

# ULSTER COUNTY COMPTROLLER'S OFFICE

Elliott Auerbach, Comptroller



October 1 - December 31, 2014

4<sup>th</sup> Quarter 2014

*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 with submitting reports to the County Legislature and Executive on the financial condition, efficiency, and management of the County's finances, at least quarterly, and posting those reports on the County website. In furtherance of this charge, our Office regularly produces reports and audits which reflect upon the County's financial condition and the efficiency of its management, with the dual goals of (i) empowering County administration and lawmakers and (ii) informing Ulster taxpayers as to the issues which impact the expenditure of their tax dollars. All of our Office's reports and audits are posted on our website at [youreyesonulster.com](http://youreyesonulster.com).

Notwithstanding the regularity of such reports throughout the year, it is our Office's practice to produce a Quarterly Report which highlights particular financial issues or reports on timely topics impacting taxpayers. Our 2014 3<sup>rd</sup> Quarter Report focused on County expenditures and noted a trend of budgeting for Fund Balance appropriation. This report focuses on explaining Fund Balance in relation to budgeting, and highlights cautions to be considered in connection with the practice of fund balance appropriation for lawmakers' consideration.<sup>1</sup>

## **Municipal Accounting Fundamentals**

It will be useful to begin by identifying and defining some fundamental government accounting terms which are essential to an informed reading of the governmental accounting discussion herein.

"Enterprise Funds" generally account for activity in which a fee is charged to external users for goods or services. Enterprise funds operate on the "full accrual" basis of accounting, which recognizes assets and liabilities at the time they are accrued and not at the time payment changes hands. "Net Position" represents the difference between assets and liabilities in Enterprise Funds.

"Governmental Funds" typically account for activity which is tax-supported, and in the case of Ulster County, these account for the majority of County financial activities. Ulster County Governmental Funds report on the "modified accrual basis" of accounting, as is prescribed by the New York State Office of the State Comptroller ("OSC"). The modified accrual basis reports cash and other financial resources which will be available for use within a specified period as "assets," and amounts owed which 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, the transaction should be recorded in the subsequent year. "Fund Balance," which is featured in the Fund Balance section below, represents the difference between assets and liabilities in Governmental Funds.

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<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.

Our report is not designed to highlight the Enterprise Funds and related Net Position. Therefore, it does not substantially elaborate on the “full accrual” method of accounting, the details of the differences in accounting methods, or the budgetary practices involved in such funds. Rather, our report focuses on the budgeting of Governmental Funds and the use of Fund Balance in the budgeting process, along with the suggestion of a multiyear budget plan.

## **Fund Balance**

**General Discussion.** Fund Balance is categorized in a hierarchy which indicates the extent to which a government is required to observe spending constraints for each category, as follows:

*Non-spendable:* Assets which are inherently non-spendable in the current period because they are not in spendable form or are legally or contractually required to be maintained intact. In Ulster County this Fund Balance classification is used, for instance, for prepaid expenses and inventories.

*Restricted:* Resources which are unavailable for appropriation or have legal limits to their use. In Ulster County this usually consists of restrictions imposed by creditors, grantors, contributors, or laws and regulations which expressly limit the right to utilize the funds to certain purposes or impose a time restriction.

*Committed:* Funds which 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. This type of Fund Balance is rarely used at the county level.

*Assigned:* Funds which 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 which 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 available for future appropriation or, in cases of a negative Fund Balance, to be recouped over time by efficient surplus budgeting. In Ulster County, all governmental funds besides the Capital Projects funds have positive unassigned Fund Balance. It is common for the Capital Projects Fund to have a negative Fund Balance when anticipating resources from borrowing.

**Ulster County Legislature Fund Balance Policy.** The Ulster County Legislature has adopted a Fund Balance Policy. That Policy designates 5-10% of the current operating annual

expenditures as the desired Fund Balance to be carried over to the next fiscal year. It should be noted that the financial statements elect to show Fund Balance amounts budgeted for appropriation in the subsequent year as “assigned,” which means these amounts should be added to the unassigned amounts to determine the percentage available as of year-end. This amount would become unavailable on the first day of the year. As is noted below in greater detail, the Fund Balance available for appropriation is trending above the recommended amount in the Ulster County Fund Balance Policy.

Budgeting & Budget Projection. 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* in which 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 if the amount being appropriated continues to grow, and budgets prove to be accurate.

If the actual annual results of operation were to match the predicted budget of Ulster County as designed by the budget documents, the County would deplete Fund Balance rapidly. Because the actual results of operation vary from the predicted budgeted results of operation as noted in our 2<sup>nd</sup> and 3<sup>rd</sup> Quarter Reports, the majority of County funds have increased Fund Balance over time. The General Fund is the fund of the greatest relevance when discussing Fund Balance, as this fund represents over 85% of total Ulster County governmental fund operations.

The level of Fund Balance in the General Fund is one indicator of how stable County finances are and to what extent the County would be able to overcome unforeseen times of financial stress. The County should consider whether the current budget practice is too conservative. Obviously, conservative budgeting during uncertain economic times is prudent management. Overly conservative budgeting, however, may lead to unnecessary tax levies and, where fund balance is being appropriated, long-term risk. If a five year budget plan were presented for review it might well reflect that the practice of appropriating Fund Balance would likely only be available for the first three years of the multiyear budget, and we would be interested in the County’s budgeting approach on the remaining years of the multiyear budget.

Benefits of Budget Practice. The Ulster County Executive and Legislature must be recognized for increased efficiencies in operation, which benefit the taxpayer, and have resulted in budgets in which the property tax levy was lowered in 2013 and kept flat in 2014. This has been coupled with further decrease in the property tax levy in 2015 by 1%. These efficiencies are notable. However, since the present Fund Balance budget practice has resulted in a Fund Balance level in excess of the County’s Fund Balance Policy, the question of whether the practice, or the policy, should be modified, is worthy of being examined, as the Legislature may determine that both could need to be addressed and updated.

## **Budgeting and Appropriations**

Ulster County's current and recent practice in balancing the annual budget is to appropriate Fund Balance. This designates a portion of Fund Balance to help finance the operations of a fund for the subsequent year to the extent expenditures exceed revenues. The Chart below shows the budgeted Fund Balance appropriated for each fund for each of the 2009-2013 budgeted years.

<b>Budgeted Fund Balance / Net Position Appropriations</b>										
	<b>2009</b>		<b>2010</b>		<b>2011</b>		<b>2012</b>		<b>2013</b>	
	<b>\$*</b>	<b>%*</b>	<b>\$*</b>	<b>%*</b>	<b>\$*</b>	<b>%*</b>	<b>\$*</b>	<b>%*</b>	<b>\$*</b>	<b>%*</b>
General Fund	\$ (1,884,252)	0.54%	\$ (5,806,357)	1.66%	\$ (12,000,000)	3.41%	\$ (10,850,000)	2.99%	\$ (10,000,000)	2.78%
Enterprise	(2,992,835)	0.87%	(2,209,404)	0.63%	-	0.00%	-	0.00%	-	0.00%
County Road	(800,000)	0.23%	(1,020,000)	0.29%	-	0.00%	-	0.00%	(900,000)	0.25%
Road Machinery	(400,000)	0.12%	(369,044)	0.11%	(226,000)	0.06%	-	0.00%	-	0.00%
Debt Service	(900,000)	0.26%	(2,975,000)	0.85%	(143,250)	0.04%	(650,000)	0.18%	(2,350,000)	0.65%
Total Appropriated	(6,977,087)	2.02%	(12,379,805)	3.54%	(12,369,250)	3.51%	(11,500,000)	3.17%	(13,250,000)	3.68%
Reserves Appropriated	-	0.00%	-	0.00%	-	0.00%	-	0.00%	(476,000)	0.13%
<b>Total Budgeted Appropriations</b>	<b>\$ (6,977,087)</b>	<b>2.02%</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>
Total Budgeted Expenditures	\$ 345,987,694		\$ 349,219,637		\$ 352,016,690		\$ 362,846,647		\$ 360,036,399	

\$\* Appropriated Per Budget

%\* Percentage of Appropriation per Budgeted Expenditures

The chart above reveals that the technique of appropriating Fund Balance in the budget has been used each year from 2009 through 2013, and the amount appropriated has increased over time. The negative amount next to each fund represents the amount of Fund Balance appropriated in the budget of that year for the respective fund. The total amount budgeted for appropriation has nearly doubled, increasing approximately \$7 million or 1.75% of total expenditures. If the projected budgeted numbers prove to be accurate, which has been rare, the level of future Fund Balance would drop below the County Fund Balance Policy recommended amount within a five year period.

Typically, Fund Balance appropriations should be considered available for *non-recurring expenditures*, rather than for use to support *recurring expenditures* during the budgeting process.

If OSC determines that a government entity consistently appropriates Fund Balance for the purpose of recurring expenditures in the budget process, they can mandate the entity provide a detailed multiyear 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. The plan must also show that the entity would have a sufficient Fund Balance to be available for any unforeseen non-recurring expenditures.

## **Budgeted Fund Balance Appropriation Compared to Actual Results of Operations**

Highlighted in the 2<sup>nd</sup> and 3<sup>rd</sup> Quarter Reports, we called attention to the variance between the original budgetary expectations and the actual results concerning the revenue and expenditure categories. Such variances are not unexpected or necessarily material. The reality is that budgets rarely work out precisely as planned, leading to operating deficits or operating surpluses. The magnitude of the deficit or surplus usually indicates how

aggressive or conservative the budget was for that year. As long as these deficits or surpluses are minor or intermittent, they do not constitute a material problem for the local government and should not be cause for concern. It is when there is a pattern of large surpluses or deficits that there should be greater consideration regarding the budgeting practices of the government.

We have noted it is common practice for Ulster County to balance the annual budget by appropriating Fund Balance. However, the actual results of operations indicate a variance between the amounts of budgeted appropriated Fund Balance and actual results from 2009-2013. The charts below display the annual budgeted change in Fund Balance compared to the actual change in Fund Balance for the five year period.

### Budgeted Vs. Actual Change in Fund Balance / Net Position

	2009	2010	2011	2012	2013
<b>General Fund</b>					
Budgeted (Decrease) in Fund Balance	\$ (1,884,252)	\$ (5,806,357)	\$ (12,000,000)	\$ (10,850,000)	\$ (10,000,000)
Actual (Decrease) Increase in Fund Balance	(635,582)	3,181,572	3,549,191	181,911	17,119,416
<b>Over (Under) Budgeted Appropriation</b>	<b>\$ 1,248,670</b>	<b>\$ 8,987,929</b>	<b>\$ 15,549,191</b>	<b>\$ 11,031,911</b>	<b>\$ 27,119,416</b>
<b>Enterprise Funds</b>					
Budgeted (Decrease) in Net Position	\$ (2,992,835)	\$ (2,209,404)	\$ -	\$ -	\$ -
Actual (Decrease) Increase in Net Position	101,629	(2,648,427)	(6,007,773)	(931,468)	2,802,578
<b>Over (Under) Budgeted Appropriation</b>	<b>\$ 3,094,464</b>	<b>\$ (439,023)</b>	<b>\$ (6,007,773)</b>	<b>\$ (931,468)</b>	<b>\$ 2,802,578</b>
<b>Debt Service Fund</b>					
Budgeted (Decrease) in Fund Balance	\$ (900,000)	\$ (2,975,000)	\$ (143,250)	\$ (650,000)	\$ (2,350,000)
Actual (Decrease) Increase in Fund Balance	760,059	(2,201,020)	(49,404)	2,643,865	(1,508,423)
<b>Over (Under) Budgeted Appropriation</b>	<b>\$ 1,660,059</b>	<b>\$ 773,980</b>	<b>\$ 93,846</b>	<b>\$ 3,293,865</b>	<b>\$ 841,577</b>
<b>Other Govt Funds</b>					
Budgeted (Decrease) in Fund Balance	\$ (1,200,000)	\$ (1,389,044)	\$ (226,000)	\$ -	\$ (900,000)
Actual (Decrease) Increase in Fund Balance	(541,165)	(317,300)	(26,566)	2,665,010	(359,777)
<b>Over (Under) Budgeted Appropriation</b>	<b>\$ 658,835</b>	<b>\$ 1,071,744</b>	<b>\$ 199,434</b>	<b>\$ 2,665,010</b>	<b>\$ 540,223</b>

The budgeted change in Fund Balance varies notably from the actual changes in Fund Balance for each fund. The negative budgeted amount represents the amount the budget appropriated Fund Balance that year and the negative actual change in Fund Balance represents the amount Fund Balance actually decreased during that year. A positive actual change in Fund Balance represents the amount Fund Balance actually increased that year.

When analyzing the general fund specifically, it can be seen that the average difference is above \$9.2 million, even excluding 2013, as this year includes the anomaly created by the sale of Golden Hill noted below. Years 2010 through 2013 were budgeted to appropriate Fund Balance to cover expenditures in excess of revenues, but, instead, the actual results of operation show increases to the level of Fund Balance, a marker of overly conservative budgeting. An overly conservative budgeting style can lead to increases in Fund Balance above the appropriate levels as stated in the Ulster County Fund Balance Policy.

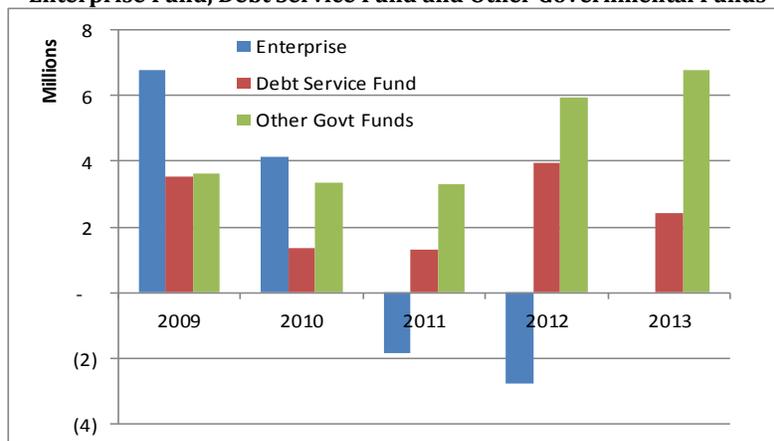
The average annual amount of appropriated Fund Balance in the preceding budgets represents less than 5% of annual expenditures. However, the amount of Fund Balance

appropriated has grown to represent over 25% of the remaining Fund Balance available for appropriation, meaning if accurately budgeted, Fund Balance would deplete in less than four to five years.

A significant (although not entire) portion of the delta between in budget-to-actual results for 2013 can be explained to a large extent by the effect of the sale of Golden Hill. Revenue of \$11.25 million for the sale and the equity transfer of \$13.8 million total \$25.05 million.

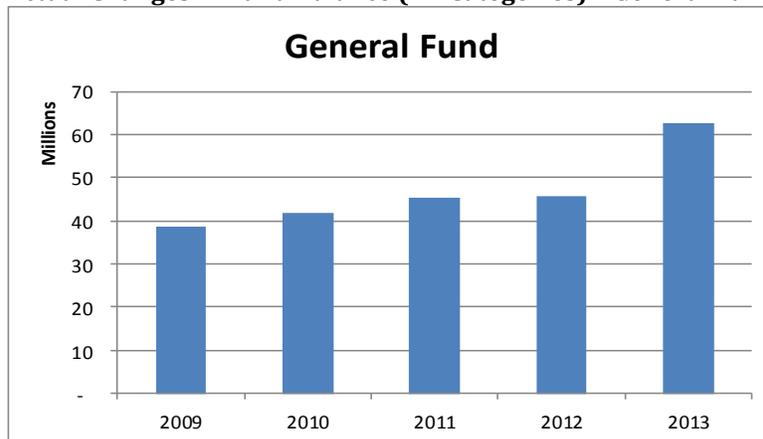
Analyzing the other funds listed on the chart above, one can see the budgeting process is closer to actual results than with the General Fund; yet, all of the other funds listed combined represent less than 15% of governmental fund operations. The Charts below show actual changes in Fund Balance (all categories) from year to year.

**Actual Changes in Fund Balance / Net Position (All Categories)-  
Enterprise Fund, Debt Service Fund and Other Governmental Funds**



Note: a Prior period adjustment was made on the 12/31/2013 financial statements increasing Fund Balance of Other Governmental Funds by \$1,194,075.

**Actual Changes in Fund Balance (All Categories) - General Fund**



The actual annual results of operation above indicate stable or growing Fund Balances, in most cases, and are not always representative of the budget. This may indicate either an overly conservative budget or an extremely efficient use of resources during each year. If it is the former, this indicates that taxes are higher than necessary for current operations as Fund Balance levels have increased by over \$20 million in the General Fund over the five year span. If it is the latter, over time the budget process should recognize the County's

increased efficiency and make corrections in the subsequent years budgeting process. Budget practice should continually evolve as the comparisons of actual versus budgeted amounts are available, providing those directly involved in the budgeting process with useful information about the trends of prior year results.

The chart, “Actual Changes in Fund Balance or Net Position (All Categories)– *Enterprise Fund, Debt Service Fund and Other Governmental Funds,*” shows that Fund Balance has remained steady or grown over the five year span for Other Governmental Funds. It shows Fund Balance has decreased slightly for the Debt Service Fund. The Enterprise Fund is the only fund that shows a decline in Net Position due to the sale of Golden Hill prior to the sale, then the resurgence to a zero Net Position at the end of 2013.

The chart, “Actual Changes in Fund Balance (All Categories)– *General Fund,*” shows the growing Fund Balance in the General Fund, contrary to the budgeted appropriation amounts shown in the previous charts. While Fund Balance appropriations can be utilized to fund suspected deficits, there has been a trend of surplus in the General Fund actual annual results, as shown by the increasing Fund Balance year over year. Efficient budgeting is essential to the monitoring of Fund Balance and the future financial stability of the County, while ensuring taxes aren’t higher than necessary. The operating efficiency of the County has actually increased Fund Balance, while pointing out a budgeting deficiency.

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

The following chart is a projection of the amount of Fund Balance available for appropriation for the 2016 budget, pending the 2014 and 2015 budgets were to accurately predict the actual operating results of the County.

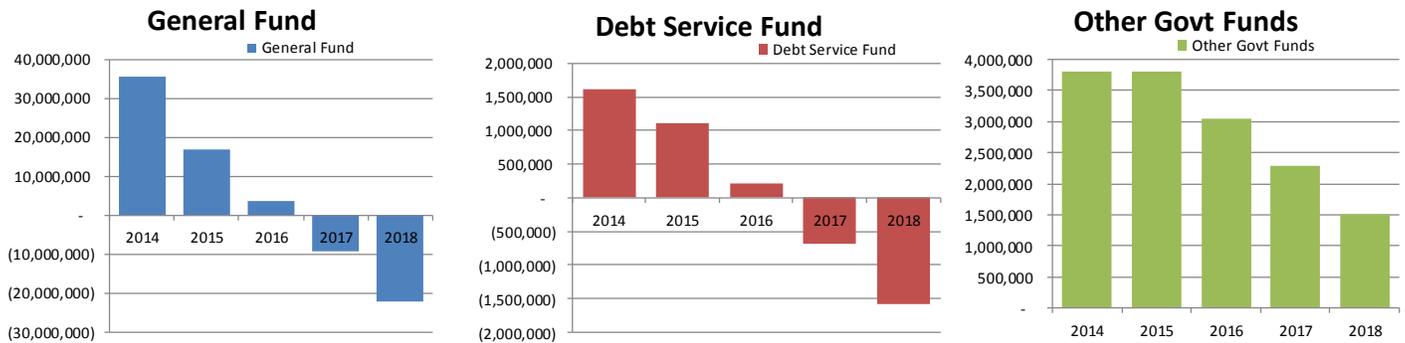
Fund Balance - Available for Appropriation					
	Actual 12/31/2013	Budget FY 2014 Appropriation	Estimated 12/31/2014	Budget FY 2015 Appropriation	Estimated 12/31/2015
General Fund	\$ 48,834,611	\$ (13,200,000)	\$ 35,634,611	\$ (18,965,400)	\$ 16,669,211
Debt Service Fund	2,432,331	(825,000)	1,607,331	(500,000)	1,107,331
Other Govt Funds	6,488,950	(2,685,000)	3,803,950	-	3,803,950
Total Fund Balance*	\$ 57,755,892	\$ (16,710,000)	\$ 41,045,892	\$ (19,465,400)	\$ 21,580,492

\* 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 in nature or assigned for other purposes. This chart is a projection based on the assumption that the budgeted numbers were to properly predict the annual results of operation, as mentioned prior budgeted expectations and actual results may vary.

The total Fund Balance appropriated in the 2015 budget is more than 3 times the amount of Fund Balance appropriated in the 2009 budget. The amount of Fund Balance appropriated in the budget process has increased over \$12 million over the 7 year span, while actual results have indicated a growing Fund Balance. The consistent increases in the amount of appropriated Fund Balance in the budget seems to indicate that Fund Balance is being used for recurring expenditures in the budget process. This may result in a fund deficit in the future if this practice continues, and budgets prove actual, as the appropriated amount indicates it is being used to cover recurring expenditures of the County, which will remain after Fund Balance is depleted.

The charts which follow display a continuation of the estimation of the change in Fund Balance through 2018, showing that if budgeted Fund Balance were to match the actual appropriated at the present rate, there will be a Fund Deficit in the General Fund and the Debt Service Fund by the end of fiscal year 2017. This also shows that the County's conservative budgeting practices could not be sustained in a multiyear budget.

### Future Estimated Budgeted Fund Balance Available for Appropriation (through 2018)



The charts assume the budgeted annual Fund Balance appropriated to be equal to the historic five year average appropriation to Fund Balance for each category from 2015-2011 budget years. Annual adjustments are made in the budget process and are not reflected above.

If a five year budget were to be implemented, it would allow the Legislature an extended view of the impacts of certain budget assumptions and methodologies.

### Fund Balance & Long Term Budgeting

Maintaining a reasonable level of Fund Balance is necessary to ensure long term financial stability. The County should use long term budgets to help plan Fund Balance, along with updating the Fund Balance Policy to provide greater detail as to how Fund Balance will be replenished if it were to fall below the recommended level or how Fund Balance above the recommended level is to be treated, as this occurred at 12/31/13. The Fund Balance policy update should also require there not be a reliance on Fund Balance to finance recurring expenditures in the multiyear budget, this will ensure the maintenance of Fund Balance in future years.

The estimated Fund Balance at year end for the Unassigned Fund Balance should be projected during the budgeting process and included in the annual budget documentation any time Fund Balance is appropriated.

The County would have a fund deficit in less than five years if its budgets proved actual, but we note that the budgets do not play out as planned, and have resulted in an increase in Fund Balance available for appropriation, which as of December 31, 2013 was above the Ulster County Fund Balance Policy recommended threshold of 5-10%. The current Fund Balance Policy does not address what the remedy shall be for carrying balances above the recommended threshold. The Fund Balance policy also does not address whether the 5-10% threshold should be applied to each specific fund or as a whole. The policy does not specify which classification of Fund Balance is subject to the percentage threshold; we

recommend the policy be updated to refer to the proper GASB 54 classification, which have changed since the policy's adoption.

Nonetheless, the charts below show the 2013 year end fund balance available for appropriation as a percentage of the 2014 budgeted operating expenditures by individual funds, or groups of funds, previously discussed. Even if the funds in question were isolated and not aggregated they would exceed the 10% threshold delineated in the Ulster County Fund Balance Policy.

<b>Fund Balance- Available for Appropriation as a Percentage of Current Govt Fund Operating Expenditures</b>				
<b>As of 12/31/2013</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>	\$ 35,634,611	\$ 1,607,331	\$ 3,803,950	\$ 41,045,892
<b>Budgeted 2014 Govt Fund Operating Expenditures</b>	\$ 284,524,638	\$ 10,128,763	\$ 27,964,470	\$ 322,617,871
<b>Percentage</b>	<u>12.52%</u>	<u>15.87%</u>	<u>13.60%</u>	<u>12.72%</u>

\* Note the fund balance listed is the amount available for appropriation for future year's budgets as of 12/31/13. Additional Fund Balance amounts exist in each of the Funds listed, however those amounts are either Restricted in nature or assigned for other purposes.

When combined and recalculated as a percentage of the whole, the results indicate the Fund Balance available for appropriation to be 12.72% of the total 2014 budgeted governmental fund operating expenditures, which is well above the recommended amount in the Ulster County Fund Balance Policy. Even if the 2014 budgeted Enterprise Fund expenditures were to be included in budgeted expenditure above, the calculation of the percentage would decline, only slightly, to 12.21%.

### **Conclusion**

As referenced above, a comprehensive multiyear plan to project operating and capital needs and financing sources can be mandated by the OSC. We recommend that as part of the budget process the County Executive present, and County Legislature consider, a multiyear budget plan. Multiyear plans allow lawmakers and the public to assess the use of resources from both long and short term perspectives. If there is sound reasoning for appropriating Fund Balance, the presentment of a multiyear plan will be a tool for eliciting that reasoning and demonstrating that Fund Balance remains at a sufficient amount throughout the multiyear plan, in accordance with the suggested level indicated in the County Fund Balance Policy.

Similarly, the administration's position as to the soundness of present practice should be elicited to determine whether either the practice, or the Fund Balance Policy, should be changed. The purpose of this report is to point out a budget practice which has resulted in Fund Balance levels out of compliance with the County's own policy, so that both the administration and the Legislature can consider its implications.

The County Executive and Commissioner of Finance (who also serves as the Budget Director) were provided a draft of this report and commented on that draft. Those comments were taken into consideration in the final draft. The Commissioner's insights and responsiveness were extremely useful and proactive.