Released
12-15-77

DOCUMENT RESUME

04052 - [B3194435]

Analysis of Operating Expenses in New York City's Fiscal Year 1978 Capital Budget. GGD-78-13; B-185522. November 15, 1977. Released December 15, 1977. 9 pp. + 2 appendices (14 pp.).

Report to Rep. William S. Moorhead, Chairman, House Committee on Banking, Finance and Urban Affairs: Economic Stabilization Subcommittee; by Elmer B. Staats, Comptroller General.

Issue Area: Intergovernmental Policies and Fiscal Relations: Fiscal Problems and Potential Solutions (407).
Contact: General Government Div.
Budget Function: Revenue Sharing and General Purpose Fiscal Assistance: Other General Purpose Fiscal Assistance (352).
Organization Concerned: New York, NY; Department of the Treasury.
Congressional Relevance: House Committee on Banking, Finance and Urban Affairs: Economic Stabilization Subcommittee.

The operating expenses contained in New York City's fiscal year 1978 capital budget are understated, but only by a relatively small amount. This amount was determined using a strict interpretation of the criteria, which are more strict than many municipalities might currently be following. However, in view of the current fiscal problems of the city and its need to restore investor confidence, it is in the city's best interest to apply strict criteria in determining whether budget items are valid capital outlays or operating expenses.
Findings/Conclusions: New York State law requires New York City to eliminate operating expenses from its capital budget over a 10-year period. Using criteria established by the State Comptroller, the city classified $643 million of its $1.031 billion in planned capital outlays as operating in nature. Application of a strict interpretation of the State's criteria identified an additional $18.9 million which should have been classified as operating expenses. For an additional $8.3 million in planned expenditures, city officials did not have sufficient documentation to permit determination as to whether the items were valid capital charges. City officials agreed that $5.5 million in expenditures should be classified as operating, but disagreed with the determinations on the remaining $13.4 million. Representatives of both the State and City Comptrollers' offices agreed with the determinations in all cases. (Author/SC)

4435

04052

REPORT OF THE COMPTROLLER GENERAL OF THE UNITED STATES

Analysis Of Operating Expenses In New York City's Fiscal Year 1978 Capital Budget

State law requires New York City to eliminate operating expenses from its capital budget over a 10-year period. Using criteria established by the State Comptroller, the City classified $643 million of its $1.031 billion in planned capital outlays as operating in nature. GAO applied a strict interpretation of the State's criteria and identified an additional $18.9 million. In view of the City's current fiscal problems and its need to restore investor confidence, GAO believes it is in the City's best interest to apply strict criteria and recognize this amount as operating in nature.

GGD-78-13

NOVEMBER 15, 1977

COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

B-185522

The Honorable William S. Moorhead
Chairman, Subcommittee on Economic
Stabilization
Committee on Banking, Finance and
Urban Affairs
House of Representatives

Dear Mr. Chairman:

In your letter of May 11, 1977, you requested that we supplement with additional information the briefing we gave your Subcommittee on April 29, 1977, on New York City's financial situation. Specifically, you requested that we furnish data on (1) operating expenses in the capital budget, (2) the City operating budget increases above the amounts anticipated in the 3-year financial plan, and (3) illegal aliens in New York City as they affect the City's population base.

We have already responded on the matters of illegal aliens and operating budget increases. This report addresses the issue of operating expenses in the capital budget.

You stated that the Subcommittee would like to know how much of the Mayor's proposed fiscal year 1978 budget represents operating expenses, why the proposed executive budget indicated an increase in the amount of operating expenses in the capital budget over the amount previously reported, and whether the City is adhering to the State-legislated mandate to eliminate operating expenses from the capital budget.

Your questions address some basic issues of municipal financial practice for which no hard and fast rules exist and on which opinions differ significantly.

A conservative approach to public finance dictates that all current expenses, as well as a normal level of recurring capital outlays, should be included in a municipality's operating budget and funded with current revenues. The capital budget, which is funded with borrowings, should likewise, under a conservative approach, be restricted to paying for the construction of major permanent facilities having a relatively long life.

Applying this approach in practice, however, is sometimes difficult. What constitutes a normal level of recurring capital outlays, which should be in the operating budget, is judgmental. When a local official is faced with making this determination, he may well lean toward funding all capital outlays through borrowing, thus freeing current revenues for other purposes. In the extreme situation, he may even classify certain operating expenses as capital and borrow to pay for them.

This was the case in New York City in the years preceding the fiscal crisis of 1975. For over a decade, the City, with the approval of the State, had borrowed money through its capital budget to pay for certain operating expenses which should have been paid for with current revenues. This is one of the much publicized "gimmicks" the City used to balance its operating budget.

After public disclosure of this "gimmick," the New York State legislature concluded that the funding of operating expenses through the capital budget was an undesirable practice and directed that it be eliminated in accordance with criteria to be laid down by the State Comptroller. The Comptroller issued Accounting Systems Directive Number 4, "Budgeting, Accounting and Financing of Capital Outlays and Expense Programs Eligible for Borrowing Under Law," in early 1976 and subsequently revised and liberalized it somewhat in February 1977. (See app. I.) It provides that in addition to "brick and mortar" projects, the City may capitalize equipment having a unit cost of $15,000 or more and minimum useful life of 5 years. We applied the criteria established by the Directive in responding to your questions.

HOW MUCH OF THE MAYOR'S PROPOSED FISCAL YEAR 1978 CAPITAL BUDGET REPRESENTS OPERATING EXPENSES?

The fiscal year 1978 capital budget proposed total appropriations of $1.36 billion, of which $865 million represented City funds and the balance represented Federal, State, and private grants. Since these appropriations represent, in part, what some City officials call a "wish list," that is, projects in the early stages of planning which might later be canceled, it is not the best representation of what the City will spend. A better representation of planned capital improvements is the "cash flow report," which is a forecast of those projects on which funds will actually be spent during the year. For the purposes of our tests, we focused on the cash flow forecast.

The forecast shows a total planned outlay of $1.445 billion, which is somewhat higher than the budget because it includes some planned outlays on projects authorized in prior years for which expenditures will be made in fiscal year 1978. Of the $1.445 billion, $1.031 billion represents the amount to be financed by the City and includes $608 million in operating expenses which, according to the Directive criteria, should have been included in the operating budget. Subsequent to the budget's publication, the City reclassified another $35 million as operating expenses based upon analyses conducted by the State and City Comptrollers. Thus, a total of $643 million or about 62 percent of the total outlays of $1.031 billion was identified as operating expenses, leaving 38 percent or $388 million which represented capital outlays. This can be summarized as follows.

	(millions)
Operating expenses in executive capital budget	$ 608
Addition agreed to by City	35
Total operating expenses recognized by City	643
Total capital projects--per City	388
Total planned expenditures for 1978 capital budget--City funds	$1,031

We reviewed 116 of the 434 projects which were considered valid capital by the City. These projects accounted for over 60 percent of the $388 million of valid capital projects. In conducting these tests, we applied a strict interpretation of the principles of the Directive because past interpretations of capitalization criteria contributed to the City's fiscal difficulties.

Applying this strict interpretation and a conservative approach to public financing decisions, we identified $18.9 million which we believe should be recognized as operating expenses. For an additional $8.3 million in planned expenditures, City officials did not have sufficient documentation to permit us to determine whether those items were valid capital charges. The amount of operating expenses in the capital budget, therefore, is at least $662 million rather than the $643 million recognized by the City.

City officials agreed that $5.5 million in expenditures should be classified as operating, but they disagreed with our determinations on the remaining $13.4 million. Representatives of both the State and City Comptrollers' offices agreed with our determinations in all cases.

Most of the City's disagreement centered around the following issues:

--The City feels that resurfacing of streets is a valid capital project, since it extends their useful life. We feel, however, that resurfacing merely restores streets to their original condition, and, in any event, should be expensed since it is a normal recurring maintenance expense of the City. Of the $13.4 million disputed by the City, $7.2 million is attributable to this disagreement.

--The City maintains that it can legally borrow for installment payments on equipment purchases. Whether it is legal or not, we feel the installment payments themselves represent borrowing by spreading the equipment cost over a number of years. While the equipment is clearly a capital asset, a conservative approach to public finance would dictate that the installment payments be funded through current revenues rather than by capital fund borrowings which result in principal and interest payments that must eventually be funded out of current revenues. Approximately $3.3 million is attributable to this disagreement.

--The City contends that the Directive did not become effective until July 1, 1977, and therefore does not apply to any commitments prior to that date even if money will be spent in fiscal year 1978. In our opinion, the Directive must be applied retroactively since State legislation requires that it be used as criteria in examining the capital budget for fiscal year 1976, the base year in the 10-year phase-out of operating expenses. Representatives of the State Comptroller's office also maintain that the Directive is retroactive to fiscal year 1976. Almost $2.5 million is attributable to this disagreement.

A listing of all the projects in question is attached as appendix II. That listing briefly describes our reasons for classifying the projects as we did, as well as the reasons why City officials disagreed with our conclusions.

In addition to testing the 116 projects, we also looked at another aspect of the City's fiscal year 1978 capital budget. In prior years, the City had charged salaries of certain City employees to the capital budget without documenting the validity of these charges. For fiscal year 1978 the City has developed a new system which, for the first time, systematically records and accumulates these time charges. The Directive recognizes the validity of charging these in-house labor costs to the capital budget. It requires, however, that they be allowed only up to the amount which would be incurred if the same work were contracted out to independent architects and engineers.

We examined this system and concluded that it should be adequate to insure that charges for in-house labor will not be excessive. Detailed time records will be required for each employee whose time is charged to the capital budget. Furthermore, the City, in determining the maximum amount of in-house labor it can charge, will use the same fee schedule it applies when computing fees payable to independent architects and engineers. Therefore, assuming the projects on which City employees work are valid capital projects, the system should operate to insure that excess charges to the capital budget do not occur.

WHY DOES THE PROPOSED EXECUTIVE BUDGET INDICATE AN INCREASE IN THE AMOUNT OF OPERATING EXPENSES OVER THE AMOUNT PREVIOUSLY REPORTED?

The 3-year financial plan estimated that the City would spend $515 million on operating expenses supported by capital borrowings in the third year--fiscal year 1978. However, at the time that plan was prepared, the criteria for making a capital/expense determination were uncertain. The New York State Comptroller had prepared the Directive, but City officials objected to those criteria.

One section was particularly controversial. In its original version dated February 1976, the Directive provided that, in addition to "bricks and mortar" projects, certain major equipment purchases could be considered as capital projects if the unit cost was $75,000 or more and the useful economic life was at least 7 years. That provision meant, for example, items such as garbage trucks would have to be recognized as operating expenses because they cost less than $75,000.

City officials, including the Mayor and his Deputy Mayor for Finance, pressed for a change in the Directive, proposing more liberal criteria that would allow it to borrow for equipment costing $3,000 or more and which had a useful economic life of at least 3 years. In order to end the controversy and uncertainty, the State revised the Directive by lowering the limits for equipment to a minimum unit cost of $15,000 and a minimum useful life of 5 years. By this revision, certain equipment purchases which would have been financed through current revenues under the original Directive could now be financed through borrowings.

The City deferred any new analysis of its capital budget until agreement was reached on the Directive. With a compromise finally achieved, the City began to analyze the budget as required by State law. The results of this analysis were disclosed in the Mayor's 1978 Executive Budget which showed that $608 million of operating expenses would be funded by capital fund borrowings in that year, in lieu of the $515 million previously projected in the financial plan.

Both of the estimates, $515 million and $608 million, were based on the same basic universe of items. The change represents a reclassification of items, from operating to capital and vice versa in accordance with the revised criteria, rather than the addition of new items.

The major items accounting for the net increase from $515 million to $608 million follow.

<u>City subsidy to Transit Authority reclassified as an operating expense--$71 million</u>

The New York City Transit Authority, an independent agency operating the subways and some bus routes in the City, receives funds from the City through various subsidy mechanisms. Beginning in 1975, the City used its capital budget to provide an annual subsidy to the Transit Authority. The subsidy is used for maintaining the City's subways and is thus a City operating expense. Therefore, the $71 million projected to be spent in fiscal year 1978 was reclassified as an operating expense.

Judgments and claims reclassified as an operating expense--$77 million

The City has traditionally borrowed to pay for unforeseen judgments or claims. Many of the prior claims suffered by the City have not been of a capital nature. Instead, they consisted of such operating expenses as salary and wage adjustments, compensation for personal injuries to citizens, and tuition costs for handicapped children, all of which do not meet the new Directive criteria for capital projects. As a result, the $77 million estimate for judgments and claims in fiscal year 1978 was reclassified as an operating expense.

Various purchases reclassified as an operating expense--$10 million

The new Directive criteria prohibit the City from borrowing for machinery and equipment purchases if the unit cost is below $15,000 or the estimated useful life is less than 5 years. This is a stricter definition than the criteria the City used in preparing its original estimate. Therefore, the City had to reclassify $10 million in purchases of items such as light trucks which did not meet the new criteria.

In-house labor reclassified as capital--$72 million

The new Directive considers City personnel and related costs "directly applicable to specific capital projects" as valid capital costs. This includes engineering and architectural costs for design and supervision of construction. With this provision in mind, the City determined that the $515 million in operating expenses projected in the financial plan included $72 million of such valid capital charges. The City therefore reduced the operating expenses in the capital budget by this amount.

* * * * *

In summary, then, the City adjusted its financial plan projection of operating expenses funded by 1978 capital spending as follows.

		(millions)
Fiscal year 1978 operating expenses supported by long-term borrowings per financial plan		$515
Plus:		
Transit Authority subsidy	$71	
Judgments and claims	77	
Various equipment purchases	10	
Other increases	7	165
Less:		
Personnel and other costs directly related to capital projects		72
Fiscal year 1978 operating expenses supported by long-term borrowings per fiscal year 1978 Executive Budget		$608

IS THE CITY ADHERING TO THE STATE-LEGISLATED MANDATE TO ELIMINATE OPERATING EXPENSES FROM THE CAPITAL BUDGET?

Under the mandated phase-out the City was required to gradually reduce borrowings for operating expenses over a 10-year period. In each fiscal year beginning with 1977, the City would have to reduce by 10 percent the amount of operating expenses funded in the fiscal year 1976 budget. When the compromise on the Directive was reached, the City reevaluated its fiscal year 1976 capital budget using the new criteria. It determined that $861 million of operating expenses was included in the original budget for 1976. A 10-percent reduction for each of the subsequent 2 years would leave the City with $688 million as the fiscal year 1978 ceiling for operating expenses funded by capital fund borrowings. The $608-million estimate in the City's fiscal year 1978 executive budget is within this ceiling. Even with the $35 million adjustment added and the $18.9 million we identified, the resulting $662 million is below the limit.

* * * * *

In summary, our analysis indicates that the operating expenses contained in the City's fiscal year 1978 capital budget are understated, but only by a relatively small amount. Furthermore, this amount was determined using a strict interpretation of the criteria, more strict than many municipalities might currently be following. Nevertheless, in view of the current fiscal problems of the City and its need to restore investor confidence, it is in the City's best interest to apply strict criteria in determining whether budget items are valid capital outlays or operating expenses.

We trust this analysis of the operating expenses funded through the capital budget is responsive to your Subcommittee's needs. If you have any questions or wish to discuss the information provided, we would be happy to meet with you at your convenience.

As arranged with your office, unless you publicly announce its contents earlier, we plan no further distribution of this report until 30 days from the date of this report. At that time we will send copies to interested parties and make copies available to others upon request.

Sincerely yours,

Elmer B. Staats

Comptroller General
of the United States

STATE OF NEW YORK
DEPARTMENT OF AUDIT AND CONTROL
DIVISION OF AUDITS AND ACCOUNTS

ACCOUNTING SYSTEMS DIRECTIVES FOR NEW YORK CITY

Accounting Systems Directive No. 4

Budgeting, Accounting and Financing of Capital Outlays and Expense Programs Eligible for Borrowing Under Law

Introduction

The capital budget may be financed through borrowings, current revenues, or a combination of the two. From the viewpoint of conservative public finance, ideally all governmental programs of an expense nature and a general or normal annual level of capital expenditures should be financed from current revenues. It is recognized, however, that public finance requires a balanced financing approach and that depending upon circumstances, borrowings may be used to finance all projects that can be clearly defined as capital in nature.

This directive is designed to provide a more conservative approach to financing capital construction than has been previously followed by New York City. It defines those particular elements of capital construction that may be financed through borrowing, as distinguished from those which should be financed through current revenues. It is also designed to establish practices and procedures to account for all capital outlays of the City that will conform to generally accepted accounting principles and widely followed budgetary practices, at the same time being compatible with the phase-out financing program authorized in the MAC legislation. This directive is intended, however, to cover only capital outlays to be budgeted and accounted for in the City's capital projects fund and general fund.

Capital Outlays Defined

Capital outlays are defined as those expenditures which result in the acquisition of, replacement, or additions to fixed assets. Broadly speaking, these will consist of:

1. Capital expenditures which meet the definition of a "capital project," as hereinafter defined; and

2. Capital expenditures other than those meeting the definition of a "capital project," consisting of machinery and equipment, including autos and trucks, furniture, office equipment and related items.

Capital Projects Defined

Capital projects are defined as "those capital outlays other than special assessment and enterprise fund projects, which involve the construction of major, permanent facilities having a relatively long life. These projects do not include fixed assets with a comparatively limited life, such as various types of machinery and office equipment. The latter are not generally appropriate objects for long-term borrowing by state and local governments and consequently are financed by current revenues..." 1/

1/Governmental accounting, auditing, and financial reporting, Page 43.

The City Charter states that "the term 'capital project' shall mean any physical public betterment or improvement or any preliminary studies and surveys relative thereto, which would be classified as capital expenditures under generally accepted accounting principles for municipalities."

In accordance with the above definition, capital project expenditures shall include the acquisition or construction cost of land, buildings and major improvements other than buildings.

Capital project construction costs shall include all direct costs for materials and labor, engineering and "first line" architectural costs for design and supervision of construction. (Such costs shall be included whether the architectural work is performed by consultants or by "in-house" personnel. If "in-house" personnel are used, the related costs should not exceed that which would be charged by consultants.)

This would permit the City to treat as project costs, the personnel and related costs directly applicable to specific capital projects such as the costs of site survey and site selection. To insure a reasonable limitation and control over such capital project expenditures, such charges or allocations must originate from a controlled time distribution system, accounting for all time of the unit performing these services and be reasonable in the light of that which would be charged by consultants.

Costs of fixed equipment and machinery, furniture and office equipment may be included as part of a capital project where such costs represent an initial outfitting of a specific capital project. In addition, capital outlays for certain major equipment, whether an initial or replacement acquisition, shall be considered to meet the definition of a capital project where the unit cost thereof is $15,000 or more and its useful economic life is at least five years, provided that it is other than a passenger type automobile or light truck. This latter definition is applicable only to the extent that the resulting financial statements of the capital project fund will be fairly stated in conformity with generally accepted accounting principles.

Budgeting and Accounting for Capital Outlays

Basic Principles

Generally accepted accounting principles should be followed for the purpose of determining the appropriate fund in which to account for the two types of capital outlay, as previously defined. The budgeting practice should be based on and follow the accounting principles applicable thereto.

Capital Projects Fund

A capital budget is a plan of proposed capital projects and the means of financing them. Upon adoption it shall cover such period of time as is required to complete all capital projects included therein.

Those capital outlays which meet the definition of a "capital project" should be budgeted and accounted for in a capital projects fund. As previously stated, such capital expenditures would include the acquisition or construction cost of land, buildings, and major improvements other than buildings. Machinery and related equipment would be included only when such costs represented an initial outfitting of a capital project, or consisted of major equipment with a unit cost of $15,000 or more and a useful economic life of at least five years, as heretofore defined.

Generally, all projects included in the City's capital budget for successive fiscal years can be accounted for in a single capital projects fund. Within said fund an individual capital project account should be established for each authorized project except for a series of related projects, which can be consolidated as a single project. Major projects for which a detailed classification of expenditures is deemed desirable may be accounted for by the use of sub-expenditure accounts, as provided for in the prescribed chart of accounts for the Capital Projects fund. Charges to an individual Capital Project account are limited to those costs that result in the addition to fixed assets through construction and/or acquisition, as heretofore defined.

General Fund

Those capital outlays which do not meet the definition of a "capital project" should be budgeted and accounted for in the general fund. Generally, these will include all equipment (not part of the initial outfitting of a specific capital project) required to be used by City departments and agencies whose operations are to be accounted for in the general fund, such as normal annual replacement purchases of machinery, automotive equipment, furniture, office equipment, and similar items.

Recurring City expenditures not directly related to the acquisition or construction of specific capital projects should be excluded from the capital budget. Exclusions would cover such items as recurring costs for ongoing surveys and studies of prospective project sites, general planning and administrative costs of departments or agencies involved in capital project activities, processing and audit of vouchers, budget and accounting personnel assigned to overall planning for capital projects, general administrative overhead related to such work, costs of supervising the work of consultant architects, and such extraneous items as judgments and claims. These items and any phase-out financing authorized by the MAC legislation should be budgeted and accounted for in the general fund.

Financing of Capital Outlays and Expense Type Programs Under MAC Legislation

Whether capital outlays (and eligible expense programs under the Local Finance Law) are financed by borrowing or from current revenues are matters of City financing policy and legal directives, not accounting principles or budgetary practices. Regardless of the method of financing they should nonetheless be budgeted and accounted for in the appropriate fund, based on generally accepted accounting principles, as set forth heretofore.

For many years the City has financed by borrowing all of its true capital projects, other capital outlay items; and many expense type programs permitted under the Local Finance Law to be so financed. The MAC law now mandates that the City will, on a phased basis, eliminate from its capital budget those expenses that are properly includible only in its expense budget. Under such legislation, expense type programs financed by borrowing during the authorized phase-out period will nonetheless be accounted for in the general fund. Proceeds from sale of bonds or other long-term debt would be recorded in a revenue account entitled "Proceeds from sale of bonds (or other appropriate form of long-term debt)" in the general fund until such time as the phase-out financing program is completed.

The fact that equipment or machinery is estimated to last more than a specified number of years or cost more than a specified amount are criteria for such items being included in the general fixed assets group of accounts but normally not for purposes of capital projects budgeting and accounting.

CITY AND OUR COMMENTS ON OPERATING EXPENSES IN SAMPLED PROJECTS IN FISCAL YEAR 1978 CAPITAL BUDGET

	Amount that should be recognized as an operating expense
Project HW 349: Repaving and resurfacing of streets and highways.	
--Our comments: Resurfacing should be expensed since it only restores streets to their original condition after normal wear and tear, and street resurfacing is a normal recurring maintenance expense.	$7,200,000
--City comments: Resurfacing streets extends their useful life by more than 5 years and therefore the cost should be included in the capital budget.	
Projects WM 1 & WM 6: Water main extensions and ordinary improvements to distribution system and improvements and additions to pumping plants and buildings.	
--Our comments: Projects include costs for replacements of water mains, hydrants, etc., broken by accident. These are ordinary recurring repairs which should be expensed.	1,691,000
--City comments: These items should be expensed in the future. However, $778,000 of the charges should be allowed in the fiscal year 1978 Capital Budget since this amount was committed prior to what the City considers the effective date of the State's directive, Accounting Systems Directive Number 4 (ASD-4).	

	Amount that should be recognized as an operating expense
Projects HN 191, PU 16 & TF 1: Purchase of EDP equipment for various city departments.	
--Our comments: When equipment is purchased on the installment plan which spreads cost over 5 years, the installment payments should be expensed rather than bonded and spread over additional years.	$3,316,000
--City comments: Purchase of equipment on the installment basis is legally bondable.	
Project F 109: Fire fighting vehicles and equipment.	
--Our comments: Project includes small trucks costing under $15,000 which should be expensed.	21,000
--City comments: These items should be expensed in the future. However, the charges should be allowed in fiscal year 1978 since City officials dispute the effective date of ASD-4.	
Project BR 8: Reconstruction and improvement of bridges.	
--Our comments: Project includes painting and repairs which should be expensed as normal maintenance.	430,000
--City comments: These items should be expensed in the future. However, $295,000 of the charges should be allowed in the fiscal year 1978 capital budget since this amount was committed prior to what the City considers the effective date of ASD-4.	

	Amount that should be recognized as an operating expense
Projects HO 215 & PU 15: Purchases of ambulances and trucks.	
--Our comments: Projects include vehicles costing less than $15,000. These do not meet ASD-4 criteria and should be expensed.	$962,000
--City comments: These items should be expensed in the future. However, they should be allowed in fiscal year 1978 since City officials dispute the effective date of ASD-4.	
Project E 643 R,K & M: Modernization of schools.	
--Our comments: Project includes books and supplies which should be expensed.	235,000
--City comments: These items should be expensed in the future. However, the charges should be allowed in fiscal year 1978 since City officials dispute the effective date of ASD-4.	
Project HO 214: Reconstruction and modernization of various hospitals.	
--Our comments: Project includes minor improvements which should be expensed.	311,000
--City comments: These small construction projects can be legitimately capitalized because they are improvements.	

	Amount that should be recognized as an operating expense
Project E 1750: Installation of intrusion alarm systems in various schools.	
--Our comments: Individual school alarms do not meet the ASD-4 criteria because they do not constitute a total integrated system.	$ 120,000
--City comments: These alarms constitute valid capital improvements since, when considered as one system, they meet the ASD-4 criteria.	
Projects F 212 & PU 16: Purchase of EDP equipment for various City departments.	
--Our comments: Projects include maintenance contracts on equipment. Maintenance is a normal recurring expense.	490,000
--City comments: The City agrees these items should be expensed.	
Project PU 16: Purchase of EDP equipment for various City departments.	
--Our comments: Project includes the cost of renting computers and purchase of miscellaneous minor equipment. Both should be expensed.	95,000
--City comments: These items should be expensed in the future. However, the charges should be allowed in fiscal year 1978 since City officials dispute the effective date of ASD-4.	

APPENDIX II

	Amount that should be recognized as an operating expense
Project T 150: Purchase of rapid transit cars.	
-- comments: Project includes principal repayment on Transit Authority bonds. This cost should be expensed.	$3,970,000
--City comments: The City agrees this item should be expensed.	
Project L 101 M: Reconstruction and rehabilitation of various libraries.	
--Our comments: Project includes payments for maintenance and repairs which should be expensed.	32,000
--City comments: These items should be expensed in the future. However, the charges should be allowed in fiscal year 1978 since City officials dispute the effective date of ASD-4.	
Project PW 284: Renovation of public buildings.	
--Our comments: Project includes payments for maintenance and repairs which should be expensed.	34,000
--City comments: These items should be expensed in the future. However, the charges should be allowed in fiscal year 1978 since City officials dispute the effective date of ASD-4.	
Project C 75: Improvements and modernizations, Department of Corrections.	
--Our comments: Project includes minor improvements which should be expensed.	14,000
--City comments: Cost of improvements represents a legitimate capital item.	

	Amount that should be recognized as an operating expense
Project T 2: Engineering expenses in connection with projects of other departments.	
--Our comments: Project includes cost of testing heating oil to City specifications which should be expensed.	$ 16,000
--City comments: These items should be expensed in the future. However, the charges should be allowed in fiscal year 1973 since City officials dispute the effective date of ASD-4.	
Total operating expenses	$18,937,000

(01739)