

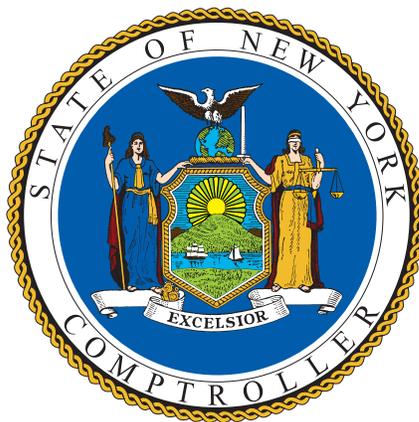
OFFICE OF THE NEW YORK STATE COMPTROLLER

DIVISION OF LOCAL GOVERNMENT AND SCHOOL ACCOUNTABILITY

# Multiyear Financial Planning

Updated 2017

LOCAL GOVERNMENT MANAGEMENT GUIDE



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State Comptroller



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## Overview

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Multiyear planning can be a vital tool for local governments, especially those struggling with difficult financial conditions. It allows decision-makers to set long-term priorities and work toward goals, rather than making choices based only on the needs and politics of the moment. This is important when resources are limited, as they are in many fiscally strained localities, but can also be beneficial to all communities in avoiding future stress.

A plan can help residents and elected local government officials see the impact of their fiscal decisions over time. They can then decide what program funding choices to make in advance, avoiding sudden tax increases or dramatic budget cuts.

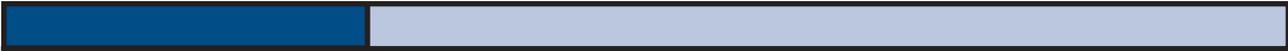
Planning is also particularly helpful in identifying one aspect of fiscal stress that affects many of New York's local governments, regardless of apparent current fiscal health – structural imbalances between revenues and expenditures. Simply put, local government costs have been growing more quickly than revenues. Expenditures have grown, on average, fueled by upward pressures caused by wages and salaries, healthcare costs and other employee benefits. Yet, revenues have grown more slowly or even declined – particularly in upstate cities struggling with stagnant property values, declining populations and troubled economies.

Without planning, fiscally-stressed localities sometimes try to limp along from year to year, spending down reserve funds or using various one-time revenues to keep afloat. But the practicality of those strategies is limited. As local governments have discovered, putting off painful decisions doesn't make problems disappear – in fact, it usually makes them worse. Financial problems that remain hidden for a long time have a way of emerging suddenly as full-blown financial crises.

Long-term financial plans were generally only required of cities and counties that were already in fiscal crisis and under the management of State-imposed control boards. In 2005, new planning requirements were added for cities receiving State aid accelerations or increases as part of the Aid and Incentives for Municipalities (AIM) program. This requirement continued through the 2008-09 fiscal year with most cities and a few villages having to submit a fiscal performance plan, which is a multiyear plan that includes projections of fiscal condition under current policy, a description of proposed policy changes to improve future fiscal condition (a fiscal improvement plan) and a description of policy changes in the recent past (a fiscal accountability report). While these plans are not currently required to receive State aid, the State promotes maintaining and updating multiyear financial plans to increase transparency and help to ensure a positive financial outlook. They should be viewed as a best practice with or without a requirement. State law also requires every municipal corporation in New York State to make copies of its most recent annual financial report, current year budget, most recent independent audit report and/or most recent fiscal performance plan or multiyear financial plan available to the public through its official website.

This guide is intended to help local governments create an effective multiyear planning process that helps identify and manage potential fiscal difficulties before crises emerge. Developed with input and assistance from local officials across the State, this handbook provides general guidelines for the development of a financial planning process, including suggestions for how to:

- Make good long-term revenue and expenditure projections;
- Measure expected benefits from proposed local actions; and
- Draw those projections together in a useful document for local decision-makers and other audiences.



## Multiyear Financial Planning Defined

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A multiyear financial plan projects revenues and expenditures for several years into the future. Unlike a multiyear budget, it does not authorize expenditures (although it should be linked to the current budget). Instead, it illustrates what will happen to a government's ability to pay for and provide services, given a set of policy and economic assumptions. These projections help policy makers assess expenditure commitments, revenue trends, financial risks and the affordability of new services and capital investments.

### Major Elements of a Multiyear Financial Plan

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Although the size, complexity, narrative and level of detail can vary widely from one multiyear plan to the next, certain elements are essential to a good plan, including the following:

- **Revenue Projections:** These demonstrate trends in existing revenue streams to illustrate the level of available resources given current policy and projected economic assumptions. Projections can be done in the aggregate by major revenue type, or they can be very detailed to show variations in individual revenues.
- **Expenditure Projections:** These estimate the future costs of current services adjusted for inflation and known obligations (such as collective bargaining increases or lease escalations). Projections can be done by object (i.e., personal services, equipment, contractual services, etc.), by program or function (i.e., public safety, recreation, etc.) or some combination of the two.
- **Annual Deficits/Surpluses:** Comparisons of projected revenues and expenditures can highlight budget imbalances that often widen in future years.
- **Reserves/Fund Balances:** These reflect the reserves (both dedicated and unspecified) available to municipalities to help endure short-run fiscal pressures such as revenue shortfalls or unanticipated expenditures.
- **Fiscal Improvement Plan (FIP):** This part of the plan identifies goals to improve the long-term fiscal condition of the municipality, specifies the local actions necessary to achieve those goals and defines performance measures that will help measure progress.

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## Creating a Multiyear Plan – Getting Organized

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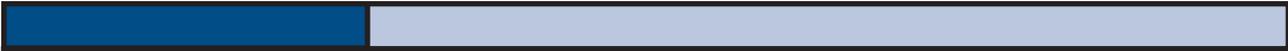
The Office of the State Comptroller (OSC) has developed a template<sup>1</sup> and a guided tutorial,<sup>2</sup> based on discussions with local government officials, which will provide a basic structure for those creating a plan for the first time. Whether or not you choose to use the template, the following steps will help you determine the size and scope of your plan, and help you organize the data you need:

- **Gather data on recent financial results** to gain perspective on revenue and expenditure trends and average annual rates of change. Most long-range financial plans are based on **three or four years of actual data** for each category being projected, including the most recent year for which data are available. In the case of major revenues, such as property and sales taxes, a longer trend line is often useful to get a sense of patterns during different economic conditions. You may also find it helpful to compare **revenue trends to economic patterns** (such as non-farm employment growth, unemployment rates, inflation, etc.) and to look at **trends in factors affecting expenditures** (such as the number of government employees, energy prices, interest rates, etc.).
- **Decide on a timeframe**, keeping in mind that projections are most useful if they cover a time period short enough to be predicted with some confidence, but long enough to reveal emerging shortfalls or other issues several years out. Most plans **project about three to five years**, including the upcoming budget year.
- **Describe your assumptions** about revenues, expenditures and the factors affecting them. Often plans have a set of broad assumptions described in a cover sheet, with specific assumptions for each individual projection laid out on a line-by-line basis. Examples of assumptions could include inflation factors, specific rising costs such as asphalt or health insurance, consolidation considerations, economic development costs, etc.
- **Select a level of detail** that meets your needs and capacity. For example, New York City may choose to complete a lengthy, line item plan with narrative detail about economic projections and policy changes at the federal, State and local level. Cities such as Buffalo, Rochester and Syracuse may also choose line-item plans, although with relatively less complexity and narrative. Smaller municipalities may choose to compile a less-detailed annual plan that shows major revenue categories (real property tax and tax items, non-property taxes, departmental income, etc.) and break expenditures down along broad functional areas (general government, public safety, etc.). Municipalities should conduct a cost-benefit analysis and not make the process more costly than the benefit expected to be gained by the plan.

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<sup>1</sup> <http://www.osc.state.ny.us/localgov/academy/modules/myfp/template.htm>

<sup>2</sup> <http://www.osc.state.ny.us/localgov/academy/modules/myfp/index.htm>

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- **Be comprehensive** enough to ensure that the plan accurately describes the operations of your government. Include **all revenues and all expenditures**, even if you aggregate them, so that you can assess the bottom line. Make sure to include **all relevant funds**. If applicable, be sure the plan includes all the elements required by any State oversight, such as a control board. Most plans include the general fund and any major operating funds guaranteed by the general fund or that receive transfers from it. Cities generally include water and sewer funds, if applicable, and towns often include highway funds. However, most do not include other enterprise funds or small special purpose funds supported by dedicated revenue streams.
  - **Revisit the multiyear financial plan at least annually.** Plans are not static documents. As with annual budgets, multiyear plans must be tracked and updated regularly in order to accurately guide policy decisions. Larger municipalities may update its plan quarterly throughout the year as part of its budget monitoring process. Smaller entities may incorporate at least one mid-year update as part of their budget process. All municipalities should update their plans when significant mid-year challenges or budget modifications are encountered.
  - **Use the plan to generate public discussion.** A good plan can stimulate constructive discussions about budgetary priorities. Although there may be initial confusion about the plan's connection to the annual budget and why it may show out-year budget gaps (most do), good multiyear plans can help voters understand the issues facing their communities in the coming years. A number of local government officials in the State use informal, internal plans to give elected decision-makers information they can bring to their constituents in more traditional ways. Others make the multiyear plan part of their public budget discussions.

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## General Principles

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This section of the guide discusses in more detail what to consider in preparing each portion of a multiyear plan, regardless of the plan's level of detail. It assumes that the plan will include revenues and expenditures for the general fund and other related funds as appropriate, and gives instructions for projecting broad categories of revenue and expense as well as specific types of revenue. The same general principles can also be applied to line-item plans, although the items themselves are not covered in detail.

### Start with What You Know – Historical Trends

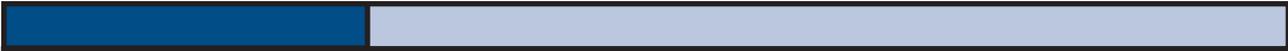
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Historical trends are often a very good starting point for projections. As noted above, most plans are based on three to four years of **historical data**, as well as **current year** estimates and any available projections for the upcoming **budget year**. You can use these data to compute annual average changes to help you in projecting future years. Two handy sources of historical data are local **budget documents** and the **Annual Financial Report Update Document** (AFR or AUD) data you submit to the Comptroller's Office.

While historical average growth rates are a very useful starting point, they should not be applied to future projections blindly, without considering current conditions or likely changes. For example, while personal service expenditures may have grown by 3 percent historically, if you know that you've committed to a 5 percent salary increase for a union that's not being offset by other savings, you should plan for that.

You may want to compare your annual average rate of change over the period with each individual year's rate of change to see if it reflects a stable trend, rather than a series of random swings. Watch, too, for trends upward or downward. If an expenditure category has risen by 15 percent annually, on average, but that average is based on 10 percent the first year, 13 percent the second year, and 19 percent the third year, you should consider the possibility that next year could be even higher than 19 percent, rather than close to 15 percent. Adjust also for the effects of one-time revenues or expenditures on your trend line – especially where one-time revenues may have distorted the underlying pattern.

Another way in which history can be a helpful guide is in the historical difference between prior years' projections and actual revenue collections/expenditures in those years. In general, according to the New York State Government Finance Officers' Association (NYSGFOA), if actual revenues or expenditures vary more than 5 to 15 percent from projections, you should analyze the reasons. Was there a specific unforeseeable occurrence in one year, or are you consistently under or overestimating? If expenditure projections have been off-base, encourage department heads to present more realistic budget needs, and be wary of utilizing projections in categories that have generally been off-target.



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## Consider Policy Changes – Local, State and Federal

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Local, State and federal law changes all impact your bottom line. For example, if your county has recently changed the distribution of sales tax revenue, or if your city has pre-empted the county sales tax, incorporate that information in your projections. Make sure that department heads account for any recent policy changes that either increase or decrease expected spending. Pending legislation should also be considered. New York State municipal/professional associations, such as NYSGFOA, the Conference of Mayors and Municipal Officials (NYCOM), Association of Towns, Association of Counties (NYSAC), Council of School Superintendents (NYSCOSS), Association of School Business Officials (NYSASBO) and School Boards Association (NYSSBA) can help you track the status of State and federal legislation.

Be aware, too, of how previous years' policy decisions affected historical trends in those years. If you cut back on hours of operation in parks and libraries in a prior year, for instance, the 2 percent historical spending trend shown for culture and recreation could be misleading. It could reflect 4 percent annual growth, with one year of 5 percent decline when you cut services. Thus the additional cost of maintaining those shorter hours might actually be 4 percent per year. You may even face a spike if your historical spending growth reflects a period of under-spending that you intend to modify in coming years. For example, if your transportation costs look low due to deferred road maintenance, your projections for that category might have to be substantially higher in coming years than historical trends would indicate.

## Be Conservative

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Although it is good to be as accurate as possible, it is best to err on the side of being conservative. If history shows weakness in a source of revenue, interpret signs of economic recovery with caution. If the recent past shows stronger-than-average revenue growth, don't assume that such growth will last indefinitely. For example, if past history showed healthy revenue growth in non-property taxes, but the economy appears to be slowing down, non-property tax revenue is likely to slow as well. Or, if past growth was anemic, more robust growth projections should be well-justified. In expenditures, of course, the risk is that things will cost more than originally projected. Be particularly careful in budgeting cost savings from policy changes – these take time to be fully effective and can easily be overstated.

## Don't Sweat the Small Stuff

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If a revenue source or item of expenditure is very small or very stable, do not worry about complicated formulas for projecting future years. Devote your efforts to large and fluctuating items that will have a major impact on your bottom line.

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## Revenue Projections

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The first step in projecting revenues is to sort revenues according to type, and consider the economic and other factors that affect each. Some revenues are very sensitive to changes in the economy, while others depend far more on policy decisions or long-term development trends. Some are fairly predictable, while others are erratic. They can be controllable or completely out of your hands. Some represent large sources of revenue, while others do not make a discernable difference to the bottom line. These factors will all shape your assumptions about them. The list below discusses major revenue sources and how factors impacting these sources can be treated in doing projections:

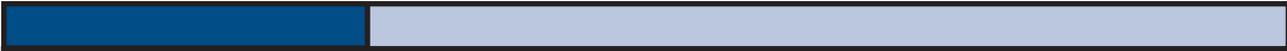
- **Real Property Taxes** represent the largest portion of local government revenues. The property tax is both fairly stable and relatively easy to administer. While property values are affected by economic trends (including, for example, changes in interest rates), the property tax base is usually fairly stable, at least in the short-term. Both assessment frequency and rates are determined by local policy-makers. You should review the trends in total assessed value and consider other changes, such as reassessment or major changes in the tax base.

You should also consider factors outside of local control, such as the outcome of major upcoming certiorari cases, and the impact of constitutional property tax limits on cities, villages and counties. If a local government exceeds its tax limit, the Comptroller is required by law to withhold certain State aid payments. Although only a small number of local governments are approaching their property tax limits, this number has been growing in recent years. Currently, the Comptroller notifies any local government that has exhausted 80 percent or more of its tax limit. This threshold indicates that the municipality has reduced revenue generating capacity and should pay closer attention to tax levies and exclusions, given its narrowing margin.

It is generally best to hold property tax revenue constant in your initial calculations. Upward adjustments can be considered as part of the strategy to maintain fiscal balance.

In addition to revenue, municipalities should separately project assessments, tax rates and levies. If your levy is not guaranteed by another level of government, you should already be using this information as part of your annual budget calculation of your over levy or overlay. This calculates the amount you must levy in order to generate a certain amount of revenue, due to delinquencies in your own tax base and in the tax base of any subcomponent governments that your government must guarantee. Pay particular attention to high or increasing delinquency rates, because they will affect your overlay, and could indicate economic distress or a need for more enforcement.

- **Real Property Tax** Items include revenues from payments in lieu of tax (PILOTs), which generally follow a pre-determined payment schedule. For school districts, this category also includes STAR payments.

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- **Sales and Use Tax and Other Non-Property Taxes** such as utility, restaurant and hotel occupancy taxes are major revenue sources for counties, cities and some towns and school districts. It is useful to track the sales tax separately from other non-property taxes, because it is often affected by different factors. Sales taxes are collected by the State and distributed through counties (except in certain cities which pre-empt the county tax) to other local governments according to formulas based on factors such as population and property values.

Sales and other non-property taxes are much more **volatile** than the property tax, being affected by **changes in the economy** with very little lag. They are also subject to **policy changes** at the State, county and sometimes municipal level, including changes to the rate (if the revenue impacted is shared with the government doing the projection), changes to the base (such as sales tax free weeks), or even municipal pre-emption of a portion of the rate by a city.

Recent history will help you determine a starting place for your projections, and information about the local economy and policy changes should provide a good reality check. The State's Division of the Budget (DOB) publishes statewide forecasts of many of the factors that can have an impact on non-property tax revenues, including national GDP, employment trends, retail trade and wage growth. You can get local data (but not projections) from the Bureau of Labor Statistics and Census of many of the same factors. **Be particularly conservative** in projecting this revenue source, because it is both large and volatile.

- **Departmental Income** is determined almost entirely by policy decisions which are made at the local level, including setting fee rates, and is therefore more easily predicted.
- **Other Local Revenues** include fines, licenses, sale of property, interest earnings and other small sources of revenue. If you aggregate some or all of these into a single category, it is best to project these based on either steady recent trends or by holding them constant, adjusting if necessary for major known changes to large revenue sources. If you are doing a line-item projection, these should be projected according to the most reasonable trend, such as inflation or known fee increases, or held constant.
- **State and Federal Aid** are generally unpredictable and beyond your control. The timing and relative health of the State budget affect most of its aid categories. It is generally accepted practice to hold these revenues constant, unless there is a reasonable possibility of a decrease or the solid expectation of a specific increase. For instance, many federal aid programs are designed as start-up grants, which end after a given period of time even though the program commitment continues at the local level.

There are some exceptions, however. For example, the mortgage tax is classified as "State aid" even though it is really non-property tax revenue that is primarily affected by local housing activity and interest rates. Similarly, certain intergovernmental aid programs are reimbursed based upon local costs or participation (many school aid grants fall into this category). Localities may contact the State agency administering the program for assistance with these types of aid projections.

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- **Interfund Transfers:** These can reflect any number of transfers into the general fund, and thus will be affected by different factors. For example, transfers from the water fund into the general fund may be one-time only or ongoing. Ongoing transfers could, in turn, be due to a policy decision to raise rates to help fund general fund expenses, or they could result from a series of “one-time” general fund hole-plugging moves that deplete the water fund and hamper its ability to invest in its infrastructure. In the latter case, you may even be unaware of the fact that this is an ongoing issue.
  - **One-Time Revenues:** OSC recommends using revenues from unexpected windfalls or other non-recurring sources for one-time needs or to build reserves, rather than spending them on recurring expenses. You should build a plan that allows you to break out these non-recurring revenues and to track them separately from recurring revenues. You may also wish to track non-recurring expenditures to determine if you are using one-time windfalls to fund one-time expenses or establish reserves.

If, however, you are funding an increasing portion of your budget with such revenues, you may be using “one-shots” to address a structural imbalance between recurring revenue and recurring expenses. Your plan should aim to address this situation with long-term revenue or expenditure adjustments.

## Expenditure Projections

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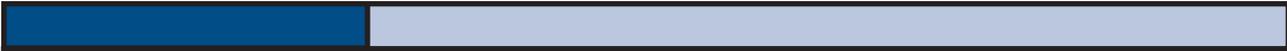
Projecting expenditures by object (i.e., by categories such as personal service, equipment and capital outlay, contractual services, etc.) allows you to think in broad terms about trends by major type of expenditures. In order to identify relative size/growth of program areas it may be helpful to analyze expenditures by function as well.

### Projecting by Object

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- **Personal Service** costs are your biggest item of expense. These costs are mainly affected by two controllable factors: **number of staff** and **contracts with collective bargaining units**. Accordingly, you should project anticipated staffing levels as well as known commitments (such as cost of living increases and salary increments) contained in existing collective bargaining agreements. In most cases, there will be several labor agreements for different types of employees such as civil service, fire, police and non-collective bargaining employees. Keep in mind that a 3 percent cost-of-living (COLA) increase may actually result in a 5 percent increase in salaries overall as employees move up job ladders and pay scales. Historical comparisons can help you determine this.

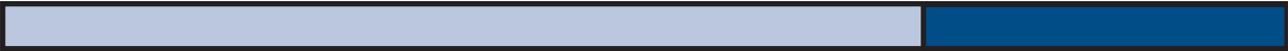
One benefit of looking at employee contracts is that it will alert you to upcoming changes that you might not have fully considered. You may, for example, have had a history of 5 percent personal service growth and 14 percent employee benefit growth over the past four years, as shown by the historical data collected. However, if you recently signed a contract with one of your bargaining units which commits to a 6 percent a year COLA, your future projections will look different than your historical trends.



Multiyear plans can be useful in conducting future labor negotiations because they show the out-year effects of collective bargaining agreements on the bottom line.

Because personal service is such a large proportion of the budget, and your department heads generally do not budget for these costs, you may want to go a step beyond looking at broad historical trends and contract changes, and calculate a few items that will help you in making any programmatic budget changes in the future, including:

- Turnover and fill rates, including projected vacancies and retirements, average salaries of those leaving vs. those entering, and how much impact turnover has on fringe benefit costs;
  - Analysis of the total cost of each additional 1 percent salary increase that would be driven by collective bargaining agreements;
  - Total number of employees vs. full-time equivalents (FTE), and the impact of part-time staff on benefit rates; and
  - Average salary rates by department – useful for calculating the amount it would cost to add employees, although the net savings from losing them will be affected by factors such as unemployment benefit payments, vacation-time buy-outs, retirement benefits, etc. (If layoffs are being considered, this number is also worth calculating.)
- **Equipment and Capital Outlay** includes all purchases of equipment and other capital outlay such as construction and purchase of rights-of-way, land or existing structures. Unlike personal services, these expenditures are usually budgeted on a departmental level, so department heads will be your best source for accurate projections. On the AUD, such purchases may actually show up in one of three different places. The equipment and capital outlay line will only include pay-as-you-go capital costs. Purchases financed through bonds will show up in an operating fund as either “debt service” or “interfund transfers” to the debt service fund. A long-range capital plan will help you determine if there are likely to be any major changes in capital outlay. (For information on constructing a more detailed and accurate capital plan, please see our Local Government Management Guide on *Multiyear Capital Planning*.)
  - **Contractual** expenses include materials, supplies and other consumable items, such as utilities. These too are generally in departmental budgets (except unallocated insurance and certain other items). Although these are often affected by factors such as inflation, you should take note of any components that are growing at a substantially different pace than the overall Consumer Price Index (CPI), such as gasoline and fuel oil.

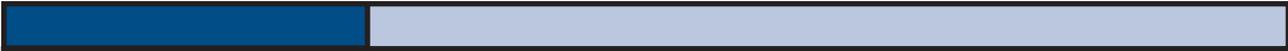
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- **Debt Service** payments, as noted above, are generally repayments of debt issued to fund capital expenditures. Your capital plan should note when capital projects will be financed by bonds or notes and estimate the resulting debt service payments associated with them. These payments should be added to any ongoing debt service payments.

If your municipality tracks debt service payments through a separate debt service fund, however, remember that those payments will show up as interfund transfers from the operating funds that ultimately support them, rather than as debt service expenditures. (See “Interfund Transfers” section.) Also, remember to account for costs associated with short-term borrowing (such as revenue, tax or bond anticipation notes) and bond-issuance.

- **Employee Benefits** costs are affected by various factors, including health care costs and pensions. Like personal services, these are rarely budgeted by department, although department heads will be able to project employment trends that affect these costs. Recently, health care costs have significantly outpaced inflation, while pension contribution rates have returned to historic norms. Health care providers and the various State pension systems can help you estimate these costs.

Collective bargaining agreements also affect benefits. For example, if one of your bargaining units settled for lower cost of living increases in exchange for a generous post-retirement health insurance package, your out-year fringe benefit costs will likely be higher, especially if you’re contemplating offering an early retirement package to reduce the workforce to pay for salary increases.

- **Interfund Transfers** are made between any number of funds, including other operating funds and, occasionally, the debt service fund. If all or most of your debt service runs through the debt service fund, make sure to account for additional debt service payments here. If your general fund is supporting a fund that had previously been self-supporting, this will show up here as well, and should be considered in your projections.
- **Other** expenditures might include contingency reserves, which are one way to plan for unforeseeable events, such as major tax shortfalls or emergency expenditures. Many municipalities do not budget contingency funds, preferring to legislatively appropriate any funds necessary to cover such situations. However, when used properly, they can give municipal executives or administrators the flexibility they may need in an emergency and help balance budgetary risks.



## Projecting by Function

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After projecting by object, the extra effort to project by function is minimal, yet the benefits are great. Knowing how fast your personal services and benefits are growing might tell you that you need to consider revising staffing levels, but it won't tell you where potential cuts can be most efficiently made. If you see that a major function is large and growing fast, you may be more inclined to address your budget problems by investigating possible efficiencies in that department rather than pursuing across-the-board cuts to all departments.

Projecting by function also gives you the opportunity to assess whether you have incorporated all of the policy information you need. Department heads can describe any major new initiatives, mandates, etc., to their areas that will affect the estimates you have already made more globally.

Most functional expenses are driven primarily by personal services costs, which account for 60-70 percent of local government expenditures. Some communities distribute part or all employee benefit expenses by function; others reflect them centrally. Non-personal service costs (i.e., equipment/capital and contractual expenses) account for the rest.

If you do project by both object and function of expense, it may be useful to cross-check totals and adjust your assumptions as necessary to make sure they are not radically different in out-years.

The major functional categories are:

- **General Governmental Support** includes expenditures for executive, legislative, judicial and financial operations.
- **Public Safety** includes fire prevention and protection, police service and other public safety programs.
- **Health** includes expenditures for ambulance services, public health administration, registrar of vital statistics and direct provision of services through departments, hospitals and nursing facilities. (Does not include Medicaid payments.)
- **Transportation** includes road maintenance, snow removal, street lighting and public transit, if relevant.
- **Economic Opportunity and Development** includes both economic development programs and social services, such as income assistance, Medicaid, daycare and home energy subsidies.
- **Culture and Recreation** includes expenditures for parks, playgrounds, youth and adult recreation programs and libraries.
- **Home and Community Services** include expenditures for the collection and disposal of sewage and garbage, distribution of water and development of the general environment (planning, zoning, etc.).
- **Employee Benefits/Fringes** include any employee benefits that are not distributed in the categories above. This can be all, none, or some portion of total benefits.
- **Debt Service** (see definition by object).
- **Interfund Transfers** (see definition by object).
- **Other** (see definition by object).

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## The Bottom Line: Your Fiscal Health

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Now you can begin to assess your overall fiscal health. The simplest measure of this is the difference between your revenues and expenditures each year, otherwise known as your annual operating **surplus** or **deficit**. Persistent deficits usually indicate a problem, but if your municipality has fund balances or reserves from previous years, you may choose to spend it down purposefully over a period of time. However, be sure to track reserves and not overspend.

Also useful is the concept of **fund equity**, which represents the difference between assets and liabilities. These include restricted and unrestricted fund balances. Restricted fund balance represents assets set aside for specific purposes (such as snow removal equipment replacement and other specific capital expenditures) that are unavailable for any other use. The amount left over after subtracting your restricted fund balance is your **unrestricted fund balance** (or your true budgetary reserve). This number is the bottom-line indicator of fiscal health: **if it dips below zero for any year, that means you do not have enough funds** to cover all necessary expenses – even if your fund equity (including dedicated reserves) for that year is still positive.

In fact, you may wish to maintain a reasonable fund balance as insurance against unanticipated expenditures or revenue shortfalls. State law allows most local governments to do this, however, school districts are subject to State restrictions on this.<sup>3</sup>

## Adding a Fiscal Improvement Plan

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The multiyear financial plan may reveal a projected budget imbalance, particularly if conservative estimates are used. These shortfalls, however, are only a function of projected revenues and expenditures assuming continuation of current policies. A fiscal improvement plan (FIP) outlines goals and local actions that will help achieve and maintain long-term fiscal stability. Ideally, these goals and actions should produce recurring benefits. However, the prudent use of non-recurring revenues (such as appropriated fund balance if available) could be used as a transition measure until an action with recurring benefit can be phased in.

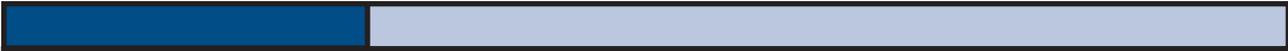
The FIP contains three elements:

- Key **fiscal performance goals** necessary to achieve and maintain long-term fiscal stability;
- Proposed **local actions** necessary to achieve such goals; and
- **Performance measures** necessary to assess the progress in implementing these local actions.

The fiscal accountability report (FAR) then assesses fiscal progress using these performance measures.

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<sup>3</sup> State law governs the percentage of “surplus unexpended revenues” school districts may retain in fund balance.



## Goals

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Goals are the most basic elements of the fiscal improvement plan. At the broadest level, all multiyear plans have the same goals: to provide necessary municipal services and infrastructure, to maintain reasonable reserves and to minimize the impact of the costs associated with those services on taxpayers. There is a natural tension between these goals which should be recognized in discussing options for maintaining long-term balance.

Generally, goals to maintain balance fall under three broad categories:

- **Expenditure Reduction:** Recurring reductions in operating expenditures can be achieved through many actions, including more efficient service provision, shared services or other methods. Unexpected revenues can be used to support investments in technology or other efficiency and productivity initiatives that permanently minimize or reduce the municipality’s operating expenses.
- **Revenue Generation:** Recurring revenue can be generated in a variety of ways, such as generating growth in the municipality’s real property tax base, increasing the sales tax base and bringing fees into line with the cost of providing services. Those municipalities subject to property tax limits should be mindful that projected property tax levels must be sustainable within those limits.
- **Reserves:** Maintaining a reasonable level of unrestricted fund balance can provide insurance against unanticipated expenditures or revenue shortfalls.

## Local Actions

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These are the specific actions needed to achieve each goal. These should be concrete actions that result in quantifiable benefits. In some cases, there may be a short-term cost for implementation, but the multiyear plan provides the opportunity to show the long-term net effect of this investment. It may be helpful to break down an action into a series of “sub-actions” to determine the net fiscal impact over multiple years. For example, if a goal of reducing personal service expenditures on police and fire services requires a local action of reducing overtime in those departments, sub-actions might include installing management software and instituting regular monthly management meetings to plan staffing.

For those municipalities choosing to prepare a fiscal improvement plan, consider including the following:

- Improved management practices;
- Initiatives to minimize or reduce operating expenses; and
- Shared service agreements with other municipalities.



## Performance Measures

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Performance measures are the quantifiable results of the proposed local actions – they allow citizens and elected officials to assess the intended results of specific actions and allow a comparison of estimated results to actual results.

Performance measures may address the type or level of program activities conducted (process), the direct products and services delivered by a program (outputs), and the results of those products and services (outcomes).

Since the goals of the FIP are all related to fiscal health, many of the program outputs will be things that affect that budget balance. For example, if a municipality’s action is to purchase management software and use it to reduce overtime, the output would be the FTE hours of overtime reduced from expected levels or from the prior year. The outcome would be a fiscal measure. In the example above, that would be the expected savings in overtime costs, net of the cost of purchasing management software.

Taken to its logical end, performance measurement should become part of a municipality’s budgeting process. In this context, it is often used to measure progress toward goals other than achieving fiscal stability, such as the increased efficiency and effectiveness of government programs.

A sample FIP narrative for the general fund is provided in Appendix A.

## Appendix A

### Sample Fiscal Improvement Plan Narrative

#### General Fund

In local fiscal year 2017-18, the City of Excelsior has three broad goals for working toward restoring fiscal balance:

1. Expand the tax base by increasing the number of properties that are currently on its tax rolls and finalizing two economic development projects.
2. Reduce personal service expenditures on police and fire services by reducing overtime in those departments.
3. Explore opportunities to achieve savings through shared service agreements, such as contracting with the County to provide the City's Civil Service function and shared highway services.

#### Goal 1: Expand the tax property base.

##### Local Actions:

- **Return properties to the tax roll.** Over the past two decades, there has been significant growth in the number of city-owned and managed properties that are not on the tax rolls. The City plans to create an inventory of these properties and set realistic annual goals for bringing them back on the tax rolls.

**Performance Measures:** Success in achieving this action will be measured by the number of parcels remaining on the list of tax delinquent properties at the end of each fiscal year and by property taxes collected on those parcels returned to the tax rolls. Currently, we estimate that there are 100 parcels of tax delinquent property. Starting in local fiscal year 2019, we plan to reduce the total inventory of these properties by 20 percent over two years, resulting in an estimated \$1,000,000 in additional annual property tax revenues once fully implemented and reducing the cost of maintaining these buildings.

- **Economic Development: Waterfront Development.** Through the development of two large projects, we hope to grow the tax base even further. First, the Bluewater River runs along our western boundary. Over the next four years, we will identify riverfront properties that are suitable for development, possible developers and available State and federal grants.

**Performance Measures:** Progress on this project will be tracked more specifically as a comprehensive plan is developed.

- **Economic Development: Big Box Store.** We will continue to proceed with our plans for developing City land located east of Barrack Road for a big box retail store. Currently, our residents travel to the City of Bargain or the Town of Deal for much of their shopping.

**Performance Measures:** Success in achieving this local action will ultimately be measured by the amount of property taxes and sales taxes collected as a result of this store, net of the expenditures made to ensure security and access. Although there are costs associated with the development of this project (for example, extending Barrack Road and adding to our police force), these costs will be offset by property and sales taxes collected from the store, with estimated net annual benefits of \$6,000,000 in 2019 and over \$10,000,000 in 2020 and 2021.

## Appendix A

### Sample Fiscal Improvement Plan Narrative

#### Goal 2: Reduce personal service expenditures in public safety.

##### Local Action:

- **Reduce overtime expenses through better management.** Personal service costs account for the largest percentage of our budget. Further analysis shows that overtime costs account for a significant portion of this cost, especially in the police and fire departments. We researched how other local governments are using management software and periodic management meetings to reduce overtime expenditures and have concluded that we would benefit by investing in this software and regularly monitoring progress. Depending on initial results, we could expand use to other municipal departments.

**Performance Measures:** This action will be measured by the reduction in the number of overtime hours as well as the operating savings generated. We estimate that overtime will be reduced by 500 hours (\$25,000) in 2019 and by 1,000 hours (\$50,000) thereafter.

#### Goal 3: Explore opportunities to cut costs through shared services.

##### Local Actions:

- **Contract with the County to provide Civil Service function.** Starting in January 2018, we will contract with the County to provide our Civil Service function.

**Performance Measures:** This action will be measured by the reduction in the number of City employees (two: one retiring and one transferring to the County) and the net financial benefit resulting from that reduction and the elimination of a City administrative office, offset by the contractual costs with the County. (The net savings will be about \$40,000 annually).

- **Explore highway maintenance sharing with the County.** We have begun discussions with the County on the potential for a highway maintenance agreement.

**Performance Measures:** This project is still in its initial phase; measures will be developed if discussions move forward.

##### General Fund Total Benefit of Local Actions:

While there will be considerable costs (\$230,000) in 2018, we estimate that the above actions will have a projected net fiscal impact of over \$6 million in 2019 and over \$10 million in 2020 and 2021.

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