

# ULSTER COUNTY COMPTROLLER'S OFFICE

Elliott Auerbach, Comptroller



## Fund Balance

3<sup>rd</sup> Quarter 2015

October 30, 2015

*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.*

## Comptroller's Quarterly Reports

The Ulster County Charter § C-57(I) charges the Office of the Ulster County Comptroller ("Office") 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](http://www.youreyesonulster.com)).

Notwithstanding the regularity of such reports throughout the year, it is our Office's practice to produce Quarterly Reports highlighting particular financial issues on timely topics impacting taxpayers. Our 2015 2<sup>nd</sup> Quarter Report focused on fiscal stress within the County, and noted that as of the end of 2014, the County's fiscal position continued to be strong. This report focuses on Fund Balance in relation to budgeting, details how Fund Balance levels can affect future fiscal stress, and addresses cautions to be considered in connection with the practice of Fund Balance appropriation during the budgetary process.<sup>1</sup> See Appendix A for Municipal Accounting Fundamentals and the Fund Balance hierarchy that indicates the extent to which a government is required to observe spending constraints for each category listed.

## The Budgetary Process and Fund Balance Appropriations

For the period reviewed, Ulster County has balanced the annual budget by appropriating its Fund Balance. This practice designates a portion of Fund Balance available at the end of the year to finance operations of a subsequent year to the extent expenditures exceed revenues. The chart below shows the budgeted Fund Balance appropriated for each fund throughout the 2010-2014 fiscal years.

Budgeted Fund Balance / Net Position Appropriations										
	2010		2011		2012		2013		2014	
	\$*	%*	\$*	%*	\$*	%*	\$*	%*	\$*	%*
General Fund	\$ (5,806,357)	1.66%	\$ (12,000,000)	3.41%	\$ (10,850,000)	2.99%	\$ (10,000,000)	2.78%	\$ (13,200,000)	3.93%
Enterprise	(2,209,404)	0.63%	-	0.00%	-	0.00%	-	0.00%	-	0.00%
County Road	(1,020,000)	0.29%	-	0.00%	-	0.00%	(900,000)	0.25%	(2,685,000)	0.80%
Road Machinery	(369,044)	0.11%	(226,000)	0.06%	-	0.00%	-	0.00%	-	0.00%
Debt Service	(2,975,000)	0.85%	(143,250)	0.04%	(650,000)	0.18%	(2,350,000)	0.65%	(825,000)	0.25%
Total Appropriated	(12,379,805)	3.54%	(12,369,250)	3.51%	(11,500,000)	3.17%	(13,250,000)	3.68%	(16,710,000)	4.97%
Reserves Appropriated	-	0.00%	-	0.00%	-	0.00%	(476,000)	0.13%	(404,000)	0.12%
<b>Total Budgeted Appropriations</b>	<b>\$ (12,379,805)</b>	<b>3.54%</b>	<b>\$ (12,369,250)</b>	<b>3.51%</b>	<b>\$ (11,500,000)</b>	<b>3.17%</b>	<b>\$ (13,726,000)</b>	<b>3.81%</b>	<b>\$ (17,114,000)</b>	<b>5.09%</b>
Total Budgeted Expenditures	\$ 349,219,637		\$ 352,016,690		\$ 362,846,647		\$ 360,036,399		\$ 336,198,197	

\$\* Appropriated Per Budget

%\* Percentage of Appropriation per Budgeted Expenditures

<sup>1</sup> 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.

As the preceding chart illustrates, the use of Fund Balance appropriations has increased since 2010. The amount in parentheses next to each fund represents the amount of Fund Balance appropriated in the budget of that year for the respective fund. The Fund Balance budgeted for appropriation **increased** \$4.73 million from 2010 to 2014 while the total budgeted expenditures **decreased** slightly more than \$13 million.

Fund Balance should be considered as available for *non-recurring expenditures*, rather than for use to support *recurring expenditures* during the budgeting process. The amount of Fund Balance that has been appropriated in the budgeting process to cover the shortfall between revenues and expenditures suggests the funds are being used to finance recurring expenditures. At the rate that Fund Balance is presently being appropriated, ***it is probable within the next five years that the County will diminish its Fund Balance to a percentage below current policy limits.***

The County Executive and Legislature must be recognized for increased efficiencies in operation that have reduced annual expenditures, benefited the taxpayer, and resulted in budgets in which the property tax levy was lowered in 2013, remained constant for 2014, and lowered for both 2015 and 2016. While we acknowledge that the ability to reduce expenditures is beneficial to the taxpayer, we also recognize that the use of Fund Balance to supplement revenues instead of maintaining or raising taxes will not be sustainable in future years when Fund Balance has been exhausted. If there is a need to appropriate Fund Balance in the budget for recurring expenditures then decreases in property tax levies are not warranted. Instead, the Fund Balance appropriation should be reduced prior to considering property tax levy reductions.

If the New York State Office of the State Comptroller (“OSC”) determines that a governmental entity consistently appropriates Fund Balance for the purpose of recurring expenditures in the budget process, they can mandate that the entity provide a detailed multi-year plan. The plan would have to outline how the entity can continue to appropriate Fund Balance for multiple years without depleting the Fund Balance to an unreasonable level. While the County is currently in a comfortable Fund Balance position, a multi-year budget would ensure future Fund Balance is maintained at the established policy level.

### **Current Fund Balance Policy**

In February 2013, the Legislature adopted Resolution 36, which placed the Ulster County Fund Balance Policy (“Policy”) in accordance with OSC guidelines. That Policy designates 5-10 percent of the current operating annual expenditures as the desired operating Fund Balance. Fund Balance available for appropriation is temporarily trending above the recommended percentage in the Ulster County Fund Balance Policy.

The Policy states that the County will strive to maintain an “Unrestricted Fund Balance” in this 5-10 percent range 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.” See Appendix A for an explanation of each fund type.

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 average budget of the County from 2014 to 2016 is \$333.57 million. Based on this average, \$16.68 million and \$33.36 million represent the respective minimum and maximum Fund Balances available for appropriation, per the current policy.

The following chart displays the 2014 year end Fund Balance available for appropriation as a percentage of the 2015 budgeted operating expenditures.

<b>Fund Balance - Available for Appropriation as a Percentage of Current Governmental Fund Operating Expenditures as of 12/31/2014</b>				
	<b>General Fund</b>	<b>Debt Service</b>	<b>Other Govt Funds</b>	<b>Governmental Fund Total</b>
<b>Fund Balance - Available for Appropriation*</b>	\$ 46,788,363	\$ 1,224,945	\$ 5,180,030	\$ 53,193,338
<b>Budgeted 2015 Governmental Fund Expenditures</b>	\$ 288,406,446	\$ 8,969,464	\$ 27,533,749	\$ 324,909,659
<b>Percentage</b>	<u>16.22%</u>	<u>13.66%</u>	<u>18.81%</u>	<u>16.37%</u>

\* Note the fund balance listed is the amount considered unrestricted as of 12/31/14 per the OSC definition. Additional Fund Balance amounts exist in each of the Funds listed, however those amounts are either Restricted or Non Spendable.

The resulting Governmental Fund Total indicates that the Fund Balance available for appropriation is 16.37 percent of the total 2015 budgeted governmental fund operating expenditures, which is \$20.7 million above the recommended range.

Fund Balances for 2014 were above the Policy threshold. However, the trend of consistent appropriation indicates that the Fund Balance will continue to diminish in future years. Using those projected balances from the 2016 Executive Budget, Fund Balance in the Governmental Fund would be expected to drop by \$14.4 million at the end of 2015 - down to 12.11 percent - and would decrease an additional \$16.12 million at the end of 2016. While this practice will bring the remaining Fund Balance within the current policy range, the County may not be able to continue appropriating Fund Balance in future years.

### **Deficit Budgeting and the Effect on Forecasted Fund Balance**

Local governments are required to submit a balanced annual budget; however, it is possible for an annual budget to be balanced while creating a future *imbalance* where expenditure obligations and disbursements grow faster than revenues. Ulster County has budgeted to appropriate Fund Balance to the extent that expenditures exceed revenue; in the long-run, this type of budgeting could develop a deficit.

The following chart, based on the 2016 Executive Budget, is a projection of the amount of Fund Balance available for appropriation for the 2017 budget.

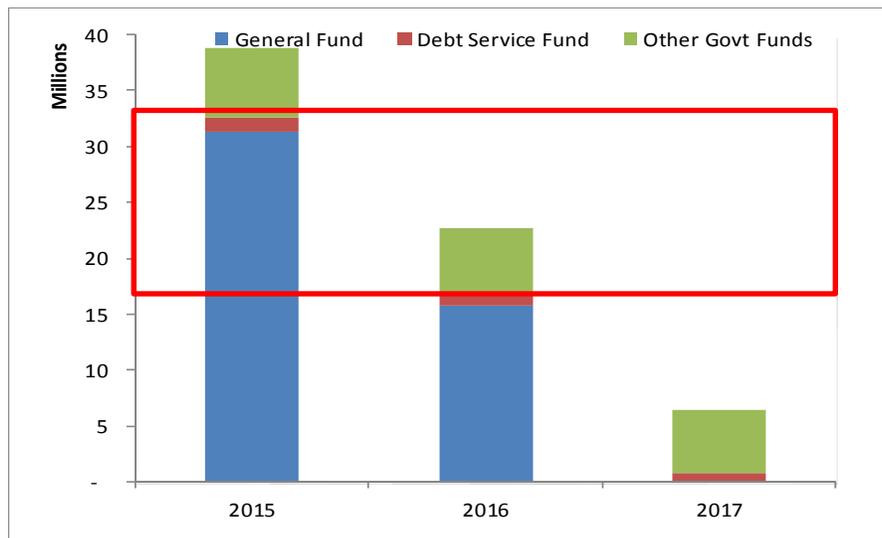
<b>Fund Balance - Available for Appropriation</b>			
	<b>Executive Budget Estimated 12/31/2015</b>	<b>Executive Budget FY 2016 Appropriation</b>	<b>Estimated 12/31/2016</b>
General Fund	\$ 31,343,438	\$ (15,623,624)	\$ 15,719,814
Debt Service Fund	1,263,621	(250,000)	1,013,621
Other Govt Funds	6,154,278	(250,000)	5,904,278
<b>Total Fund Balance*</b>	<b>\$ 38,761,337</b>	<b>\$ (16,123,624)</b>	<b>\$ 22,637,713</b>

\* Note the fund balance listed is the amount available for appropriation for future year's budgets. Additional Fund Balance amounts exist in each of the Funds listed, however those amounts are either Restricted or Non Spendable in nature. Budgeted amounts and actual results may vary.

The 2016 Executive Budget estimated the Fund Balance levels at the close of 2015, which are represented in the first column above. Those estimated values are calculated in order to determine the amount of Fund Balance available for appropriation in the 2016 budget year. The amount appropriated in the 2016 budget would then accordingly reduce the Fund Balance, as shown in the middle column. The estimated amount available for appropriation in the final column shows what is projected to be available for the 2017 budget.

The future projected appropriations may result in Fund Balance dropping below the recommended Policy range as early as the end of 2017. The following chart demonstrates the projected Fund Balance levels. The outlined box illustrates the average amount of Fund Balance that would be within the current Policy limits.

**Future Estimated Fund Balance Available for Appropriation**



The chart assumes 2016 budgeted Fund Balance appropriation will be accurate. 2017 assumes similar budget as 2016. Adjustments made in the budget process and are not reflected above.

The future estimated Fund Balance available for appropriation shows a 2015 year-end level that would be above the Policy threshold and a 2017 year-end level that would be below the Policy threshold. This figure indicates that the annual amount of budgeted Fund Balance being used to bridge the gap between revenues and expenditures is unsustainable. For a budget to be properly balanced, recurring expenditures must be supported by recurring revenues, not by available Fund Balance.

### **Fund Balance Projections & Effect on Future Fiscal Stress**

The projection of Fund Balance can also be utilized to help predict what effect the use of Fund Balance will have on future applications of the Fiscal Stress Tests (“Test”). The Test is a tool designed by the OSC to help local municipalities evaluate their current fiscal stress and associated causes. Fund Balance is used in many of the calculations involved in the financial portion of the Test. Using the projected 2015 year-end Fund Balance levels noted in the 2016 Executive Budget, the Test will show the County as being less fiscally stable than in prior years, as a result of the decreasing Fund Balance. At the close of 2015, the County will have nearly **tripled** the level of fiscal stress from the prior year due to deficit budgeting and decreasing Fund Balance levels. Further, the level of fiscal stress will continue to rise each year Fund Balance is appropriated.

For a complete analysis of the 2014 Ulster County Fiscal Stress Test application, please see the Comptroller’s 2<sup>nd</sup> Quarter Report. That report explains the importance of Fund Balance and how it is used in the Test calculations in greater detail.

### **Updating the Fund Balance Policy**

The external auditors of Ulster County have recommended updating the Fund Balance Policy. The current Fund Balance Policy does not adequately reflect the logic associated with how the County assesses its financial risks and cash flow needs. 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.

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. An explanation of how the government's expenditure and/or revenue levels will be adjusted to match any new economic realities should be included in the Policy as well.

Moreover, the Fund Balance Policy should be reviewed annually and updated if any of the factors listed above have changed. For instance, during the 2014 review, the monetary influx caused by the sale of the Golden Hill Healthcare Center in the prior year should have been addressed. At that time, a higher percentage range should have been approved, or a portion of the Fund Balance should have been reserved for capital outlay (i.e. infrastructure) to bring the County in compliance with its internal Policy.

### **Conclusion**

The Fund Balance Policy should be updated to reflect the best practice advisory published by the GFOA in September 2015 and the recommendations from the 2014 Financial Audit of the independent auditors (Drescher & Malecki).

The independent accounting firm (O'Connor Davies), which published the *Analysis and Review of the Proposed 2015 Budget* for Ulster County, recommends the preparation of a multi-year budget plan to ensure Fund Balance remains at its "current healthy level" because the "budget relies on the application of Fund Balance to eliminate the need for a substantial tax increase."

We agree with the concept of producing a multi-year budget and recommend its implementation, as it will allow assessment of the use of resources from both long and short term perspectives. A multi-year budget would afford the County Legislature an extended view of the projected Fund Balance, protect the County from significant tax increases, and help maintain balanced spending plans.

Additionally, we recommend the County utilize a multi-year budget in conjunction with the Fiscal Stress Test tool. Together they will provide insight as to how budgeted appropriations to Fund Balance affect future fiscal stress. This tool would provide valuable analysis, as the annual budgets should predict the level of fiscal stress at the close of each year.

The County Executive and Commissioner of Finance (who also serves as the Budget Director) were provided a draft of this report. Any comments made by those departments were taken into consideration in the final draft and have been included in Exhibit 1.

**APPENDIX A:**  
**Municipal Accounting Fundamentals**

**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.

**EXHIBIT 1:**  
**Commissioner of Finance Response to Draft Report**

# ULSTER COUNTY DEPARTMENT OF FINANCE

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## MEMORANDUM

**To:** Elliot Auerbach, Comptroller  
**From:** Burton Gulnick, Jr., Commissioner of Finance   
**Date:** 11/3/2015  
**Re:** 2015 3<sup>rd</sup> Quarter Report

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I would like to thank the Ulster County Comptroller for affording us the opportunity to review their draft 2015 3<sup>rd</sup> Quarter report. As demonstrated by the New York State Office of the State Comptroller ranking our county the 4<sup>th</sup> most fiscally stable county in the state, and the most fiscally stable county in our region for the second year in a row, we continue to strive to make Ulster County's finances stronger than ever. We have been able to achieve this success in the face of one of the most difficult financial environments since the Great Depression through hard work focused on improving operational efficiencies, conservative budgeting and fiscal restraint.

We will continue to review and look to best practices, some of which are mentioned in your 2015 3<sup>rd</sup> quarter report, and apply them as appropriate after careful review and consideration of the needs, legal and regulatory constraints and the financial environment the county operates within. As previously stated in past responses, our budget continually evolves over the course of time. Changes in pension fund obligations, health care costs, sales tax growth and State and Federal budget actions can and have significantly shifted out-year projections and are evaluated annually and adjusted accordingly.

Again, I would like to thank you for affording me the opportunity to review and comment on your draft 2015 3<sup>rd</sup> quarter report.