

Chapter 1

The Context of Public Sector Budgets

Chapter One Overview

The ability to tax and spend is at the cornerstone of government. Conceptually, this appears to be an easy to understand phenomenon. However, it is not that simplistic. Budgeting is a two-fold process at the very least. First, someone has to decide how much money the government needs to function at an optimal level. Second, someone has to determine how much funds to allocate to each program/department. Since budgeting involves the allocation of scarce resources, it can be a difficult process. Although elected officials formally decide how to allocate funds, collecting revenue is an administrative function. Both procedures can be very complicated, sophisticated, and crucial to the very existence of governments.

The first chapter provides the reader with a general overview of budgets and the processes that go along with them. This includes, but is not limited to: the purpose of a budget, the different types of budgets, sources of revenue and expenditures, government accounting techniques, and audits.

What is a Budget and Public Budgeting?

A *budget* is a fiscal policy document that outlines the revenues and expenditures an organization needs to carry out some specific functions during the course of a set period of time. With respect to the government, this period of time is called a *fiscal year* (FY), a twelve-month period where funds are collected and spent. For example, FY 2018 for most states begins on July 1, 2017 and ends on June 30, 2018. At the end of this period, the budget must be (legally) balanced and available for public scrutiny. The legal requirement for a balanced budget is the primary definitional difference between a public and private budget. States and local governments should not carry *deficits* over to the next fiscal year. However, in many instances, particularly at the fund level, deficits are carried over on the budget basis. *Public budgeting* is the acquisition and use of resources by public organizations for the purpose of providing a public service or good (see Swain and Reed 2010).

Three roles emanate from budgets: allocation, distribution and economic development. First, governments have to decide what services will result from the allocation of funds. Second, they determine who will benefit from the distribution of these funds and who will pay for the services. Lastly, they determine

what levels of income and job growth are required to maintain stability in the government (Musgrave 1959).

Functions of a Budget

The single most important function of a budget is *accountability*. It is one of many tools that can be used to determine if an organization has accomplished its objectives as laid out by legislative and executive institutions. Legislators and city councilmen alike use these documents when reviewing the activities of public agencies. A budget can also be used to *control* an agency. Legislators and councilmen appropriate funds to an agency based on their strategic priorities. However, if they are dissatisfied with the agency, they have the legal right to withhold or embargo funds. A third function of a budget is to *plan*. By organizing costs around some function or activity, agencies have some estimate of what their tasks will cost and how to go about carrying out those tasks. It also forces the agency to meet deadlines and behave in an efficient and effective manner. In harmony with planning are good management skills. Agencies can organize and best utilize personnel by indicating performance standards and objectives. At the end of the fiscal year, an agency can review the year's activities in order to determine if goals and objectives were met. If resources were not spent in the best manner, changes can be made to remedy the problems (Schick 1966; Bland and Rubin 1997; Howard 2002; Mikesell 2014; Solano 2004; Rubin 2006; Musell 2009; Swain and Reed 2010). In the U.S. system of government, no expenditure can be made unless the governing authority-legislature, city council, Congress-authorizes it. Rare exceptions include Executive orders, but even these do not completely negate the role of the legislative body.

Budget Formats

Generally speaking, budgets come in three formats: line-item, program, and performance. However, there are also budgeting techniques that can be applied. One seldom used example is *zero-based budgeting* (Andrews 2011).¹ In this technique, each unit submitting a budget has to justify all of their budget requests from beginning to end without assuming a guaranteed allocation by defacto (see also chapter 7). An agency can also use an *incremental* approach to budgeting where they simply add or subtract from the previous year's spending. Although a state or local government may require an agency to submit a certain type of budget, they do have some discretion as to the type of budget that they prefer (Axelrod 1995; Gianakis and McCue 1999; Thurmaier and Willoughby 2001; Smith, Sun, and Lynch 2017).

First, there is a *line-item* or a *traditional budget*, which allocates funds to

specific commodities or objects of cost. Emphasis is placed on personnel, supplies, equipment, utilities, contractual services and capital expenditures. Each of these major categories can be broken down into individual items. For example, within personnel cost, there are: salaries, fringe benefits (pensions, social security, health care, etc), retirement, and so on. Capital outlays are for higher costs items that have value for a number of years. This would include items such as: buildings, busses, highways, bridges, and equipment (see also chapter 4). Capital outlay equipment also falls into the high cost item category and therefore is not equivalent to equipment used as a major category. Equipment as a major category is for low cost items such as a single computer, a typewriter or a desk (see also chapter 3).

Line-item budgets are probably the easiest of the three types to prepare. They are quick and simple. The major shortcoming of a line item budget is its inability to describe the activities that will be performed by the agency. This type of budget is used for control and accountability. Legislators determine salaries and benefits and can clearly delineate the differences between the various categories. Salaries and benefits constitute the greatest portion of a line-item budget. Line item budgets are useful in that they provide the exact cost of specific items. This is useful if a budget needs to be cut. Exhibit 1.1 provides a partial example of a line-item budget for the Sanitation Department in Jefferson City.

Column one has each of the major categories of expenditures. Even though there is no category for equipment, it is possible to have this category as well. Whether or not a category is used depends on how the budget staff wants to categorize those items. Again, equipment that does not reach high levels of cost that reoccur over several fiscal years is not included in the capital category. The second column in Exhibit 1.1 represents *actual spending* (act.) for fiscal year 2018, while the third column has *estimated spending* (est.) for the up-coming fiscal year (2019). In estimating cost, expenditures are rounded to the nearest dollar. However, rounding to the nearest dollar cannot be used when calculating actual costs. Every last penny must be accounted for when balancing a public budget. Given this detail, line-item budgets should always be placed in a spreadsheet program to ensure fewer mathematical errors. This requirement does not necessarily hold for performance and program budgets due to the vast amount of dialogue that goes into the budget. In these cases, great care should be taken to ensure that there are no mathematical errors.

Mikesell (2004) indicates that the policies of governments dictate using traditional budgets that do not develop long term profiles. This in effect makes it easier to control the agency, but it does not allow for good planning of activities that may be occurring over several years.

The second type of budget is a *program budget*. This budget allocates funds to programs or activities within an organization. It would list items in categories by division, department or agency such as public works and public safety along with the cost of operating the agency. Program budgets are advantageous in that

they allow programs of a similar nature to be combined rather than split into separate budgets. Program budgets can allow administrators and legislators to plan for not only the current fiscal year, but also for future years. A good program budget lists the goals and objectives of an agency along with the funds that are allocated to achieving those objectives. These goals and objectives should be clear, concise and self-explanatory. This also serves the dual function of preventing redundancy among agencies as well as ensures that the annual review process will flow smoothly. Lastly, program budgets allow for the use of analytical tools to measure costs and benefits.²

Program budgets can be written using a variety of different formats. Exhibit 1.2 and 1.3 provide two basic examples for the sanitation department within Jefferson City. Let's take a look at Exhibit 1.2 and note that the goal of the department is stated followed with objectives to accomplishing that goal.³

Exhibit 1.1 Line-Item Budget
Sanitation Department, Jefferson City
FY 2018 & FY 2019 Expenditures

<i>Personnel</i>	<i>FY 2018 (Act.)</i>	<i>FY 2019 (Est.)</i>
Salaries	\$165,459.78	\$179,000.00
Fringe Benefits	22,410.56	25,000.00
Retirement	9,521.13	12,000.00
Insurance	6,510.87	7,000.00
Training	2,750.09	3,000.00
Subtotal	\$206,652.43	\$226,000.00
<i>Supplies</i>	<i>FY 2018 (Act.)</i>	<i>FY 2019 (Est.)</i>
Disposable Trash Cans	\$25,230.25	\$29,000.00
Uniforms	6,298.69	7,530.00
Mechanical Brooms	10,498.91	12,300.00
Subtotal	\$42,027.85	\$48,830.00
<i>Capital Outlay</i>	<i>FY 2018 (Act.)</i>	<i>FY 2019 (Est.)</i>
Equipment	\$23,789.90	\$28,987.00
Desks	2,987.32	.00
Trucks- F 350	49,874.23	84,890.00
Subtotal	\$76,651.45	\$113,877.00
TOTAL	\$325,331.73	\$388,707.00

Exhibit 1.2 Program Budget One **Jefferson City, FY 2018 Expenditures**

Sanitation Department

The goal of this agency is to provide comprehensive sanitation services within the Jefferson City in the most effective and efficient manner as possible.

Objectives:

- a. Ensure that trash and debris is removed from the streets effectively.
- b. Provide for the effective removal of recycled material.
- c. Provide for street cleaning.
- d. Provide for snow removal in an efficient and effective manner.

TOTAL: \$325,331.73 (actual)

In Exhibit 1.3, notice how the budget directs attention towards the subject of the expenditure rather than the object of expenditure. In this example, there are three divisions within the department: trash collection, street cleaning, and snow removal and each division has a budget.

Exhibit 1.3 Program Budget Two **Jefferson City, FY 2018 Expenditures**

Sanitation Department

The goal of this agency is to provide comprehensive sanitation services within the Jefferson City in the most effective and efficient manner as possible.

Objectives:

- a. Ensure that trash and debris is removed from the streets effectively.
- b. Provide for the effective removal of recycled material.
- c. Provide for street cleaning.
- d. Provide for snow removal in an efficient and effective manner.

Divisions:

-Trash Collection	\$200,375.00
-Street Cleaning	85,456.73
-Snow Removal	<u>39,500.00</u>
TOTAL	\$325,331.73 (actual)

Although each division has a separate budget, their combined budgets make up the total budget for the Sanitation Department. If the budget director requests estimates for future years, you can create a separate budget and modify your objectives and expenditures. If your objectives are the same, you can simply add another column next to the existing expenditure column with the appropriate

fiscal year.

The last type of budget is a *performance budget*. A performance budget classifies funds based on some activity and the direct output created by that activity rather than the purchase of resources. This type of budget relies heavily on strategic planning, operational planning, and performance accountability. *Strategic planning* is a future oriented process of diagnosis and strategy building. It closely monitors an agency's mission, capacity, and the environment in which it exists (Bryson 2010; Poister 2010; Rubin and Willoughby 2011). *Operational planning* monitors the allocation of resources on a task-by-task basis in order to ensure that goals and objectives are met. Lastly, *performance accountability* measures progress by results. For example, measuring graduation rates, documenting the number of students in a classroom, or measuring the amount of snow removed from streets. The Governmental Accounting Standards Board (GASB) has a concept statement and provides examples and a framework that governments are encouraged to use when formulating accountability measures (see Smith, Sun, and Lynch 2017, p. 156; Joyce 2011).

An advantage to using a performance based budget is the direct correlation between spending and services provided (i.e. results). Performance budgets can be very useful for management because it provides accountability measures for both agency heads and legislators. This, however, is a double edged sword. On the one hand, agency heads must be very specific in detailing their operations. Legislators on the other hand must *appropriate funds* based on performance rather than the normal line-item format (Gianakis and McCue 1999). In summary, this means greater effort on the part of legislators. Unless they have some level of expertise with that particular agency, they may find themselves ignorant of the details of spending and the long-term repercussions of their acts. The main benefit of a performance budget is that it allows for the outcomes of spending to be monitored every fiscal year. Hence, they are tied directly to performance reviews. Performance budgets date back to the early 1900s in New York City where attempts were made to bring greater accountability to agency heads and politicians (Mendoza 1983; U.S. General Accounting Office 1993; Smith, Sun, and Lynch 2017).⁴

Exhibit 1.4 provides an example of a performance budget for Jefferson City. Note the exact functions that are to be carried out as a result of the expenditures. In addition, a performance budget can list the result of previous activities. For example, Exhibit 1.4 shows that the number of neighborhoods served by the recycling program has increased. Also, note that the performance objectives are tied to the performance review.

Unfortunately, one of the problems with performance budgets is the inability to relate cause to effect. For example: Why are more people participating in the recycle program? Was it because more emphasis was placed on providing receptacles for the recycled material or because the newsletters highlighted the advantages to recycling? These problems are not necessarily limited to perfor-

mance budgets. Similar problems exist with line-item and program budgets.

One thing that the reader should recognize is presentation of the budget is very important. It is important that the user examines the budget and navigates through it with relative ease. If items are ambiguous and hard to find, it is a clear sign that the budget should be revised. If it is within their power, legislators and council members do not prefer to spend their days and nights working with budgets. As a result, your goal is to make the budget understandable to all users. In so doing, you can highlight important items by using the bold function, italics, underlining, and shading sections in your spreadsheet programs. In performance and program budgets, carefully placed words and explanations are also very useful (Seckler-Hudson 2002; Smith, Sun, and Lynch 2017; see also chapter 8).

Exhibit 1.4 Performance Budget

Jefferson City Sanitation Department, FY 2018-2020 Expenditures

Program/Division: Trash Removal

Description: Collection and removal of trash and recyclable material.

	FY 2018	FY 2019	FY 2020
<u>Operating Expenses</u>	<u>Actual</u>	<u>Recommended</u>	<u>Projected</u>
Personnel Services	\$215,681.24	\$235,050.00	\$225,000.00
Supplies	35,500.00	39,000.00	45,000.00
Equipment	54,650.15	59,000.00	65,000.00
Printing	<u>20,000.34</u>	<u>25,000.00</u>	<u>28,000.00</u>
TOTAL	\$325,331.73	\$358,050.00	\$363,000.00

Program Performance Objectives:

1. Expand the recycle program to the southwest area of town.
2. Provide multipurpose recycle containers to all of the existing customers.
3. Provide feedback to the customers on the outcomes associated with recycling.
4. Decrease the amount of recyclable material in the landfill.

Performance Review:

	FY 2018	FY 2019	FY 2020
	<u>Actual</u>	<u>Estimated</u>	<u>Projected</u>
1. Neighborhoods Served	5	7	8
2. Recycle Containers Dispensed	920	1045	1200
3. Customer Recycle Newsletters	1200	1370	1450
4. Materials Recycled	10 tons	15 tons	18 tons

Reading a Budget

A good budget should be user friendly. The lay reader at the very least should be able to determine how much revenue the government intends to collect, how much the government plans to spend and on what (expenditures). As previously mentioned, there are three basic budget formats and they provide different types of information. However, there are several things that each of these budgets have in common.⁵

1. *Budget Message/Budget Highlights/Executive Summary*: A good budget always has a message, usually in the form of a letter from the governor or mayor of the city directed to the state legislature, city council and/or the residents of the city or state. This message should indicate the law or statute that requires the submission of the budget and the time period that it covers. The message should also indicate the amount of revenue that is expected during the fiscal year and whether or not this is an increase or decrease from the previous fiscal year. If the legislative body governing the state or locality has recommended changes in budget allocations, those items should be indicated. If cuts were made, the reader should see what departments were cut in the message. If new programs were established or expanded, these should be highlighted. The letter should be followed with a table of contents outlining the remainder of the budget (see Appendix 1A for an example of a Budget Letter).

2. *Budget Summary*: The budget summary is normally a spreadsheet document indicating all of the revenue sources by type (property taxes, sales taxes, user fees, etc.) and the expenditures by type (each agency or department should be listed). Small cities with limited revenue sources will frequently use this format. It is important that each fund is clearly labeled (see Appendix 1B for an example).

3. *Source of Revenue*: This section should detail to the reader exactly where all the revenue came from and the changes that occurred from previous fiscal years. Each source of revenue should be listed with, at a minimum, the actual budget for the previous fiscal year, budget estimates for the current year, and budget projections for the subsequent years. This page allows the reader to see the overall growth of the budget over the past years, as well as which revenue source is growing and which is decreasing (see Appendix 1C for an example).

4. *Source of Expenditures*: This section lists the major expense categories: personnel, operating, capital expenditures, and special appropriations for the entire government. You can also list the various departments by fiscal year along with the expenditures. A program or performance budget can follow the same format by listing the program or activity that is in use. Again, each of these categories

show the comparisons between the current fiscal year and the previous two fiscal years with a column for the actual dollar amount change and the percent change from the previous fiscal year (see Appendix 1D for an example).

5. *Department/Agency Budget Information*: The bulk of the budget contains the individual budget requests for each department. There are several good ways to prepare this information in an efficient manner. The first way is to list the various line-item expenditures of the department in the right hand column and then indicate the changes in the budget by fiscal years. On a second page, you should list the fund sources for that department and the changes that have occurred over the previous fiscal years. Again, the presentation of this information will vary with respect to the type of budget. To say the least, the reader should be able to determine exactly how much revenue is coming into the department and what it is used for. Since most agencies are balancing the budget from previous fiscal years, the spreadsheet should provide the reader with the amount of allocations from the previous two fiscal years along with the percent change in both dollar amount and percentage change (see Appendix 1E for an example).

6. *Supplemental Budgeting Information*: The budget document should provide the reader with any new laws, statutes, rules, or ordinances that affect the budget document. This is particularly true for capital improvement projects. Again, if necessary, a spreadsheet should be created for these projects in a format similar to the previous documents.

Public Versus Private Budgets

Although there are many common themes that exist in all budgets, public budgeting does differ from the private sector in many respects (see Table 1.1). First, public budgeting often involves the interaction of many actors involved with a variety of different agendas. Private budgeting may involve one or a few personnel regardless to the size of the organization. Second, funds that are spent and collected in the public sector are collected from tax payers who may or may not want the monies to be collected and spent and may not receive any direct services as a result of paying the tax. On the other hand, monies collected in the private sector are not compulsory and services are directed accordingly. Third, public budgets are public documents and therefore are open to be scrutinized by citizens, while private budgets are not. Fourth, public budgets are well designed documents that are written to last an entire fiscal year (or two). Hence, they are not very flexible. When crisis or other unplanned events occur, it can be catastrophic to budget analysts as well as elected officials. Private budgets are very flexible and can be changed at a moments' notice in order to move with changes in the economy, budget shortfalls, etc. Fifth, the number of rules and actors involved in public budgeting far surpasses that in the private sector. For example,

there may be rules affecting expenditures, tax collection, balancing the budgets, assessments, mandates, etc. While there may be rules applied in the private sector, the process does not tend to be overly bureaucratized (Rubin 2006). Last, appropriation acts and ordinances are legal documents that place limits on spending. Many governments have severe penalties for overspending appropriations, including jail time.

Table 1.1 Comparing Public and Private Budgets

Public Budgets

- Many decision makers
- Revenue is collected from tax payers who may not benefit from the tax
- The budget is open to the public
- Covers an entire year and are not very flexible
- Many rules affecting the collection of taxes (i.e. legally set tax rates)

Private Budgets

- Few decision makers
- Monies are collected and a service or product is provided
- The budget is not publicly available
- Budget is very flexible and can be modified to fit the circumstances
- Fewer rules and regulations

Overview of Revenues and Expenditures

State and local revenues come from a variety of sources.⁶ *Revenues* are the monies collected by all levels of government to pay for the operation of government. *Expenditures* are financial obligations that flow from the operation of government. The major source of revenue for state and local governments is taxes. For some states, *income taxes* make up the greater proportion of taxes collected (in addition to sales taxes). Unlike state governments, some local governments have the option of collecting payroll taxes (income taxes).

Payroll taxes can be used for special purposes or serve as additional income for the local government. Income taxes are deducted directly from individual earnings and are compulsory. State income tax rates tend to be lower than federal income taxes. They are *progressive taxes*. That is, higher income individuals pay more taxes than lower income individuals. Although corporations pay income taxes, they tend to be a much lower percentage of all taxes collected. Individual income taxes make up about one-third of all taxes collected in a state. All states do not have state income taxes (Mikesell 2004; Bland 2005).

The second major source of revenue in a state (and in some localities) comes from *sales and use taxes*. These are taxes placed on goods and services.

Sales taxes are considered *regressive taxes* because citizens pay the same rate regardless of their income level. Each state sets its own sales tax rate. States and localities also have some discretion as to what items will be assessed sales taxes. For example, sales taxes are not applied to the sale of un-prepared foods in Kentucky. Other sources of revenue for the state include: tobacco, alcohol, petroleum product taxes, inheritance taxes, automobile taxes, and public utility taxes. States can also allow local governments to establish a *local option sales tax* which can be used to pay for a specific item of cost.

States also get a large amount of revenue from the federal government in the form of *grants*. Grants come in two major forms: categorical and block. *Categorical grants* make up the largest type of grants that a state receives. A categorical grant is used for a specific program and has very strict guidelines for the activities to be carried out within a specific time period. Categorical grants exploded during Johnson's Great Society programs in the 1960s. Formula and project grants fall within the umbrella of categorical grants. *Formula grants* use a distribution formula to determine the amount to be allocated to the state or locality. Population, geography, income and education are variables that are used in formula grants. A *block grant* is used for broad policy areas. It can be used for a variety of programs and activities by state and local governments.

A major source of revenue for local governments is *property taxes*. These are taxes levied against real property, perhaps personal property and private utilities. Many local governments have the ability to impose sales taxes. The taxes are piggy-backed onto state sales taxes for collection efficiency. Many local governments have the ability to impose license fees on motor vehicles. Another source of revenue for local governments is licenses and permits, franchise fees and user charges. A *license fee* is a flat rate tax for business entities. The cost of the license fee differs by activity. For example, the cost of a hunting license is different from that of a license to operate a restaurant. Without a license, an individual or business is forbidden to engage in the activity legally. The owner of a license does not receive any specific government service by having the license. Under normal circumstances, everyone who applies for a license receives it (Bland 2005; Raphaelson 2004).

A *franchise fee* appears to be closely related to a license fee, but there are some subtle differences. Franchises are provided on a very limited basis. A franchise presupposes that the business will serve the entire community, operate with a certain quality and rate, and outlines the responsibility of the owner and the government.

A *user charge* is a fee charged to individuals who voluntarily use a publicly provided service. For example, large municipalities may implement a toll charge to pay for the construction of a new road. If you do not use the new road, then you do not pay the charge. The purpose of a user charge is to relieve the financial burden placed on the general revenue system. In most cases, user charges are geared toward the population that is benefiting from the public service. User charges are useless if they are not enforceable (Bierhanzl and Downing 2004).

Another source of revenue for local governments is the proceeds from *public utilities*. Public utilities are government owned business. These include but are not limited to water utilities, gas utilities, electric utilities, sewers, and inter-city transit. These government businesses have little or no competition (*monopoly*). One of the newest forms of revenues for states and local governments are the revenues collected from casinos, lotteries, and other forms of gambling. This revenue stream has grown tremendously over time and are frequently used for educational purposes.

Although *bonds* are not considered a source of revenue in most cities and states, they do serve as a major source of funds for the construction of public buildings, schools and other big ticket items. A bond is basically money that is borrowed from an individual with the assurance that the bond can be cashed in during a given period of time for a sum of money (principal and interest). State and local governments use bonds to finance projects that cannot be financed from the current revenue sources. The interest earned on bonds is not taxable by the United States government. There are two types of bonds: full faith and credit bonds (general obligation bonds) and non-guaranteed bonds. General obligation bonds are paid for out of the general revenue fund and are guaranteed by the state or local government that issued them. Non-guaranteed bonds have a limited backing, usually from a revenue source such as water and sewer revenue. The only backing is the revenue stream that is pledged to repay the debt. (Vogt 2004; Bland 2005; Lee, Johnson and Joyce 2013).

Taxes and other sources of revenue are used to pay for government *expenditures*. An expenditure is "the disbursement of money to cover the costs of a governmental agency's operation" (Riley and Colby 1991). The majority of revenues collected by local governments are used toward the payment of salaries and fringe benefits to employees. In addition to personnel cost, supplies, equipment, contractual services and *capital outlays* make up the vast amount of the budget. Capital outlays are monies allocated for big ticket items that cannot be completed in a single fiscal year. Normally, personnel cost will range from 65%-75% of a local budget. States typically have large expenditures for transfer payments to local governments or individuals, such as primary and secondary education allocations to school districts, payments to institutions of higher education, and Medicaid payments for low income individual. The operating expenditures for states typically make up only 35%-45% of total spending. The percentage change would depend on the function of an agency. For example, police and fire departments frequently have higher equipment cost than an auditor's office.

Tables 1.2 and 1.3 provide examples of a revenue and expenditure summary for Jefferson City and the state of Alexander respectively. Table 1.2 shows that property taxes tend to make up the greater portion of all taxes collected by local governments, followed by sales taxes. In the expenditure column, the Executive and Highway and Streets departments have the largest budgets. A line-item budget for each of these divisions would reveal that the majority of the budget is

used for personnel services.

**Table 1.2 Estimated Revenues and Expenditures
Jefferson City (FY 2018)**

<u>Sources of Revenue</u>	<u>Amount</u>
1. Property Tax	\$361,250.00
2. Local Sales Tax	232,979.00
3. Beer Tax	59,752.00
4. State Sales Tax	153,000.00
5. State Petroleum Tax	59,500.00
6. Automobile Registration	15,725.00
7. Minimum Business Tax	21,482.00
8. Corporate Excise Tax	12,750.00
9. Solid Waste Fund	154,445.00
10. Debt Service Fund	65,025.00
11. Water and Sewer Fund	642,485.00
12. Other	<u>120,210.00</u>
TOTAL	\$1,899,450.00

<u>Sources of Expenditures</u>	<u>Amount</u>
1. Executive Department	\$282,455.00
2. City Recorder	133,790.00
3. Police	199,494.00
4. Fire	56,396.00
5. Highways and Streets	292,570.00
6. Playgrounds	64,770.00
7. Solid Waste	136,000.00
8. Water Utilities	218,926.00
9. Non-Operating Exp.	95,200.00
10. Bond Principal	60,106.00
11. Libraries	12,750.00
12. Other	<u>346,993.00</u>
TOTAL	\$1,899,450.00

Table 1.3 shows that half of the revenue collected by the State of Alexander comes from taxes. It is also noteworthy to mention that expenditures are typically listed by department in a “line-item” format. However, in a summary expenditure sheet, such as this one, there is no need to break down expenditures into sub-categories that detail personnel, equipment and capital outlays (Bahl 2004). That information would be provided in the individual agency line-item budget sheets (see Appendix 1A).

Table 1.3 Estimated Revenues and Expenditures, FY 2018
State of Alexander (in billions)

<u>Sources of Revenues</u>	<u>Amount</u>	<u>Sources of Expenditures</u>	<u>Amount</u>
1. Tax Collections	\$43.5	1. General Government	\$2.1
2. Federal Funds	25.4	2. Health and Human Services	26.1
3. Licenses and Fees	7.4	3. Public Education	26.4
4. Lottery	4.4	4. Higher Education	11.9
5. Interest Income	3.9	5. Public Safety	7.0
6. Other Revenue Sources	<u>2.7</u>	6. Natural Resources	1.7
TOTAL	\$87.3	7. Business and Economic Dev.	10.3
		8. Other	<u>3.7</u>
		TOTAL	\$87.1

Governmental Accounting

One of the most important functions of state and local governments is to maintain a meticulous accounting record. Unlike individuals who are paid a certain amount of dollars at some set period, governments receive various amounts of money throughout the course of a fiscal year. Hence, they must allocate and manage funds in order to cover all expenditures. State and local governments typically use a *fund accounting system*. The Governmental Accounting Standards Board (GASB) establishes accounting and reporting standards for state and local governments. This board created what is called Generally Accepted Accounting Principles (GAAP). Audits of state and local governments are performed based on GAAP and an opinion is rendered by an auditor. The federal government requires all governmental units receiving federal funds to adhere to the principles outlined in GAAP.⁷ The GASB provides standards for reporting, but not budgeting. There are no standards for budgeting unless they are established by state law (Lande and Rocher 2011; Ball 2012).

Governmental accounting normally takes three forms: cash basis, modified accrual and full accrual. A *cash basis* system is very comparable to your personal checking account system. Budget officials basically add the revenue to an account when they literally receive the funds in their hands. On the expenditure side of the equation, funds are subtracted from an account as soon as they are spent. This technique will work for all sorts of accounts, but is not necessarily the best system for all accounts (Table 1.4).

Similar to a cash basis system, a *modified accrual* system records revenue when the funds are measurable and available. The terms measurable and available are mutually exclusive and are the result of donor contributions. They largely apply largely to the nonprofit sector. For accounting purposes, contributions must be recorded even though the funds may not be available immediately. The amount is known and available means that it is received during the fiscal year or

soon enough after the end of the year so that obligations for that fiscal year can be paid. This period is typically 60-120 days. However, expenditures are recorded when a fund liability is incurred. That is, an entity has agreed in principle to spend funds. A *full accrual* system records revenue as it is earned regardless to whether the revenue has been received. For example, property taxes are recorded when the bill is mailed (earned) rather than when the bill is paid (received). A full accrual system records expenses when a financial obligation is incurred. The accrual basis of accounting is used primarily for matching revenues to the cost of production. The basis of accounting for state and local governments is prescribed by the GASB based on the fund type that is involved.

Generally speaking, budgeting takes place on a prospective basis. That is, funds are deducted as soon as a commitment is made. For example, the Transportation Department gave a contract to Whitley's Construction Company to repair the city's streets. As a result, the dollar amount of the contract is immediately deducted from the department's budget even though the full payment has not been made. The accounting system will not record an obligation until services have been rendered.

Table 1.4 **Accounting Methods**

Cash Basis System:

- a. Revenue is recorded when the funds are received.
- b. Expenditures are recorded when the funds are spent.

Modified Accrual:

- a. Revenue is recorded when the funds are measurable and available.
- b. Expenditures are recorded when a fund obligation is made.

Full Accrual:

- a. Revenue is recorded when actually earned or when the government established a claim.
- b. Expenses are recorded when a financial obligation is made.

Governments tend to be financially conservative when it comes to estimating or forecasting revenue. For example, local governments do not count on collecting 100% of the property tax, so they normally estimate anywhere from 90-95% based on the collection or historical trend.

As a result, most governments use the cash basis method for budgeting taxes in general, although some use the modified accrual method. Some use a hybrid system—modified accrual for some sources and cash for others. The federal government uses the cash basis system except for interest and credit programs (Analytical Perspectives: Budget of the U.S. Government, 2004, 470). Private entities tend to use the accrual method since the objective is to match expenses

to revenue (Laughlin 2012).

Government Funds

As revenue comes into the government, it is placed into separate *funds*. GAAP sets up three classes of funds—governmental, proprietary and fiduciary. *Governmental funds* are those that are used to carry out basic government services and are primarily supported through taxes and shared revenues. *Proprietary funds* are business-type in nature and are similar to those used in the private sector. *Fiduciary funds* are used to account for assets that are held by the government as an agent or trustee. Fiduciary funds are not used to carry out government activities. Within each class of funds, there are several types of funds. As a general rule, funds act as fiscal control agents. That is, they force governments to spend the money for the purpose that it was created.

The largest classes of funds are governmental funds. There are five types of funds within this class: General Fund, Special Revenue Funds, Debt Service Funds, Capital Project Funds, and permanent. With regard to the number of funds a government can have, the only limit involves the General Fund—there can only be one. GASB recommends that only the minimum number of funds needed for legal and operating requirements should be established. It is common for governments to have more funds for budgeting purposes than for external reporting purposes. For external reporting, governments tend to combine like funds, such as federal grant funds (GASB Codification Section 1100).

- The *General Fund* includes all revenue not designated in another fund. It is the largest fund in terms of the dollars that transfer through it. An example of revenue that goes into this fund is property taxes, license fees, and income taxes.
- *Special Service Funds* are designed for earmarked revenue or revenues that are designated for special purposes. For example, taxes on petroleum products would go into this fund. Governments frequently use grant funds in special revenue funds to ensure that monies are *allocated* for the designed purpose. A government is not limited to the total number of special revenue funds that it may have.
- *Debt Service Funds* are funds designed to collect revenue for the repayment of long term debt. Revenue in this fund frequently comes from transfers from the general fund. The purpose of the fund is to ensure that revenues are set aside for the repayment of debt. For example, general obligation bonds are included in this fund. There are no limits on the number of debt service funds.
- *Capital Project Funds* are designed to collect revenue for the pur-

chase and construction of capital projects. For example, the proceeds from the issuance of bonds would go into this fund.

- *Permanent Funds* are used to report resources that are legally restricted to the extent that only earnings, and not principal, may be used for purposes that support the government's programs. For example, money may be donated to the government to maintain a cemetery and provides that only the earnings from investments can be used for that purpose.

Proprietary Funds

Proprietary funds are for public service activities that resemble those of the private sector, proprietary or business like activities. This would include for example the use of a public gas company or a public golf course. There are two types of proprietary funds: enterprise funds and internal service funds.

- *Enterprise Funds* contain revenues collected from individuals external to the government. These are collected on a fee basis.
- *Internal Service Funds* contain revenue from agencies within the government for services rendered.

Enterprise funds operate much like that of a private sector business. They collect most of their revenue from user charges. For example, drivers pay a fee to cross the Bay Bridge from Oakland to San Francisco. Other examples would include public utility companies, public transportation, and government owned public radio and television stations. The purpose of this fund is to determine if the entity is collecting enough revenue to maintain its existence.

Unlike enterprise funds, internal service funds are used within the government and provide a service to other government agencies rather than the public at large. For example, Jefferson City has a central motor pool that provides transportation services for all of the cities agencies. When a car needs to be repaired, the city garage repairs it. Thus, revenues are shifted to this department from other departments when services are rendered. Since most agencies have funds dedicated for this service, they are likely to use it. There is no charge unless the service is used.⁸

The distinction between an enterprise fund and internal service fund is the primary customer. If the primary customer is outside the government, an enterprise fund is used. If it is within the government, an internal service fund is used.

Fiduciary Funds

There are also other types of funds that may be used by state and local gov-

ernments. The first type is fiduciary funds. *Fiduciary funds* are essentially revenue held for other individuals or government organizations. There are four types of fiduciary funds: pension trust funds (and other employee benefit trust funds), investment trust funds, private-purpose trust funds and agency funds (Mikesell 2014).

- *Pension (and other Employee Benefit) Trust Funds* hold monies for government employee's pension plans, other post-employment benefits, or other employee benefit plans. This is usually the largest type of fiduciary fund.
- *Investment Trust Funds* are used to report the external portion of investment pools reported by the sponsoring government.
- *Private-purpose Trusts* are used to report trust arrangements under which the principal and interest benefit individuals, private corporations, or other governments.
- *Agency Funds* hold monies in a purely custodial capacity for individuals or other governments.

Conclusion

As the chapter shows, elected officials can use the budget as a tool to control the bureaucracy, as a plan of action, and to create accountability. The type of budget used plays a significant role in the information that is conveyed. Elected officials frequently do not have in depth knowledge of all the agencies that they ultimately govern and as a result, the type of budget used can serve several purposes. Similarly, the type of accounting methods used can affect how the monies can be spent and held. The next chapter will show the reader how elected officials close this information gap.

Chapter 2

Preparing a Budget Proposal

Chapter Two Overview

Chapter two of the book deviates somewhat from the basic budgeting terms, phrases and practices that you learned in chapter one. In this chapter you will focus on preparing a budget and determining if a budget is efficient and effective. On the surface, this may seem to be an easy task. However, budgeting is not as simple as it appears. For instance, at any given time, a state or local government may be working on three separate budgets: the current year, previous year, and the up-coming fiscal year. This process requires the cooperation and efforts of a lot of individuals and agencies, including various groups and individuals that may have completely separate agendas.

The chapter begins by first examining the budget cycle and the various phases that it goes through. This section is followed with an analysis of the individuals involved in the budget process. The chapter ends with a discussion of determining agency needs and writing agency policy statements.

Budget Cycles

Repetition of events essentially drives the *budget cycle*. A budget cycle is a period of time in which the budget has to be prepared and executed. This cycle or system ensures greater accountability for decisions. It also allows decision makers to modify the budget for greater *efficiency* and *effectiveness*. The budget cycle has three phases: executive preparation, legislative approval, and budget execution. However, there is also an audit/evaluation phase that occurs after the execution phase.

Phase 1. Executive Preparation: The chief executive of a state or local government is the one person who sets the tone for the policy issues that are addressed during the budget preparation phase. Guidelines are generally prepared by the chief budget/fiscal officer and given to agencies laying out key issues that will be addressed for the upcoming budget year, along with the timetable for submission of the budget. These include items such as policy priorities and proposed new legislation affecting the budget. A good budget should be very comprehensive in describing: anticipated revenues and proposed expenditures;

provide accountability for spending; avoid *earmarking funds* which could hinder new priorities; and indicate the purpose for new spending and the desired results (Kittredge and Ouart 2005; Musell 2009; Mikesell 2014). Agencies in turn use this information when preparing their budget requests. In addition to preparing spending requests, agencies that have dedicated funding sources, such as federal grants, licenses and permits, and charges for services, provide estimates of revenue for the forthcoming budget year in their submission.

These requests are then forwarded to the chief executive's budget office to be reviewed and analyzed. Often, hearings will be held with the agency to clarify the budget request. The chief budget/fiscal office is responsible for the preparation of revenue estimates, particularly for the General Fund. In analyzing the requests, the revenue that will be available is a key factor during the internal budget deliberations. More often than not, the sum total of the budget requests for the General Fund exceeds the available revenue. As a result, decisions have to be made regarding the amount that will appear in the budget submission for each agency. It is not uncommon for department heads to be upset with the final recommendation. Some will try to get more money by lobbying the legislature/council, or will use special interest groups for that purpose.

Many state and local governments are legally bound to have a balanced budget pursuant to state law, local charter, or ordinance. The problem with most balanced-budget legislation is that it does not specify what "balanced" means. Usually, it is on the budget basis, which is most often cash. A cash budget can be manipulated by simply not paying bills at the end of the year. If the budget has to be balanced based on a modified accrual basis, then more discipline is added to the process since liabilities cannot simply be passed on into the future. Some balanced budget laws state that revenues have to equal expenditures (without stating the basis that is to be used). This means that available balances are not able to be used to fund a deficit.

Once the requests have been received and analyzed, they are assembled into a single document. The budget is then submitted to the legislative body and also released to the public. Some governments prepare a budget-in-brief, which is intended for the citizens. It contains summaries of the requests along with an explanation as to what will be accomplished during the upcoming year.

Phase 2. Legislative Approval: Similar to other legislation, a legislative body has to approve the budget. The chief executive forwards the budget to the legislative body and when it approves the document, it has the force of the law. This process seems very simple, but in reality it is not. Negotiations between the executive and members of the legislature or city council are very common. In some cases, these negotiations can be very stressful given partisan differences. Party politics plays a smaller role at the local level when compared to the federal and state governments (Smith, Sun, and Lynch 2017; Musell 2009). For every state except Nebraska (which only has one house), the budget is

submitted to the lower house, similar to the process used by the federal government. The Finance Committee is in charge overall. However, other committees will be involved. For example, the Transportation Committee will hear the request for the Department of Transportation. After they conclude the hearing, the recommendation will be forwarded to the Finance Committee. During the course of the hearings, many parties will comment on the request. The department head will provide an overview of the request. Public interest groups will offer their comments as well. Most states have legislative budget offices that provide projections independent of the executive, which are used by the legislature in formulating the appropriations. Once the lower house completes its hearing, they vote on the measure. It is then sent to the upper house (Senate), and the process starts all over again. Once the upper house completes its process, more often than not changes are made from the version passed by the lower house. As a result, a conference committee is formed with representatives from both houses. The responsibility of the conference committee is to come up with a single appropriation act that is acceptable to both houses. Although it is desirable to have the budget passed before the start of the next fiscal year, it often does not pass quickly because of political differences. In that case, a *continuing resolution* is passed, so that government can operate while the problems are worked out. Eventually, an appropriation act is passed and sent to the governor for signature. Many governors have the ability to use a line-item veto, by which specific appropriations can be vetoed. The legislative body has the ability to override the veto if it can muster the necessary votes.

The process is much simpler in local governments. The legislative body is the council, board, or commission. The executive branch still presents information regarding the request. The public and special interest groups still have the ability to testify and offer ideas. Eventually, an appropriation ordinance is passed and signed by the chief executive officer. Many local governments have charter or ordinance provisions that require the budget to be enacted before the start of the fiscal year.

Phase 3. Budget Execution: At the beginning of the fiscal year, agencies carry out or execute their approved budgets. Spending is monitored by the agencies and the executive budget office in order to ensure that appropriations are not overspent. This is usually done through the use of accounting software that is designed to ensure that spending is within the authorized amounts or allotments. This process helps to ensure that agencies do not spend all of their funds in the first month or quarter of the fiscal year (Musell 2009). Monthly, quarterly, and midyear budget reports are issued so that comparisons can be made between appropriations, actual revenue received, revenue projections, and actual expenditures (see Appendix 2A for an example). If revenue projections are off the target, modifications should be made to ensure that the budget is balanced. Budget short falls can cause serious operating and personnel problems for

agency heads (Nice 2002; Smith, Sun, and Lynch 2017). Many state and local governments have legislation that requires the chief executive officer to take action to reduce spending if revenue projections are not met.

Most states and large local governments use an allotment process to help control the budget. At the start of the year, each agency is required to allot the annual appropriation by quarter. This, in effect, means that agencies are managing quarterly budgets. Another budget control tool is the *encumbrance*. When an agency enters into a contract or purchase order, an encumbrance is established setting aside that amount so that when the goods and services are received, funds are available to pay the expenses.

Audit/Evaluation Phase: The purpose of this phase is to determine if the budget was executed and implemented by the bureaucracy in the manner that was set forth in the legislation (Nice 2002; Musell 2009; Mikesell 2014). That is, does the approved budget and actual budget match up? An audit occurs after the fiscal year has ended and can be done internally or externally. Individuals working within the agency conduct *internal audits*, and *external audits* are done by paid professionals outside of the organization. Audits vary according to the type of budget that is used by agencies. Generally speaking, there are two types: financial and performance. A *financial audit* checks to ensure that an agency's financial statements fall within the principles of GAAP and gauge whether an agency has followed the laws and statutes regulating its spending.

A *performance audit* concentrates its efforts on efficiency and effectiveness, by examining procurement, duplication, utilization of staff, legal compliance and measuring and reporting performance (Solano 2004; Smith, Sun, and Lynch 2017; Lee, Johnson and Joyce 2013). Basically, what was accomplished with the funds that were spent? There are two types of performance audits: economy and efficiency, and program audits. *Economy and efficiency audits* determine whether the governmental unit is acquiring, protecting, and using its resources economically and efficiently and whether it has complied with laws and regulations on matters of economy and efficiency. *Program audits* determine the extent to which desired results are being achieved and whether there are related compliance issues. There are also *single audits* that concentrate more closely on the expenditure of grant resources than do other types of audits. A single audit is required by the federal government for all state and local governments that have \$500,000 or more in federal grant awards and requires auditors to test to see if grant provisions are being followed.

Pariser and Brooks (1997) highlight some generally accepted government auditing standards that administrators should have in place as a follow up to determine the effectiveness of the audit. That is, were the recommendations followed and did they achieve desirable results? They suggest that the following bulleted items should be included in an audit recommendation follow up system (p. 337).

- Firm policy basis for following up on audit recommendations
- Organizational commitment to implementation
- Evaluation of recommendations including budgetary and organizational impact
- Clear assignment of follow up responsibilities
- Preparation of corrective plans
- Special attention to key recommendations
- Periodic review to evaluate the adequacy of actions taken on recommendations
- Preparation and distribution of periodic status reports
- Use of status reports for oversight and management evaluations

Further, management should be fully committed to implementing the suggestions from the audit and this should be evidenced by formal policies or a procedures manual that describes the details of the audit recommendation follow up system as well as securing individuals to be responsible for implementing the recommendations.⁹

The Budget Calendar

Since state and local governments work around a fiscal year, budget approval has to occur prior to the beginning of the fiscal year. The beginning of the budget cycle differs for most states and cities. For 46 states, the fiscal year begins on July 1st and ends on June 30th. Exhibit 2.1 provides a summary of the various budget periods.

Exhibit 2.1 Budget Fiscal Years

<u>Government</u>	<u>Fiscal Year Beginning</u>
U.S. Federal Government	October 1-September 30
46 States	July 1-June 30
2 States	October 1-September 30
1 State	September 1-August 31
1 State	April 1-March 31
Local Governments	Variously January, July, September, October

Source: Lee, Robert, Johnson, Ronald, and Joyce, Phillip, 2013. *Public Budgeting Systems*. 9th Edition. Jones and Bartlett Publishers Inc, Burlington, MA. Mikesell, John L. 2014. *Fiscal Administration: Analysis and Applications for the Public Sector*. 9th Edition. Wadsworth Cengage Learning: Boston, MA.

A lot of local governments begin the fiscal year in January, July, September and October. The federal fiscal year is October 1st through September 30th.

Exhibit 2.2 shows the budget time frame for Jefferson City. Although fiscal year (FY) 2019 begins on July 1, 2018 for the city, the process began officially on March 12, 2018. At this point, the city makes the final adjustments to close out the FY 18 budget while they are in the FY 19 budget season. So, they are in affect managing three budgets simultaneously. By establishing exact dates and times for forms and meetings, it brings a lot of order to the process. Unless something out of the ordinary occurs, agency personnel and elected officials tend to stick to the set times frames.

Exhibit 2.2 Jefferson City Budget Timetable, FY 2019

1. March 12, 2018, Audit & Finance Committee meets to finalize time table with agencies and departments on budget request.
2. March 13, 2018, Send out notices to agency heads that deadline to submit appropriation request will be Friday, March 31st.
3. March 30, 2018, Deadline for Agencies, Boards and Commissions to submit budget proposals to CAO for copying for elected officials.
4. April 9, 2018, A&F Committee Meeting. Preliminary revenue Projection and summary spreadsheets of requested expenses submitted to Mayor and Audit and Finance Committee from CAO and Financial Director.
5. April 16-20, 2018, Agency and Department Appropriation Hearings before Audit and Finance Committee.

April 16th (Monday): Agencies-7:00 to 10:00 a.m.

April 18th (Wednesday): Agencies-7:00 to 10:00 a.m.

April 20th (Friday): Departments-6:00 to 10:00 p.m.

Public Works-6:00 to 7:00 p.m.

Police Dept.-7:00 to 8:00 p.m.

Fire Dept.-8:00 to 9:00 p.m.

Administration Dept.-9:00 to 10:00 p.m.

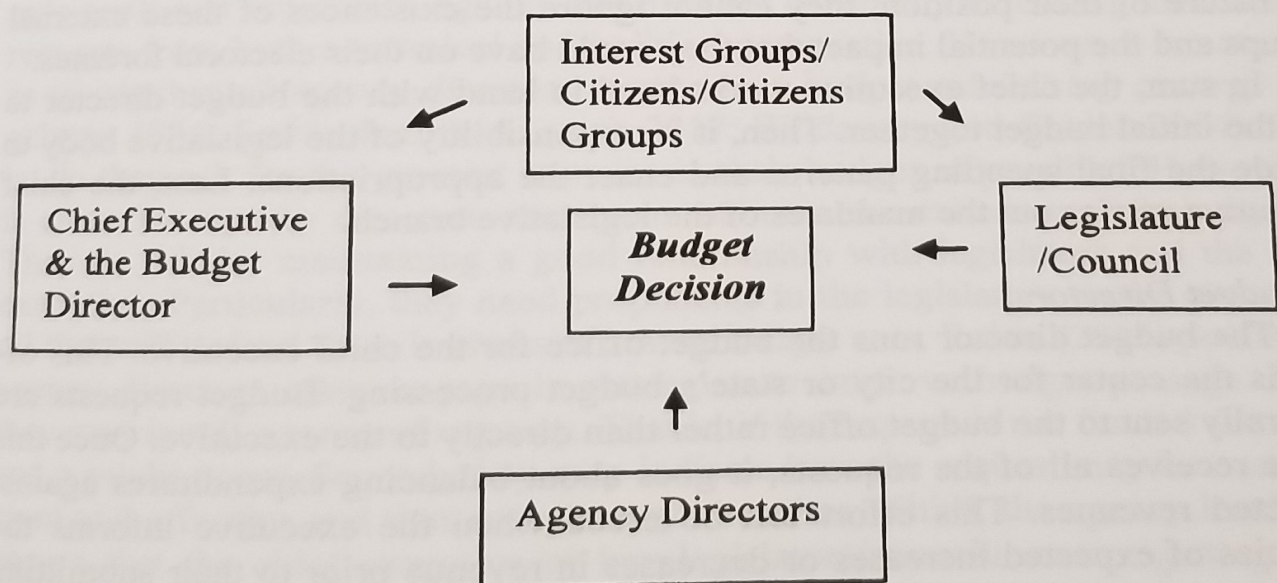
6. April 23, 2018, A & F Committee Meeting. Final revenue Projections submitted to Mayor and Audit & Finance Committee. Mayor and Committee discuss budgetary emphasis and priorities, and agree on strategy to handle revenue shortfalls, request overruns, etc.

7. May 7, 2018, MRA/LGEAF Budget Hearings held as required by state law.
8. May 21, 2018, Mayor's Budget and Budget Message presented to Council. Mayor usually delivers his proposed budget at a special called meeting late in the month.
9. June 4, 2018, First Reading of the FY 19 Budget Ordinance.
10. June 18, 2018, Second Reading of FY 19 Budget Ordinance.
11. June 20-30, 2018, Publication of FY 19 Budget Ordinance.

The Budget Game

Making budgeting decisions can be a very complicated process given the number of individuals involved and their ideas and goals. In an executive budgeting system, the chief executive plays the major role in the budgeting process. That is, he/she initiates the process. However, there are a number of others involved in the process as well, including the budget office, legislature, and agency directors. In addition, there are some non-governmental actors that can play a role in the process such as interests groups and individuals (Rubin 2006). All governments however do not use an executive budgeting system.

Figure 2.1
Actors and Budget Decisions



County governments tend to have administrators, auditors, or someone in

the legislative branch prepare the budget. Some states have legislative budget offices that expend enormous amounts of energy and paperwork on the budget (Lee, Johnson and Joyce 2013). Under normal circumstances, the word game and government would not go together. These two terms tend to go hand in hand at the state level and in very large cities when it comes to devising the budget.

Budgeting is a bit more bureaucratic in smaller governments. However, when one considers the entire decision making process, it does display some of the same characteristics of a game. Players/decision makers use strategy and sometime they win and sometime they do not. Policy makers render decisions that are good and bad for certain individuals and agencies. Figure 2.1 illustrates the four main actors involved in the process as well nongovernmental actors (Bland and Rubin 1997; Smith, Sun, and Lynch 2017; Rubin 2006; Mikesell 2014).

Budget Actors

1. Chief Executive

The chief executive is the only person responsible for the entire institution of a particular governmental entity. As a result, executives try to ensure that spending is done as harmoniously as possible in order to satisfy the greatest number of individuals and agencies. The executive, via the *budget director*, initiates the budgeting process and is responsible for sending letters to the various agencies informing them of important dates and deadlines for information.¹⁰ Although the chief executive may appoint agency heads, this relationship may not be as friendly as it appears. The executive has the option of saying no, and does so frequently. You must also consider the role of interests groups, citizens, and citizen groups. Mayors, governors as well as legislators and councilmen are frequently bombarded with requests that may impact budget decisions. Given the nature of their position, they cannot ignore the existences of these external groups and the potential impact that they could have on their electoral fortunes.

In sum, the chief executive works hand in hand with the budget director to put the initial budget together. Then, it is responsibility of the legislative body to decide the final spending patterns and enact the appropriations. Last, the chief executive carries out the mandates of the legislative branch.

2. Budget Director

The budget director runs the budget office for the chief executive. This office is the center for the city or state's budget processing. Budget requests are generally sent to the budget office rather than directly to the executive. Once this office receives all of the requests, it goes about balancing expenditures against expected revenues. This effort can be eased when the executive informs the agencies of expected increases or decreases in revenue prior to their submitting budget requests. However, budget projections are not finalized until the last possible moment. Given the constraints of limited revenues, the budget office must

ensure that items of high priority, as deemed by the chief executive and legislative body, be provided for. However, this process can cause a lot of friction between the budget office and the agency directors. Although there are many different reasons why an agency may be denied funding for some program, common reasons would include the following: 1.) Items were not adequately justified; 2.) The money is not available; 3.) Items do not fit the goals and objectives of the agency; and 4.) Items are not in harmony with the executive's priorities (Bland and Rubin 1997; Smith, Sun, and Lynch 2017; Kittredge and Ouart 2005; Mikesell 2014).

3. Legislator/Council Member

This group of persons is responsible for approving the budget. They are always looking for an opportunity to bring in programs and projects that will benefit their constituents. Most legislators/councilmen do not have a good grasp of the budget process from a micro perspective. This is not necessarily a bad thing given their role in the budget process. They are often given dense information with little time to react to it. As a result, they tend to center their efforts on their individual pet projects. Legislators on powerful committees and party leaders can use their influence to secure pet projects a lot easier than less senior legislators. Unlike the chief executive, the decisions made by legislators and councilmen are more likely to be impacted by interest groups, citizens, and citizen groups.

4. Agency Directors

Agency directors head the various departments within the *bureaucracy*. These departments provide the services that affect the well-being of the citizens. Since their efforts gravitate towards the individuals that they serve and the agency's goals and objectives, agency directors are constantly defending their budget requests from both a technical and political perspective. However, it is not clear as to whether all agency directors engage in a *budget maximizing strategy* (Sigelman 1986; Smith, Sun, and Lynch 2017; Wildavsky and Caiden 2004). That is, do they ask for the greatest increase in their budget as possible? However, it is clear that agency directors attempt to maintain the existence of their agency. They do this by maintaining a good relationship with legislators and the chief executive. Particularly, they need proponents in the legislature or the city council that will defend them in times of severe budget cuts. Rubin (2006) points out, agency directors often engage in strategies to improve budget passage. First, they may instill a sense of urgency. That is, if the request is not funded then x, y, and z might occur. Second, they may indicate how the request may be cost efficient and effective and thus save money over time. Third, the agency head may ensure that the chief executive or key legislators/councilmen are getting their individual demands met in the request.

As an agency head making a request, it is very important that you articulate

the needs of the agency in a manner that is clear and understandable to those who can control your budget. Therefore, you must connect the goal and objectives of your proposal to the needs of citizens and desires of politicians. These goals and objectives must also coincide with easy to understand performance measures that you must include in your proposal.

Agency Roles Expanded

While requesting budget statements from an agency, the budget office project revenue collections for the up-coming year based on available data (previous tax collections, inflation, interest rates, population movement, etc.). This increase (or decrease) is compared with the *baseline* for agencies to continue at their current rate and the new demands brought on by new legislation and priorities that have been set by the chief executive. If there are gaps between expected revenues and expenditures, the chief executive (first line) and the legislative body (second line) have to decide where cuts should be made to compensate for the disparity.

In most cases, budget requests are denied rather than raise taxes. As a result, each agency has to essentially defend its budget in a formal hearing. In preparing for a hearing, each agency should submit to the budget office a narrative explaining the purpose, goals and objectives of the agency, a budget request, and a detailed explanation justifying new requests. This would include items such as a request for a new employee. It is much easier for an agency to defend spending new monies when they can show that it fits the goals of the agency, the mission of the chief executive, and the priorities set by new legislation. If an agency cannot elaborate in detail why it needs to expand a program or hire a new employee, it will be extremely difficult for that agency to receive new funding during a period of *budget constraint*. A request for spending is not limited to one occasion. An agency may request additional funding during the course of the fiscal year (Smith, Sun, and Lynch 2017; Solano 2004; Mikesell 2014).

Justifying and Defending the Budget

Ideally, the best news for an agency is to find out that their entire budget was approved. Unfortunately, agencies frequently find that the chief executive and the legislative body demand more services with less money. Rarely is a budget completely funded without some changes. As a result, it is imperative that agency heads are completely prepared to justify their budgets. If they are not prepared, they may quickly find the agency on the short end of the revenue stream. Hence, agency heads must know how to sell their budget.

Preparation of the Budget Proposal

The phrases *political budget* and *technical budget* are two methods that characterize the process. Generally speaking, all budgets are political in nature given that government is political. However, some budget processes are more political than others. Likewise, all budgets should be technical in nature. That is, contain budgetary facts. However, the stance used to sell the budget can vary. A description of political and technical budgets is explained below.

Political Budgets

An agency director who uses a political budget strategy plays the political game. Rather than concentrate on the numbers, they use other slight-of-hand tricks in an effort to out-maneuver the politicians. Wildavsky (1979), Meyers (1999), Rogers and Brown (1999) and Wildavsky and Caiden (2004) offer several budget maximizing strategies that an agency director may employ. Using these methods are not sure fire methods to selling your budget. Policy makers are not ignorant of these "tricks".

- Cultivate a clientele in the legislative and executive branch.
- Serve a specific clientele and encourage them to contact their elected officials and sing your praises.
- Build confidence in your agency by not covering up bad deeds.
- Cut or eliminate programs that are popular with complete knowledge that they will be reinstated.
- Shift the blame of cutting the program onto the policy maker.
- Combine new programs with old programs so that they do not appear as new programs.
- Argue that new programs are modified old programs.
- Lower the budget levels for new programs with the assumption that you will get more funds later.
- Maintain your baseline and use the funds for other purposes.
- Argue that some of your expenditures are short term.
- Study the political scene and use crisis to expand or create new services.
- Show how expenditures will save money later.
- Show how a program will pay for itself in user charges.
- Use workload data to build up the budget base.

Again, there are no guarantees that these or any other strategies will work. Agency directors should assess the political environment and proceed from there. If revenues increase, it may be easier to use the technical strategies. In some cases, legislators and executives may take it upon themselves to cut or

limit agency programs despite the efforts of the agency director. In some cases, they may simply cut a program. This is particularly true when resources are limited. In fact, legislators and council members may quickly find that their pet projects will disappear. It is a lot easier to cut a program that is utilized by one district rather than the entire jurisdiction (Meyers 1999; Swain and Reed 2010; Mikesell 2014).

Technical Budgets

A technical budget concentrates on the numbers or budgetary facts. Expenditures can be split into two categories: mandatory and discretionary spending. A baseline (Base) is a technique that can be used in both categories.

Mandatory expenditures are reflected in state and local law. That is, the agency is legally required to conduct the service. These expenditures include: salaries, FICA, pensions/retirement, unemployment compensation, and any other legal obligations. While there are always questions surrounding how many employees are actually needed to provide services, eliminating an employee or cutting the personnel budget is the last thing that a politician wants to do. Under normal circumstances, elected officials honor mandatory spending.

Discretionary spending constitutes the smallest part of the overall budget. These funds often only represent increases in the budget and are sought by everyone. While not necessary for the general operation of the agency, these funds will allow the agency to expand services and operate more efficiently and effectively. Due to limited funding, agency heads should put a lot of effort into justifying spending. Data indicating population shifts, economic up swings, legal requirements are all useful in justifying new positions and an expansion in services (see also Le Loup 1977; Lee, Johnson, and Joyce 2013).

Base expenditures are expenditures that an agency needs to maintain the same level of services from the current fiscal year. This includes operating expense items such as office supplies, printing, equipment, utilities, vehicles, tools, and other related items. Agency directors can justify these items using the previous year's budget, the current year's budget, ongoing projects, or projects for the upcoming year. In any case, the director should be able to justify the request given any change in the amount of the request. This would include an increase or decrease in any part of the budget. By highlighting productivity, a budget is much less likely to be cut.

Key Components of the Budget Proposal

The budget proposal has several key components and the agency staff must be prepared to defend every portion of the budget. Below is a short description

of the key parts of the budget proposal.

A. *Project Title*: Believe it or not, a name does matter. One should spend a few minutes thinking about the label that captures the essence of their project. The title of the project should capture the interest of the reader as well as offer a very brief description of the project in five or fewer words. For example: Working Together to End Homelessness

B. *Description and Rationale*: This section of the budget is the beginning and the end to the success of your budget. It should describe what you are trying to accomplish and why it is needed in as few words as possible. For example, a rationale could be as simple as saying: We need a homeless shelter because the number of homeless people has increased by 50% since the electrical plant closed and the city wants to increase and expand employment opportunities.

C. *Objective Justifying the Need*: Objectives emanate from the description and the rationale. Objectives related to the homeless theme could include:

- The city wants to improve tourism in the downtown area. Therefore, we must eliminate people sleeping on benches, in alley ways and in front of businesses.
- The city can provide educational and job training and/or retraining at the homeless shelter.
- Statistics show that a fair number of homeless people are engaged in illegal activity in the downtown area. Hence, we can reduce the crime rate as well as pan handling.

D. *Budget and Budget Description*: The budget as a set of numbers is fairly straight forward, but the description, should be direct. That is, briefly describe who or what you need in order to accomplish your goals. For example, it is reasonable in the example above to expect that someone has to manage the homeless shelter, provide training and educational materials. Thus, you will need staff as well as computers, desks, printers, etc to manage the facility. So, these persons and items should be highlighted in the description.

E. *Measures of Success*: This is also a critical part of the budget proposal. The measures of success must be tied to the theme and objectives provided in the previous sections of the budget. For example, measurement for our homeless theme could be:

- We expect to lower the number of people sleeping on benches in the downtown area by 50% during the first year.
- We expect to train and find jobs for 50 people during the first year of

- operation.
- We will provide housing in a safe environment for 100 men and women in the first year of operation.
 - We will seek external funding to enhance our budget.

Councilmen and legislators are looking for a reason to deny your budget, particularly during periods of revenue shortfalls. So, you should make sure that your budget proposal is clear, concise, and answers more questions than it raises to the reader. See the Appendix for an example of a budget proposal.

Conclusion

By now the reader should have concluded that preparing a budget is an arduous task as well as ensuring that it is defensible. While there are time frames established to make the process logistically more efficient and effective, any number of problems may come up along the way. In fact, establishing the time frames may be the easiest part of the process. Unfortunately budget decisions are not always technical in nature. Budget games are real and are played throughout the fiscal year. If an agency wants to achieve the most for the organization, the wise decision is to be completely prepared to argue for the political or technical budget. In addition, one must be prepared to provide data indicating that programs and services are achieving their intended purpose.

Chapter 3

Personnel Services and Operating Budgets

Chapter Three Overview

Typically, a budget has three main components: personnel services, operating and capital outlay expenditures. The purpose of this chapter is to introduce the reader to the components of a standard personnel services and operating budget. Specifically, the chapter provides information on: writing the budget, justifying new positions, position classifications, pay ranges, and the calculating benefits for different types of employees. The chapter also discusses calculating FICA, Medicare, and pension benefits. Lastly, the chapter considers the different formats, advantages, and disadvantages of an operating budget. Capital outlays are discussed in chapter four.¹²

Writing a Personnel Services Budget

The personnel services budget is normally funded out of the general fund. Personnel services include salaries and *fringe benefits* for employees and can be managed in a step by step process.¹³ A salary is simply the wages paid for services rendered over a given period of time. Salaries can be calculated very easily using a spreadsheet. However, many governments have software that automate the calculation of salaries and associated benefits. That is, it is very easy to increase or decrease salaries using a very simple formula. Fringe benefits are payments and services rendered by an agency in addition to normal wages to an employee. Fringe benefits can be based on a percentage of pay roll, such as *pensions*, *social security* (FICA) and *Medicare*. Social security and Medicare are represented as a tax on your pay stub. Some argue that these two items are personnel costs rather than benefits. A second group of benefits represent a flat amount that can vary based on the employee's circumstances. These include: life and health insurance. Non-monetary benefits include: paid time off, such as holidays, vacations, sick leave and personal leave which are a component of the annual salary; take-home cars; free parking; employee incentive programs; and time off for educational purposes. Social security is required for all government employees according to federal law unless the government has its own retirement system. Medicare is required for all government employees. It is not a legal requirement that an employer provide: health, life insurance, training supplements or any non-monetary benefits to all of its employees. There are a variety of circumstances that dictate who should receive benefits. One of the

important factors is full time versus part time status.

Another important factor in the personnel services budget is overtime. This is particularly true for police and firefighters, since they typically have 24/7 schedules. Overtime is normally paid at the rate of one and one-half times the hourly rate of pay. Overtime can be a significant cost for many governments. Percentage-driven benefits, such as pensions and Medicare are also a component of overtime. Many governments prefer to pay overtime rather than add employees because it keeps the headcount down. Another advantage is that new employees have to learn the job while existing employees are familiar with job requirements.

Calculating FICA and Medicare

The federal government sets agency contributions to Medicare and social security annually. Currently, agencies match the 6.2% social security rate that employees have deducted directly from their paycheck. Hence, the employee and employer contribute a total of 12.4%. In 2017, the social security tax rate applied to earnings up to \$127,200.00 (www.ssa.gov). No taxes are due from the employee or employer beyond that amount. For example, if a public administration professor had a salary of \$135,200.00 in 2018, she would pay \$7,874.00 and the university would also contribute \$7,874.00 on her behalf for a total of \$15,748.00 in social security taxes for the year ($\$127,200.00 \times .124 = \$15,748.00$). Note that the remaining \$8,000.00 of her salary is not subject to social security taxes when calculating FICA during the current calendar year.

The rate for Medicare is 2.9%, and is split equally between the employer (1.45%) and the employee (1.45%). Contrary to social security, the Medicare rate applies to the full salary. Let's consider the professor used in the above example. Based on her annual salary of \$135,200.00 in 2018, the Medicare tax is \$3,920.80 ($\$135,200.00 \times .029 = \$3,920.80$). Medicare is mandatory at the full amount for all employees regardless of age or employment status. If an employee is a part time or a contract worker, he or she may not qualify for full fringe benefits. For example, if the agency does not pay their share of social security and Medicare benefits the employee (full and part time) has to pay the full amount to the federal government. Hence, the employer's contribution of half the social security and Medicare payment is considered a fringe benefit or an additional cost. So, it is important that you remember that you should only consider the government's portion of the payment on the budget rather than the total amount. Employee contributions to social security, Medicare, pensions, etc is included in a separate budget document.¹⁴ However, when calculating Social Security and Medicare taxes in a personnel budget, you should only include the government's contribution.

Pensions

For the most part, nearly all full time government employees participate in what is commonly called a pension plan. Some government pension plans are in lieu of Social Security while others may have both. Very small governments may only have Social Security. A *pension plan* provides financial benefits to an employee after he/she retires and/or has reached a certain age. Some plans allow an employee to retire after attaining a certain number of years of service, such as 30, at any age. Others require both a particular age and a minimum number of years of service. Still others have only a strict age requirement. Both employee and the employer contribute funds to the pension plan (not necessarily at the same rate) and both receive benefits. The employee receives the monetary benefit and security of knowing that they will have funds upon retirement. The government benefits because they can serve their personnel management objectives. They want employees to make a career out of public service. The experience and training that is gained through the years contributes to a professional bureaucracy. So, in order to recruit the best people and keep them in the public sector, the government must provide a good retirement package (Hildreth and Miller 1996; Smith, Sun, and Lynch 2017). Pension rates can range from a low of 2% up to a high of 30% or more of an employee's salary. There may be an equal contribution or the greater burden may be on the employee (Stalebrink, Kriz, & Guo 2010).

A pension resembles and behaves like social security. However, unlike social security, pension funds are invested in accounts that belong to the employee. Social Security is a "pay-as-you-go" system, whereby current contributions are used to pay the cost of past retirees. As history would indicate, it is possible for pension fund balances to suffer or grow as the economy changes. When the economy or the investment portfolio takes a turn for the worse for an extended period of time, it is important that fund managers ensure that enough funds are set aside and the tax base is stable enough to make up for the difference in lost investments (Smith, Sun, and Lynch 2017). As a general rule, pension fund portfolio managers should ensure that they are making socially beneficial investments. This process is facilitated with a *pension board of directors*. Normally made up of member representatives along with outside appointments, they are responsible for implementing legal requirements (Hildreth and Miller 1996; Hildreth and Adams 1997).

Pension investments normally fall into two categories: fixed income securities and equity securities. *Fixed income securities* are obligations that provide a steady stream of interest payments barring any defaults, such as a corporate bond or corporate annuity. *Equity securities* (which are more risky) are investments in *stocks*, which may or may not pay *dividends* (Petersen 2004; see also Hildreth and Adams 1997).

As years have passed and budgets have tightened, public pension fund accounts have grown and have become more and more susceptible to fungibility

issues. Again, it is important that the pension fund managers and the board of directors make sure that these funds are not transferred to other funds haphazardly (Nollenberger 2003; Petersen 2004).

Until the mid-1990's, virtually all government pension plans were defined benefit plans. When an employee began work, he/she was handed a book that stated exactly how much could be expected at retirement based on age, years of service, and final average salary. Pension fund managers have the liability for pensions calculated by *actuaries*. The actuaries determine how much the employer and employee have to contribute to fund the pensions. It is the responsibility of the managers to find investments that will yield the amounts necessary to cover all members in the system. When the economy has significant downturns, as happened in the late 2000s, investments are not able to keep pace with the required amounts. This means that the pension contributions should be increased. However, that is not easy to do. It requires legislation to raise contributions. Some pension plans have had to borrow to meet their obligations.¹⁵ Others have had to supplement pension contributions with general fund subsidies.

Since the mid-1990s, a number of governments have established defined contribution plans. The government and employee each contribute a required amount for the pension. However, the employee is responsible for investing the funds. Employees are provided various investment options and select an option that is appropriate. Defined contribution plans are portable. That is, when the employee leaves government service, the pension stays with the employee. In a defined benefit plan, the employee may not get back any of the contributions or may receive a refund of his/her contribution. The advantage to the employer of a defined contribution plan is that there is no long term liability. Some governments, such as Orlando, Florida, have replaced a defined benefit plan with a defined contribution plan for all employees coming on board after October 1, 1998.

Calculating the Pension Benefit

While the years of service can vary, most state and local governments require their employees reach an age between 62-65 and work at least 5-10 years in order to receive a pension. However, there are a number of other factors that can take place to change that scenario. These would include things like disabilities.

There are two key factors involved in calculating the pension benefit—final average salary and the annual multiplier. The final average salary is based on the highest earning years of an employee and can vary from three, four or five years depending on the pension system. An annual multiplier is the percentage of final average salary that is applied to each year of service. For example, a pension plan provides for each year of service to be multiplied by two percent. An employee working 30 years would receive 60% of his/her final average salary. This

comprises the total percentage value. An employee that works 5 years, the usual minimum vesting period, would receive 10% of their final average salary.

Exhibit 3.1 provides a model that can be used to calculate retirement benefits. In this example, Mrs. Deepthi Kollipara worked 30 years for the city and is 64 years of age. The last piece of data needed to calculate her retirement benefit is her five highest calendar year salaries. In order to calculate her benefit, you must:

- First, multiply her years of service times the percentage value per years of service.
- Second, her five highest years of service should be added up and divided by the years of service (5).
- Third, her average five year salary should be multiplied by the total percentage value (TVPP).
- Based on the formula, Mrs. Kollipara would receive \$37,544.07 per year and \$3,128.67 per month for her 30 years of service. Note: When age and years of service are not on the same line, choose the factor that best benefits the employee.

Exhibit 3.1 Sample Calculations of Retirement Benefits

Step 1: Creditable Services and Percentage Value

	% Value Per Year of Service	Total Years of Service	Total % Value Per Plan (TVPP)
Retirement up to age 62 or 30 Years	1.60%	x _____	= _____
Retirement at Age 63 or 31 Years	1.63%	x _____	= _____
Retirement at Age 64 or 32 Years	1.65%	x <u>30</u>	= <u>49.50%</u>
Retirement at Age 65 or >32 Years	1.68%	x _____	= _____

Step 2: Average Final Compensation (AFC)

Mrs. Kollipara worked for 30 years in the same system	\$85,000.00
and retired at age 64. In this step, we add her five highest	87,590.00
fiscal year salaries and divide the total by five (years).	95,890.00
	99,569.00
	<u>103,899.00</u>
AFC = \$471,948.00 / 5 = \$94,389.60	\$471,948.00

Step 3: Annual Benefit Calculation

$$\text{AFC} \times \text{TVPP} = \text{Annual Benefit} \quad \$94,389.60 \times .4950 = \$46,722.85$$

Step 4: Monthly Benefit Calculation

$$\text{Annual Benefit} / 12 = \text{Monthly Benefit} \quad \$46,722.85 / 12 = \$3,893.57$$

$$\text{Annual Benefit}/12 = \text{Monthly Benefit} \quad \$46,722.85 / 12 = \$3,893.57$$

Source: Smith, Robert W. Jinping Sun, and Thomas D. Lynch. 2017. *Public Budgeting in America*. 6th ed. Irvine, CA: Melvin & Leigh, Publishers.

Exhibit 3.2 is an Excel spreadsheet of the same person that is calculated in Exhibit 3.1. This computer program expedites the process and provides the user an opportunity to examine various retirement scenarios.

Exhibit 3.2 Short Version for Calculating Retirement Benefits (in Excel)

<u>% Value Per Year of Service</u>	<u>Total Years of Service</u>	<u>Total % Value PP</u>	<u>Average Final Compensation</u>	<u>Annual Benefit</u>	<u>Monthly Benefit</u>
1.65%	30	49.50%	\$94,389.60	\$46,722.85	\$3,893.57

5 Highest Years

\$85,000.00
87,590.00
95,890.00
99,569.00
103,899.00
\$471,948.00

\$94,389.60 Ave. AFC

There are some other issues that this model does not examine, but they are still important to the employee. This includes things such as vesting, portability systems, cost of living adjustments, early retirement, and disability/survivor protections. *Vesting* occurs when an employee works a certain number of years making them eligible to receive retirement benefits. The minimum number of years required for vesting can range from 3-5, but really depends upon the system where you work. In some cases, you can move your vested status to another government job (portability). This is simple when you stay in the same system (work for the same municipality or state), but less likely to occur if you move to a different city or state. This is one of the drawbacks of the defined benefit plan and one of the advantages of the defined contribution plan.

There is an array of issues and questions related to disability status. For example, will you be able to receive pension benefits if you become disabled prior to becoming eligible for benefits? Will your children or spouse receive your pension if you die prior to receiving benefits? Will you qualify for benefits if you permanently injure yourself outside of work? The answers to these and many other questions will vary based on where you are working. It is important that a government address all of these questions with written policies (Hildreth and Miller 1996; Smith, Sun, and Lynch 2017).

Position Classifications and Salary Ranges

Exhibit 3.3 shows a simple agency budget with each of three main categories along with classification codes. The codes are for administrative purposes. They make it easier to locate a specific line in a budget. This particular budget represents a specific division within an agency. Because it is in a line item format, it essentially tells the reader the amount of funds necessary to run the division without any cost associated with a particular individual and their responsibilities. However, the budget does not tell the reader the number of persons who work in the Procurement Division, nor does it break down the fringe benefits by employee. Most budgets are typed into a computer spreadsheet. This expedites the budget process and reduces mathematical errors.

Exhibit 3.3 Simple Agency Budget

Agency: *Central Budget Office Division: Procurement*

Code	Item	Adopted Budget
1000	1. <i>Personal Services</i>	
1001	Salaries	\$146,000.00
1002	FICA	18,104.00
1003	Insurance	6,000.00
1004	Retirement	<u>19,578.00</u>
		\$189,682.00
2000	2. <i>Operating Expenses</i>	
2001	Contractual Services	\$6,500.00
2002	Training	650.00
2003	Travel	505.00
2004	Utilities	3,000.00
2005	Printing	1,700.00
2006	Misc. Supplies	<u>12,500.00</u>
		\$24,855.00
3000	3. <i>Capital Outlay</i>	
3001	Vehicles	\$35,000.00
3002	Equipment	<u>2,500.00</u>
		\$37,500.00
<i>Total Agency Budget</i>		\$252,037.00

The most common employee classification is a *full time equivalent* (FTE). Full time positions are normally 35-40 hours per week. A full time employee (equivalent) is eligible to receive the full range of fringe benefits. *Part time employees* (PTE) normally work 15-35 hours per week and are not eligible for full

fringe benefits. Some part time employees may receive prorated benefits. A bus driver for the city bus would be an example of a part time employee who works for the majority of the fiscal year and could be eligible for fringe benefits.

Temporary positions may also exist. These are employees who may work full time, but are not permanent, such as summer employees for a park and recreation department or a secretary or janitor hired during peak season on a temporary basis. They may also be eligible for prorated fringe benefits as well (Riley and Colby 1991).

The classification FTE is used by the government in calculating the number of hours associated with a position. For example, a full time employee who works for the entire fiscal year would be the equivalent to 1.0 FTE. Four janitors, each working six months out of the year, would equal 2.0 FTE's (.5 for each person). By using this system, the government views personnel cost in terms of the number of positions and costs needed to complete a job rather than the number of people.

State and local governments frequently use pay plans for employees. These plans normally apply to full time employees. The plan lists each position class along with the salary range for that position. It is very difficult to justify paying a particular employee a salary out of the range without raising the bar for all other employees in that classification. The *Salary Range Plan* includes the title of the position, administrative code associated with the position, and annual salary range. Exhibit 3.4 contains an example of a salary range classification.

Exhibit 3.4 Salary Range Classification

Position Code	Class Title	Min. Salary	Max. Salary
1100	Accountant	\$65,000.00	\$79,000.00
1101	Administrative Assistant	45,000.00	55,250.00
1102	Budget Analyst	65,000.00	75,000.00
1103	Clerk	50,000.00	60,500.00
1104	Division Director	95,000.00	109,950.00
1105	Janitor	28,000.00	33,595.00
1106	Principal Investigator	75,000.00	89,000.00
1007	Security Guard	48,000.00	64,000.00

Like most things related to government, a salary range classification is approved by a legislative body and serves many purposes. A few of these purposes are listed below.

- Provides government officials data that may be useful in accounting, payroll and personnel processes.
- Ensures that salaries are reasonable and equitable relative to the responsibilities of the employee.

- Limits opportunities to discriminate.
- Allows the government to remain competitive in an open market and retain experienced employees.
- Acts as a control over salaries when new positions and raises are considered.

Justifying a New Position

Growth in responsibilities of an agency and personnel are fairly standard in most governments. As a result, it is necessary on occasion to request one or more new positions. There is never a guarantee that a request for a new position will occur. Nonetheless, it is important that agency heads ensure that they adequately review the old and new responsibilities of the agency in order to make sure that they can thoroughly justify new positions and maintain the previous positions. There are several items that go into a request for a new position that will facilitate the process (Riley and Colby 1991). The agency can:

- Justify the creation of the new position(s) by outlining the responsibilities of the person(s) relative to increases in workload or expanded programs.
- Describe the qualifications of the employee(s) with a notation as to whether it fits the current salary pay classification.
- Show how this position(s) will make the agency more efficient and effective.
- Show how the new position(s) will enhance new assignments or enhance current responsibilities.
- Program changes follow the same logic as a position request. Show how the program will make operations more efficient and effective.

Calculating a Personal Services Budget

Preparing a new budget can be difficult for the budget officer. In fact, this period causes a fair amount of trepidation for the entire staff. However, the process can be eased with several items. First and foremost is accurate information. It is very important that agency directors and the personnel office provide the budget officer with reliable data that corresponds with known facts. Second, a computer can expedite the budgeting process, but it cannot read minds. Hence, it does not notice mathematical errors in data entry for example. In most cases, budgets are inaccurate because of human error. Specific items needed by the

budget office include:

- A manual to review budget requests. The manual would normally contain management policy information (the direction the agency is headed and potential areas to cut or expand).
- Budget preparation forms along with instructions.
- Salary information related to personnel (includes information on projected salary increases as well as fringe benefits).
- Operating and capital outlay instructions.

Beginning with the previous year's base, the budget officer can put the new projected salary information (based on *budget projections*) into a computer spreadsheet program for each position classification. Budget projections are based on projected revenue, which are unknown versus what is known. *Budget estimates* are based on more concrete information. Assuming that no changes occurred, the computer will automatically calculate the fringe benefits associated with the salary. In some cases, the percentage or dollar amount of fringe benefits may change. Exhibit 3.5 is an example of an *Agency Salary Projection Report*.

Exhibit 3.5 Agency Salary Projection Report

FY 2018 (General Fund)

Agency: Police Department

Division: Homicide

<u>Title</u>	<u>Salary</u>	<u>FICA</u>	<u>MED</u>	<u>Pension</u>	<u>Health</u>	<u>Total</u>
Director	\$69,569	\$4,313.26	\$1,008.75	\$6,956.90	\$3,500	\$85,347.91
Captain	45,230	2,804.26	655.84	4,523.00	3,500	56,713.10
Detective	38,987	2,417.19	565.31	3,898.70	3,500	49,368.20
Detective	35,789	2,218.92	518.94	3,578.90	3,500	45,605.76
<u>Assistant</u>	<u>27,123</u>	<u>1,681.63</u>	<u>393.28</u>	<u>2,712.30</u>	<u>3,500</u>	<u>35,410.21</u>
TOTAL	\$216,698	\$13,435.26	\$3,142.12	\$21,669.80	\$17,500	\$272,445.18

This report allows the viewer to determine the exact cost associated with a position or an individual. Social security, Medicare, and retirement funds are based on formulas while health care cost for the individual employee is the same for everyone that has a particular characteristic, such as single, married with one dependent, and married with multiple dependents for health care benefits. Each of the employees listed here are current employees. The total cost included in Exhibit 3.5 is the total cost to the government. The employee contribution is not considered a part of the entire budget. That is, the employee contribution is ultimately deducted from their salary. With that said, it is not necessary to show the contributions of both the employee and employer on a line item personnel

budget.

If there are a number of employees who have the same salary, the budget officer may simply want to list the position by title and put the number of employees who correspond to that position/grade. This format saves time and space. However, this format only works when there are a number of employees who have the exact same salary.

A request for a new position along with salary projection follows the same format. However, there should be a justification for the new position at the bottom of the budget request (see Exhibit 3.6). The justification should indicate why the position is needed along with any supporting evidence that would substantiate the request. Data are particularly useful in a position justification. Since the agency is not making a verbal argument for the new position, the justification should be carefully prepared.

A separate form should be used for each new position request. If the administrative position code does not indicate whether the position is an FTE or PTE, then it should be included on the personnel request form. Since positions are based on class, the requested salary for the new employee should fall within the legal pay range that was set by the legislative body. These forms normally come with complete instructions dictating what should be included. Specifically, these instructions should indicate the current rates for FICA (12.4%), Medicare (2.9%), and retirement (18%). In addition, it should contain the cost of health insurance (\$1,800.00) and any other pertinent information.

Exhibit 3.6 New Personnel Request Form

Agency Personnel Salaries

FY 2018 (General Fund)

Agency: Police Department

Division: Homicide

Position Title	Position Code	Base Salary	FICA	Medicare	Pension	Health	Total Costs
Dispatcher	1011	\$22,500.00	\$1,395.00	\$326.25	\$4,050.00	\$1,800.00	\$30,171.25

Justification:

Due to an expansion in 911 services the number of incoming phone calls has proved to be a burden for one person. As a result, we had to hire a temporary employee and use patrol officers to aid in this effort. Therefore, it is economically feasible to have a full time employee to carry out these responsibilities.

Preparing an Operating Budget

As stated earlier, the personnel budget makes up the bulk of expenditures in the budget process. However, operating costs are just as important. These requests are reviewed and justified each fiscal year. Operating costs include items such as travel, telephone services and other utilities, pencils, paper, adding machines, rent or any other item that recurs. In simple terms these are items needed by an agency to conduct business. Equipment, such as vehicles, can also be included as an operating expense if the agency is not requesting a large number of new vehicles every year. Further, if vehicles were to be replaced over a number of fiscal years, this might not be the best category to include them. It would depend on the policy of the government. Other exclusions would include high cost items such as super computers and buildings. These are capital expenditure items.

When making a request for operating expenditures, an agency has to indicate how these items will be used to meet the mission of the agency and any new activities that the executive or legislative body may have. The agency director submitting the budget should indicate in the budget transmittal letter how the requests are tied to the goals of the agency. In addition, data showing how expenditures are tied to programs and performance is very useful. Despite the inclusion of these items, operating budgets are not examined as much as personnel budgets. The few exceptions are training and travel.

There are three basic ways to present an operating budget proposal. The first is the incremental method. An *incremental operating budget* essentially shows a modest increase in the budget due to inflation and other naturally occurring economic factors. A lot of agencies tend to use this type of budget because it links spending directly to a service or item (see Exhibit 3.7 for an example).

Exhibit 3.7 Incremental Operating Budget Proposal

Object Code	Item	FY 2018 Cost (est.)	FY 2019 Cost (prop.)
2003	Travel	\$5,000.00	\$6,000.00
2004	Utilities	2,569.00	3,000.00
2005	Printing	12,904.00	15,000.00
2006	Misc. Supplies	459.00	600.00
2007	Pens	245.00	300.00
2008	Paper	2,349.00	3,600.00
2009	Adding Machine	299.00	150.00
2010	Telephone	1,349.00	2,800.00
TOTAL		\$25,174.00	\$31,450.00

Also, this budget is particularly useful when there have been no new re-

quests in the personnel budget and when there is no indication of changes in the agency. In addition, it is easy to convey the budget in this manner when the agency can show that it has efficiently and effectively pursued the mission of the agency. The incremental operating budget has four main components: an object code, item/service, current year cost, and estimated cost for the upcoming fiscal year. Where appropriate, it may also be useful to indicate the number of items requested (for example, the number of adding machines).

The estimates in FY 2018 should be based on the appropriation. That is, the estimate would not exceed the appropriation, but could be less based on costs as of the date of budget preparation. The agency could add an additional column with FY 2017 actual spending to give the reviewer a better trend analysis.

This method is also good to use when there is a drastic change in the cost of an item. For example, let's assume the cost of telephone usage has increased by 5% each fiscal year for the last five years and the amount for FY 2018 is a 15% increase over the previous year (Exhibit 3.8). This increase would require a justification since it does not follow the previous trend. The same would be true for the 2019 proposed budget. Ideally, the justification would indicate what policy change or other events precipitated the increase in phone service costs. Clear crisp explanations to changes expedite the approval process (Riley and Colby 1991).

Exhibit 3.8 Police Department Program Operating Budget Proposal

<u>Program</u>	<u>Travel</u>	<u>Utilities & Fuel</u>	<u>Printing</u>	<u>Telephone</u>	<u>FY 2018 (est.)</u>	<u>FY 2019 Request</u>
911 Service	\$79,999	\$3,985	\$175	\$10,785	\$80,546	\$94,944
DARE	1,459	350	100	150	1,643	2,059
Patrol	359,999	15,899	150	987	338,456	377,035
<u>Annual Ball</u>	<u>450</u>	<u>600</u>	<u>1,200</u>	<u>100</u>	<u>1,789</u>	<u>2,350</u>
TOTAL	\$441,907	\$20,834	\$1,625	\$12,022	\$422,434	\$476,388

Justifications:

- A.) *DARE Program*: In harmony with the Mayor and City Council's mission to expand the program into every school, we have increased the number of officers who go into the schools and the amount of information that they disseminate.
- B.) *911 Service*: Due to the expansion of emergency services into the newly annexed suburbs of Mt. Vernon and Taylorville, we are requesting two new patrol officers and thus need to provide them with adequate training and other amenities.

The second and third types of operating budgets are *performance* and *program budgets* (see chapter 1). A performance or program operating budget

would link the operating expenditures to performance and programs (Riley and Colby 1991; Kelly and Rivenbark 2003). The budget examiner should be able to look at this budget along with the justification and see exactly where and what the funds are used for.¹⁶

Conclusion

Personal services and operating budgets appear to be more or less operational functions. However, there is still a degree of negotiation that takes place. Positions are not always guaranteed despite arguments indicating the need. Budget personnel officers should ensure that they are meticulous with their data entry skills. A computer is only as good as the operator. It is very easy to put in the wrong number and throw off the entire budget. Budgets must balance to the last dollar. Hence, rounding errors must be minimized.¹⁷