

City of Little Falls

Financial Condition

JUNE 2021



OFFICE OF THE NEW YORK STATE COMPTROLLER
Thomas P. DiNapoli, State Comptroller

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Report Highlights

City of Little Falls

Audit Objective

Determine whether the City of Little Falls (City) Common Council (Council) and officials adopted realistic budgets that were structurally balanced, routinely monitored financial operations and took appropriate actions to maintain the City's fiscal stability.

Key Findings

The Council and City officials did not adopt structurally balanced budgets, properly monitor the City's financial operations or take appropriate actions to maintain the City's fiscal stability. As a result, the City has significant fiscal stress. We found:

- The former Treasurer over-reported fund balance from 2017 through 2019 by more than \$200,000, and the Council did not receive sufficient financial reports to monitor City finances.
- General fund balance declined to about \$244,000 (by 52 percent) at the end of 2019, and officials had to rely on loans for cash flow.
- Errors in the 2020 accounting records make it difficult for officials to accurately assess the City's current financial condition.
- Officials have not adopted a fund balance policy, multiyear financial plan or capital plan.

Key Recommendations

- Adopt structurally balanced budgets and closely monitor City finances.
- Correct accounting errors and ensure financial reports are accurate.
- Adopt a fund balance policy, multiyear financial plan and capital plan.

City officials generally agreed with our recommendations and indicated they planned to initiate corrective action.

Background

The City, located in Herkimer County (County), is governed by its charter and State and local laws.

The Council comprises an elected Mayor and eight elected aldermen. The Council is responsible for the overall management and oversight of City operations, including its financial condition.

An elected Treasurer is the custodian of City money and is responsible for maintaining the City's accounting records.

The former Treasurer retired in May 2020. A Treasurer was then appointed to fill the vacancy, but he left City employment in February 2021, after our audit fieldwork was complete.

Quick Facts

2020 Appropriations

General Fund	\$6,468,536
Golf Fund	\$98,387

General Fund

Year	Fund Balance	Cash Balance
2017	\$503,763	\$376,239
2018	\$365,656	\$198,278
2019	\$244,132	\$17,706

Audit Period

January 1, 2019 – July 31, 2020

We extended our audit scope back to January 1, 2017 for financial comparisons and forward to December 31, 2020 to review current year-to-date operating results.

Financial Condition

The City contracted with an independent certified public accounting (CPA) firm to audit its 2017 and 2018 financial statements, but these audits were not done in a timely manner. The audit of the 2017 financial statements was completed in December 2018 and the audit of the 2018 financial statements was not completed until June 2020 (18 months after the end of the fiscal year). Significant adjustments were made as part of the audits, indicating that City officials did not have timely or accurate financial information to use in managing City finances during the year or to use in developing the budgets.

Based on the audited financial statements, the City's general fund balance was overstated in the annual financial reports by \$204,294 in 2017 and \$220,098 in 2018 (an average of 50 percent). The City has not yet obtained a CPA audit of the 2019 financial statements. When analyzing the City's general fund balance, we used the audited financial statements for 2017 and 2018. We used the CPA's 2018 ending fund balance and applied the 2019 operating results to estimate the 2019 ending fund balance of approximately \$244,000.

How Does a Council Effectively Manage Financial Condition?

Financial condition may be defined as a city's ability to balance recurring expenditure needs with recurring revenue sources, while providing desired services on a continuing basis. A key measure of a city's financial condition is its level of fund balance, which is the difference between revenues and expenditures accumulated over time. The city should maintain a reasonable amount of fund balance to ensure its ability to continue to provide services at current levels when faced with unexpected revenue shortfalls or expenditure overruns.

Fund balance may be appropriated in the budget to help finance operations. However, consistently doing so – instead of planning to use recurring revenue sources – can deplete fund balance to levels that are insufficient to cover unexpected contingencies and routine cash flow. It is important for the council to adopt a policy that addresses the level of fund balance to be maintained in each fund and to use the policy in the annual budgeting process to help ensure that fund balance levels are adequate. Also, officials should ensure that the city's cash balances are sufficient to meet current obligations, without relying on short-term debt to address cash flow needs.

It is essential that the budget is properly constructed because it is the city's financial plan for the fiscal year. As such, it is important to prepare the budget using realistic estimates based on the most current and accurate information available and not to rely on one-shot revenues to support recurring expenditures. As a general rule, no expenditure may be made unless an amount has been appropriated. Therefore, it is necessary to adopt the budget before the start of the fiscal year.

Accounting records and reports provide a basis of checks and balances for determining whether city funds are accounted for. The treasurer is responsible for maintaining complete, accurate and current accounting records for each fund, reconciling bank accounts and providing periodic financial reports. The treasurer should keep the mayor and council fully advised of the city's financial condition and its future financial needs.

It is essential that the mayor and council receive regular financial reports to fulfill their responsibility of monitoring financial operations and to be able to make informed financial decisions. Interim reports should provide timely information on financial position, results of operations, budget status and available cash balances. Effective management includes monitoring budgets during the course of the year and making any needed amendments to address revenue shortfalls or costs that exceed appropriations.

Multiyear financial planning is a vital tool for cities, especially those struggling with difficult financial conditions. It enables officials to identify developing revenue and expenditure trends, establish long-term priorities and goals and consider the impact that one-time financing sources or other short-term budgeting decisions may have on future fiscal years.

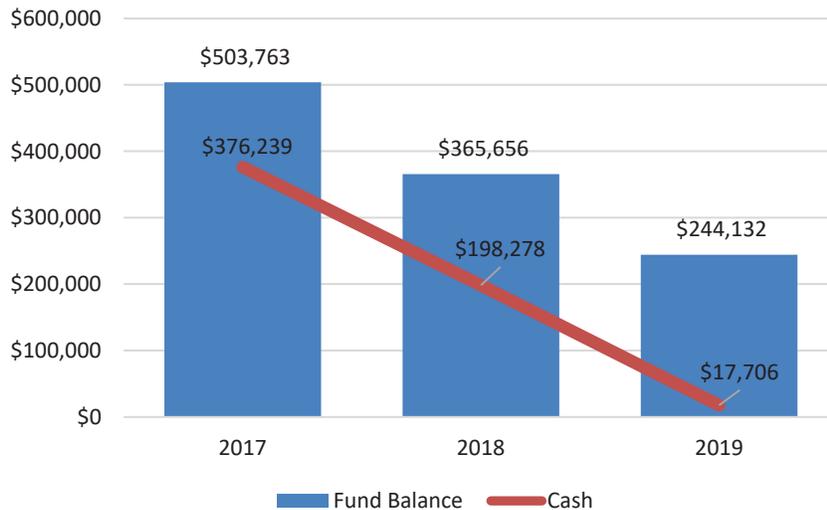
A capital plan is designed to help officials maintain and improve a city's capital assets over time. It should identify and prioritize all capital and major equipment needs, reflect the estimated costs and the proposed method of financing (e.g., grants, debt, reserve funds) and project operating budget impacts.

The City Is Fiscally Stressed

City officials did not effectively manage the general and golf funds' financial condition. The Council has not adopted a written fund balance policy that addresses the reasonable levels of fund balance it wants to maintain from year to year to preserve a sound financial condition. General fund balance has been declining due to operating deficits (when expenditures exceed revenues) since the fiscal year ending (FYE) 2017. As shown in Figure 1, fund balance at FYE 2017 was \$503,763, and it dropped by more than half to \$244,132 in FYE 2019. This amounted to about 3 percent of 2020 appropriations (\$6,468,536) and left little financial cushion in case of emergency or unforeseen revenue shortfalls.

FIGURE 1

General Fund - Fund Balance and Cash



Note: 2019 results are unaudited and may be subject to change.

The City's general fund cash and fund balance declined, in large part, because officials used appropriated fund balance to help balance the budgets. The Council appropriated fund balance of \$99,000 and \$120,000 in the 2018 and 2019 budgets, respectively. It also appropriated \$50,000 of the \$244,132 ending 2019 fund balance to finance the 2020 budget.

Additionally, the general fund loaned \$26,000 to the golf fund, which had a \$25,301 deficit fund balance as of FYE 2019. This deficit fund balance represented nearly 26 percent of the golf fund's 2020 budgeted appropriations of \$98,400. The golf fund has reported a deficit fund balance since 2012. The deficit got worse in 2018 and 2019 because the actual revenues were under budget by an average of \$9,856 (10 percent). Because the golf fund is not self-sustaining, the general fund has, in effect, been subsidizing golf fund operations through loans which negatively impact the general fund's cash flow.

As shown in Figure 1, the general fund's cash balances declined 95 percent from \$376,239 as of FYE 2017 to \$17,706 as of FYE 2019. At the end of 2019, officials advanced \$220,000 from the sewer fund (which had a stable financial condition) to the general fund to help with cash flow. The general fund repaid this loan in 2020. Had the loan not been made, the general fund would have had negative cash of \$202,294. In addition, the Treasurer was unable to provide support for some of the accounts reflected on the City's balance sheet as of FYE 2019, including the receivable and payable balances. This increases the potential

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instability of the City's financial condition because it is uncertain whether funds recorded as due to the City and payable from the City were accurate, which could impact the City's cash flow.

2020 Operating Results – The COVID-19 pandemic (pandemic) impacted the City's finances in 2020, but it is difficult to determine the full extent of the impact due to deficiencies in the records. The Mayor told us that he required major department heads to reduce spending by 10 percent in May 2020 in response to expected reductions in sales tax and State aid revenues. He said that officials did not modify the budget because of uncertainty surrounding the revenues.

The pandemic caused the State to reduce or withhold aid to localities during the State's 2020-21 fiscal year. At the end of our audit fieldwork, \$173,207 (20 percent) had been withheld from the New York State Aid and Incentives for Municipalities (AIM) payments to the City during 2020. However, most of that aid has been restored and was paid in March 2021, leaving a \$43,302 (5 percent) shortfall in AIM payments to the City. The City's 2020 sales tax receipts were close to estimates, about \$18,000 (2 percent) lower than budgeted.

The Mayor told us he met with the Treasurer and other City officials to go through the 2020 budget and operating results line by line. As of November 2020, they estimated there would be about a \$25,000 operating surplus at the end of 2020. However, he said this was an informal analysis, so he did not provide support for their estimate. However, based on our review of the 2020 accounting records, we question how City officials could develop an accurate estimate of the year-end operating results. At the end of our fieldwork (January 15, 2021), the 2020 operating results were unknown because not all revenues and expenditures were posted correctly during the year. For example,

- Real property tax revenues (\$3,410,092) had not yet been recorded, along with any interest and penalty amounts for unpaid taxes turned over to the County for enforcement. The interest amount depends on the unpaid taxes each year. For reference, the amount related to unpaid taxes in 2019 was \$35,205.
- One payroll expenditure was posted twice in September, and five subsequent payrolls were not posted. If those payrolls are similar to others, the net amount unrecorded could amount to over \$400,000.
- A \$101,078 bond payment due in August was not posted.
- A \$49,227 bond anticipation note was erroneously recorded as general fund revenue.

Furthermore, bank reconciliations were not up to date. As of August 2020, monthly bank reconciliations had not been done since April 2020. In December 2020, the Treasurer told us that he was working on getting the bank

...[T]he 2020 operating results were unknown because not all revenues and expenditures were posted correctly during the year.

reconciliations up to date, but he was having trouble reconciling the City's main bank accounts. Bank reconciliations help verify that all cash receipt and disbursement transactions are captured and properly recorded. Without accurate bank reconciliations completed on a monthly basis, officials lack assurance that the accounting records are correct or that funds are accounted for properly.

Given these errors, City officials cannot rely on the 2020 accounting system reports to project 2020 operating results or ending fund balance. Without reliable records and reports, it makes it difficult for the Council to effectively monitor the City's finances and develop realistic estimates for the 2021 budget.

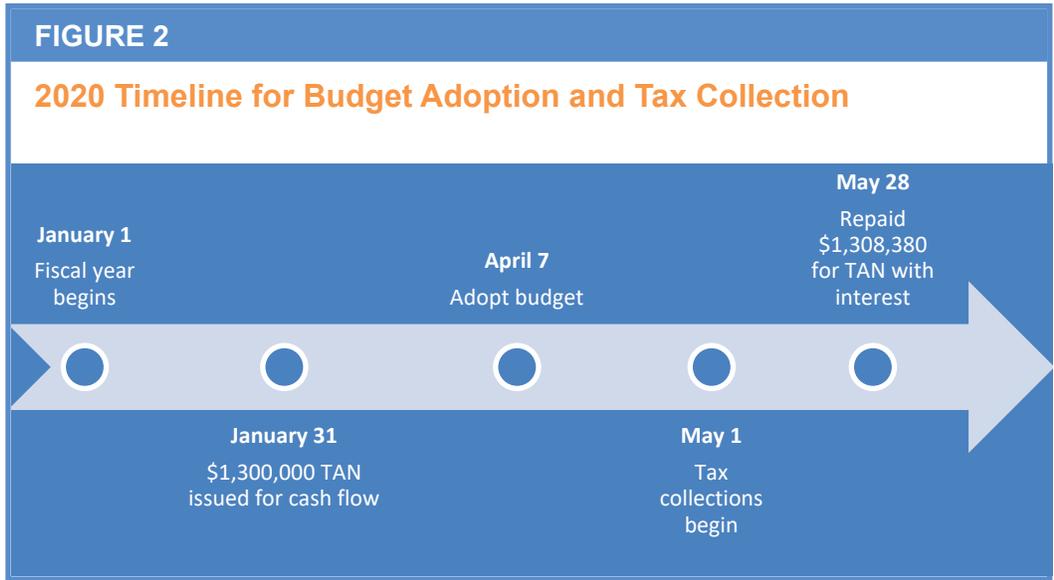
The Treasurer indicated he was working on making the necessary entries to fix the records. It will be important for City officials to correct the recordkeeping deficiencies so the City can file an accurate annual financial report for 2020 and have reliable information for making financial decisions in the future.

The Council Did Not Adopt Timely, Structurally Balanced Budgets and Adequately Monitor Financial Operations

Budget Timeliness – The City operates its fiscal year on a calendar year basis but does not adopt its budget until April each year. This is not a good business practice because any spending that takes place before budget adoption is made without an available budget appropriation. In addition, City officials are not able to compare actual revenues and expenditures against the budget for the first quarter of the fiscal year.

Although the City Charter allows this budget adoption timeline, it also states that officials shall not make purchases in excess of budgetary limitations (appropriations). The Charter conflicts with itself because not spending for the first three months of the fiscal year is not practical.

Also, the Charter calls for real property taxes to be collected beginning in May. At \$3.4 million for 2020, real property taxes are a major revenue source for the City (about 53 percent). Accordingly, the City has less revenue in the first four months of the year and takes out short-term tax anticipation notes (TANs) each year. From 2017 through 2020, this debt cost the City a total of \$36,620 in interest expenses. Figure 2 demonstrates this cycle. Had tax collections taken place at the beginning of the fiscal year, these interest costs may have been avoided.



Also, given this timeline, the City would need to rebuild its cash balances to have significant cash on hand to sustain operations for the first four months of the fiscal year, or it will continually need to borrow funds to cover the earlier months' spending.

Structurally Balanced Budgets – Because non-recurring financing sources are limited, they should not be used to regularly finance recurring expenditures. As discussed previously, the Council adopted budgets that relied on fund balance as a financing source to fill structural budget gaps in the general fund (\$99,000 in 2018; \$120,000 in 2019; \$50,000 in 2020). This contributed to the depletion of fund balance and a corresponding decline in cash.

The adopted budgets also included interfund transfer revenues as a financing source in the general fund (\$200,000 in 2017; \$245,000 in 2018; \$100,000 in 2019; \$18,000 in 2020). The former Treasurer transferred over \$400,000 from the capital projects fund to the general fund from 2017 through 2019. Another \$27,595 was transferred in 2020 (\$9,595 more than budgeted). This depleted the cash in the capital projects fund, so this funding is no longer available for future budgets.

Also, it is unclear whether these transfers were proper. The Treasurer did not provide any detailed capital project records maintained by the former Treasurer showing what capital project(s) financed the interfund cash transfers to the general fund. Capital projects are commonly financed by bond proceeds. Legal and contractual requirements can vary from one project to another depending on how a project was financed. But, generally, capital project resources should be segregated from operating funds and should be used only for their specified purpose, especially when a project has been financed by bond proceeds.

Because detailed capital project records were either not maintained or not made available if they were maintained, it is unclear whether the City used bond proceeds or other restricted funds for general fund operations.

Because the City has significantly depleted its fund balance and can no longer rely on capital fund resources to finance future general fund budgets, City officials will need to replace these funds with other recurring revenues and/or cut costs to balance the budget.

The City's ability to fill budget gaps by increasing property taxes may be limited in future years as it nears the Constitutional Tax Limit (CTL). The CTL is the maximum amount of real property taxes that may be levied in any fiscal year. With the 2020 tax levy, the City exhausted over 87 percent of its taxing authority. If the City were to exceed the CTL, it could risk losing some of its State funding.

Interim Financial Reports – The Treasurers provided monthly budget versus actual reports of expenditures to the Council once the budget was adopted, but the Council did not receive budget versus actual reports for revenues until after our audit fieldwork began.

No other routine financial reports were provided. For example, the Council did not receive cash reports or balance sheets for each fund. Cash reports should include cash balances at the beginning of the month, receipts by source during the month, disbursements during the month, cash on hand at the end of the month and reconciliation with bank statements. Balance sheets are a useful tool to provide the Board with information about assets and liabilities in each fund, such as receivables and payables.

Although the Council received budget vs. actual reports that showed appropriation accounts were overdrawn, they did not make any budget modifications during 2019. Nearly half of the 2019 general and golf funds' appropriation accounts were overspent, and general fund total expenditures exceeded appropriations by \$170,548 (3 percent). For example, expenditures were higher than appropriations for the following accounts/amounts:

- Street lighting - \$59,000;
- Snow and ice contractual - \$39,000;
- Street personal services - \$32,000; and
- Police contractual - \$26,000.

Without available appropriations, the former Treasurer should have advised respective department heads that they had overspent these budget items and worked with them to identify budget amendments to propose for Council approval.

If the City were to exceed the CTL, it could risk losing some of its State funding.

Given the City's weak financial position, it is especially important for the Treasurer, department heads and Council to closely monitor the budget throughout the year and ensure spending is kept within the available appropriations so financial condition is not negatively impacted.

The Council Did Not Establish Multiyear Financial and Capital Plans

City officials did not develop a multiyear financial or capital plan. Had such plans been developed, the Mayor and Council would have had a valuable resource to help them to make more informed financial decisions.

Going forward, developing a financial plan would be a useful tool for the Mayor and Council to ensure that recurring revenue sources are sufficient to finance anticipated recurring expenditures. This will help to maintain a reasonable level of fund balance at year end and to develop a plan for building fund balance up.

In addition, a capital plan identifying capital needs with time schedules and the method of financing each improvement or capital expenditure would aid City officials with assessing the impact future capital expenditures will have on subsequent years' operating budgets. These plans should then become a part of the City's budgeting process, and the annual budget should take the current portion of the long-term plans into consideration.

What Do We Recommend?

The Council should:

1. Adopt a written fund balance policy that addresses the reasonable amount of fund balance the City should maintain in each fund for unanticipated expenditures, revenue shortfalls and cash flow purposes.
2. Adopt structurally balanced budgets that include realistic estimates and fund recurring expenditures with recurring revenues.
3. Review the budget adoption and real property tax collection timing. Consider amending the Charter to require adopting the budget prior to the beginning of the fiscal year and collecting real property taxes to coincide with the start of the fiscal year.
4. Review periodic financial reports that include cash activity and reconciled cash balances, balance sheet accounts, and budget-to-actual comparisons for revenues and expenditures.

The Council and City officials should:

5. Closely monitor the City's finances, including available fund balance and cash balances, to prevent further decline in the City's financial condition.

-
6. Establish a plan to eliminate the golf fund balance deficit and ensure that fund is self-sustaining.
 7. Ensure bond proceeds are only used for their intended purposes.
 8. Monitor the budget throughout the year, ensure timely budget modifications are made when necessary and do not allow appropriation accounts to be overspent.
 9. Develop and adopt comprehensive, written multiyear financial and capital plans to provide a framework for preparing future budgets and managing the financing of future capital needs.

The Treasurer should:

10. Correct the errors in the accounting records and ensure accurate results are reported on the City's annual financial report.
11. Perform timely monthly bank reconciliations and promptly investigate and correct any differences.
12. Maintain complete records for each capital project to track all financial activity.

Appendix A: Response From City Officials



OFFICE OF
MAYOR
659 E. Main Street
Little Falls, New York 13365
Office: (315) 574-5248

Hon. Mark Blask
Mayor

June 14, 2021

Office of the New York State Comptroller
Division of Local Government and School Accountability
110 State Street, 12th floor
Albany, NY 12236

Subj: CITY OF LITTLE FALLS' FINANCIAL AUDIT

Dear Sir/Madam,

The City of Little Falls is in receipt of the draft report containing the findings of the Office of State Comptroller's audit of the City's financial records. We appreciate the assistance and recommendations that were made by the examiners throughout the course of this audit.

Like most small communities in New York, Little Falls operates on a tight budget with many items beyond our control (increasing medical costs, severe flooding, etc.). Additionally, after having the same Treasurer for over three decades we have seen considerable turnover in that office having had three Treasurers in less than 8 months. The Common Council recently passed a resolution which, if the referendum passes, will result in the Treasurer position being appointed rather than elected. That change to the charter will ensure we get the correct person in the position.

We work hard to ensure they taxpayer's dollars are well-spent and have put a premium on sound fiscal policies. The steps we will take to address the issues laid out in the audit will be contained in the corrective action plan.

Thank you again for highlighting areas which need improvement. We are committed to improving processes and will work hard towards that end.

Sincerely,

Mark Blask
Mayor

Cc: Common Council

Appendix B: Audit Methodology and Standards

We conducted this audit pursuant to Article V, Section 1 of the State Constitution and the State Comptroller's authority as set forth in Article 3 of the New York State General Municipal Law. To achieve the audit objective and obtain valid audit evidence, our audit procedures included the following:

- We interviewed Council members and City officials and reviewed the charter and Council meeting minutes to gain an understanding of the City's processes for financial management (e.g., fund balance, budgeting, monitoring and long-term planning).
- We reviewed City accounting records to determine whether they were complete, accurate and timely.
- We compared 2018 accounting system records and reports to audited financial statements and reviewed CPA adjusting entries.
- We compared 2019 accounting system records to source documents such as bank statements, canceled checks, invoices and deposit slips and reviewed available supporting documentation for certain balance sheet accounts.
- We reviewed FYE 2019 bank reconciliations.
- We analyzed fund balances and operating results and compared total budget to actual results for the City's operating funds (general, water, sewer and golf funds) for 2017 through 2019.
- We prepared general and golf fund cash flow analyses to determine whether cash balances were sufficient to fund operations without relying on short-term debt.
- We compared general and golf fund adopted budgets to actual revenues and expenditures by line item to determine whether budgets were realistic and structurally balanced.
- We reviewed transfers from the capital projects fund to the general fund and this revenue's availability for future budgets.
- We reviewed general and golf fund 2020 year-to-date budget status reports and reviewed the 2020 general ledger to assess the usefulness and reliability of the budget status reports.
- We reviewed the CTL computation to determine the extent to which the City has exhausted its constitutional taxing limit.
- We analyzed the tax levy trend over the last three years to determine whether increases were reasonable. We also reviewed tax cap calculations to verify the City stayed under the cap.

We conducted this performance audit in accordance with generally accepted government auditing standards (GAGAS). Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

Unless otherwise indicated in this report, samples for testing were selected based on professional judgment, as it was not the intent to project the results onto the entire population. Where applicable, information is presented concerning the value and/or size of the relevant population and the sample selected for examination.

The Council has the responsibility to initiate corrective action. A written corrective action plan (CAP) that addresses the findings and recommendations in this report should be prepared and provided to our office within 90 days, pursuant to Section 35 of General Municipal Law. For more information on preparing and filing your CAP, please refer to our brochure, *Responding to an OSC Audit Report*, which you received with the draft audit report. We encourage the Council to make the CAP available for public review in the City Clerk's office.

Appendix C: Resources and Services

Regional Office Directory

<https://www.osc.state.ny.us/files/local-government/pdf/regional-directory.pdf>

Cost-Saving Ideas – Resources, advice and assistance on cost-saving ideas

<https://www.osc.state.ny.us/local-government/publications>

Fiscal Stress Monitoring – Resources for local government officials experiencing fiscal problems

www.osc.state.ny.us/local-government/fiscal-monitoring

Local Government Management Guides – Series of publications that include technical information and suggested practices for local government management

<https://www.osc.state.ny.us/local-government/publications>

Planning and Budgeting Guides – Resources for developing multiyear financial, capital, strategic and other plans

www.osc.state.ny.us/local-government/resources/planning-resources

Protecting Sensitive Data and Other Local Government Assets – A non-technical cybersecurity guide for local government leaders

<https://www.osc.state.ny.us/files/local-government/publications/pdf/cyber-security-guide.pdf>

Required Reporting – Information and resources for reports and forms that are filed with the Office of the State Comptroller

www.osc.state.ny.us/local-government/required-reporting

Research Reports/Publications – Reports on major policy issues facing local governments and State policy-makers

<https://www.osc.state.ny.us/local-government/publications>

Training – Resources for local government officials on in-person and online training opportunities on a wide range of topics

www.osc.state.ny.us/local-government/academy

Contact

Office of the New York State Comptroller
Division of Local Government and School Accountability
110 State Street, 12th Floor, Albany, New York 12236

Tel: (518) 474-4037 • Fax: (518) 486-6479 • Email: localgov@osc.ny.gov

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