

City of Watervliet

Financial Condition

FEBRUARY 2018



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

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Report Highlights

City of Watervliet

Audit Objective

Determine whether the Council adopted realistic budgets that were structurally balanced, routinely monitored financial operations and took appropriate action to maintain the City's fiscal stability.

Key Findings

- The Council adopted general fund budgets that were not structurally balanced because of continued reliance on fund balance.
- The City experienced operating deficits, and declining fund and cash balances in all three operating funds from fiscal years 2014 through 2016.
- The Council did not receive budget-to-actual reports on a regular basis, and accounting records did not agree with annual financial reports.

Key Recommendations

- The Council and officials should develop and adopt structurally balanced general fund budgets.
- The Council should ensure that the Director maintains accurate and timely financial records.
- The Director should provide the Council with quarterly budget status reports and cash flow projections for each fund. The Council should use these reports to monitor the City's financial operations and prevent a further decline in the City's financial condition.

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

Background

The City of Watervliet (City) is located in Albany County. The City Council (Council) is composed of the Mayor and two Council persons, acting as both legislators and administrators. The Mayor serves as the City's chief executive officer and presides over the Council. The General Manager (GM), appointed by, and subject to the control of, the Council, is responsible for managing the daily operations of all City departments and activities. The Director of Finance (Director) is the City's chief fiscal officer and is responsible for the City's fiscal affairs.

The previous Director retired in October 2015 and was not replaced until August 2016. The previous GM resigned in November 2016 and was replaced with an acting GM who was formally appointed as GM in June 2017. One Council seat was vacant during most of 2017.

Quick Facts

2017 General Fund Budgeted Appropriations	\$11,995,317
2017 Water Fund Budgeted Appropriations	\$2,849,699
2017 Sewer Fund Budgeted Appropriations	\$1,227,185
Population	10,254
Employees	90

Audit Period

January 1, 2014 – June 30, 2017

Financial Condition

What Is Effective Financial Condition Management?

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. To maintain the City's fiscal stability, it is important for the Council to adopt realistic, structurally balanced budgets (recurring revenues finance recurring expenditures) and monitor each fund's actual results and budgeted estimates regularly throughout the year. Officials are also responsible for ensuring that the level of fund balance maintained is sufficient to provide adequate cash flow.

While fund balance can be appropriated in the budget to help finance operations, consistently doing so, instead of planning to use recurring revenue sources, can deplete the fund balance to levels that are not sufficient for contingencies and cash flow. A continuous decline in fund balance indicates a deteriorating financial condition.

Additionally, the Council and officials should regularly review financial reports and develop comprehensive multiyear financial and capital plans to monitor the City's financial condition. Multiyear plans project operating and capital needs and financing sources over an extended period. Planning on a multiyear basis allows officials to identify developing revenue and expenditure trends, establish long-term priorities and goals and consider the impact of current budgeting decisions on future fiscal years. Plans should be monitored and updated on a continuing basis to provide a reliable framework for preparing budgets and to ensure decisions are guided by the most current and accurate information available.

To develop such plans and effectively monitor the City's financial operations and financial condition, the Council needs complete, accurate and timely financial information. The City's Charter requires the GM to attend all Council meetings, provide the Council with periodic reports of the City's affairs, and keep the Council fully advised of the City's financial condition and its future financial needs. The Director should prepare a quarterly report to be presented to the Council that includes comparisons of actual revenues and expenditures with the amounts estimated in the annual budget (budget status reports) for each operating fund.

The Council Adopted General Fund Budgets That Were Not Structurally Balanced

While the City's budgets were realistic, general fund budgets for the period reviewed were not structurally balanced. Specifically, although variances between budgets and actual results for 2016 were within 4 percent for each operating fund, the City's general fund continually relied on a \$300,000 annual fund balance appropriation to finance operations. Furthermore, overestimated revenues contributed to the use of more fund balance than the budget appropriated.

Because of the revenue shortfalls, the City issued a \$1 million revenue anticipation note (RAN) in November 2016.

While the City does not have a fund balance policy, the GM indicated that the City has been appropriating one-third of fund balance annually and was making changes in future budget development to discontinue this. The Council's adoption of budgets that were not structurally balanced resulted in a general fund unassigned fund balance of \$129,754 at the end of 2016, which is only 1.1 percent of the 2017 general fund adopted budget appropriations of \$12 million.

The Council Did Not Adequately Monitor Financial Condition

The Director did not provide budget-to-actual reports to the Council on a regular basis; rather, he provided reports upon request. Although the Mayor had access to the City's financial software, there was no support to demonstrate how frequently the Council reviewed and analyzed budget-to-actual reports. However, the GM met with department heads at least monthly to discuss operations noted in budget-to-actual reports to share information with the Council. Beginning in 2017, the Director provided cash disbursement details to the Council on a monthly basis.

The City also lacked multiyear plans. Although the Council has not established multiyear financial and capital plans, the GM and Director are currently working on developing multiyear plans.

Without quarterly budget-to-actual reports and multiyear plans, the Council could not effectively oversee the City's operating funds' financial operations.

The City's Financial Condition Declined

The City's fund balance declined during fiscal years 2014 through 2016 for each of the operating funds, and the sewer fund had a deficit fund balance at the end of all three years. Both the general and sewer funds experienced operating deficits in two of the last three fiscal years, while the water fund experienced operating deficits in all three. For fiscal year 2016, the operating deficits within both the water and sewer funds were unplanned, while the operating deficit in the general fund exceeded the \$300,000 planned deficit¹ by \$285,819. Figure 1 illustrates the operating results experienced by each fund and Figure 2 illustrates each operating fund's ending fund balance over the last three fiscal years.²

1 A planned deficit is the result of appropriating fund balance to finance operations in the adopted budget, resulting in budgeted appropriations exceeding budgeted revenues.

2 The Director submitted adjustments to the 2016 annual financial report on August 15, 2017. The 2016 amounts in Figure 2 reflect the adjustments.

FIGURE 1

Operating Funds - Results of Operations

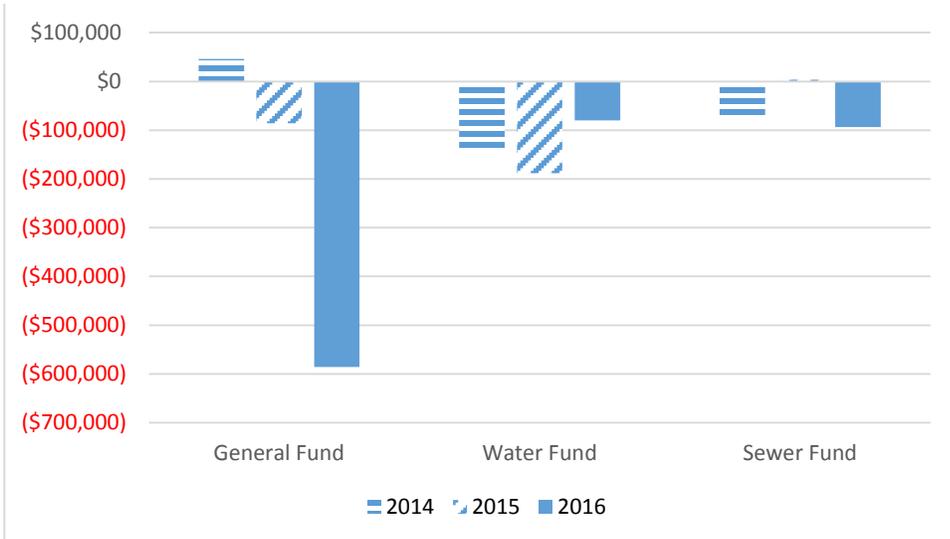
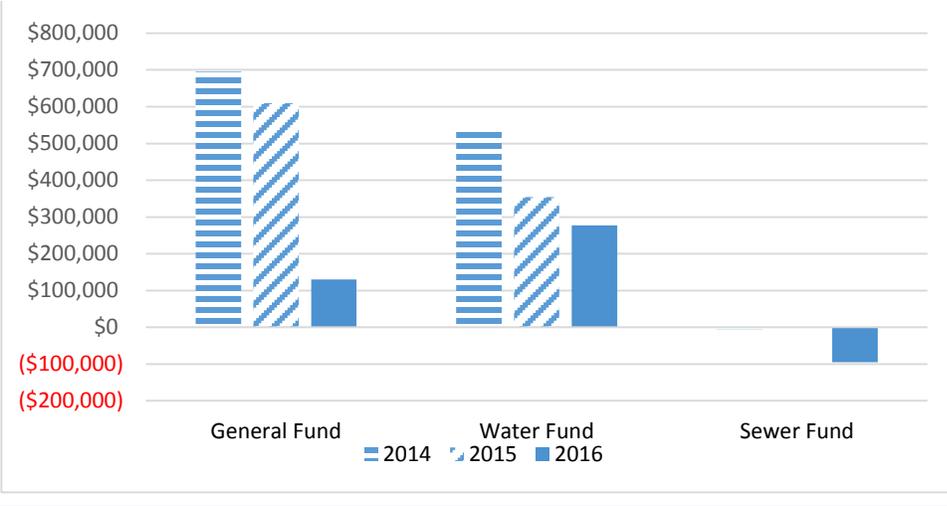
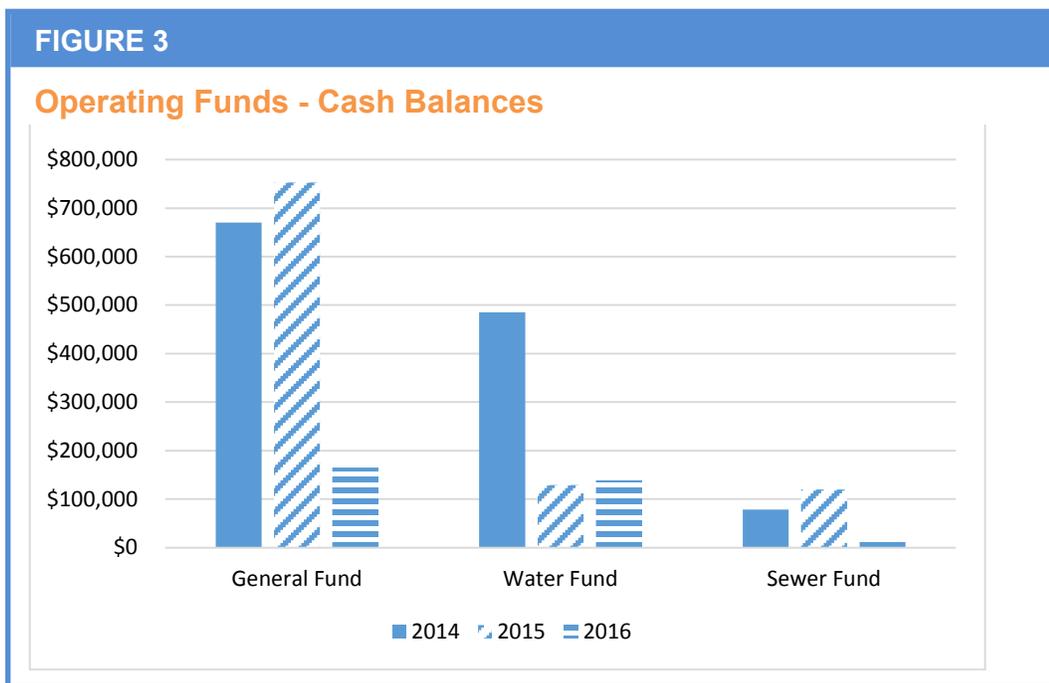


FIGURE 2

Operating Funds - Ending Unassigned Fund Balance



Furthermore, total combined cash balances for the three funds declined approximately 75 percent over the last three years, from \$1.2 million to \$325,186 in 2016. The operating funds also carry interfund liabilities without sufficient cash to cover them. For example, the general fund owed the water fund over \$600,000 as of December 31, 2016. Without other funds repaying amounts owed to the general fund,³ the general fund cannot repay the water fund. If the balances were netted within the operating funds, the sewer fund would owe other funds \$148,960 and the cash balance as of fiscal year end 2016 would not be sufficient to repay the other funds. Figure 3 illustrates each operating fund's cash decline over the last three fiscal years.



The Council's practice of annually appropriating \$300,000 of fund balance in the general fund and lack of monitoring of budget estimates and actual revenues and expenditures contributed to the City's declining financial condition during the audit period. While the GM noted that the City has made changes in budgeting in the last year and plans to increase sewer rates, the continued reliance on fund balance in the general fund without consideration of additional revenue sources could lead to the City's financial condition deteriorating further. We reviewed

³ Various capital projects owe the general fund a total of \$1.2 million, while the sewer, trust and agency and debt service funds also owe the general fund \$158,162, \$153,443 and \$300,000, respectively.

the City's 2018 proposed general fund budget and determined it is structurally balanced as opposed to previous years. To address the declining fund balance from previous unbalanced budgets, the GM proposed a 19 percent increase in real property taxes. The Council approved the budget with a 15 percent increase in real property taxes. The budget was balanced without a fund balance appropriation and also funds reserves to replenish accounts, plan for future operations and capital purchases, and reduce the City's reliance on fund balance.

The City's Accounting Records Did Not Agree With Annual Financial Reports

The Director reported general fund revenues in the City's 2016 annual financial report (AFR) that were approximately \$625,000 less than recorded and general fund expenditures that were approximately \$465,000 less than recorded.⁴ The Director also reported water fund expenditures that were \$33,509 higher than recorded because of an unrecorded transfer to the capital projects fund. There were additional variances within water fund expenditure codes that did not differ from expenditures in total. Similarly, while the total reported sewer fund expenditures agreed to the total recorded, the Director changed the City's practice of accounting for services between funds as a transfer to instead report them as direct charges to the funds. This change caused the differences noted within both the water and sewer funds. The Director maintained records outside of the accounting system to support the amounts recorded in the general fund but reported in the water and sewer funds.

Additionally, the Director recorded and reported transactions in the capital projects fund that were not related to established capital projects. For example, the City receives aid through the Consolidated Local Street and Highway Improvement Program (CHIPS) which can be used for either any operations and maintenance highway purpose or capital highway improvement. When there is no established capital project, the accounting is in the fund that normally finances such expenditures. Although there was no established capital project for the use of this aid, the Director accounted for the expenditures and related revenue in the capital projects fund. Other transactions incorrectly recorded in the capital projects fund included a workers' compensation settlement and a City-wide reassessment.

⁴ Specifically, in the AFR, the Director reported revenues and other financing sources totaling \$11,109,197 and expenditures and other financing uses totaling \$11,695,016. However, recorded revenues totaled \$11,734,343 without any other financing sources and expenditures and other financing sources and expenditures and other financing uses totaled \$12,160,049. The excess of expenditures over revenues was financed by fund balance.

The Director indicated that he maintained the accounting records in the same manner as the previous Director. The City is also in the process of researching and obtaining different accounting software. As part of the process, the Director intends to update the chart of accounts to better align with OSC guidance.

The Director accounted for the transactions noted above in the capital projects fund because of the expected negative impact they would have on cash flow or because debt was issued. When records are not maintained accurately and do not agree with the related reports, the Council lacks reliable data for monitoring financial condition.

What Do We Recommend?

The Council and officials should:

1. Develop and adopt structurally balanced general fund budgets.
2. Develop comprehensive multiyear financial and capital plans, and frequently monitor and update them.

The Council should:

3. Ensure that the Director maintains accurate and timely financial records to enable him to provide timely and accurate periodic and annual reports that can be relied upon to monitor financial operations.
4. Implement a plan to eliminate the sewer fund's fund balance deficit.

The Director should:

5. Provide the Council with quarterly budget status reports and cash flow projections for each fund. The Council should use these reports to monitor the City's financial operations and prevent a further decline in the City's financial condition.
6. Correct the accounting records for the direct charges reported in other funds and the items unrelated to established capital projects.

Appendix A: Response From City Officials

MICHAEL P. MANNING
MAYOR

CHARLES V. PATRICELLI
COUNCILMAN

FRANCIS G. MCGROUTY
COUNCILMAN

CITY OF WATERVLIET



JEREMY A. SMITH
GENERAL MANAGER

January 31, 2018

2017 OSC AUDIT – RESPONSE FROM CITY OFFICIALS

In response to “The Council Adopted General Fund Budgets That Were Not Structurally Balanced.”

In an effort to stay below the NYS imposed Tax Cap law while still providing the same level of service to the residents of the City of Watervliet, City Officials appropriated Fund Balance to help finance operations. For five years the City of Watervliet appropriated fund balance, but the efforts of City administration and department heads prevented utilizing these appropriated funds. In 2016, for the first time, these appropriated funds were fully utilized. Although it was continued in 2017, it is anticipated that it will NOT be utilized. Following recommendation from NYS OSC, this practice of allocating fund balance was discontinued in the implemented 2018 budget and going forward.

In Response to “The Council Did Not Adequately Monitor Financial Condition.”

The City administration and Department heads reviewed budget to actual reports on a monthly basis. The Council currently receives monthly disbursement and quarterly Budget-to-Actual reports. These reports are also available to each Department Head and the Council for more frequent review. The practices in the finance department, as recommended by NYS OSC, as well as the finance system has been modified to provide real time updates.

In Response to “The City’s Financial Condition Declined.”

In regards to the Water Fund deficit over each of the three years reviewed, this is directly related to a decrease in hydroelectric production and wholesale electricity rates. Rates and production have dropped in each of the three years reviewed. A more conservative approach to estimating these revenues has been implemented for 2017 and 2018 and going forward.

In regards to the General Fund, 2016 provided multiple financial obstacles for the City. Each matter that accumulated to cause the large deficit was a one-time expense or one-time loss in revenue. The Corrective Action Plans that will be provided will show how the City plans to prevent and prepare for such occurrences in the Future.

In response to *“The City’s Accounting Records Did Not Agree With Annual Financial Reports.”*

In 2017 the City began the transition to showing expenditures in the appropriate funds, as recommended by the Office of the State Comptroller. In doing so, the Director of Finance adjusted the reporting to show these expenditures properly rather than a lump sum transfer to the General Fund. While making the transition to this method, the Director maintained consistency within the City’s software system to allow for comparable reports to be presented to the Council.

In response to *“What Do We Recommend?”*

The City has made significant changes throughout 2017 including but not limited to; a newly updated procurement policy, and encumbrance system and a new purchasing/purchase order policy. The city will provide a Corrective Action Plan within 90 days of completion of the report.

Michael P. Manning
Mayor

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, we performed the following audit procedures:

- We interviewed officials and reviewed Council minutes to gain an understanding of the City's financial management policies and procedures and determine whether the Council developed plans to address the City's financial condition decline.
- We reviewed budgets to determine whether they were structurally balanced and compared estimates with actual results to determine whether budgets were realistic.
- We reviewed and analyzed financial reports to determine the City's financial condition and whether accounting records were supported and agreed with reports.

We conducted this performance audit in accordance with GAGAS (generally accepted government auditing standards). 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.

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

www.osc.state.ny.us/localgov/regional_directory.pdf

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

www.osc.state.ny.us/localgov/costsavings/index.htm

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

www.osc.state.ny.us/localgov/fiscalmonitoring/index.htm

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

www.osc.state.ny.us/localgov/pubs/listacctg.htm#lmgm

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

www.osc.state.ny.us/localgov/planbudget/index.htm

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

www.osc.state.ny.us/localgov/lgli/pdf/cybersecurityguide.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/localgov/finreporting/index.htm

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

www.osc.state.ny.us/localgov/researchpubs/index.htm

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

www.osc.state.ny.us/localgov/academy/index.htm

Contact

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Division of Local Government and School Accountability
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