Title Two of the New York Code of Rules and Regulations during the year ended June 30, 2006. Management is responsible for the Authority's compliance with those requirements. Our responsibility is to express an opinion on the Authority's compliance based on our examination.

Our examination was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants and the standards applicable to attestation engagements contained in *Government Auditing Standards* issued by the Comptroller General of the United States and, accordingly, included examining, on a test basis, evidence supporting the Authority's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our examination provides a reasonable basis for our opinion. Our examination does not provide a legal determination on the Authority's compliance with specified requirements.

In our opinion, the Authority complied, in all material respects, with the aforementioned requirements during the year ended June 30, 2006.

This report is intended solely for the information and use of the Board of Directors, management, officials of the City of Buffalo, and the Office of the State Comptroller of the State of New York. It is not intended to be and should not be used by anyone other than these specified parties.

Lumsden & McCormick, LLP

September 18, 2006