

Section 4: Finance

Chapter 19: Budgeting

The budget: A financial plan

The annual budget is the most significant of all policy making opportunities available to local officials. Used wisely, the budget development process can be used as an important element in strategic planning to achieve the goals and objectives of the village. The resultant document and the implementing activities during the fiscal year serve the very purpose for which local governments exist – to provide for the safety and well being of citizens and their property.

Pathways to financial priorities

Many municipal governments are turning to needs studies to help set priorities for allocating scarce resources and determine the financing preferences of their citizens, who are looked upon as customers. Needs studies include community-wide surveys, advisory task forces, citizen study committees, consultant studies and staff reports. Survey methods and techniques should be left to the experts if reliable results are expected.

Governing bodies sometimes hold goal-setting exercises. Some have study retreats. Use of facilitators to keep focused on the process is common. Participants in such exercises may include the governing body, the chief administrative officer, staff members, citizen advisory groups, task forces and possibly consultants.

After the governing body establishes a sense of priorities in a consensus-building exercise, the chief administrative officer is given the responsibility and authority to prepare the proposed budget for consideration by the governing body. This authority is assigned by the GLV Act and the Michigan Uniform Budgeting and Accounting Act, 1968 PA 2 (MCL 141.421-141.440a).

Budgets must

- present revenues and expenditures for the previous fiscal year, those estimated for the current fiscal year and those estimated for the next fiscal year, which is the subject of the proposed budget.
- display the amount of surplus or deficit existing at the end of the previous fiscal year and that estimated for the current year.
- present proposed capital outlays and sources of financing for them.
- achieve balance between revenues and expenditures (Be balanced!).
- follow other requirements of the Uniform Budgeting and Accounting Act (1968 PA 2) and the GLV Act.

The operating budget – A plan for day-to-day operation

In general, a budget is a plan of financial operation for a given period of time, including an estimate of all proposed expenditures from the funds of a local unit and the proposed means of financing the expenditures (definition from 1968 PA 2, as amended).

Specifically, the budget is the plan for revenues and expenses to assure the delivery of day-to-day services for the community. In preparing and examining this important policy document, local officials are urged to avoid the temptation of dwelling on that with which they may feel comfortable – line item details of paper clips, for example – thereby avoiding that which requires strategic planning, deliberation, compromise and possibly stressful relationships with others. In short, focus on policy, not paper clips.

Types of operating budgets:

- **The line item budget:** Expenditures are divided into categories such as salaries, fringe benefits, contractual services, insurance, telephone, office supplies, printing, postage, etc. This type of budget is easy to prepare, but it is not goal- or program-oriented.
- **The program budget:** Expenditures are presented by program along with narrative descriptions of services to be provided. This type is more complex to prepare than the line item type, but it is more goal-oriented for policy making purposes
- **The performance budget:** Attempts to show the relationship between dollars spent and units of service performed, based on cost per unit (e.g., cost per mile of street swept, etc.). This is the most complex of all types of budgets and unit costs for some services are difficult to measure (e.g., cost per crime prevented by a crime prevention bureau). This type of budget is most helpful in productivity improvement programs where units of measure are practical and reasonable.
- **The zero-based budget:** This type usually follows the program or performance format. Each year the department or unit must defend every dollar requested. This includes defending existing programs and services as well as new ones. By its nature, it is goal-oriented, but it is very time consuming and costly to prepare.

Of the foregoing types of budgets, the program budget is the most useful and practical for local officials. It permits understanding of the purposes for which funds are being proposed and it encourages a policy-making approach to budgeting.

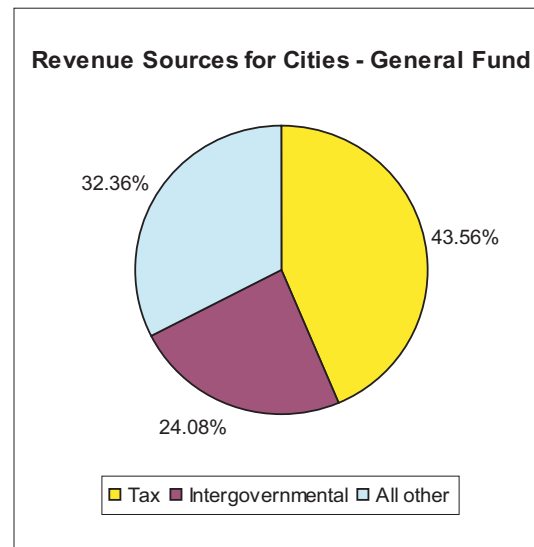
Revenue sources:

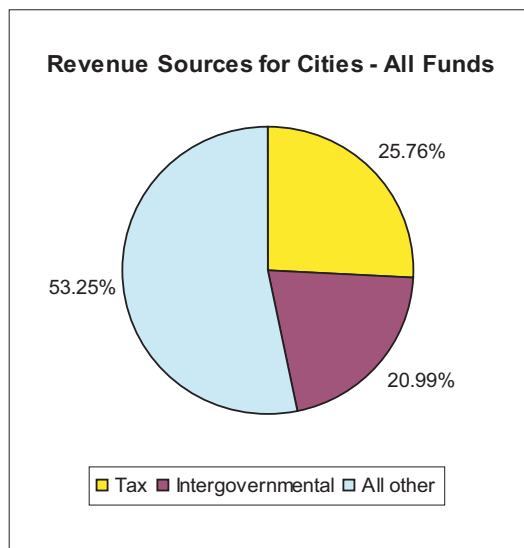
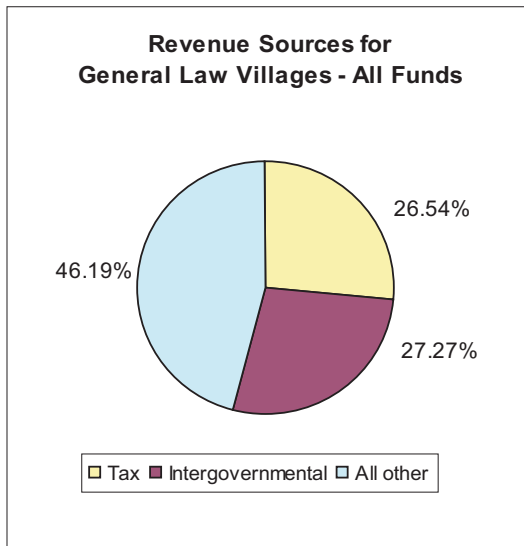
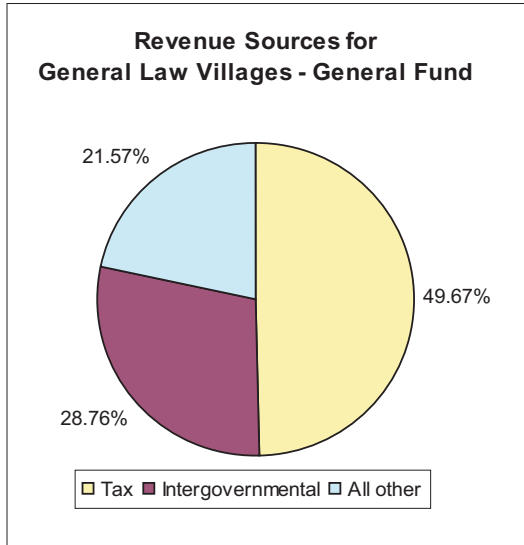
As described earlier in this chapter, state statute closely governs revenue sources for the operating budget. Special items of income vary among local units of government.

Revenue sources for general operating budget purposes:

- property taxes (controlled by law);
- licenses and permits (building, plumbing, hearing, electrical, air conditioning, occupancy, amusements, etc., controlled by ordinance);
- intergovernmental revenues (state shared revenues, liquor licenses and grants such as CDBG);
- charges for sales and services (engineering review fees, duplication and photocopies, police reports, plan review fees, etc.);
- fines and forfeitures (drug forfeiture proceeds, library book fines and penal fines);
- interest income and
- miscellaneous.

For 2004, 171 general law villages filed the F-65 form with the state treasury department. The combined results indicate approximate revenues sources, as shown in the following charts:





Of those revenue sources, local officials have much discretionary authority in all except property taxes and intergovernmental revenue sources. Property taxes were discussed earlier. Intergovernmental or state shared revenues require added attention.

Revenue sharing to local governments consists of both constitutional and statutory payments. The constitutional portion allocates for cities, villages and townships, 15% of gross collections from the first 4% of the sales tax. This amount is then distributed on a population basis. This amount is fixed; in other words the legislature must appropriate whatever is calculated. It cannot reduce or increase the constitutional portion.

The statutory portion of revenue sharing has undergone dramatic changes. Today, the distribution formula calls for 21.3% of the first 4% of sales tax collections to be distributed in accordance with the formula set forth in Public Act 532 of 1998. Since state law sets the statutory portion, the governor and legislature have the ability to adjust the distributed amount; an ability they have used to the detriment of local units, especially during state revenue shortfalls. The actual formula has not been used in a few years.

According to available data filed by local units of government with the Department of Treasury in 2004, revenue sharing generally accounts for 19% of a city budget, 21% of a village budget and 35% of a township budget.

Be careful of creative financing

Because of decreasing revenue, the ever-increasing demands for added services, and the increasing costs of operations and facility upkeep, local officials may be inclined to reexamine the revenue side of the budget with an eye to creativity. One should approach creative financing with caution.

The International City/County Management Association (ICMA) in its *Handbook for Elected Officials* advises what approaches to increasing revenues should be avoided:

- overestimating revenues in the annual budget. Overly optimistic projections are great for balancing budgets, but they don't do much for end-of-the-year financial reports and fund balances.
- borrowing to cover operating expenses. Some day these borrowed funds have to be paid off. It may be necessary to take out short-term loans to cover seasonal cash shortages (property tax receipts only come in once a year but expenditures occur throughout). Officials must make sure these loans are paid off and accounted as such by the end of the fiscal year.
- changing revenue payment dates or changing the fiscal year for the purpose of realizing cash receipts for more than one fiscal year in the span of one. For example, quarterly paid state shared revenues could be manipulated to reflect five quarters of receipts in one fiscal year but only three quarterly payments would be realized the following year. The first year would be well financed but the following year could spell disaster.
- treating short-term revenue sources, such as "one shot" federal grants, as if they were continuing long-term commitments for funding.
- creating a new revenue source which increases revenues in the short-term, but provides disincentives and erodes the base of revenues in the long run. Here, one is reminded of the controversies over the Single Business Tax on the state level and property tax abatement on the local level.
- allowing all revenues to be spent as soon as they are received, leaving no opportunity for reserves to build up to within reasonable limits. Without reserves, local governments are unable to meet emergencies such as natural disasters, a time when citizens have nowhere else to turn for their critical needs. The size of your fund balance is should be a matter of local policy. It is recommended that you adopt a fund

balance policy. In doing so, consider the local political climate; special plans and needs; potential liabilities, such as environmental mandates or legal challenges; cash flow; volatility of revenue sources; fiscal health for bond ratings, etc. Some common guidelines for fund balance minimums are five to twenty percent of annual budgeted expenditures or one month's operating expenditures.

The foregoing provides insight into the revenue side of the operating budget. Now let's examine the expense, or expenditure, side.

Expenditures for the operating budget

Expenditures provide for the day-to-day services to support the residents and businesses of the village. Expenditures for operations are re-occurring day after day and possibly year after year. All expenditures are to be for public purposes only. An abbreviated listing looks like this:

- general government (council, manager, finance, clerk, etc.),
- public safety (police, fire, code enforcement and inspections),
- public works (streets, drains, walks, engineering) and
- leisure services (parks and recreation, library, museum, etc.).

Questions villages should ask themselves for compliance with appropriate budget requirements:

- Does the person responsible for your accounting function use the state mandated uniform chart of accounts?
- Who is your chief administrative officer for budget purposes? 1968 PA 2 mandates a chief administrative officer to prepare and present the budget to the legislative body.
- Who is your fiscal officer for budget purposes? Per 1968 PA 2, this person is the official who prepares and administers the budget.

- Do you have an annual audit performed by a certified public accountant and file a copy with the state treasurer? NOTE: You have the option of a biannual audit if your population is less than 4,000. However, the biannual audit will cover two years. If you plan to issue bonds, you will need an audit for the most recently completed fiscal year on file with the Michigan Department of Treasury. Most villages find it more efficient to have audits conducted annually.
- Does your chief administrative officer prepare and present a budget to the council according to an appropriate time schedule, with adequate time for review, discussion and public input before the beginning of the new fiscal year?
- Do department heads provide necessary information to the chief administrative officer?
- Does the council get the information necessary for proper consideration of the recommended budget?
- Are three years of figures included: the most recent complete fiscal year, the current fiscal year estimates and the upcoming fiscal year?
- Is the budget balanced? (Total estimated expenditures shall not exceed total estimated revenues. (MCL 141.435))
- Do you hold a public hearing before budget adoption as required by 1963 PA 43, as amended (MCL 141.411 to 141.415)? Do you include millage information so you don't need to hold a separate hearing in taxation hearing?
- Do you adopt the budget by indicating general appropriations by program, rather than by line item? Does the appropriations resolution or ordinance provide sufficient guidelines for the chief administrative officer and/or fiscal officer in administration of the budget?
- Do you adopt the budget prior to the start of the new fiscal year? If not, you have no authority for spending in the new fiscal year.
- Have you determined the millage you need to meet the liabilities for the coming fiscal year?
For samples of budgets, budget ordinances, investment policies, fund balance policies, purchasing ordinances and/or policies and other specific and general information on budgeting, contact the League's Library at 800-653-2483. Much of this information is also available on the Michigan Municipal League's web site at www.mml.org. A sample budget ordinance is in Appendix 9 of this handbook.
For copies of the Uniform Chart of Accounts, the Uniform Budgeting Manual for Local Units of Government, contact the Department of Treasury, Local Audit and Finance Division, State of Michigan, 517-373-3227 or download them from their website at www.michigan.gov/treasury.
For copies of public acts, as amended, go to www.legislature.mi.gov. This is a fairly user-friendly web site. The General Law Village Act is Act 3 of 1895.

The capital budget – a longer view

The capital budget provides funding for non-recurring expenditures such as construction and acquisition of buildings, infrastructure, facilities and equipment. These expenditures are “lumpy,” non-repetitive and may span several years for project completion or acquisition.

The capital budget is another annual plan of revenues and appropriations. It is a document adopted by the village council, having the force of law as a legally binding allocation of funds. It often represents the first year of a multi-year capital improvement program.

Revenue sources for the capital budget

Revenue sources for the capital budget may include any of those for the operating budget plus other sources for long-term capital improvements:

- special assessments,
- fees charged for construction,

- major road funds, Act 51 – gas and weight taxes,
- local road funds, Act 51 – gas and weight taxes,
- enterprise fund allocations from water, sewer and other utilities and
- bond proceeds from issues by the local governing body and any of the authorities created by it (e.g., building authorities, downtown development authorities, housing authorities, tax increment financing authorities).
- installment sales contracts for periods not exceeding 15 years for acquisitions of land, equipment or property (PA 99 of 1933).

Capital budget expenditures

Capital budget expenditures for property acquisition, construction and equipment usually include allocations to provide facilities for the operating departments of the local unit. Most of these are easily recognizable:

- general public works (streets, drains, water, sewer, sidewalks, lighting, motor pool),
- police (equipment, vehicles, facilities),
- fire (equipment, apparatus, station houses),
- parks (land acquisition, recreation centers, play fields, athletic equipment, nature trails, etc.) and
- library and museum (buildings, furnishings and equipment).

When considering capital expenditures for new facilities, budget makers must keep in mind the need for operating funds to place the new building or facility into operation and keeping it running in the future. The need for additional employees, costs for heat, lighting, water, telephones, etc. are appropriate considerations.

The capital improvement program (CIP)

The capital improvement program (CIP) is perhaps the most important policy-planning tool available to local budget makers.

The CIP usually extends three to five years beyond the current or proposed budget year. It provides a schedule of projects year-by-year into the future. The first year on the CIP should be considered the next year for capital budget allocations. Each operating department is expected to be represented in the CIP and the task of the budget makers is to make sure the year-to-year estimated costs are within the financial capacity of the local unit.

Used properly, the CIP provides a systematic approach to financial planning over a period of years for:

- a) increases in operating costs for new facilities,
- b) acquisition of rights-of-way,
- c) contributions to other authorities,
- d) special assessment projects and
- e) bond issuance planning.

The CIP can be the keystone of a strategic plan.

The CIP can also provide opportunity for a systematic approach to preventive maintenance and the rebuilding of facilities and infrastructure. Scheduling of heavy preventive maintenance and rebuilding will often extend beyond the CIP time span. For example:

- concrete streets – joint grouting and resealing plus selective slab replacement – seven-year cycle,
- concrete sidewalks – leveling and flag replacement – five-year cycle,
- water distribution system – system replacement – 20 to 30 year cycle or
- public buildings – plumbing, heating, electrical system updates – 20 to 30 year cycle.

Capital improvement programming is essential for the long-term well being of the community. The importance of this part of municipal finance cannot be overstated.

A suggested schedule for the budgeting process (assuming that your fiscal year begins March 1. If yours is different, adjust the schedule accordingly)	
On or about	Step in the budget process
November 1	Chief administrative officer or fiscal officer asks department heads to compile budget requests for the coming fiscal year
December 1	Department heads submit budget requests for the coming fiscal year
January 1	Chief administrative officer presents the proposed budget to the legislative body
February 1	Council review completed; revisions made; union negotiations completed, etc.
February 7	If necessary, council adopts a resolution on the proposed additional millage rate for the coming fiscal year
February 16 (Optional)	Public hearing on the millage rate if you take advantage of increased SEV or want to increase the millage rate (Note: If you hold this separate hearing for the millage rate, the notice must include requirements set forth in MCL 211.24(e).)
February 28	Public hearing on budget, which may also include the millage rate information. Budget adopted (no more than 10 days after public hearing)
May	Millage set after final SEV figures are received. Cannot be more than proposed in public hearing.

Bidding

How are goods and services obtained to implement the budget and capital improvement plan? Most villages do not have a policy in place for purchasing big ticket items, or for seeking professional services such as an engineering study or planning ordinance update.

There are no longer any state statutes requiring public bids on municipal contracts. 1993 PA 167 & PA 168 which required municipalities to seek competitive bids for purchases over \$20,000 in order to receive state shared revenue money, were **repealed** in 1996. The state has relegated the task of developing public purchasing guidelines to local governments.

The GLV Act does not address bidding practices. In order to follow bidding policy control mechanisms, general law villages must enact their own ordinances and/or policies. A bidding policy would contain a:

- designated individual responsible for purchasing function
- monetary threshold for which competitive sealed bids must be obtained;
- method for announcing, collecting and opening bids; and
- method for disposing of obsolete property

The MML has sample bidding policies in our library and on our web site.

About the Authors...

Lois Thibault is retired Director of Field Operations for the Michigan Municipal League. Ms. Thibault joined the League staff in 1988, serving the members as director of Information Services from 1990 to 1998. Before that, she gained ten years of local government experience and expertise as manager in the Village of Ortonville. She also served as the Secretary/Treasurer to the Michigan Local Government Management Association.

Ms. Thibault completed her undergraduate work at Northern Michigan University, majoring in education. She earned a master's degree in public administration from Eastern Michigan University.

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He has served as president of the Michigan Local Government Management Association, midwest vice president of the International City/County Management Association and chairman of many special committees of these associations. He has served as adjunct professor of management at Walsh College of Business and Accountancy, and is a volunteer teacher in the Elected Officials Academy of the Michigan Municipal League. Mr. Gerstenecker is a member of the Board of Directors of the Michigan Municipal League Foundation.

Mr. Gerstenecker received a Masters Degree in Governmental Administration from the Wharton School, University of Pennsylvania and Bachelor of Arts degrees in government and economics from Southern Illinois University.