

Avoiding the Fiscal Cliff: A Lesson in Budgeting and Financial Condition Analysis

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What is a “Fiscal Cliff”?

The current level of service is not supported, either partially or in full, going forward.

- Requires reallocation of resources or finding new funding source(s) to maintain the same levels of service.

Why is a Fiscal Cliff More Likely to Happen Now?

- American Rescue Plan Act (ARPA) payments bolstered budgets in 2021 and 2022
- Inflation increases
- Interest rate increases
- Sales tax revenues have moderated



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Common Cause of Reaching the Fiscal Cliff

Failure to monitor financial condition and/or take action when facing a declining financial condition.

Financial Condition: An entity's ability to finance expected services on a continuing basis.



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Factors Affecting Financial Condition



Four Components of Financial Condition

- Cash Solvency
- Budgetary Solvency
- Long-term Solvency
- Service Level Solvency

Factors Affecting Cash Solvency

- Billing cycles that do not coincide with cash flow requirements
- Receivables are not collected timely
- Delaying necessary rate increases
 - Real property taxes and user fees
- Improper use of interfund loans



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Factors Affecting Budgetary Solvency

- Reliance on non-recurring revenues
- Not understanding real program costs
- Management lack of understanding of:
 - Financial information, proper budget preparation, monitoring procedures
- Reliance on appropriated fund balance to avoid rate increases



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External Factors Affecting Budgetary Solvency

- Legal Constraints
 - Tax cap
 - Statutory limits
- Declining population or industry
- Unexpected Circumstances
 - Weather, national disaster



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Factors Affecting Service Level Solvency

- A stagnant or shrinking tax base and/or revenues
- A high or increasing level of tax-exempt properties
- Rising costs and inflation
- Failure to recognize changes in demand for services



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Factors Affecting Long-Term Solvency

Non-existent or inadequate multiyear financial & capital planning may lead to:

- Deteriorating infrastructure
- Lack of funds for contractual obligations
 - Debt payments, salary negotiations, OPEB, etc.
- Legal reserves issues
 - Funded at ineffective levels, or
 - Not created at all

Other Factors Affecting Financial Condition

- Community needs and resources
 - Taxpayer service need and the entity's ability to provide
- Economic and environmental conditions
 - Recognize, understand or plan for their impact even though you can't control them
- Culture
 - How we work together matters
 - Management's actions drive the culture

Implications of the Fiscal Cliff

- Cutting needed or desired programs
- Immediate large rate increases rather than gradual
- Layoffs and reduction of workforce
- Erosion of public trust
- Seeking immediate fixes for long term practices
- Inability to prepare and file financial statements

What Have We Seen?

- Closure of school buildings and loss of staff through layoffs
- Double digit rate increases (taxes & user fees)
- Exceeding the tax cap while losing taxpayer support to do so
- Rating agency downgrading or withdrawing of a credit rating
- Issuing debt for cash flow

What Have We Seen? (cont.)

- Local governments questioning the ability to open doors in the coming fiscal year
- Request for deficit financing and/or special legislation to have the State oversee operations



Potential Causes Contributing to a Fiscal Cliff

- Avoiding rate increases for many years
- Reliance on non-recurring revenues
- Budgets that are not structurally balanced or properly monitored
- A lack of long-term planning
- Failure to understand the true cost of services



Steps to Avoid the Fiscal Cliff

1. Adopt & monitor structurally balanced budgets
2. Develop multiyear plans and fund balance policies
3. Prudently fund reserves, where necessary
4. The board and management should receive and understand financial reports and use them to continuously analyze financial condition
5. Take action early when indicators of poor financial condition exist



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Structurally Balanced Budget

Estimated Revenues = Appropriations.

A structurally balanced budget matches certain revenues with certain appropriations.

- Recurring revenues to recurring expenditures
- One-shot revenues to one-shot expenditures



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Structurally Balanced Budget (cont.)

- Real property tax levy should be the result of a budget formula, not a starting point.
- Match non-recurring revenues with the appropriations they are funding (reserves, appropriated fund balance, grants, etc.)



Budget Formula

- + Appropriations (True Cost of Services)
- + Appropriations (Tied to Reserves)
- + Appropriations (Tied to Grants & Aid)
- + Budgetary Provisions for Other Uses (Funding Reserves)- 962
- + Unappropriated Revenues – 990
- + Interfund Appropriations (Tie to Revenues Generated)
- + Contingency (Except for School Districts)- 1990.4



Budget Formula (cont.)

- Departmental Income (Licenses, fines, certain sales)
- Grants/ Aid (Tie Back to Appropriations)
- Sales Tax (Estimated based on trend)
- Other Revenues (Franchise fees, one-shots, PILOTs,etc.)
- User Charges (General Fund)
- Appropriated Reserves (tie Back to Appropriations)
- Obligations Authorized (RAN, TAN, Budget Note)
- Interfund Revenues (Tie Back to Appropriations)
- Appropriated Fund Balance (*Perform Calculation)

= To be raised by Taxes/ User fees



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Appropriating Fund Balance

General Fund (A)	Total Fund Balance (A)
Beginning of Year Total Fund Balance	\$ 8,000,000
<i>Restricted (Reserves)</i>	<i>\$4,000,000</i>
<i>Unrestricted (Available to Appropriate)</i>	<i>\$4,000,000</i>
-Less Assigned Appropriated to Current FY Budget	500,000
+Plus Actual Revenues Collected to Date	12,000,000
-Less Actual Expenditures Incurred to Date	(10,700,000)
Total Fund Balance to date	\$ 8,800,000 <i>(800,000 surplus)</i>
<i>Restricted (Reserves)</i>	<i>\$4,000,000</i>
<i>Unrestricted (Available to Appropriate)</i>	<i>\$4,800,000</i>
+Plus Estimated Revenues Deemed Collectable	1,750,000
-Less Estimated Expenditures Expected to Incur	3,550,000
Estimated FB at the End of the Fiscal Year	\$ 7,000,000 <i>(1,000,000 deficit)</i>
<i>Restricted (Reserves)</i>	<i>\$4,000,000</i>
<i>Unrestricted (Available to Appropriate)</i>	<i>\$3,000,000</i>



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Appropriating Fund Balance (cont.)

- An estimated budget deficit represents the additional fund balance needed to balance the current year budget.
- Before you can use any unanticipated- unrestricted revenue, or appropriate fund balance in next year's budget you must use current unrestricted revenues or unrestricted fund balance to balance current year budget.
- Fund Balance Appropriated should be cash or easily convertible to cash in the near future.
- Need to conduct trend analysis to determine if appropriating fund balance is in line with fund balance policy and multiyear plans.



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Contemporary Budget

General Fund- Contemporary Budget for Board Review

	(DIRECT) Appropriations	(INDIRECT) Allocated Cost	Total Cost	*Revenues	**Real Property Tax Efforts	Overall Tax Effort %
Community Services	\$ 900,000	\$ 26,000	\$ 926,000	\$ 400,000	\$ 526,000	12%
Parks & Recreation	\$ 2,700,000	\$ 1,850,000	\$ 4,550,000	\$ 3,725,000	\$ 825,000	18.8%
Law Enforcement	\$ 800,000	\$ 45,000	\$ 845,000	\$ 815,000	\$ 30,000	0.6%
General Gov. Supt.	\$ 5,000,000	\$ 1,000,000	\$ 6,000,000	\$ 3,000,000	\$ 3,000,000	68.5%
Employee Benefits	\$ 2,000,000	(\$2,000,000)				
Debt Service	\$ 921,000	(\$ 921,000)				
Total	\$12,321,000	\$ 0	\$12,321,000	\$ 7,940,000	\$ 4,381,000	

*Overall tax effort represents the percentage of the total levied taxes allocated to the program/department. Allows you to focus on services with the biggest drain on taxes.



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Contemporary Budget- Detail

General Fund- Contemporary Budget for Board Review

	(DIRECT) Appropriations	(INDIRECT) Allocated Cost	Total Cost	*Revenues	**Real Property Tax Efforts	% Of Tax Impact
General Gov. Supt.	\$ 5,000,000	\$ 1,000,000	\$ 6,000,000	\$ 3,000,000	\$3,000,000	68.5%
Legislative Board	\$ 500,000	\$ 75,000	\$ 575,000	\$ -0-	\$ 575,000	19%
Treasurer	\$ 900,000	\$ 75,000	\$ 975,000	\$ 975,000	\$ -0-	0%
Public Works	\$ 900,000	\$ 350,000	\$ 1,250,000	\$ 1,000,000	\$ 250,000	8%
Law	\$ 900,000	\$ 75,000	\$ 975,000	\$ 200,000	\$ 775,000	26%
Assessment	\$ 900,000	\$ 75,000	\$ 975,000	\$ 200,000	\$ 775,000	26%
Tax Collection	\$ 900,000	\$ 350,000	\$ 1,250,000	\$ 625,000	\$ 625,000	21%

*% of tax impact represents how much of the program/ department budget is funded with real property tax. Allows you to focus on areas heavily reliant on taxes.



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Multiyear Plans

- Help management set long-term priorities and work toward goals, rather than making decisions based only on the current environment.
- Plans should be formally adopted and monitored by the governing board.
- Types of plans we cover today:
 - Multiyear Financial Plan
 - Multiyear Capital Plan



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Multiyear Financial Plan

<https://www.osc.ny.gov/local-government/resources/planning-resources>

- Illustrates what will happen to a government's ability to pay for and provide services, given a set of policy and economic assumptions.
 - “Can we continue on the path we are on?”
 - “What might be the impact of our decision to...?”
- Schedules out anticipated future financial position.
 - Based on a set of criteria
 - Supported by management analysis
 - Includes impact of capital decisions contained in a Multiyear Capital Plan.



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Multiyear Capital Plan

What does a Multiyear Capital Plan do?

- Identifies all capital and major equipment needs,
- Incorporates a process for prioritizing projects, and
- Includes a maintenance cycle to sustain current capital assets.



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Multiyear Capital Plan

- What assets do we currently own?
- What are our local government's capital investment needs?
- How have we prioritized these needs?
- How much will they cost to build and maintain?
- What is our fiscal capacity to support capital spending over time?
- What is the best way to finance these capital investments?
- How can we effectively manage these projects?
- How much will they cost to operate once constructed?

Effective Fund Balance Policy

- For each fund, a policy should:
 - Be adopted by the governing board with input from key officials (e.g., CFO, budget officer)
 - Be in a written form and subject to review by governing board on a regular basis
 - Be used to develop and amend multiyear capital and operational plans
 - Address how surplus balances will be applied
 - Address the timing for balances to be replenished to the desired level

Legal Reserves

- Reserves are portions of fund equity generally representing cash resources.
 - Legally segregated by action of the governing board for a specific future use
 - Not available for current operations.
- Examples include:
 - Capital reserve
 - “Type” or “Specific”
 - Repair reserve
 - Others

Purpose of Reserves

- Help with long-term capital and operational planning.
- Potentially reduces the need to borrow.
- Helps save for future contingencies.
- Can stabilize effects from fluctuations in the economy.
- Legally segregate equity to prevent unintended use in the future.

Monitoring the Budget


The governing board is responsible for monitoring the budget and making modifications prior to appropriations being overspent.

The board should review:

- Budget status reports
- Cash flow reports
- CFO monthly reports
- Multiyear plans and fund balance policies (periodically)

Local Government of EXAMPLE GENERAL FUND (A)						
Budget-to-Actual Report for the <u>X</u> Months ended June 30, XXXX						
(A) Revenues	(B) Actual Last Year 12 Months	(C) Current Budget 12 Months	(D) Actual To-Date 6 Months	(E) Current Variances D – C (Unfavorable)	(F) Projected for Year 12 Months	(G) Projected Variance F – C (Unfavorable)
Property Taxes	215,000	220,000	220,000	0	220,000	0
State Aid	310,000	325,000	175,000	(150,000)	350,000	25,000
User Charges	14,000	17,000	9,000	(8,000)	18,000	1,000
Departmental Income	27,000	30,000	17,000	(13,000)	35,000	5,000
Sales Tax	245,000	270,000	100,000	(170,000)	200,000	(70,000)
Federal Aid	17,000	25,000	10,000	(15,000)	17,000	(8,000)
Interfund Transfers	0	0	0	0	0	0
Total Revenues	\$828,000	\$887,000	\$531,000	(\$356,000)	840,000	(\$47,000)
Expenditures						
General Government	120,000	142,000	80,000	62,000	130,000	12,000
Public Safety	280,000	300,000	162,000	138,000	315,000	(15,000)
Health	17,000	19,000	7,000	12,000	15,000	4,000
Transportation	255,000	272,000	145,000	127,000	280,000	(8,000)
Economic Assistance	14,000	12,000	18,000	(6,000)	22,000	(10,000)
Home and Community	30,000	37,000	21,000	16,000	43,000	(6,000)
Employee Benefits	29,000	42,000	24,000	18,000	52,000	(10,000)
Debt Service	94,000	63,000	30,000	33,000	63,000	0
Total Expenditures	\$839,000	\$887,000	\$487,000	\$400,000	\$920,000	(\$33,000)

Cash Flow Report

	GENERAL FUND (A) Actual									Estimates			20XX
Inflows	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Total
Real Property Taxes	50,000	125,000	37,500	25,000	12,500								250,000
Interest and Penalties		19,250	10,500	3,500	1,750								35,000
Sales Tax			75,000			75,000			75,000			93,750	318,750
Court Fines and Fees	7,000	7,000	7,000	7,000	7,000	7,000	7,000	7,000	7,000	7,000	7,000	7,000	84,000
Clerk Fees	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	12,000
Court Grant			15,000										15,000
Total Inflow	58,000	152,250	146,000	36,500	22,250	83,000	8,000	8,000	83,000	8,000	8,000	101,750	714,750
Outflows	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Total
Salaries and Benefits	40,000	40,000	40,000	40,000	40,000	40,000	40,000	40,000	40,000	40,000	40,000	40,000	480,000
Building Maintenance		5,000				12,500							17,500
Utilities	1,750	1,750	1,750	1,750	1,500	1,500	1,500	1,500	1,500	1,500	1,750	1,750	19,500
Computer Equipment	20,000												20,000
Clerk	2,100	2,100	2,100	2,100	2,100	2,100	2,100	2,100	2,100	2,100	2,100	2,100	25,200
Board	750	750	750	750	750	750	750	750	750	750	750	750	9,000
Court	8,000	8,000	8,000	8,000	8,000	8,000	8,000	8,000	8,000	8,000	8,000	8,000	96,000
Court Capital Outlay					17,500								17,500
Debt Payment	10,000												10,000
Total Outflow	82,600	57,600	52,600	52,600	69,850	64,850	52,350	52,350	52,350	52,350	52,600	52,600	694,700
Surplus/Deficit	(24,600)	94,650	93,400	(16,100)	(47,600)	18,150	(44,350)	(44,350)	30,650	(44,350)	(44,600)	49,150	20,050
Cash Balance [A200] BEFORE	(4,600)	100,050	173,450	57,350	9,750	27,900	13,550	(30,800)	59,850	25,500	(9,100)	100,050	
Investing/Borrowing													
Investments - Purchase		10,000	100,000	-	-	-	-	-	-	-	-	-	110,000
Investments - Sold	-	-	-	-	-	30,000	-	60,000	10,000	10,000	-	-	110,000
Short-Term Borrowing	10,000										60,000		70,000
Short-Term Borrowing - Repaid		10,000										60,000	70,000
Cash Balance [A200] AFTER	5,400	80,050	73,450	57,350	9,750	57,900	13,550	29,200	69,850	35,500	50,900	40,050	
Investing/Borrowing													
Beginning CashBalance 1/01/XX	20,000									Ending CashBalance (A200)	12/31/XX	40,050	
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Assessing Financial Condition

- Assess each fund individually
- Assess each unit as a whole – keeping in mind legal and/or other restrictions
 - Are there funds which can legally provide assistance/loans to other funds?
 - Do not use tax revenues from one tax base to fund expenditures for another tax base (i.e. lighting districts, sidewalk districts, refuse collection, etc.)

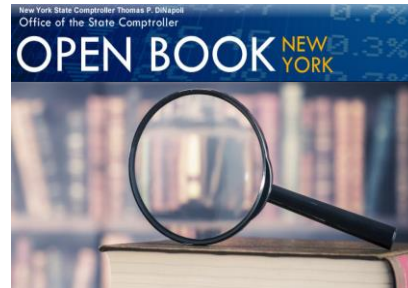


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Assessing Financial Condition (cont.)

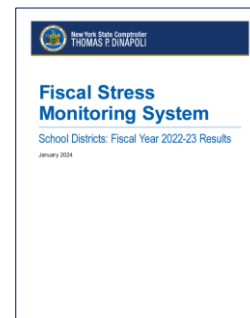
- Budget vs. Actual
- Cash Position
- Interfund Activity
- Long-Term Debt per Capita
- % of Debt Limit Exhausted
- Tax Levy/Tax Rates
- Taxable Valuation
- % of Tax Limit Exhausted
 - Counties/Cities/Villages
- Fiscal Stress Monitoring System Scores (if applicable)



Fiscal Stress Monitoring System (FSMS)

Evaluates fiscal stress from a budgetary solvency perspective. Includes:

- Financial indicators
- Environmental indicators
 - System Information:
<https://www.osc.ny.gov/local-government/fiscal-monitoring>
 - Self assessment tool:
<https://www1.osc.state.ny.us/localgov/fiscal-monitoring/fsms.cfm>
 - Webinars: <https://www.osc.ny.gov/local-government/academy/webinars>



Resources

- Multiyear Planning Tools:
<https://www.osc.ny.gov/local-government/resources/planning-resources>
- On-Demand training including “Multiyear Planning”, “Financial Condition Analysis” and “Developing a Fund Balance Policy” (Webinar Link on previous slide)
- OSC Financial Condition Audits of Local Governments: <https://www.osc.ny.gov/local-government/fiscal-monitoring/condition-audits>



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Thank You

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