



# **for Georgia Mayors and Councilmembers**

**FIFTH EDITION**

## **Part Five: FINANCING and REVENUES**

**Operations Budgeting**



# Operations Budgeting

In developing and adopting a balanced operating budget, municipalities are creating far more than a legal document. A budget serves as a planning tool, an allocation of resources, a description of governmental activities, and proof of the commitment to the efficient use of taxpayers' dollars. A budget is the product of revenue estimation, expenditure plans, policies, and procedures. A budget becomes the framework to determine the number of employees, organizational structure and other day-to-day functions. A budget and its development is as unique to each municipality as political, economic, and geographical factors are to the operations of, Albany, Dillard, Roswell and all other cities across the state.

A budget facilitates the Administration's task of delivering reliable service, assists in dealing with changing conditions, becomes a tool for reporting governmental activities and measures the government's performance. While the adopted budget is a legal document, created by ordinance or resolution, it provides the public with a record that describes the activities to be undertaken during the upcoming fiscal year. In communicating a budget's many functions, a reliable system of procedures, data, and information will help foster the public's trust in government. When used correctly, a budget is a means to promote future growth, forecast revenues, estimate expenditures, reveal the status of the government's long range plans and serves as a cohesive policy document over time.

## State Legal Requirements

The Official Code of Georgia identifies the legal requirements for a balanced budget, outlines the steps in the approval process, and clarifies the legal level of budgetary control. Chapter 36-81 is dedicated exclusively to the local government budgetary process and imposes the following requirements:

- Local governments must establish an official fiscal year for the municipality's operations by resolution, ordinance or local law;
- Each municipality must prepare a proposed budget for submission to Mayor and Council;
- Notify the public that the budget proposal is available for public review;
- Conduct a public hearing at least one week prior to the adoption of the budget resolution or ordinance;
- Adopt a budget resolution or ordinance, which can contain dollar amounts different from the amounts contained in the proposed budget;
- Adoption of a balanced budget for governmental funds such as the general fund, special revenue funds, debt service funds and permanent funds. Municipalities are not required to adopt annual budgets for fiduciary funds, internal service funds or enterprise funds such as water and sewer funds. Capital project funds are required to operate under a project length balanced budget;
- Adopt budget amendments by ordinance or resolution;

- Provide for an audit of the financial affairs and transactions of all funds and activities in accordance with generally accepted accounting practices (GAAP); and
- Submit a copy of the audit report to the Georgia state auditor within 180 days after the close of the fiscal year, or the close of each second fiscal year in the case of cities not required to be audited annually.

Additionally, the legal level of control is identified as the departmental level within each fund unless a more detailed level of control is established. Overspending at the level of budgetary control adopted by the Mayor and Council or commission would result in a violation of the law. Transfers of appropriations within any fund below the legal level of control (department) only require the approval of the budget officer; however, the law does not define departments. Also, any transfers above the legal level of control will require Mayor and Council or commission approval.

## The Budget Process

The budget includes three distinct phases: **1) development and preparation, 2) implementation and execution, and 3) audit and review.** Based on this process, staff is responsible for developing the budget for the following year, implementing the current budget, and at the same time reviewing and preparing for the audit the previous year's budget. Due to the array of tasks associated with the budget cycle it is vital that staff has an comprehensive understanding of the elements of the budget cycle.

To accomplish the **development and preparation** phase of the annual budget, Georgia Code § 36-81-5 provides an outline of the process; however, the first phase is focused on developing revenue projections, expenditure plans, goals, objectives, and the adoption of the budget among other things. During this initial phase of the budget process the governing authority sets policy parameters that determine revenue and expenditure levels, conducts public hearings, and adopts a balanced budget.

As the budget is developed and prepared for public review, revenue projections and the identification of new revenue should be completed in accordance with the policies outlined by the governing authority. During recent years as economic conditions have changed, the importance of accurate revenue estimates has increased as municipalities are challenged to use limited resources more effectively. Also, the demand for more services can strain scarce resources as new requests impact available funding for existing programs. The economy and service demands have placed additional importance on the forecasting of revenue and expenditures, and to ensure the jurisdiction's fiscal well-being, forecasts should also include an evaluation of the medium and long range.

In order to complete the various tasks associated with the development of an annual budget, a budget development action plan should be generated to efficiently outline the activities of the budget process. This action plan should be developed in conjunction with a budget calendar to include due dates, activities and responsible parties. Utilizing the budget calendar as a budget action plan should be similar to the following and have a timeline of four to six months in length:

Due Date	Activity	Responsible Party
August 1	Mayor and Council evaluate policies and goals	Mayor and Council
August 15	Budget preparation forms prepared for distribution	Budget Officer
September 1	Kick-off meeting with staff; Distribution of budget information manual; Revenue estimates are complete	Administration Budget Officer
October 1	Budget requests returned	Management Team
October 2 – 15	Analyze department requests	Administration and Budget Officer
October 16 – 30	Assemble budget requests, compare with revenue estimates and compile the budget document	Budget Officer
November 1	Proposed Budget to Mayor and Council	Budget Officer
November 15	Advertise for Public Hearing	Clerk or Budget Officer
December 1	Conduct Public Hearing	Mayor and Council
December 15	Final Review and Adoption	Mayor and Council
January 1	Budget is effective	Budget Officer

After the budget development action plan and the budget calendar are developed, staff should create and prepare to disseminate the budget information manual. The budget information manual helps ensure the budget is consistently prepared in accordance with the government policies and the desires of the administration. It is critical for the guidelines in the manual to communicate any constraints or assumptions that will guide the decision-making process. The manual will be used to prepare departmental budget requests and should include the following:

- The budget calendar;
- A statement of the budget policy;
- Cost factor guidelines, such as pay increase levels and inflationary factors;
- Price lists and commonly used vendor web sites which may be used to determine costs associated with products purchased by the government;
- Request forms, expenditure forms and detailed instructions for completing the forms and budget estimates;
- Revenue and expenditure guidelines; and
- Uniform Chart of Accounts.

To facilitate the collection of data, a systematic approach may include expenditure request forms as a method to engage department heads in the budget process. Expenditure request forms should encompass the various components of the expense categories including salaries and benefits, contracted services, purchased services, supplies and capital outlay. Combining the forms with detailed instructions and guidelines will provide staff with a streamlined method to guide the budget development in a standard format.

While the expenditure request forms will help identify service modifications due to shifting geographic or economic conditions, many expenditure changes are associated with maintaining the government's infrastructure. Evaluating the impact of new facilities, maintaining existing capital, assessing changes to state or federal regulations, quantifying matching grant funds and anticipating legal judgments is essential in determining the jurisdiction's minimum expenditures for the upcoming year. Also, compiling the cost of payroll, including any changes, should be made in accordance with market standards.

When the revenue projections are finalized and expenditure plans completed, the next step is to begin the approval process. This is the responsibility of the Mayor and Council. As the budget is presented to the Mayor and Council, a copy must be made available to the public, and a notice identifying the location of the available budget document must be placed in a newspaper. Prior to the adoption of the budget, the Mayor and Council must conduct at least one public hearing. After the hearing and any modifications, the budget is adopted by ordinance or resolution.

After the adoption of the annual budget, local governments begin to **implement and execute** the expenditure plans by controlling expenditures in a way that is consistent with the adopted budget, continuously assessing revenue collection and monitoring resource use. Budget implementation invariably requires adjustments to adapt to changing economic conditions or to respond to citizen demands. Ensuring sufficient cash is available when demands are placed on public resources is critical in the execution of government services.

As departments execute the operating budget, monitoring activity is essential for ensuring compliance with budgeted expenditures. As a result of maintaining conformity with state law, an encumbrance system of accounting should be employed. An encumbrance identifies commitments for services or products that have yet to be performed or delivered. Allocating an encumbrance against budgetary accounts helps guarantee that total actual expenditures plus related commitments do not exceed appropriations. Without encumbering funds, future services or purchases could result in overspending. Encumbrance accounting facilitates effective cash planning, control, and management of government funds. Finally, encumbrance accounting ensures sufficient balances to cover expenditures.

While encumbrances exert some control over the day-to-day activities of local government, city governments face changes or challenges every day, thus amendments to the existing budget may be necessary. Amendments above the legal level of control require Mayor and Council approval and may occur when the municipality experiences shortfalls in revenue, expenditures associated with unexpected events such as severe weather or a capital purchase not originally considered in the initial budget. Budgetary changes are not objectionable; however, sufficient information is important for accountability, decision making that is based on the original budget, and management of resources.

The final stage of the budget process is the **audit and review phase**. State law requires cities have their financial statements audited on an annual basis by an independent auditor unless otherwise authorized under state law. Further, these audited statements must be submitted to the Georgia Department of Audits within 180 days of the end of the fiscal year. Staff prepares for the audit in compliance with the Generally Accepted Accounting Principles (GAAP) developed by The Governmental Accounting Standards Board (GASB).

To prepare for the audit, staff will gather documents such as minutes of council meetings, bank statements and reconciliations, bank accounts, invoices, agreements, bid documents, financial reports and other items of importance. While documents are gathered, schedules of activity will be developed and include fixed-asset acquisitions and disposals, inventory balances, adjusting entries and investment balances. These documents and files are used to provide feedback to the Mayor and Council regarding the integrity of financial transactions, efficiencies of programs, and effectiveness of policies and programs. The annual financial report will also include a letter from the auditor containing its judgment on the financial statements, results of operations, and cash flows of proprietary funds.

## Budget Formats

Jurisdictions should develop a budget policy which encompasses two sections. The first should address long-term needs and the second should outline goals, objectives, and priorities for the coming year. Identifying the long-term needs will assist in developing a financial plan, capital improvement plan, and budget options. The long-term financial plan will ensure programs will be maintained within the municipality's means and will allow decision makers to better understand the long term implications of policies, programs, and assumptions. Cities should develop an annual budget policy statement, which is consistent with the long range plans, by outlining its goals, objectives, and priorities for the coming year. The policy statement is the Mayor and Council's directive to administration, department heads, and staff regarding the jurisdiction's financial outlook, economic factors, itemization of priorities, and guidelines to follow in preparing budget requests.

In order to achieve the goals outlined in the budget policy, information is required to be quantified and shared. The budget document becomes the venue for this exchange of ideas and information. As a result of the differing goals and data requirements, budgeting may take on many formats. Some budget formats include Line-Item Budgeting, Program Budgeting, Performance Budgeting, Zero-Based Budgeting and others. The chosen format will depend on the philosophy of the jurisdiction's Mayor and Council.

**A line-item budget** is a control based budget which takes the form of detailed line-item descriptions of expenditures. The line-item budget is a list of the municipality's revenues and expenditures in vertical columns. The line-item budget is widely used and offers many advantages such as:

- Easily prepared;
- Straightforward;
- Simple to administer;
- Easily understood by Mayor and Council, employees and citizens; and
- Easy to monitor.

When adopted as the legal level of control, a line-item budget becomes inflexible for minor adjustments and is not as responsive to unanticipated issues as other budgeting formats. If utilizing broad categories, the format may provide no method for determining the cost of a particular service or if priorities are being achieved.

**Program budgeting** focuses attention on results and activities as opposed to what a municipality buys. In a program budget, revenues and expenditures are linked to a municipality's goals and objectives and identify the anticipated results and outputs of associated investments. The benefits of program budgeting include:

- Presents budget investments in a format that enhances the community's understanding of services;
- Focuses attention on goals, needs and capabilities; and
- Establishes an informed basis upon which cities make decisions.

Program budgeting will assist municipalities in making sound stable financial decisions; however the system requires a significant amount of time to establish and maintain. Also, data collection is difficult as programs will overlap between and within departments.

**Performance budgeting** is similar to program budgeting except budget indicators are used to measure performance which is tied to expenditures. When a municipality employs performance budgeting methodology, it would allocate funding to conduct a certain number of court calendar calls a year. Performance budgeting provides the Mayor and Council with spending data related to the amount of service delivered by any given program. Also, the exact cost of the service can be determined. One issue with performance budgeting is it can be difficult to determine a quantitative measure for services such as Fire and Rescue or Administration.

**Zero-based budgeting** is a comprehensive review of all departmental functions, whereby all expenditures must be approved rather than only incremental increases. To accomplish a zero-based budget, department heads complete a budget information package that details each of the department's programs. The department head would identify the level of service that could be provided based on different levels of funding, including a zero funding level. After completing a package on each service, the department head then expresses an opinion on each of the programs and prioritizes each service. The advantages of a zero based budgeting approach are:

- Cutbacks can be made based on lowest priorities;
- Requires a thorough evaluation of all programs on a continuing basis;
- Detects inflated budgets;
- Identifies opportunities for outsourcing; and
- Drives managers to find cost effective ways to improve operations.

Zero-based budgets can be time-consuming, making it difficult to define decision units and candor of the managers must be reliable and uniform. The process can also be costly, requiring a level of staff expertise that is not always available.

State law does not provide a specific method a municipality must follow; rather a municipality must identify its budgetary focus and detail to include within its budget document. The philosophical decision should be evaluated against community priorities and an appropriate level of expertise and staffing associated with the process.

## Budget Policies

In carrying out the budget-making responsibilities the Mayor and Council must address numerous issues and questions on a recurring basis (at least annually). A sensible solution is to develop policies to repeat questions and formalize policy statements as guidance regarding Mayor and Council expectations. Those questions include how to manage the stabilization funds, debt management, and use of prior year unused appropriations.

Stabilization funds are a coat of many colors carrying names such as reserves, rainy day funds, undesignated fund balance or contingency funds. These funds provide flexibility for municipalities to address economic downturns, emergencies, one-time expenditures or cash flow issues. In developing a policy to guide the creation, maintenance, and use of this resource for fiscal stabilization, it is important recognize that these financial resources help protect against reducing service levels or raising taxes due to a temporary shortfall in revenue. A policy on building and maintaining fund balance should include the process to accumulate a fund balance, the purpose for which they may be used, and the minimum and maximum level of funds retained. Recently the Government Accounting Standards Board (GASB) issued a statement regarding the classification of constraints placed on stabilization funds. The classifications include:

- Non-spendable – generally meaning that it is not expected to be converted to cash;
- Restricted – constraints are imposed by creditors, grantors, contributors, or laws or regulations of other governments;
- Committed—constraints are imposed by formal action of the government’s highest level of decision making authority;
- Assigned – constraints placed as a result of the municipality’s intent to use for a specific purpose but is not classified as committed or restricted; and
- Unassigned – The residual amount for the General Fund and represents the fund balance that has not been restricted, committed or assigned. The General Fund should be the only fund that reports a positive unassigned fund balance amount.

Cities should adopt debt policies which would integrate with other financial policies including operating and capital budget policies. The policy should reflect regulatory requirements and the government’s financial condition. Issuing debt commits a municipality’s revenues, thus flexibility to respond to changing conditions may be limited, therefore debt should be managed to maintain a sound fiscal position and to protect credit quality. The policy should outline the following:

- Purposes for which debt may be issued;
- Identifying the limitations for debt supported by revenues of enterprise funds;
- Matching the life of the capital asset with the maturity of the debt;
- Short-term debt program;
- Types of permissible debt;
- Refunding of debt; and
- Limitations resulting from legal provisions or financial constraints.



At the end of most fiscal years a municipality will have a portion of the budget which is unspent. Georgia law does not address the use of unspent budgets specifically. A Mayor and Council may determine the appropriate use of these funds in a number of methods including:

- Allow the unspent appropriations to lapse at the end of the year and not roll forward;
- Any appropriation that is encumbered is added to the subsequent budget; or
- Allow all unspent funds to be carried forward.

Adopting a financial policy will clarify whether an item approved in a previous budget is carried over to subsequent budgets or not. Further it may provide a mechanism to develop a funding source for capital projects, debt financing, or accumulation of appropriations for future departmental activities.

## Uniform Chart of Accounts

The Georgia General Assembly passed the Local Government Uniform Chart of Accounts and Reporting Act in 1997. The Georgia Department of Community Affairs developed the chart of accounts for all units of local government which was approved by the Georgia Department of Audits in 1998. Local governments were required to begin using the uniform chart of accounts no later than the fiscal year ending 2001. The uniform chart of accounts lists the account titles that an accounting system will use. The chart also introduced a numbering system which is recommended but not required. The list and numbering system is not comprehensive and local governments should evaluate the classification system as needed. The account code includes the fund number, account class, function, activity, department, and account information (balance sheet account, revenue source, and expenditure object). Local governments are required to utilize the uniform chart of accounts in accounting reports, financial reports, and reports to the state.

## Rules and Resources

The **Government Finance Officers Association (GFOA)** established the Distinguished Budget Presentation Awards Program (Budget Awards Program) in 1984 to encourage and assist state and local governments to prepare budget documents of the very highest quality. The Budget Awards Program encourages both the guidelines established by the National Advisory Council on State and Local Budgeting and the GFOA's recommended practices on budgeting. The program then recognizes individual governments that succeed in achieving that goal. Documents submitted to the Budget Awards Program are reviewed by selected members of the GFOA professional staff and by outside reviewers with experience in public-sector budgeting

While GFOA provides an excellent opportunity to improve budgeting practices, The Governmental Accounting Standards Board (GASB) was established in 1984 by agreement with the Financial Accounting Foundation and 10 national associations of state and local government officials, and is recognized as the official source of generally accepted accounting principles (GAAP) for state and local governments. The organization establishes and improves financial

reporting for governments, as governments are fundamentally different from for-profit businesses; the needs of the users of governmental financial statements are different from the needs of the users for private company financial statements.

GASB does not have enforcement authority, and its standards are not laws or regulations. Compliance with GASB's standards is typically evaluated through the audit process, as auditors render opinions on the fairness of financial statement presentations in conformity with GAAP.

Audited financial statements are required by the Official Code of Georgia Annotated, Section 36-81-7. The State of Georgia has approximately 538 cities which submit audited financial statements to the **Georgia Department of Audits and Accounts (State Auditor)**. This code section also requires the State Auditor to review these financial statements to ensure compliance with generally accepted accounting principles, generally accepted government auditing standards, and federal and state regulations.

Municipalities failing to submit acceptable audit reports to the State Auditor are subject to state law restricting state funds for local governments. The law states: "No state agency shall make or transmit any state grant funds to any local government which has failed to provide all the audits required by law within the preceding five years." The State Auditor has produced a set of documents which assist cities in satisfying financial reporting requirements. Georgia law identifies financial reporting requirements based on the government's level of annual expenditures.

Municipalities having annual expenditures of \$300,000, or more are required to have an annual audit. If expenditures are less than \$300,000 then a municipality may elect to provide for a biennial audit covering both years. Either the audit report or report of agreed-upon procedures is required to be submitted to the State Auditor. Should the annual audit or report contain findings or recommendations, the municipality is required to submit a corrective action plan and comments on the findings and recommendations.

## Summary

The Official Code of Georgia requires local governments to adopt a balanced operating budget by ordinance or resolution. The law also provides for an outline of the budget process, the establishment of the legal level of control, and required financial reporting of the Mayor and Council's activities. While the law offers an outline of the budget activities, local governments should establish a budget development action plan that includes a calendar of activities, budget information packets, expenditure request forms, and information related to the municipality's procurement activities. The budget information manual should be developed based on the budget format selected as the most appropriate for achieving the community's goals and objectives. Regardless of the budget format, state law requires the use of the Uniform Chart of Accounts established by the Department of Community Affairs (DCA) in accounting reports, financial reports and reports to the state. The information provided in reports to the State is consistent as a result of the Uniform Chart of Accounts. While the accounts are similar across the state it is imperative that local governments adopt budget policies related to stabilization funds, debt, prior year appropriations, and other budgetary issues to ensure the municipality's responsiveness if economic conditions change. Finally, these policies should reflect the

guidance provided by the professional organizations established to improve the budget and reporting process. By utilizing the outline established in the Official Code of Georgia, identifying a budget format that helps achieve community goals, and utilizing the professional guidance in establishing budgetary policy, city leaders can improve the financial flexibility necessary to respond to changing demands.