ULSTER COUNTY
COMPTROLLER'S OFFICE

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Fund Balance

3rd Quarter 2016

The mission of the Ulster County Comptroller's Office is to serve as an independent agency of the people and to protect the public interest by monitoring County government and to assess and report on the degree to which its operation is economical, efficient and its financial condition sound.

<u>Comptroller's Quarterly Report: Ulster County's Fund Balance</u>

Notwithstanding the regularity of such reports throughout the year, it is the Office of the Comptroller's practice to produce Quarterly Reports highlighting particular financial issues on timely topics impacting taxpayers. This report focuses on Fund Balance in relation to budgeting and addresses issues to be considered in connection with the practice of Fund Balance appropriation during the budgetary process.[1]

The Ulster County Comptroller reports that while *it is good news that the County reflects an available $36 million Fund Balance*, *it is bad news that County spending is outpacing its declining revenue collections*. The Comptroller warns that this trend will negatively affect the County's ability to sustain its current budget practices or that forthcoming budgets will have to be tightened to meet declining revenues.

<u>The Budgetary Process and Fund Balance Appropriations</u>

For the period reviewed, Ulster County has balanced the annual budget by appropriating – or spending down – its Fund Balance to the extent that expenditures exceed revenues. However, a structurally sound budget must be supported by recurring revenues (e.g. real property tax, sales tax, etc.) – not by Fund Balance. To illustrate this point, the chart below shows the budgeted Fund Balance appropriated for each fund for the 2013-2017 fiscal years.

Budgeted Fund Balance Appropriations

	2013		2014		2015		2016		2017	
	$*	%*	$*	%*	$*	%*	$*	%*	$*	%*
General Fund	$ (10,000,000)	2.78%	$ (13,200,000)	3.93%	$ (18,965,400)	5.67%	$ (15,623,624)	4.73%	$ (15,344,341)	4.72%
County Road	(900,000)	0.25%	(2,685,000)	0.80%	-	0.00%	(250,000)	0.08%	-	0.00%
Road Machinery	-	0.00%	-	0.00%	-	0.00%	-	0.00%	(1,000,000)	0.31%
Debt Service	(2,350,000)	0.65%	(825,000)	0.25%	(500,000)	0.15%	(250,000)	0.08%	-	0.00%
Total Appropriated	(13,250,000)	3.68%	(16,710,000)	4.97%	(19,465,400)	5.82%	(16,123,624)	4.88%	(16,344,341)	5.03%
Reserves Appropriated	(2,476,000)	0.69%	(404,000)	0.12%	(140,000)	0.04%	(254,506)	0.08%	(215,450)	0.07%
Total Budgeted Appropriations	**$ (15,726,000)**	**4.37%**	**$ (17,114,000)**	**5.09%**	**$ (19,605,400)**	**5.86%**	**$ (16,378,130)**	**4.96%**	**$ (16,559,791)**	**5.10%**
Total Budgeted Expenditures	$ 360,036,399		$ 336,198,197		$ 334,523,714		$ 330,369,802		$ 324,824,144	

*The amounts and percentages from 2013-2016 represent adopted budgets, the figures for 2017 represent the Executive Budget as the budget is yet to be adopted

The above chart illustrates that the use of Fund Balance appropriations have increased overall since 2013. Total Budgeted Appropriations of Fund Balance **increased** $.83 million from 2013 to 2017 while the total budgeted expenditures **decreased** by more than $35.21 million over the same period.

We recognize the County Executive and Legislature for increasing efficiencies in operation that have reduced annual expenditures by $35.21 million from 2013 to 2017. Although we acknowledge the need to reduce expenditures and its positive effect on taxes, we caution that over-reliance on Fund Balance to supplement non-existent or dwindling revenues has increased the County's budget imbalance. It stands to reason that decreasing the property tax levy is not warranted when such a high level of Fund Balance is appropriated in the budget for expected, recurring expenditures. Accordingly, the diminishing remainder of fund balance jeopardizes the County's ability to sustain its budget in future years.

[1] The data presented herein relies upon the accuracy of Ulster County and national data available at the time of its preparation. This report is intended to inform taxpayers and local officials of general trends and Ulster's positioning in the midst of those trends. Future reports will continue to identify fiscal and performance issues relevant to the effective operation of government, with a constant goal of encouraging educated public discourse and decision making by voters and policy makers in Ulster County.

The demonstrated reduction in expenditures is being outpaced by a more drastic decline in revenue (i.e. total budgeted revenues have fallen by $36.05 million from 2013 through 2017). To ensure property tax levies are maintained at the lowest rate possible, County officials should investigate ways to enhance or maximize recurring revenue sources, including obtaining new ones. In order to maintain a structurally balanced budget, the amount of recurring revenues should dictate the amount of expenditures for which the County should budget for the year. Otherwise, the low property tax levy currently enjoyed by residents will surely increase once costs exceed available Fund Balance for appropriation.

Current Fund Balance Policy

In February 2013, the Ulster County Legislature adopted Resolution 36, which placed the Ulster County Fund Balance Policy ("Policy"). This Policy designates 5-10 percent of the current operating annual expenditures as the desired level of unrestricted Fund Balance at all times. Per the OSC bulletin on *Fund Balance Reporting and Governmental Fund Type Definitions*, "Unrestricted Fund Balance" shall mean the "total of the Committed, Assigned, and Unassigned classifications."[2]

Fund Balance available for appropriation has been above the recommended percentage in the Ulster County Fund Balance Policy since the close of 2013. The percentage went from approximately 17.5% (2013) down to 11.5% (for the 2016 year end projection).

The County's Policy states that levels below 5 percent should be replenished within the succeeding year, yet the Policy does not address a remedy for carrying balances above the recommended threshold. The Policy also does not address whether the 5-10 percent threshold should be applied to each specific fund, each classification of fund, or to all County Funds as a whole.

The following chart displays the Executive's projected 2016 year end Fund Balance available for appropriation as a percentage of the 2017 Executive Budget proposed expenditures.

Fund Balance - Available for Appropriation as a Percentage of Current Governmental Fund Operating Expenditures as of 12/31/2016				
	General Fund	Debt Service	Other Govt Funds	Governmental Fund Total
Est. Fund Balance - Available for Appropriation*	$ 29,800,826	$ 1,265,555	$ 5,180,535	$ 36,246,916
Budgeted 2017 Governmental Fund Expenditures	$ 283,909,060	$ 9,846,685	$ 20,995,482	$ 314,751,227
Percentage	10.50%	12.85%	24.67%	11.52%

* Note the fund balance listed is the amount estimated by the 2017 Executive Budget as of 12/31/16. Additional Fund Balance amounts exist in each of the Funds listed, however those amounts are either Restricted or Non Spendable.

The projected Fund Balances available for appropriation at the close of 2016 are above the Policy upper threshold of 10 percent. However, the historical trend of consistent appropriation indicates that the Fund Balance will continue to diminish in future years. Using those projected balances from the 2017 Executive Budget and the amounts appropriated, Fund Balance available for appropriation in the Governmental Funds would decrease $16.34 million by the end of 2017. The chart below shows the County would be within the limits of the current Fund Balance Policy at the close of 2017.

[2] *See* Appendix A: Municipal Accounting Fundamentals

Fund Balance - Available for Appropriation as a Percentage of Current Governmental Fund Operating Expenditures as of 12/31/2017				
	General Fund	Debt Service	Other Govt Funds	Governmental Fund Total
Est. Fund Balance - Available for Appropriation*	$ 14,456,485	$ 1,265,555	$ 4,180,535	$ 19,902,575
Est. 2018 Governmental Fund Expenditures**	$ 285,442,959	$ 9,482,027	$ 24,977,197	$ 319,902,183
Percentage	5.06%	13.35%	16.74%	6.22%

* Note the fund balance listed is the amount estimated by the 2017 Executive Budget. Additional Fund Balance amounts exist in each of the Funds listed, however those amounts are either Restricted or Non Spendable. The average includes the 2017 executive recommendation amounts.

** Note the 2018 Governmental Fund Expenditures have been estimated using the average 2015-2017 Budgeted Expenditures

We note that the budgeted amounts and the actual amounts of Fund Balance utilized during the year tend to vary significantly. The immediately preceding chart assumes the amount of Fund Balance appropriated in the 2017 Executive Budget will accurately project the deficit of revenues over expenditures.

Deficit Budgeting and the Effect on Forecasted Fund Balance

Local governments are required to submit a balanced annual budget; however, by using Fund Balance it is possible for the current budget to be balanced while creating a future *imbalance* where expenditure obligations and disbursements grow faster than revenues. In the case of Ulster County, *revenues have decreased faster than expenditures have fallen since 2013*, which has created an *imbalance*. In the long-run, this type of budgeting – where Fund Balance is appropriated to the extent that expenditures exceed revenue – could deplete County savings and would perpetuate and potentially exacerbate a budget deficit if differences between revenues and expenditures are not addressed.

The average amount of Fund Balance utilized in the Governmental Funds during 2014 and 2015 using actual figures was $4.94 million per year. If we apply the average actual usage to upcoming years, the Governmental Fund Total would project as follows:

Projecting the longevity of Fund Balance available for appropriation						
	2017	2018	2019	2020	2021	2022
Beginning of year	$36,246,916	$31,302,537	$26,358,157	$21,413,778	$16,469,398	$11,525,019
Less: Average actual usage*	4,944,380	4,944,380	4,944,380	4,944,380	4,944,380	4,944,380
End of year	$31,302,537	$26,358,157	$21,413,778	$16,469,398	$11,525,019	$ 6,580,639

* The beginning balance for 2017 is as projected in the 2017 Execuitive Budget. Average actual usage is calculated as the average annual change in total fund balance during 2014 and 2015.

The chart reflects the effect of using Fund Balance in future years should the County continue to budget this way. The County budget is historically over $300 million each year, requiring the County to maintain at least $15 million in Fund Balance to adhere to the current policy. Based on our projections, the amount of Fund Balance available would be below the 5% threshold by 2021. Budgeting for 2023 would present a challenge, as there would not be sufficient Fund Balance available to supplement revenues to the extent presented within the conservatively budgeted 2017 Executive Proposal.

Updating the Fund Balance Policy

In our previous report on Fund Balance in 2015, we recommended updating the Fund Balance Policy to address our aforementioned concerns. Our recommendations remain the same and have been echoed by the external auditors of Ulster County. The current Fund Balance Policy does not adequately reflect the logic associated with how the County assesses its financial risks and cash flow needs. Moreover, the Policy does not analyze or quantify those risks and needs, nor does it incorporate associated findings.

The Government Finance Officers Association ("GFOA") has published a best practice on this topic, *Appropriate Level of Unrestricted Fund Balance in the General Fund,* which was approved by the GFOA Executive Board in September 2015. This best practice outlines additional factors to consider while determining the "appropriate level" of Fund Balance for each municipality. The Policy should take into account the uniqueness of the County, including the likelihood of a natural disaster, infrastructure failure, and other emergency expenditures. Other factors to consider are predictability and timing of revenues, potential impact on the entity's bond ratings, the effects of retroactive settlements of labor contracts, and the exposure of general fund resources from other funds. GFOA recommends the Policy maintain, at a minimum, no less than two months of regular general fund operating expenditures. It is likely that the Fund Balance projected at the close of 2022 would be less than the first two months' worth of expenditures.

The Policy language should also clearly identify the type of Fund Balance to which the Policy is referring, using the Fund Balance classifications noted in Appendix A. The updated Policy should specify plans for increasing or decreasing the level of Fund Balance if it should fall below or be above the recommended threshold. A time period for either scenario should be outlined, along with the contingencies for which Fund Balance can be used and the means for replenishment.

Authority

The Ulster County Charter § C-57(I) charges the Office of the Ulster County Comptroller with the task of submitting reports on at least a quarterly basis to the County Legislature and Executive regarding the financial condition, efficiency, and management of the County's finances, as well as posting these reports on the County website. In furtherance of this responsibility, our Office regularly produces reports and audits that reflect upon Ulster County's ("County") financial status and the performance of its management, with the dual goals of (i) empowering County administration and lawmakers and (ii) informing Ulster taxpayers as to the issues impacting the expenditure of their tax dollars. All of our Office's reports and audits are also made available on our website (www.youreyesonulster.com).

APPENDIX A:
Municipal Accounting Fundamentals[1]

[1] *See gen* “Account and Reporting Manual: Counties, Cities, Towns and Villages, Soil and Water Conservation Districts, Libraries,” by Office of the New York State Comptroller: Division of Local Government and School Accountability (Reprinted January 2016); and *See gen* “Fund Balance Reporting and Governmental Fund Type Definitions,” Office of the New York State Comptroller: Division of Local Government and School Accountability (Updated April 2011)

Proprietary Fund - is a classification that includes both Enterprise Funds and Internal Service Funds. Proprietary funds operate on the "full accrual" basis of accounting, which recognizes assets and liabilities at the time they are accrued, not when payment is made.

Enterprise Funds - generally account for activity in which a fee is charged to external users for goods or services.

Internal Service Funds - account for any activity that provides goods or services to other funds, departments or agencies of local government and its component units, or to other governments on a cost reimbursement basis.

Net Position - represents the difference between assets and liabilities in Proprietary Funds.

Governmental Funds - typically account for activity that is tax supported. These funds report on the "modified accrual basis" of accounting, as is prescribed by the NYS OSC. The modified accrual basis reports cash and other financial resources available for use within a specified period as "assets," and amounts owed that are expected to be paid off within a specified period as "liabilities." OSC has described this specified period of availability to be no more than 60 days after year end - meaning if the funds necessary to complete the transaction are not available within that time frame then the transaction should be recorded in the subsequent year.

Fund Balance - represents the difference between assets and liabilities in these funds. Fund Balance is categorized in a hierarchy that indicates the extent to which a government is required to observe spending constraints for each category, as follows:

Non-spendable: Assets that are inherently non-spendable in the current period, as they are not in spendable form or are legally or contractually required to be maintained intact. This Fund Balance classification is commonly used for prepaid expenses and inventories.

Restricted: Resources that are unavailable for appropriation or have legal limits to their use. Such limitations consist of restrictions imposed by creditors, grantors, contributors, or laws and regulations limiting the right to utilize the funds for certain purposes or imposing a time restriction.

Committed: Funds that have a designated purpose constraint placed upon them by the municipality's highest level of decision making authority and require the same level of formal action to remove the constraint. This restraint would be imposed, for instance, by the Legislature and could only be lifted by a subsequent act of the Legislature.

Assigned: Funds that have a designated purpose constraint placed upon them by the municipality's highest level of decision making authority, but unlike Committed Fund Balance, these funds do not require the same level of formal action to remove the constraint. Examples would be assignments for encumbrances and subsequent year expenditures.

Unassigned: Resources that can be used for any purpose related to the fund in which the balance exists. This category is a surplus or a deficit, meaning either is available for future appropriation, or in cases of a negative Fund Balance, to be recouped over time by efficient surplus budgeting.