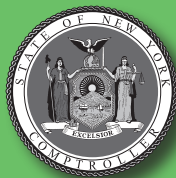




OFFICE OF THE STATE COMPTROLLER
DIVISION OF LOCAL GOVERNMENT
AND SCHOOL ACCOUNTABILITY

**Trouble Ahead:
Managing Your Budget
in Times of Fiscal Stress**



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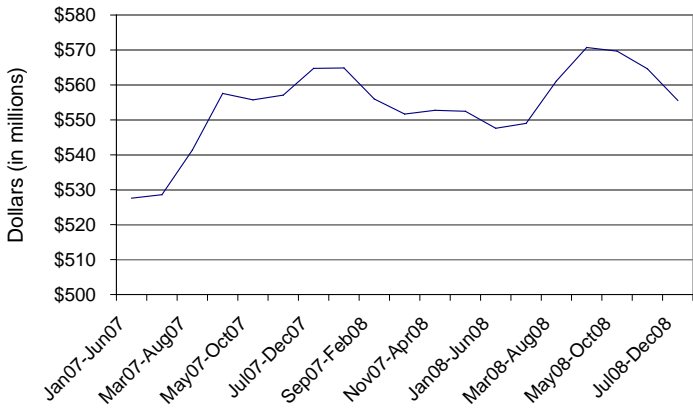
New York State and its local governments face tremendous financial challenges as a result of the worst economic downturn since the Great Depression. The precipitous decline in the financial sector has hit New York State particularly hard, contributing to a significant slowdown in most of the major revenue sources on which local governments rely.

Indeed, revenues generated by the sales tax and mortgage recording tax are declining in some areas at a greater rate than might have been projected just a few months ago. Cities and school districts, which are dependent on State aid, are particularly vulnerable to cuts in local assistance as the State grapples with closing its own budget deficit. Many local governments are already reducing or deferring discretionary expenditures in response.

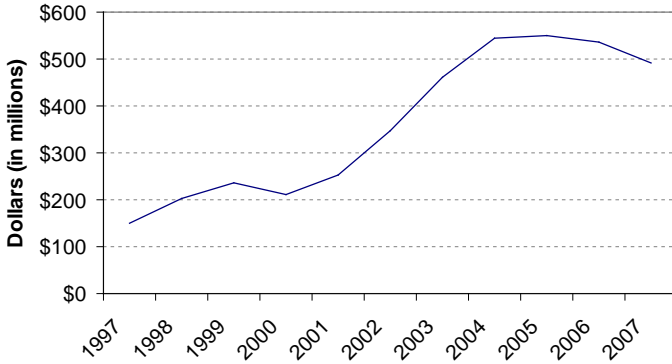
In the longer term, the economic downturn may impact property tax collections as property values decline, home foreclosures increase and surrounding property is devalued. Moreover, increasing property taxes to fill budget gaps created by the decline in other revenues will be difficult given New York's already high property tax burden, and as taxpayers struggle to make ends meet. The deterioration of the economy will continue to impact State and local government finances in the years ahead.

In this environment, it is more important than ever that finance officers actively monitor their budgets against actual revenue collections and expenditure outlays to minimize the risk of a year-end deficit. By following a simple, step-by-step process, local governments can determine what budget assumptions may need revisiting, what expenditures may need to be reduced to maintain

Six Month Rolling Average Sales Tax Collections



Mortgage Recording Tax Collections by Local Governments, 1997-2007



budget balance, and where they stand financially throughout the fiscal year. During times of fiscal stress, the overriding financial principle must become “don’t spend money you may not have.”

If you find yourself facing declining revenues and believe that your current budget is no longer workable, we suggest that you consider taking the following steps to make mid-course corrections, before the situation results in deficits.

Step #1: Declare a spending moratorium.

To develop an appropriate response to growing fiscal stress, you need to buy yourself some time. You can do this by declaring a “spending moratorium” and immediately stop all spending other than payroll, debt service, fixed contractual obligations and mandatory health and public safety spending. Any other necessary expenditures during this period should require approval by your municipal CFO (comptroller, budget director, or treasurer) and CEO (mayor, supervisor, or manager).

Step #2: Prepare a cash forecast.

The spending moratorium creates an opportunity for you to take your adopted budget and create or modify a monthly cash flow statement: how much revenue is expected to be collected each month and how does that compare to monthly projected spending? Many larger local governments develop elaborate cash flow monitoring as a matter of course, but smaller local governments often lack the time or staff resources to develop such a

system. The Office of the State Comptroller has a free online tutorial ([module 4 of a series on cash management](#)) that includes step-by-step instructions for constructing a simple but effective cash flow monitoring system, along with sample cash flow tables.

Step #3: Review your revenue assumptions.

Once you create a cash flow statement, you can begin to run a series of simple “what-if” scenarios against your budget assumptions. The assumptions related to major revenue sources (property taxes, sales tax distributions and State aid) should be reviewed to determine if budgeted amounts are still realistic. In addition, smaller but more volatile sources such as mortgage recording taxes should also be examined for reasonableness, but don’t sweat the small stuff.

For example, revenue assumptions that seemed reasonable at the time of budget adoption may now seem optimistic. Your municipality may have budgeted sales tax growth at 2 percent over 2008 collections, but what happens if there is no growth? By examining a series of these scenarios, you can begin to quantify the range of budgetary risk in your numbers, and identify the potential “peak and valley” months during your fiscal year. The shortfalls you identify indicate the amount of savings you may need to create in your current year budget in order to keep it in balance, and the key months become your milestones for budget decisions.

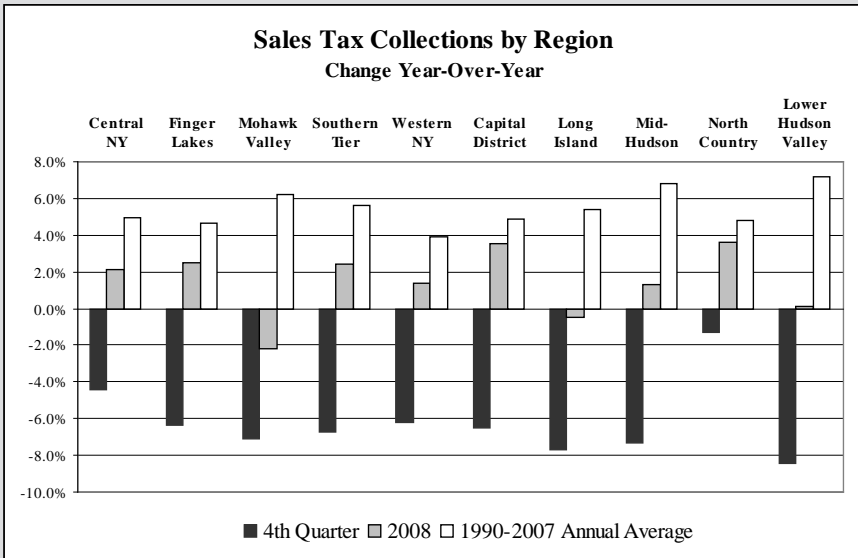
Step #4: Develop a budget remediation plan.

The various cash flow scenarios you have created will give an indication of the range of risk in your budget and whether expenditures may need to be curtailed to avoid a deficit at year end. In the current environment, it’s best to be conservative. It is easier to relax spending constraints toward the end of the year, if revenues come in stronger than anticipated, than it is to scramble to avoid a deficit if revenues come in short, especially if the shortfall hits late in the year.

Expenditure assumptions such as hiring levels, retirements and other personnel turnover, and scheduled salary and benefit changes should be reviewed. Changes such as leaving vacancies open and reducing or deferring discretionary items should be immediately implemented. Major capital, equipment and supply purchases could be deferred. Department heads should be asked to review their spending plans and prioritize necessary outlays, including programs that may not be essential for health or safety

Sales Tax Distributions: A Cautionary Tale

At the time when counties, towns and most cities were adopting their 2009 budgets (around November of 2008), sales tax collections had slowed but had not yet declined from the same point in 2007. Therefore, it would have seemed reasonable to budget no growth in sales tax collections. Despite the dire predictions of economic distress, sales tax collections were strong for the first three quarters of 2008 – up 3.8 percent over the same period in 2007. But fourth quarter collections were **down** 6.8 percent over that same period in the prior year, bringing total sales tax collections for all of calendar year 2008 down to a growth of only 1 percent over the year before. This was the lowest annual growth since 1991.



Source: Department of Taxation and Finance, Office of Tax Policy Analysis, Sales Tax Cash Distribution Database; additional calculations by Office of the State Comptroller. Numbers not adjusted for tax rate or tax law changes.

Two conclusions may be drawn from this:

1. Flat or low growth projections for 2009 may now be optimistic: sales tax revenues could actually decline.
2. Cash flow projections should be particularly conservative for the sales tax, as the tax itself is very sensitive to economic changes, collections are often affected by policy changes, and distributions from the State to the county level may be affected by accounting adjustments.

The Office of the State Comptroller's publication, *New York State County Sales Tax Collections by Region* (July 2008), has a discussion of factors affecting local sales tax collections.

reasons. The goal here is to identify and eliminate or at least defer spending where you can, until you see how your revenues come in over the remainder of the fiscal year, particularly during the peak periods. However, use caution when deferring capital maintenance, and prioritize spending so that the most critical projects can be done even if funding is reduced.

In addition to these actions, you should identify and confirm your fiscal reserve levels. These may be in the form of contingency appropriations where permitted, or unreserved fund balance. If you have a legally-established contingency or tax stabilization reserve, these funds may also be available.

Step #5: Modify your budget.

This is where it pays to have done the work of Steps #1-4. Your discussions with department heads should have already identified budget items that can be reduced or eliminated. You may want to have your governing board consider a formal hiring freeze or elimination of vacant personnel positions. Discretionary spending items such as travel and conferences can be reduced or eliminated. If training budgets must be reduced, investigate alternative venues, such as low- or no-cost “webinars,” teleconferences or locally-presented training sessions offered by State agencies or nonprofit organizations. Work schedules may be modified, and overtime should be reduced if possible. Equipment and capital expenses can be reduced, although these types of budget cuts come at a potential cost of deferring maintenance; the long term costs of renovation and repair could be higher, potentially requiring the future issuance of debt. The Office of the State Comptroller offers a local government management guide on capital planning, and related resources, such as guidance on fleet management, that may be useful as you work through these issues.

It can be tempting under these fiscal circumstances to order department heads to cut all expenses by some required amount (e.g., an across-the-board 10 percent reduction). While this may appear to be the easiest route, this approach does not prioritize the services provided to citizens. In tough times, it may be better to consider completely eliminating one or two programs, or to make large cuts in selected areas, in order to maintain necessary services elsewhere.

In addition, local governments should consider longer-term savings actions to make operations more efficient in the future. This includes such things as shared services and functional consolidation, cooperative purchasing, and other cost containment strategies.

Step #6: Continue to monitor your budget monthly.

Because economically sensitive revenues could decline at a faster rate than predicted, you need to monitor your budget actively after you've taken initial action. This means performing monthly reconciliations of budgeted-to-actual revenues and expenditures, and analyzing any significant variances. The cash flow tables you created can help you do this easily. If your monthly projections still show a potential deficit even after taking actions to slow spending, you will need to amend your budget further.

For example, a cash flow analysis produces a potential sales tax revenue risk of \$1 million. You identify \$500,000 in spending you can defer from the first quarter of 2009 until the end of the fiscal year, and another \$500,000 in discretionary spending you can eliminate. By amending your adopted budget cash flow for these factors, you create a modified cash flow with which you can track actual revenues and expenditures. If you still have a projected negative variance (expenditures exceed revenues) as monthly data comes in, you will need to alert your governing board and devise options for further budget reductions.

Step #7: And in an emergency...

If your fiscal situation continues to deteriorate and additional cuts will not produce sufficient savings in time to balance the books at year-end, using unreserved fund balance or issuing a budget note may be necessary. These measures should only be considered as a last resort; the current fiscal climate is likely to last for a while, and using fund balance is a "one-shot" that only delays the tough decisions that will have to be made for the upcoming fiscal year. In addition, local officials need to be mindful not to overappropriate fund balance; you cannot use fund balance reserved for other purposes to cover budget shortfalls, only the unreserved portion.

Conclusion

In tough fiscal times, many of the financial tools that are useful in good times become absolute necessities to avoid a potential deficit. Even though implementing the steps outlined above requires additional work up front, a good cash flow analysis is an invaluable tool for local governments to help keep their budgets in balance. Again, the guiding principle should be: don't spend money you may not have.

Appendix: Resources

The Office of the State Comptroller offers guidance, web-based training, and technical assistance to help you navigate through these challenging times. We are committed to assisting local governments in their efforts to achieve good fiscal controls and efficient operations.

Our website, www.osc.state.ny.us/localgov, contains a wealth of publications, web-based training modules, local government data and other resources, some of which are listed below:

Internet-Based Training Module on Cash Management

- Cash Management: A Tutorial for Local Governments and School Districts, Module 4: Monitoring Cash Balances

Local Government Management Guides on Related Topics

- Cash Management Technology
- Financial Condition Analysis
- Multiyear Capital Plans
- Multiyear Financial Planning
- Personal Service Cost Containment
- Reserves
- Travel and Conference Expense Management
- Understanding the Budget Process

Short “Toolbox” Guides on Specific Cost Savings Topics

- Capital Planning for Local Governments and School Districts
- Cash Management for Local Governments
- Containing Employee Health Insurance Costs
- Credit Card Accountability: Minimizing the Risk of Error, Misuse and Fraud
- Electronic Banking
- Establishing an Effective Fleet Management System
- Evaluating Solid Waste Collection Options
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- Going Green and Saving Greenbacks: Tools and Tips for Municipalities and School Districts
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