# Section 4: Finance

# Chapter 19: Budgeting

The annual budget is the most significant of all policy-making opportunities available to local officials. Used wisely, the budget process can achieve the goals and objectives of the city or village and assure the delivery of the services expected by the citizens.

Focusing on the budget as a policy document allows elected officials to avoid the temptation to deal only with those items with which they may feel most comfortable—line item details of office supplies, for example—and concentrate instead on basic policy issues.

Budgeting often takes two forms. The first is the operating budget dealing with short-term, year-after-year matters. The second is the capital budget for long-term, non-recurring expenses.

## The Operating Budget – A Plan for Day-to-Day Operations

Section 15 of the Uniform Accounting and Budgeting Act requires cities and villages to adopt a balanced budget (expenditures cannot exceed revenues) prior to the beginning of each fiscal year. The Act, however, does not specify the format of the budget for either the general fund (operating budget) or any special or enterprises funds your community may use. Local governments are also required to set the millage rate required to cover the anticipated expenditures for the year, as well as to establish the necessary fees and charges for various services.

### Common Budget Formats

There are several budget formats available for use by local governments. The most basic is the line item budget. Other budget formats have been developed to assist legislative bodies in establishing policies rather than counting paper clips, the most common being the program budget, program performance budgeting (PPBS); management by objectives (MBO); and zero based budgeting (ZBB). It is also possible to combine one or more of these formats.

- **The line item budget** divides expenditures into administrative categories such as salaries, contractual services, office supplies, postage, etc. This type of budget is easy to prepare, but makes it difficult to determine if goals are achieved or if programs are adequately funded.
- **The program budget** presents expenditures by program along with a narrative description of the services to be provided. Each program budget is composed of line item amounts. For example, a municipality may decide to initiate a street sweeping program. The entire program is presented including line item allocation of the costs required to support the program. While a program budget is more complex to prepare, it allows the council to view and evaluate the merits and costs of each program.
- **The program performance budget (PPBS)** shows the relationship between the dollars spent and units of service performed to determine a cost per unit (e.g., cost per mile of street swept). This is the most complex of all types of budgets to prepare and unit costs for some services are difficult to measure (e.g. cost per crime prevented by a crime prevention bureau). However, it is useful in assessing the relative success of each program. Once again, line item allocations of the costs must be made.
- **The management by objectives budget (MBO)** allows the identification of specific programs or objectives to be accomplished during the budget year. This approach will allow the management to establish target dates

and costs for specific objectives and provide a means for the legislative body to measure the performance of the various departments and the management structure.
- **Zero based budgets (ZBB)** require each department to examine its programs by requiring justification for every dollar requested. Because of its somewhat complicated nature, ZBB should only be used on a limited basis.

Of the foregoing types of budgets, the program budget is often the most useful and practical for local officials. It clearly outlines the purposes for which funds are being proposed and it encourages a policy-making approach to budgeting. Many local governments will use parts of all the budgeting types, adapting each to the needs of the community. Regardless of the overall budget format used, it is necessary to prepare line item detail for each section.

### Revenue Sources

An important step in the budget process is to determine, as accurately as possible, the amount of revenue available for the upcoming fiscal year. Revenue sources for the operating budget are closely regulated by state law and local charter. Special items of income vary among local units of government. Revenue sources for general operating budget purposes include:
- property taxes (controlled by law and charter);
- City income taxes;
- licenses and permits (building, plumbing, heating, electrical, air conditioning, occupancy, amusements, etc., controlled by ordinance);
- intergovernmental (state shared revenues, Act 51 monies, grants such as CBDG, Clean Michigan, etc.);
- charges for sales and services (engineering review fees, plan review fees, etc.);
- fines and forfeitures (drug forfeiture proceeds, library book fines, and penal fines);
- interest income; and
- miscellaneous.

Of those revenue sources on the list, local elected officials have much discretionary authority in all except property taxes, city income taxes, and intergovernmental revenue sources.

A city income tax is currently imposed in 22 Michigan cities, ranging in population from 1,884 (Grayling) to 713,777 (Detroit). Again, as is the case with property tax, state statutes closely control the creation of revenues from this source through the Uniform City Income Tax Act (1964 PA 284). As amended, the Act now provides:
- Newly imposed city income taxes must receive voter approval.
- The tax may be imposed on residents, non-residents earning income in the city and the income of corporations earned in the taxing city.
- Limits on the rate of taxation (percent of income) permitted based upon the size of the city and other criteria.
- Exclusion of certain types of income from the tax.

Intergovernmental revenues are a constant concern for local officials as the formula for the statutory portion of revenue sharing is subject to change by the state legislature and to reduction by executive order of the governor. The same is true for grants from both the state and federal government, as well as Act 51 monies.

## Expenditures

Public expenditures are the amounts paid by the municipality for the services required by the residents and businesses of the city or village. Under state law, all public expenditures are to be only for public purposes. Generally, allowable expenditures fall into the following categories:
- general government (council, manager, finance, clerk, etc.);
- public safety (police, fire, code enforcement and inspections, etc.);
- public works (streets, drains, sidewalks, engineering, water and sewer, etc.); and
- leisure services (parks and recreation, library, museum, etc.).

## The Capital Budget—A Longer View

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

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

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

- special assessments;
- fees charged for construction;
- major road funds, Act 51—gas and weight taxes,
- local road funds, Act 51—gas and weight taxes;
- enterprise fund allocations from water, sewer, and other utilities; and
- bond proceeds from issues by the local governing body and any of the authorities created by it (e.g., building authorities, downtown development authorities, housing authorities).

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

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

When considering capital expenditures for new facilities, budget makers must keep in mind the need for operating funds to place the new building or facility into operation. The need for additional employees, costs for heat, lighting, water, telephones and so on are appropriate concerns of those with budget making authority.

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

The CIP provides a longer-range schedule for the community's major capital projects year-by-year. The Michigan Planning Enabling Act of 2008 (MPEA) requires that the CIP must project at least six years into the future: the first year of the CIP should be the upcoming budget year for capital budget allocations. Each operating department is expected to be represented in the CIP, and the task of the budget makers is to make sure the year-to-year estimated costs are within the financial capacity of the local unit.

Used properly, the CIP provides a systematic approach to financial planning so that budget makers can weigh the relative priority of these projects, build up funds for plan ahead for major investments, or undertake multi-year projects. This planning may include:

- increases in operating costs for new facilities;
- acquisition of rights-of-way;
- contributions to other authorities;
- special assessment projects; and
- bond issuance planning.

The CIP can also provide opportunity for a systematic approach to preventive maintenance and the rebuilding of facilities and infrastructure. Scheduling of heavy preventive maintenance and rebuilding will often extend beyond the required 6-year CIP time span, making a longer planning horizon appropriate for some projects. For example:

  - concrete streets—joint grouting and resealing plus selective slab replacement—seven-year cycle,
  - concrete sidewalks—leveling and flag replacement—five-year cycle,

- water distribution system—system replacement—20 to 30 year cycle or
- public buildings—plumbing, heating, electrical system updates—20 to 30 year cycle.

Under the MPEA, the planning commission is responsible for preparing the CIP annually and submitting it to the legislative body for final approval, unless exempted by charter or otherwise. The planning commission should coordinate with the chief executive official (e.g. village president or manager) to compile projects from each department or operating unit within the village into the CIP. Each year, the CIP should be updated to maintain the minimum 6-year planning horizon, and to review and adjust the planned projects for each year based on changing budgetary conditions. This process provides an opportunity for the planning commission to consider projects against the adopted master plan for the village, ensuring that major investments best support the community's long-range goals.

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

## For More Information

Sample budgets, budget policies and ordinances are available through the League's Resource Center, by emailing info@mml.org.

Chapter based on materials provided by **A. Frank Gerstenecker,** retired city manager and former consultant for the League's Executive Search Service.

**Michigan Planning Enabling Act (ACT 33 of 2008) CIP requirements:**

The capital improvements program shall show those public structures and improvements, in the general order of priority, that in the planning commission's judgment will be needed or desirable and can be undertaken within the ensuing 6-year period. The capital improvements program shall be based upon the requirements of the local unit of government for all types of public structures and improvements. Consequently, each agency or department of the local unit of government with authority for public structures or improvements shall upon request furnish the planning commission with lists, plans, and estimates of time and cost of those public structures and improvements. The planning commission, after adoption of a master plan, shall annually prepare a capital improvements program of public structures and improvements, (unless the planning commission is exempted from this requirement by charter or otherwise). If the planning commission is exempted, the legislative body shall either prepare and adopt a capital improvements program, separate from or as a part of the annual budget, or delegate it to the chief elected official or a nonelected administrative official, subject to final approval by the legislative body. (MCL 125.3865)