

{ Budget & Finance 101 }

Understanding Municipal Budgets & Financial Reports

**Michigan Local Government Management Association
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Presented by: Joe Heffernan, CPA and Tim St. Andrew, CPA

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Overview of Today's Session

Governmental Financial Statements and Fund Accounting

Fund Balance

Budget Concepts

- Overview of the Budget Process
- Budget Process — Preparation/Adoption/Execution
- Multi-year Budgeting
- Capital Budgeting

Financial Forecasting

Purpose of governmental financial statements

The purpose of governmental reporting is to demonstrate accountability for the money entrusted to it;

- The individual fund statements demonstrate how we spent our taxpayers' money;
- The government-wide statements demonstrate whether the current set of taxpayers has paid the full cost of government services (or not).

(Today's presentation will focus on the individual governmental funds financial statements and budgets.)

What is a fund?

In the private sector, sometimes separate companies are set up for legal liability purposes, or tax purposes; in the public sector, separate activities are accounted for in separate funds, in order to show accountability.

- A specific revenue may be legally restricted, so it is reported in a separate fund to demonstrate that the revenue was spent only for the intended purpose;
- Any unspent amounts (in governmental funds) will then be reported as “restricted, committed, or assigned.”

What is the “General Fund?”

Individual funds are created because of laws, grant requirements, or the desires of the governing body;

All activity that has not been assigned to a specific individual fund is then accounted for in the General Fund.

- As a result, most people find the General Fund to be the most important fund. That is the fund that contains uncommitted resources that may be used for general purposes.

Funds other than the General Fund

What kinds of funds would we have, other than the General Fund?

- **Funds are normally created to show accountability (to show how specific revenue is being spent); sometimes they are created to pay for goods or services in advance (internal service funds and capital project funds).**
- **The following slide presents the various types of funds:**

Types of funds

Different fund types that a government may have:

GOVERNMENTAL FUNDS	<ul style="list-style-type: none">• General fund• Special revenue funds• Debt service funds• Capital project funds *• Permanent funds
PROPRIETARY FUNDS	<ul style="list-style-type: none">• Enterprise funds• Internal service funds *
FIDUCIARY FUNDS	<ul style="list-style-type: none">• Trust funds (pension and other employee benefit, investment, private purpose)• Agency funds

** Capital projects and internal service funds have a somewhat higher potential for resources that could be available for general unrestricted spending; the specific funds would need to be evaluated.*

Key take-away

- ❑ **Take the time to learn about all of your local unit's funds. The General Fund is typically the most important – but some of the other funds may be important to understanding your overall financial health.**



What is fund balance?

Accounting 101 tells us that we have:

- Assets (things we own); and
- Liabilities (amounts we owe others);
 - The difference between assets and liabilities is equity. In the governmental funds, this equity is called fund balance.
- Since governmental funds generally report only assets that are available (cash or will be cash within 30-60 days), and only report liabilities that are current claims, the resulting fund balance represents amounts available to be spent.



Is fund balance available to be spent as our governing body sees fit?

Maybe – but not necessarily

- Fund balance is reported based on how constrained it is; the categories are:
 - Nonspendable (not in spendable form)
 - Restricted (external legal restrictions)
 - Committed (internally – by formal action)
 - Assigned (internally; less formally)
 - Unassigned

The governing body always has the authority to re-commit or re-assign fund balances.

Minimum Fund balance factors

- **Most governments should be in the 10–20% range (fund balance as a percent of expenditures).**
- **A very small government might have a 20–25% target.**
- **A very large government might have 5–10% as a target.**

- **The GFOA (Government Finance Officers Association) in its best practices document, suggests two months' worth – 16.7%, as a minimum; the State of Michigan used to have a “Fiscal Stress” scoring for local governments that used 13% as a minimum.**

Budget Concept

Definition of a Budget

- A budget is a plan of financial operations embodying an estimate of proposed expenditures for a given period of time and the proposed means of financing them.
- In the State of Michigan, all General and Special Revenue Funds are required by law to be budgeted annually.

Budget Concept

Budget Mission

- The mission of the budget process is to help decision makers make informed choices about the provision of services and capital assets and to promote stakeholder participation in the process.
- In one sense, the “budget document” is the package of information that the governing body reads to educate and inform itself so that it may give the legal approval to management to incur expenditures during any given fiscal year.

Budget Concept

Budget Dimensions

- A budget process that is well-integrated with other activities of government, such as the planning and management functions, will provide better financial and program decisions and lead to improved governmental operations. A process that effectively involves all stakeholders — elected officials, governmental administrators, employees and their representatives, citizen groups, and business leaders — and reflects their needs and priorities will serve as a positive force in maintaining good public relations and enhancing citizens' and other stakeholders' overall impression of government.

Budget Concept

Good Budgeting

- A good budget process is characterized by several essential features. A good budget process:
 - Incorporates a long-term perspective,
 - Establishes linkages to broad organizational goals,
 - Focuses budget decisions on results and outcomes,
 - Involves and promotes effective communication with stakeholders, and
 - Provides incentives to government management and employees.

Budget Concept

Budget Challenges

- The following issues need to be taken into account in the tools and techniques that support budgetary practices:
 - Managing the budget process and changes to budget practices
 - Dealing with differences between governments, including size and legislative processes
 - Adjusting for organizational structure and issues
 - Election campaign issues

Budget Concept

Budget Challenges (cont'd)

- Desire to have change or to prevent change
- Level of resources available for programs
- Available level of technical system and support
- Dealing with high (or low) expectations
- Legal requirements
- Ensuring citizen processes work
- The level of stakeholder understanding
- Accuracy of projections and assumptions
- Level of disclosure

Budget Concept

Budget Process

- The annual budgetary process involves the following three phrases:
 - A. Preparation
 - B. Adoption
 - C. Execution

Budget Concept

A. Preparation

- The preparation phase is usually the responsibility of the chief financial executive of the municipality. It is accomplished by analyzing the financial data and projecting the program requirements of the various functions and activities for which a particular government may have responsibility.

Budget Concept

B. Adoption

- Once the budget has been prepared, it is presented to the governmental unit's legislative body for consideration, possible modification and final approval. Typically, the public is invited to participate in this phase via public hearings on proposed budgets.

Budget Concept

C. Execution

- Budgetary accounts are set up to record the estimated revenue and appropriations in the fund accounts. As economic conditions change, budget amounts can be amended by a process determined by the governmental unit's legislative body.

Overview of the Budgeting Process

Legal Requirements for a Budget

- P.A. 621 of 1978 requires a budget appropriation to be in place before a governmental unit may commit to spending money.
- Budget vs. General Appropriations Act
- Required data to be included in the budget

Overview of the Budgeting Process

Types of Budget

- Line item
- Cost center (department, activity, program or function)
- Fund total — provided it meets activity level exception

Budgets are commonly prepared on a line-item basis and adopted at a less restrictive level.

Budget Requirements

Required Data

- Must include prior year actual, current year estimates and proposed budget
- Must include fund balance, projected to the end of the budget year; this amount must be positive (the definition of a “balanced budget”)

Budget Preparation

Responsibility

- PA 2 of 1968 requires each local unit to have a “chief administrative officer” and generally defines this for each unit of government, as follows:
 - the city manager or the mayor
 - the village manager or president;
 - the township manager or township supervisor;
 - the elected county executive, county manager, county controller, or an individual designated by the county board of commissioners

Budget Preparation

While P.A. 2 gives ultimate legal responsibility to the above individuals, the source for the information to be included in the budget document is certainly from the accounting records; further, the financial and analytical skills of the finance department generally makes this process their process, to be accomplished under the direction of the chief administrative officer.

Budget Preparation

Short- and long-term objectives

Most governments have broad goals that guide the direction for the government and serve as a basis for decision-making. In the best practices, these goals are committed to writing; but if not, the broad goals still probably exist. Further, many governments have specific approaches to move towards achievement of these long term goals (policies, plans, programs and management strategies).

The budget should discuss these goals and approaches; the budget document should explain how this budget moves the government towards achievement of the goals.

Budget Preparation

Best Practices:

- Public budget workshops
- Citizen focus groups
- Town hall meetings
- Citizen input via the web
- Video presentations

Budget Adoption

Legal Requirements

- An annual budget is required by Public Act 2 of 1968, as amended. Public Act 2 differentiates between the budget document and the General Appropriations Act. The budget document is the informational package that is put together by the Chief Administrative Officer in order for the governing body to pass the resolution approving spending for the upcoming year. This resolution is referred to as the “General Appropriations Act.”

Budget Adoption

The General Appropriations Act represents the legal authority for local officials to provide the level of services agreed upon by the governing body. A General Appropriations Act is required for any General Fund and any Special Revenue Funds; it would violate P.A. 2 to commit the local unit to purchase goods or services from General Fund resources, or from any special revenue fund, unless there is a budget in place with an appropriation that covers that expenditure.

The budget, however, is not the ultimate approval for any specific purchase. Individual purchases are subject to the local unit's purchasing policies (as to approval of prices, amounts, vendor, etc.).

Budget Adoption

The legislative body must pass a general appropriations act (i.e. adopt a budget) for the General Fund and all Special revenue funds, unless another method of adopting the budget is provided for in the charter. Before adopting the general appropriations act, the local unit must hold a public hearing. There must be a public notice of this meeting, stating in 11-point type, “The property tax millage rate proposed to be levied to support the proposed budget will be a subject of this hearing.”

Budget Adoption

To be effective, a GAA should also include:

- Specific roles, responsibilities and powers of elected and appointed officials
- Detailed schedule of the adoption AND the amendment process
- Legal level of control
- Prescribed consequences for violation of the GAA

Want to maintain flexibility, however the more you can prescribe the less room exists for “extraordinary actions.”

Budget Adoption

Beyond the “legal” requirements – getting a budget adopted is a *communication process – selling the document.*

Strong, clear budget message

- Communicate the economic and fiscal conditions that support the budget
- Establishment of priorities, linking the detail to those priorities
- Why things were done this way

Budget Execution/Monitoring

WHY?

- Legal Compliance
- Internal Controls/Fraud
- Performance Measurements
- Community Goals & Legislative Priorities
- Future Forecasting and Budgeting

Budget Execution/Monitoring

WHO?

- Legislative Body
- Budget Office/Officer
- Department Heads/Directors
- Office Managers

Budget Execution/Monitoring

WHAT?

- Revenues
- Expenditures/Expenses
- Capital Outlay
- Other

Budget Execution/Monitoring

How do you monitor?

- System of Internal Controls followed by Community to assure compliance with laws

How do you report?

- Memorandum / Report
- System Report
- Spreadsheet

Budget Execution/Monitoring

How can we structure the report?

- Executive summary
- General fund details
- Other fund summaries
- Department details

Municipal Budget Summary of Requirements

Yes/No

1. Has a budget been adopted (General Fund, Special Revenue Funds)?

2. Was a public hearing held on the budget?

3. Was all the necessary information in the budget document for the budgetary funds:

- Actual prior year (both revenue and expenditures)?
- Estimate of current year (both revenue and expenditures)?
- Proposed budget (both revenue and expenditures)?

Municipal Budget Summary of Requirements

Yes/No

- Amounts for contingencies if appropriate?
 - Amount of fund balance (deficit) accumulated?
 - Amount of fund balance (deficit) accumulated from prior years and the estimated surplus or deficit expected in the current year?
- 4. Is the budget balanced (including fund balance or deficit)?**
 - 5. Has the budget been amended when necessary if actual revenue is less than the budget estimated?**

Municipal Budget Summary of Requirements

Yes/No

6. Has the budget been amended to allow expenditures in excess of the original appropriation?
7. Is the new debt entered into, if applicable, permitted by law?
8. Are expenditures equal to or less than amounts appropriated?
9. Are all expenditures authorized in the budget?

NOTE: In order to be in compliance with the Budget Act, all questions should be answered “Yes.”

Multi-Year Budgeting

The process of producing DETAILED revenue estimates and expenditure authorizations across a number of fiscal years.

- Most commonly a 3-year basis or a 2-year basis

Adoption, monitoring, amending, and reporting over a multi-year period

- Forcing a detailed look at the longer term future can enforce the discipline to make better⁴ decisions in this year's general appropriation act.

Multi-Year Budgeting

Why do this? One primary question:

- **Do you (your unit of government) plan to be in business for more than one fiscal year???**
- If you do, then it is prudent public policy to financially plan for that event!
- Do you take a mortgage or car loan out without figuring out how you're going to make the payments — not just in the short-term but over the life of the loan?

Multi-Year Budgeting

Budget issues and problems are not limited to a single fiscal year, they trend over several years. Use of multi-year budgeting allows a unit to capture and deal with those trends.

Multi-year budgeting also provides some basis of continuity.

- With appropriations planned for at least two years, managers and employees can, collectively and individually, make and implement plans knowing that they at least have a couple of years of support.

Finally, multi-year budgeting builds a discipline of concentrating on long-term fiscal views rather than an annual review.

Multi-Year Budgeting

To be successful, a multi-year budget should NOT simply be a repeat of one year's budget into the next year, with inflation.

Each year, although building from the previous, needs to be analyzed and proposed independently.

The key is to locate and analyze the trends that drive certain revenues and expenditures, build budgets based upon those trends.

- If the trends change or are altered by policy action, the changes must be noted and budgeted.

Capital Budgeting

What is it?

- Long-term planning and budgeting for fixed and other long-lived assets
- Can involve two aspects
 - Capital Improvement Planning
 - Infrastructure, buildings, major repairs
 - Ongoing capital purchases
 - Vehicles (police, fire, recreation, grounds); computers; office equipment; major equipment (security, medical, etc.)

Capital Budgeting

Why engage in this practice?

- As resources become tighter a tendency develops to defer these types of expenses. That could be a rational response in the short term.
- However, as with multi-year budgeting, if your unit plans to be in existence for many years, these needs must be addressed.
- Capital budgeting allows you to address these needs in a thoughtful, planned basis.
 - Avoid knee-jerk reactions or “crisis replacements”
- Oh, yeah – a 6 year capital improvements plan is required by P.A. 33 of 2008 (the Municipal Planning Enabling Act)

Capital Budgeting

Capital Budgeting requires a long term perspective.

- Analyzing the long-term needs of the specific operation
 - Condition of current equipment
 - Demand inventory (population, demographic data, planned projects)
- Identify projects or items
 - Not simply what, but how much (over several years), the rationale, impact on the operating budget, proposed funding source

Capital Budgeting

Evaluate the proposed project and/or item.

- Specifically develop a prioritization.
 - Urgent; Necessary; Desired; On-going; Deferrable
- Develop meaningful evaluation criteria.
 - Fiscal impact; health and safety effects; community economic effects; environmental and social effects; disruptions and inconvenience caused; implications from deferring the project or purchase
- Detailed review
 - Capital cost (including escalation); technical feasibility; operating cost impact; cost/benefit analysis; financial capacity analysis

Financial Forecasts/ Projections

What is the purpose of a financial projection?

Provide information that is useful for making decisions about our future financial direction

- e.g., Changes to service levels (Can we do more? Must we do less? Or at a lower cost?)

This is not a prediction about where our fund balance will be in 5 years – presenting that would mean predicting the decisions that the governing body will make over that 5 year period;

(continued)

Financial Forecasts & Projections

Principles of Presentation:

- **Keep it simple!** Evaluate whether the governing body's spending decisions will focus on things like salary levels, number of employees, fringe benefit levels, capital spending; or things like where we allocate these resources – police, fire, recreation, etc. The answer to this should drive whether you project by program/ department, or by line item (total salaries, etc.) – or both!
- **Include historical comparison**
- **Include footnotes or narrative discussion**
- **Be intentional about the level of conservatism**
- **Scope: Just the General Fund? Which other funds?**

Thank you