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Budgeting for Nebraska Local Governments

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BUDGETING FOR NEBRASKA LOCAL GOVERNMENTS

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PREFACE

This manual is designed to assist Nebraska local government officials to develop an understanding of and skills in budgeting. It stresses fundamentals including information necessary to prepare and execute budgets and also discusses revenue estimation and expenditure classifications and estimations.

The exercises are designed to familiarize local government officials with some of the most common budgeting activities they will face.

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CHAPTER I

THE FUNDAMENTALS OF BUDGETING

Introduction

Budgeting is a complex set of activities. To those unfamiliar with its details, it is a mysterious rite conducted annually, and even those familiar with the process give a multitude of definitions. The simplest definition is that *budgeting involves the acquisition and allocation of resources.*

Budgeting is common to both the public and private sectors. In the public sector, budgeting is especially a matter of *political choices.* These choices involve revenue sources and amounts on one hand and areas of expenditure and their amounts on the other. One especially vexing choice is how to match revenues and expenditures. No matter what choices are made, some people will bear the cost of either providing revenue or of foregoing services. Deciding whether to collect more in property taxes or to forego resurfacing streets is the kind of political choice that local governments often have to make in budgeting.

From a practical standpoint, *budgeting is the act of producing a series of work plans with dollar signs attached.*

Purposes

The basic purpose of budgeting is to *make good decisions about the acquisition and allocation of resources.* Good budgeting practices aim at providing appropriate information and analysis to achieve this. However, as those in budgeting processes hold different perspectives, various emphases result. These emphases are often the underlying cause of many budget disagreements. See Figure 1 for examples.

The Budget Process

Because the budgeting process is lengthy and complicated, writing an overall budget calendar to organize this process is a good idea. A budget

will specify:

- When the process starts
- What work products and actions are required (e.g., revenue and expenditure estimates, hearing notices, budget submission)
- Who is responsible for work products and actions (e.g., clerk, mayor, finance director, legislative body)
- When work products and actions must be completed (e.g., specific dates, before a specific date, so many days before another action)

Figure 2 is an example of a budget calendar. The four phases in a budgeting cycle are:

- Preparation
- Adoption
- Execution
- Audit

Generally, two or more budget cycles are occurring at the same time. Figure 3 shows an example.

Emphasis	Budgeting seen as:
Policy	The process through which governments decide what to do
Control	The means by which administrators are controlled
Management	The means to foster efficient government operations
Planning	The means by which governments decide what to strive for and achieve over an extended period of time
Public Relations	A public relations activity to create a favorable public response

**FIGURE 2
BUDGET CALENDAR**

City of Maverick

1983	<u>Due Date</u>	<u>Activity</u>	<u>By Whom</u>
	June 15	Write letter to department heads giving directions on preparing department budget estimates	Executive or chief administrator
	June 25	Prepare preliminary revenue estimates	Clerk
	July 5	Prepare work programs and budget requests and submit to executive or chief administrator	Department heads
	July 20	Review and revise budget requests	Executive or chief administrator
	July 25	Prepare proposed budget and proposed budget summary	Clerk
	July 27	Check mathematical accuracy of proposed budget summary	Executive or chief administrator
	July 30	File proposed budget with clerk	Executive or chief administrator
	August 6	Publish notice of public hearing with proposed budget summary	Clerk
	August 12	Hold public hearing—adopt or amend proposed budget	Council
	August 14	File copy of adopted budget with county board and state auditor's office	Clerk
1984	July 1	Begin implementation of budget	Finance director
1985	June 30	Budget year ends	---
	December 1	Submit audit to state auditor's office	Clerk

**FIGURE 3
MULTIPLE BUDGET CYCLES IN PROGRESS**

June 15, 1983	FY 82 in execution phase FY 83 adopted FY 84 preparation begins
July 1, 1984	FY 82 executed—will be audited FY 83 execution begins FY 84 preparation continues
December 1, 1985	FY 82 audited and finished FY 83 in execution phase FY 84 adopted

Preparation

Generally, budget preparation is carried out by administrators of the various departments or units under the overall direction of the chief executive or top administrator. Budget preparation involves making expenditure and revenue estimates for the legislative body to deal with in the adoption phase.

Adoption

When administrators and chief executives complete budget preparation, the final product is a

proposed budget that is submitted to the legislative body for scrutiny, revision, legal adoption, appropriation of monies, and levying of taxes. Legislative bodies hold hearings to acquire more information and greater understanding of budget proposals, engage in discussion and debate for the purpose of making informed decisions, and take legally binding votes that transform budget proposals into appropriation and revenue laws.

Execution

The legally adopted budget is then given back to administrators who execute it, usually over a one-year period. They collect and spend monies in the manner specified by the operating budget adopted by the legislative bodies.

In the execution phase, administrators frequently refer to their operating budgets to ascertain whether they are following legal directives. During the execution phase, administrators take the following actions:

- Apportionment
- Allotment
- Pre-audit of expenditures
- Record keeping
- Reprogramming.

Audit

After the execution of an operating budget is completed, the execution phase activities are subject to an audit. An audit is a review of the practices, actions, and reports made on a budget's execution. Audits can answer a number of questions. In Nebraska, they primarily review the accuracy of financial records and reports. Some local governments also have their financial management practices reviewed and have their auditors suggest possible improvements.

Legal Requirements

Budgeting by Nebraska localities is a process bound and regulated by legal requirements imposed by the State of Nebraska or local governments' own legal actions. The legal requirements for Nebraska local governments are found in the

Nebraska Budget Law (Rev. Statutes Supplement 1972, Sec. 23-921-23-933—see Appendix). The law prescribes certain budget practices and procedures such as due dates, public hearings, and written records. The law applies to all political subdivisions of Nebraska with budgets of more than \$5,000, including cities, towns, counties, school districts, special districts, vocational schools, and airport authorities. The only exceptions are home rule cities (Omaha and Lincoln) and agricultural societies with budgets of less than \$5,000.

The amounts approved in the adopted budget become the legal maximum expenditures permissible for the fiscal year. In case of emergency, the governing body has the authority to transfer monies from one fund to another, but the amounts actually spent may not exceed the approved total. The only way expenditure maximums may be changed is with a supplemental budget. Due public notice must be given, and a public hearing must be held on the proposed changes and reasons for them. If a supplemental budget is adopted, copies must be filed with the county and the state auditors.

As an aid to standardization, the state auditor provides the municipalities with recommended budget forms designed to meet the minimal requirements of the budget law. The budget law emphasizes revenue sources but deals with expenditures in a summary fashion only. Revenues from all sources for each fund must be identified. Municipalities are not prohibited from preparing their own budget forms in order to provide more information tailored to fit the needs of local citizens. The budget law prescribes only the minimal amount of information to be provided.

Summary

Budget making is not—or should not be—just an annual affair. Attention to budget and budgetary formulation should influence day-to-day decisions of management at all levels. For example, the action of a city council on last year's budget determines the programs and activities now being conducted. Progress under the current budget shapes and limits the programs and activities that can be considered under the budget

being prepared. Time is also a factor—if everything were static, programs and plans would precede the budget, and budget making would merely consist of financial and managerial implementation. However, life is not static. Sudden changes do occur, and time schedules for the phases of the budget cycle must occasionally be altered to con-

form with immediate and pressing problems. As a result, unless some flexibility is allowed in the time dimension of budget making, the crisis or crash programs cannot be administered. The key to good budgeting is asking, *“What do we want out of budgeting and what purpose should it serve?”*

Exercise: Ranking Activities

This exercise is designed to help you see what you want out of budgeting. It may also provide insight into what other people want.

Directions: Rank the various activities in terms of their importance to you by numbering the items in each group from 1 to 5, with 1 being the most important and 5 the least.

GROUP I

- _____ Deciding whether to add a new service
- _____ Looking for waste
- _____ Choosing between two operating techniques or pieces of equipment to do a particular activity
- _____ Figuring out where to build a public facility
- _____ Figuring out what public support is for various activities

GROUP II

- _____ Looking for places to cut or increase
- _____ Examining line items in budget proposals
- _____ Making workload projections
- _____ Looking at capital item proposals
- _____ Considering impacts of budget decisions on the public

GROUP III

- _____ Looking at the functional or service area distribution of monies in a budget
- _____ Deciding on expenditure procedures
- _____ Figuring out unit costs
- _____ Looking at the way current choices will affect future choices
- _____ Making popular choices

GROUP IV

In hiring a department head would you want an individual who would:

- _____ Determine the amount of funds necessary to implement his/her department work plans regardless of past budgetary practice?
- _____ Be more concerned with the cost of items to be purchased than the use to be made of them?
- _____ Present the budget on the basis of work to be accomplished rather than on the items to be purchased?
- _____ Have all whose activities are covered by the budget request meet together to review department goals and draft the budget based on these goals?
- _____ Draft the work goals and budget based on the number of citizen complaints about the work of the department?

GROUP V

In making a budget decision, the most important aspect is:

- _____ Policy
 - _____ Control
 - _____ Management
 - _____ Planning
 - _____ Public relations
-

Interpretation

	Your pattern is:
If you usually ranked the first answer as the most important, then	Policy
If you usually ranked the second answer as the most important, then	Control
If you usually ranked the third answer as the most important, then	Management
If you usually ranked the fourth answer as the most important, then	Planning
If you usually ranked the fifth answer as the most important, then	Public relations

Note: If your answers were inconsistent, you might want to re-think what your purposes in budgeting are. The exercise should provide an insight into:

1. Your budgeting emphases and associated behaviors
2. How others may view you in budgeting
3. Others' budgeting emphases and their associated behaviors.

CHAPTER II

REVENUE ESTIMATION

Introduction

Revenue estimates are made repeatedly in the budget process, and estimates are changed (as the process moves along) to reflect the most current information. The sources of revenue vary owing to a variety of factors. Income from taxes and compulsory payments varies less than that from sources that do not involve compulsory payments. The most important factors in predicting revenues are the *characteristics of a revenue source, general economic conditions, and intergovernmental fiscal relations*. Furthermore, in the process of estimating revenue, attention should be paid to cash balances available for expenditure.

Revenue Sources

The first step in estimating revenues is to develop a list of revenue sources, past income from regular sources, and restrictions placed on the use of particular revenues. A listing of some tax and other revenue sources for Nebraska local governments is shown in Figure 4.

Estimating Techniques

Revenue estimating techniques vary from the complicated, high technology econometric models to good old expert opinion. The two approaches most commonly used at the local government level, aside from very populous jurisdictions, are deterministic equations and expert opinion. Deterministic equations simply set out revenue elements in a simple equation into which estimates of the various figures are substituted. A deterministic equation is usually some variation of the following:

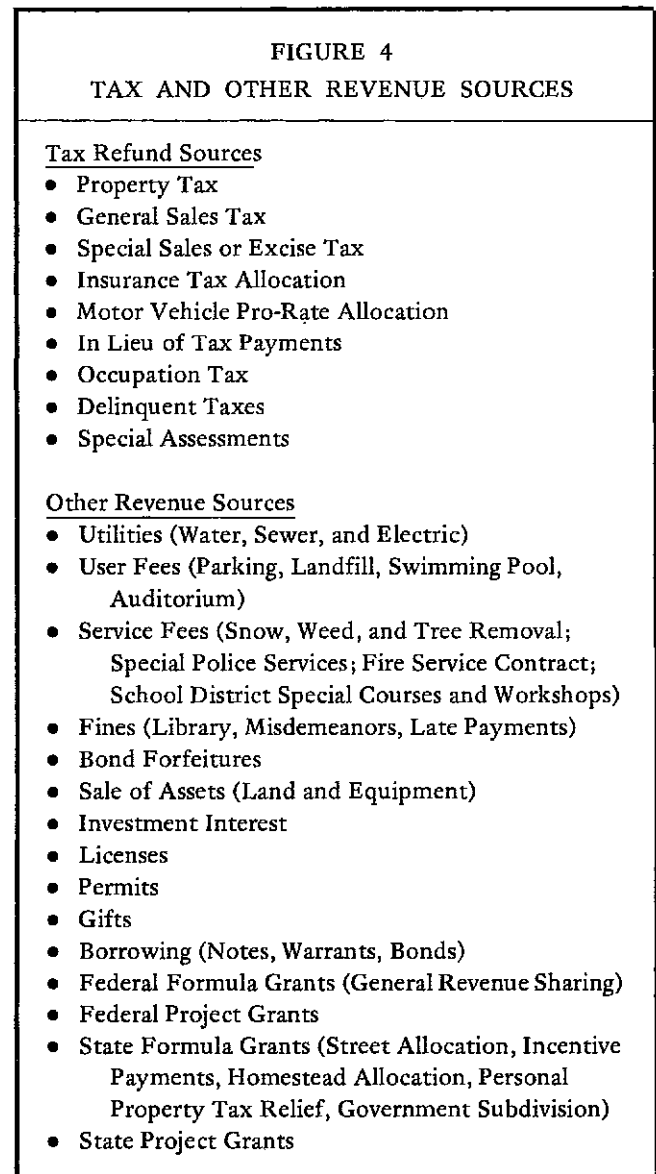
$\text{Base} \times \text{Rate} = \text{Yield}$

Expert opinion involves a judgment call based on all the relevant factors known and usually is

the hardest estimation technique to use effectively. It is best used by those with substantial experience with a given revenue source.

Computing Revenue Source Estimates

Tax revenue estimation focuses on the deterministic equations and the characteristics of their



components:

$$\text{Tax Base} \times \text{Tax Rate} = \text{Revenue Yield}$$

Important characteristics of the tax base are:

- How large it is in dollar amounts
- How much it varies
- How stable it is over time

Important characteristics of the tax rate are:

- Who determines the rate
- What the legal limits and restrictions are
- How much it can be varied

Another important aspect of any tax revenue source is the impact of delinquency on the revenue yield.

These characteristics can be illustrated by looking at how they affect property and sales tax estimations.

Property Tax Revenues

Base. The property tax base is predominately real property. The size of the base in dollar amounts is set by county assessors who place an assessed valuation on real property. Adding up the assessed valuations of all real property in a jurisdiction provides a total known base. The primary cause of variation is reassessment. *The property tax base, then, is very stable and relatively easy to predict based on county assessor information or estimates.*

Rate. The property tax rates are set by the various local units with authority to levy property taxes. Legal restrictions are placed on the real property rates for general usage and specific purposes, e.g., road levy. *Property tax rates are highly variable up to the legal limits.*

Delinquency. A particularly important feature of the property tax is the degree to which its revenue yield is dependent upon tax delinquency which, in turn, varies with general economic conditions. Delinquency rates on property taxes ordinarily vary between 1 and 10 percent of levied property taxes. Good economic conditions are associated with low delinquency rates and payment of previously delinquent taxes. Poor economic conditions are associated with higher delinquency rates. Also, each county's economic condition is the most important predictor. A county's history

of delinquency rates under varying economic conditions is the best information source for predicting delinquency rate.

A suggested formula for predicting property tax revenue is:

$$\text{Base} \times \text{Rate} = \text{Levied Taxes} - (\text{levied taxes} \times \text{delinquency rate}) = \text{Yield}$$

This equation may also be used to predict the amount of delinquent property taxes that will be collected.

Two intergovernmental fiscal relation aspects of property taxes are interesting. First, revenue yields in Nebraska local governments are diminished by the county-wide delinquency rates. Second, state and federal property is not subject to local property taxes. State and federal purchase of properties diminishes the real property tax base.

Sales Tax Revenues

Sales tax revenue estimates are quite different from those for property tax. The tax bases are generally retail sales and the sale of specific items that have a special sales or excise tax. Historical patterns, recent changes in the base, and general economic conditions are important in predicting the base. Bases for the last few years are the most common starting points for estimation. Factors affecting increases and decreases in the base are changes in population, jurisdictions and the number of retail businesses, plus general economic conditions and the inflation rate of the Consumer Price Index.

An equation of a sales tax base might look like this:

$$\begin{aligned} &\text{Present year's base} + (\text{percent population} \\ &\text{growth} \times \text{base}) + \text{new shopping center change} \\ &\text{in base estimated} + (\text{percent inflation} \times \text{base}) \\ &- (\text{decline in economic conditions, a percent,} \\ &\times \text{base}) = \text{next year's base} \end{aligned}$$

The sales tax rates are not easily varied and are limited by state statutes.

An additional factor affects the yield of sales tax revenues. Vendors and the state both retain

3 percent of the sales taxes they collect as an administration fee. This factor must be taken into account when computing sales tax revenue estimates.

In using deterministic equations, the results are only as good as the numbers estimated for the base, rate, and delinquency rate. The estimator should use historical experience, pay close attention to legal and administrative changes affecting the factors in the equation, and estimate conservatively. Conservative estimates protect against revenue shortfalls which cause major inconveniences, while surplus revenues are somewhat easier to cope with.

Estimating Other Revenue Sources

In addition to taxes, other types of revenues are utility, service, and user payments; shared revenues; formula project grants; and fines. Formula grants and shared revenues, among others, are most easily estimated using a deterministic equation, but expert opinion may also be used. The estimation error is likely to be somewhat greater on these revenue sources as the factors are more difficult to predict. *The key to deciding on an estimation is what works best in an individual case.* Where the factors are more predictable, the deterministic approach is better. Where the factors are unpredictable, expert opinion works better. Project grant revenues are so unpredictable before award that the activities they will possibly finance are treated separately, contingent on the grant award.

The expert opinion approach looks very simple but is quite complicated. First of all, an expert must be available. In many cases the expert is not the person formally in charge of the preparation of revenue estimates. Being an expert is not a matter of formal education but rather of concrete experience and day-to-day contact with the relevant information. The less qualified a person is on these two points, the less likely that his/her estimation of a revenue source is going to be accurate. Building permits, dog licenses, parking meter fees, and fines are prime examples of areas where expert opinion should be relied on.

Once one has an expert, a quasi-expert, or more than one expert on hand, one can proceed on a deterministic equation basis or obtain an overall revenue figure for a revenue source. In the case where more than one expert opinion is available, the choice is between taking the most expert opinion, the most conservative one, or an average of the various opinions. Also, one might want to take an expert opinion and render it more conservative by subtracting 5 percent as a safety factor.

Summary

Revenue estimation is a source by source analysis. Since it is predictive in character, some degree of error is always present. Errors on the conservative side, within reason, are preferable to optimistic predictions. Revenue estimation relies on past experience, individual or statistical, to predict the future.

Exercise: Estimate Tax Revenue

Directions: You are in charge of estimating for the Maverick local government. You are in the process of estimating property tax receipts. You have gathered the following information on past years for property taxes:

Maverick Property Tax

<u>Past Years</u>	<u>Assessed Valuation</u>	X	<u>Tax Rate</u>	=	<u>Taxes Levied</u>	—	<u>Delinquency Rate</u>	=	<u>Revenue Yield</u>
5th	\$20 M	X	10%	=	\$2 M	—	4%	=	\$1.92 M
4th	30 M	X	10%	=	3 M	—	3%	=	2.91 M
3rd	40 M	X	10%	=	4 M	—	2%	=	3.92 M
2nd	50 M	X	10%	=	5 M	—	6%	=	4.70 M
1st	60 M	X	10%	=	6 M	—	8%	=	5.52 M

From your experience, you have pinpointed the following major factors associated with delinquency rates:

Delinquency Rate Factors

<u>Past Years</u>	<u>Agricultural Prices</u>	<u>Interest Rates</u>	<u>Unemployment</u>	<u>Inflation</u>	<u>Business Optimism</u>	<u>Delinq. Rate</u>
5th	Medium	Medium	Medium	High	Medium	4%
4th	High	Medium	Low	Medium	High	3%
3rd	High	Medium	Low	Medium	High	2%
2nd	Low	Medium	Medium	High	Medium	6%
1st	Low	High	Medium	Medium	Low	8%
This Yr.	Low	Medium	Medium	High	Low	—

Armed with your information, you are ready to estimate property tax revenue for Maverick.

The first step is to obtain the assessed valuation from the county assessor's office. A key factor is the accuracy of this figure. Fortunately, your county assessor can give you actual figures that do not change substantially. Maverick's assessed valuation for the coming budget year is \$80 million.

<u>Assessed Valuation</u>	X	<u>Tax</u>	=	<u>Levied Taxes</u>	—	<u>Delinquent Taxes</u>	=	<u>Revenue Yield</u>
80 Million	X	?	=	?	—	?	=	?

You now have two possible ways to go. You can shoot for a desired revenue yield amount by selecting an appropriate rate, or you can simply predict a revenue yield based on the past year's tax rate. The first option is associated with a relatively high degree of commitment to particular expenditure levels, while the second is associated with a relatively high degree of commitment to minimizing taxes and tax increases. Wise budgeteer that you are, you choose to figure it both ways.

1. Same Rate

What is the revenue yield?

$$80 \text{ Million} \times 10 \text{ percent} = 8\text{M} - (8\text{M} \times \text{Delinquency Rate}) = \text{Revenue Yield}$$

<u>Delinquency Rate (Percent)</u>	<u>Revenue Yield</u>
1	7.92 M
2	7.84 M
3	7.76 M
4	7.68 M
5	7.60 M
6	7.52 M
7	7.44 M
8	7.36 M
9	7.28 M
10	7.20 M

What is your predicted revenue yield? _____

2. Variable Rate

What is the tax rate required to obtain 8.6 M?

$$80 \text{ Million} \times ? = ? - (\text{delinquent taxes}) = \text{Yield}$$

First, you predict a delinquency rate. Your predicted delinquency rate is _____

Given that delinquency rate and your assessed valuation, what is your approximate tax rate?

Levied taxes where assessed valuation is \$80 million:

<u>Rate (Percent)</u>	<u>Levied Taxes</u>
10.0	8.0 M
10.5	8.4 M
11.0	8.8 M
11.5	9.2 M
12.0	9.6 M

$$\text{Levied Taxes} - \text{Delinquent Taxes} = \text{Revenue Yield}$$

$$\text{Delinquent Taxes} = \text{Levied Taxes} \times \text{Delinquency Rate}$$

What is your proposed approximate tax rate? _____

Interpretation of Exercise

1. Revenue estimation is not a task for the president of the local Optimist's Club. The delinquency rate predictors are no better than the year past and worse than the second year past. Your predicted delinquency rate will probably be between the rates for the two past years but should be closer to the higher one. The appropriate estimated delinquency rate should be between 7 percent and 9 percent. A lower rate is too optimistic. A higher delinquency rate prediction might be justified by the tradition of conservative revenue estimation.

2. Given the following delinquency rates, your tax rate should be as indicated to achieve revenues of approximately \$8.6 million.

<u>Delinquency Rate</u>	<u>Tax Rate to Generate 8.6 M Revenue Yield</u>
6	11.5
7	11.7
8	11.8
9	11.9
10	12.0

CHAPTER III

EXPENDITURE CLASSIFICATIONS

Introduction

How information is organized affects how it is understood. Local government finances are organized by funds, and expenditures are classified in various ways, such as by function, organizational unit, object of expenditure, and "things done" categories.

Funds

A fund can be defined as:

A fiscal and accounting entity with a self-balancing set of accounts recording cash and other financial resources, together with all related liabilities and residual balances.

Source: NCGA—GAAFR Restatement of Principles

Funds are special accounting classifications for revenues and expenditures. All local government revenues or expenditures go into or out of a particular fund. Funds are used to separate diverse revenues or expenditures to fulfill special regulations, restrictions, and limitations.

Eight different types of funds are commonly used by local governments. The eight types and their purposes are shown in Figure 5.

Various revenues and expenditures are handled within one or more of these types of funds created to serve the needs of particular local governments. Financial reports, particularly audits, are also organized in terms of funds.

Expenditure Classifications

Budget data on expenditure and revenue must be organized in such a way that they may be understood and that comparisons may be made. No ideal single classification system exists or probably can be created. In spite of this, *classifica-*

FIGURE 5
TYPES OF FUNDS USED
BY LOCAL GOVERNMENTS

Type	Purpose
1. General	Non-restricted resources
2. Special Revenue	Revenues restricted to special purposes
3. Capital Project	Capital construction projects
4. Debt	Long-term debt payments
5. Special Assessment	Special assessment projects (where those benefiting pay part of the cost, e.g., curb, gutter, sidewalk projects)
6. Enterprise	Business-like activities (where payments finance service provision)
7. Internal Service	Services or goods provided by one internal department to another (not commonly used in Nebraska)
8. Trust or Agency	Assets held in trust or as an agent for another person or organization

tion is the key to conscious and rational budgeting. The manner in which items of expenditure and revenue are grouped will have a great deal to do with the character of the decisions that can be made in the budgetary process. The classification system must not bracket the important questions—it must center on them. Some classification systems are directed primarily toward expenditures and others toward revenue but both should be used.

Classification systems serve three purposes:

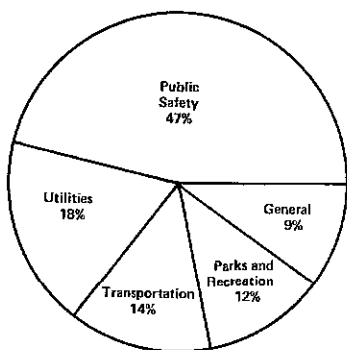
- Decisions—Clarify budget choices
- Execution—Identify expenditure authority
- Accountability—Show where revenues came from and where expenditures go.

Types of Classification

Classification by Function

Functional classification is designed to facilitate program formulation at the executive and legislative level. It is often described as the "citizen's classification" because it provides general information on governmental operations. Ideally suited to an analysis of governmental activities over a period of time, it facilitates measuring changes in the nature of governmental programs. Use of the familiar pie graph shows what percent of the expenditures go for particular functions.

City of Maverick Expenditures



Functional classification has certain characteristics not common to other systems. Among these are:

- Public works are not identified as a separate function because they are not regarded as significant in themselves. (They are significant only in relation to the interests served in government programs.)
- The general government (miscellaneous) category is kept as small as possible. This means that general overhead items should be allocated to functional categories even if it requires some statistical estimating.
- Debt service is maintained as a separate item.
- Arbitrary decisions are sometimes made about where to place an activity. For example, food inspection is a health activity, and a sewage treatment plant is normally classified as a utility function—even though its major purpose is health protection.

An example of expenditures classified by function is shown in Table 1.

Health	\$ 150,000
Welfare	450,000
Transportation	200,000
Culture	100,000
Leisure	200,000
Public Safety	300,000
Debt	100,000
Miscellaneous	200,000
	<u>\$1,700,000</u>

Classification by Organizational Units

Every budget system must include a presentation of accounts based on organizational units. Legislative appropriations are made to departments. This legislation authorizes specific departments to incur obligations for specified purposes. Thus the responsible department head knows how much the department has to carry out its mission. What the organizational unit classification system does is to underline the ultimate legal authority extended by the council to carry out the work assigned to that department. This classification system not only indicates the department to which the appropriation is made but also to which fund or funds the expenditures are to be charged.

An example of expenditures classified by organizational units is shown in Table 2.

Clerk's Office	\$ 50,000
Police Department	200,000
Fire Department	150,000
Library Department	80,000
Streets Department	210,000
Parks Department	70,000
Utility Department	400,000
	<u>\$1,160,000</u>

Classification by Object of Expenditure

Classification by object of expenditure means that what is purchased provides the categories for expenditure information. This system centers attention on the accounting aspect of governmental operations. Since departments tend to buy the same things, setting up a system of accounts that is uniform throughout the whole government is possible. A typical system breaks down purchases into account categories such as:

- 100 Personnel Services
- 200 Operating Expenses
- 300 Supplies and Materials
- 400 Equipment and Building Rentals
- 500 Capital Outlay
- 600 Debt Service

Within each of these objects of expenditure schedules and sub-items will be listed depending on how far costs are broken down. For example, under Personnel Services these items might be listed:

- 100 Personnel Services
 - 110 Regular Wages and Salaries
 - 120 Overtime Wages
 - 130 Part-time Salaries and Wages
 - 140 Employee Insurance
 - 150 Retirement Contributions
 - 160 Other Employee Benefits
 - 170 Payroll Taxes
 - 190 Other Personnel Costs

Within each of these categories costs can be broken down as far as desired. For example, under 140 Employee Insurance, the classifications might be:

- 141 Health-Accident
- 142 Group Life
- 143 Workman's Compensation

An object classification system serves certain budgetary purposes very well. It provides strong central control over expenditures, serves to strengthen the council in relation to the operating departments, and permits the establishment of a pattern of accounts that can be controlled and easily audited.

The basic weakness of this classification approach is that it focuses attention on what is purchased instead of on what will be done. While

it strengthens the policy making body in relation to the operating departments, the results are not always the best. The council may concentrate on the details of purchases rather than on the larger problem of what is going to be accomplished.

The "line item" budget, as object classification is often called, should be used as a supplementary system for accounting purposes rather than as the main classification system. Little attention is placed on what is to be done—which should be the main concern of administrators and policy makers. In other words, a classification system that shows what is to be accomplished, with the object classification system used to show "this is what it will take to do it," is much more useful for decision making.

"Things Done" Classification

Three expenditure classification schemes emphasize what is done rather than what is bought in various programs. These classification schemes, often identified as budgeting approaches, are:

- Performance Classification
- Program Classification
- Zero-Based Classification

Performance Classification. Performance classifications may be used either as expenditure categories or as performance predictions. Both focus on the output or activities of governmental divisions. Two examples of performance classification are shown in Table 3.

Using performance of activities as an expenditure classification requires a unit of activity, a prediction of workload, and identification of line items necessary to carry out the activity. Also, unit cost figures are frequently used with this kind of classification scheme. It is especially associated with a concern for efficiency.

Performance predictions do not stress "things done" as much as performance expenditure classifications but still provide "things done" information.

Program Classification. Program classification schemes focus on outcomes (final results) rather than outputs (activities). Program classification is associated with a concern for policy. An example is shown in Table 4.

TABLE 3
PERFORMANCE CLASSIFICATION

Example 1: Performance Expenditure Classification

City of Maverick
Billing Department

1984
Performance Activity: Bills Sent Out
Unit: Bill
Predicted Number: 16,000

The billing department sends out bills for water, gas, and sewer. Last year 15,000 bills were sent out, and a slight increase is expected this year.

<u>Line Items</u>	<u>Amount</u>
Personnel	14,000
Supplies	1,500
Utilities	500
Total	16,000

Unit Cost: \$1.00 per bill

Example 2: Performance Predictions

City of Maverick
Billing Department

1984

<u>Line Items</u>	<u>Amount</u>
Personnel	14,000
Supplies	1,500
Utilities	500
Total	16,000

Performance Predictions

Bills	16,000
2nd Notices	500

Program classifications emphasize budgeting for purposes or goals. The hypothetical Maverick Police Department would also have other programs. The performance indicators (predicted outcomes) may not be so neatly laid out, but the thrust of program classifications is to focus on measures of outcomes.

Zero-Based Classification. Zero-based expendi-

ture classifications provide a menu-like approach to expenditure choices. This classification approach is much like performance expenditure choices. The two key terms are *decision unit* and *decision package*. Decision units are very flexible but usually are activities. Decision packages are the various choices that are presented within a particular decision unit category. Decision units are like

**TABLE 4
PROGRAM CLASSIFICATION**

City of Maverick	1984	
Police Department	Program: Crime Solution	
 <u>Line Items</u>		
Personnel	25,000	
Vehicle	3,000	
Supplies	1,000	
	Total	29,000
 <u>Performance Indicators</u>		
<u>Projected Crimes</u>		<u>Predicted Solutions</u>
Murder 0		—
Rape 0		—
Robbery 2		1
Assault 6		4
Burglary 15		5
Theft 100		25
Auto Theft 7		1
Arson 0		—

menu categories, e.g., sandwiches, while decision packages are the possible individual choices available within a menu category, e.g., bologna. An example is shown in Table 5.

With a zero-based expenditure classification, different decision packages which include a level of activity, an object classification, and a cost estimate can be chosen.

The “things done” classification is not often found in local government budget documents. However, supporting documents, oral presentations, and evaluative discussions will frequently include information classified along this line. Examples include unit cost projections, workload projections, goal statements, and “what we could do with so many more dollars” projections. Individuals must determine in their own budgeting processes how much to focus on this classification and whether or not to formalize it in budget documents.

Exercise 1: Identify Classification Schemes

Directions: Match the various classification schemes on the right with the descriptions on the left.

Note: Some classification schemes may fit more than one description.

- | | |
|--|-------------------|
| _____ 1. The maintenance department request is \$100,000. | a. Fund |
| _____ 2. With our request, we expect to be able to upgrade three bridges from impassable to completely safe. | b. Organizational |
| _____ 3. In order to meet our debt payments, we have to put \$100,000 in the Debt Service Fund. | c. Objects |
| _____ 4. The appropriations for the library come from the library fund and the General Fund. | d. Performance |
| _____ 5. For an additional \$100,000, our department can provide 1,000 more visiting nurse calls to citizens in their homes. | e. Program |
| _____ 6. We will need \$100,000 for personnel expenses next year. | f. Zero-Based |
| _____ 7. Our department's goal is to achieve a 5 percent reduction in the crime rate. | |
| _____ 8. By purchasing this machine, we will lower our unit costs. | |
| _____ 9. We expect to increase our number of service calls to 15,000 next year. | |
| _____ 10. How much will it cost to increase your number of service calls to 15,000 next year? | |

Exercise 2: Construct a "Things Done" Classification

Directions: Using estimates, construct a "things done" expenditure classification for a budget area you are familiar with. (Be as brief as possible.)

Interpretation of Exercises

Exercise 1

	Key Word or Idea
1. b	Department
2. d or e	Things done—activity or outcome
3. a	Fund
4. a, b	Library department and fund
5. f	Things done and cost
6. c	Personnel—a line item
7. e	A goal—things done
8. d	Unit cost—efficiency
9. d	Activity
10. f	Things done and cost

Exercise 2

Questions to ask yourself:

1. Is this classification approach useful for my budget involvement?
2. How much work is there using this classification scheme?
3. Is the classification by the “things done” approach worth the effort?

Your answers to these questions should tell you how much and whether or not the “things done” classification scheme is valuable to you in budgeting.

CHAPTER IV

EXPENDITURE ESTIMATION

Introduction

One of the most crucial steps in budget preparation is to determine the costs of operation for the coming budget year. In estimating expenditures for a budget request, a wide variety of factors must be taken into account and a number of techniques must be used.

Factors in Estimating Expenditures

The factors to be considered in estimating expenditures are:

- Politics
- Policy Shifts
- Technological Changes
- Workload Predictability
- Cost Changes

Politics

Different governments have different political norms concerning budget requests, ranging from extreme over-estimation of expenditures to precise, conservative expenditure estimates. Politics is also reflected in policy shifts. As a result, the relevance of politics in local government budgeting must be acknowledged.

Policy Shifts

Policy shifts refer to changes in goals and activities in units, whether initiated by the department, chief executive, or at the legislative levels. For example, a school shifts its efforts from college preparatory to vocational education; a police department shifts its efforts from traffic control toward more crime prevention. Policy shifts generally require a change in objects of expenditure to accomplish different tasks.

Technological Change

When a new and better way of accomplishing a task is adopted or proposed for adoption, it creates a new estimating problem for preparing budget requests. Therefore, extra care is called for, particularly by the person or persons who are responsible for implementing a technological change.

Workload Predictability

Certain activities are completely within the control of local governments and, as such, the workload is predictable. Other activities are only partially predictable. For example, student-teacher ratios can be easily predicted as can daily hours of police patrol and health inspection, but estimating expenditures for snow plowing is difficult.

Cost Changes

Attention must be paid to the changing costs of objects of expenditure. This must be done on an object-by-object basis as price changes vary by both degree and direction. Last year's budget and current experience help.

All these factors may enter into determining an appropriate set of expenditure estimates. Expenditure estimates are extremely difficult owing to the fact that the prediction may be made for up to 18 months into the future. Regardless of these difficulties, all expenditure estimating can be put into criteria of old and new estimating problems. The old problems are ones with which one has experience; the new problems are those being faced for the first time.

Typical Situations and Techniques Used

The old-new and predictable-unpredictable

criteria provide four typical cases in expenditure estimating:

- Old-Predictable
- Old-Unpredictable
- New-Predictable
- New-Unpredictable

Regardless of the type of case, a statement or view of the expenditure estimating problems being dealt with is necessary. These include:

- What factors are involved
- What terms are used to estimate

Example: You can estimate more easily by deciding what your objects of expenditure will be than by setting appropriate workload levels and calculating what objects of expenditure are necessary to accomplish the projected workload. (Usually, one is at the very least implicitly dealing with projected workload levels, even if the workload levels are not formally expressed or analyzed.)

- What the breakdown is
(Expenditure estimating situations are frequently, though not always, broken up into distinct pieces by activity or organizational parts.)

Once one has a view, he or she proceeds to apply estimating techniques to various cases.

Old-Predictable

Generally, the old-predictable category involves continuing to do what was done previously on something very predictable. Estimating in this case involves policy shifts and analysis of cost factors. Policy shifts are judgmental and somewhat unique in each jurisdiction, whereas changes in cost are common to all. Once the budget officer has a handle on the level or workload and the objects to produce the work, all that remains is to predict accurately the costs of the objects. Here, historical experience from previous budget years is useful. Such objects can be grouped in the broad categories of personnel, contractual services, supplies, equipment, and capital outlay.

Personnel. Personnel is almost always the greatest single cost category for local governments.

In order to predict costs, the budget officer must:

- 1) Determine what changes occurred since last year's budget that will affect personnel costs. Examples would be a turnover in personnel that results in greater or lesser wages or salaries, fringe benefits, and step increases.
- 2) Analyze levels of wages and salaries, special pay, and fringe benefits. These personnel costs may be proposed, predicted, or previously determined.
- 3) Account for interrelationships in personnel costs, such as increased overtime costs with wage increases, increased pension costs with salary increases, and increased seniority costs with wage increases. This may be simplified where an across-the-board change in personnel costs has taken place. However, checking through such numbers would still be a good idea. If personnel costs are overlooked, they probably will have to be paid for from money committed to over-expenditures.

Contractual Services. Contractual services can be estimated by obtaining price listings or estimating cost changes. Some contractual service suppliers can be tied to a yearly service contract or relied upon to provide accurate price estimates. The kinds of services needed will depend upon the jurisdiction but will usually include rental, advertising, printing, and dues. Other supply costs are less controllable or predictable—utilities and travel expenses are prime examples. With such services, a reasonable estimate can be based on projected increase in the Consumer Price Index or an informed view of what the price trends are. Estimating a little on the high side is wise to protect against the greater consequences of under-estimation.

Supplies. Supply cost, like contractual services, may be tied down by a yearly supply agreement. Where supply prices are volatile, the supplier will tend to increase the price slightly beyond what he believes it might be in order to protect himself. Some but not all supplies can be reasonably estimated by suppliers. Finally, some can be estimated by generalized inflation predictions or analysis of price trends.

Equipment. Equipment cost estimates can be handled in the same fashion as contractual services and supplies. However, equipment is subject to more frequent substantial price changes.

Capital Outlays. In most cases, capital outlays should be budgeted for separately in a multi-year capital budget. In those cases where capital outlays for equipment are a part of a department budget, the budget officer either has contracts or has to make reasonable estimates.

In determining expenditure estimates, the issue of yearly contracts may enter in. The key idea of a yearly contract, for whatever expenditure, is that the supplier is bound to performance by a contract and assumes all risks of cost changes unless they are built into the contract itself. Therefore, the contractor will build in to the price a charge for assuming the risk. For example, if the expected average yearly price for a large quantity of gasoline is \$1.00 a gallon for the following year, a supplier who enters into a contract to supply gasoline is likely to do so at a price of \$1.03 to \$1.06 a gallon. Local governments usually weigh the cost of a certain price against the benefit of a likely cost savings. In most cases, the certain price is chosen to avoid the difficulty that a price increase would cause.

Finally, due to the predictive character of many expenditure estimates, estimation usually follows two rules.

**RULE 1
THE RULE OF REASONABLENESS**

The estimating effort should be equal to the value of a correct estimate. Large cost items deserve greater estimation effort than do small cost items. Some predictions will be off either on the high or low side. To be close on the big ticket items is more important.

**RULE 2
THE FUDGE RULE**

Fudge estimates slightly higher than expected. This means estimating costs slightly higher than the actual cost is likely to be. The more volatile the price, the larger the fudge factor.

Old-Unpredictable

While the old-predictable case is the easiest, the old-unpredictable case is only somewhat more difficult. The key problem is the inability to predict a workload level accurately. Snow removal and health client cases are two examples of old-unpredictable services. Such unpredictable services involve various estimating techniques. For smaller cost services, depending on the overall budget size, a *high side estimate* will suffice. Where the costs are substantial, the options are a *service cap* or a *work plan*. A service cap or maximum service level provision simply states that so much of this service will be provided and no more. Then budgets for the maximum service level are prepared. Certain variable demand services, such as mental health and educational counseling, can be dealt with in this manner.

However, some services are too important to cap, e.g., animal control, health services, and snow plowing. With these services, the budget officer needs a work plan for variable service levels. Table 6 provides a work plan for snow plowing.

Essentially a work plan lays out what services will be performed at various levels of demand and cost. Work plans have to be costed out, i.e., have expenditure estimates attached. The plans deal with short-term and long-term demand levels. For example, in terms of short-term where a large snowfall occurs, the city's or county's own equipment and personnel might be used for accumulations up to a certain depth and a contract for supplemental snow removal services made at pre-arranged prices above this level. To do this how much snow removal capability is on hand must be planned for and at what snowfall levels additional assistance is required. In terms of long-term demand, expenditure levels may be set at which snow removal would be curtailed in a variety of ways: snowfall depths, when removal begins, designated streets, degree of snow removal (plowing and/or hauling), and speed of snow removal.

Variable expenditure plans have cost advantages. In the short-term cases, temporary assistance is much cheaper than a continuous peak-load capability. In the long-term cases, overall high demand plans identify at what levels high costs justify

TABLE 6
WORK PLAN – SNOW PLOWING

Fixed Expenditures:

1 new snowplow (every five years @ \$20,000)	\$4,000
Yearly snowplow maintenance (contracted)	200

Operating Costs:

Personnel @ \$10 an hour + fuel @ \$10 an hour =
Operating costs of \$20 an hour

LEVEL I – Plowing Almost Certain to be Needed

Wait until 1 inch of snow falls.
Plowing of 1 inch of snow takes 1 hour.
Maintain this pattern for 30 inches of snow to be plowed.
30 inches requires 30 hours of snowplowing.
Operating costs: 30 hours @ \$20 an hour = \$600

LEVEL II – Plowing Likely to be Needed

Wait until 2 inches of snow falls.
Plowing of 2 inches of snow takes 1½ hours.
Maintain this pattern for 40 inches of snow to be plowed.
Operating costs: 30 hours @ \$20 an hour = \$600

LEVEL III – Plowing Unlikely to be Needed

Wait until 3 inches of snow falls.
Plowing of 3 inches of snow takes 2 hours.
Maintain this pattern for 30 inches of snow to be plowed.
30 inches requires 20 hours of snowplowing.
Operating costs: 20 hours @ \$20 an hour = \$400

LEVEL IV – Plowing Very Unlikely to be Needed

Wait until 4 inches of snow falls.
Plowing of 4 inches of snow takes 2½ hours.
Maintain this pattern.
2½ hours @ \$20 an hour = \$50

Budget Request in Line Item Form (Levels I-III)

Sinking Fund for Snowplow Purchase	\$4,000
Yearly Snowplow Maintenance Contract	200
Operating Costs: Personnel = 80 hours @ \$10 an hour	800
Fuel = 80 hours @ \$10 an hour	800
	\$5,800

decreasing service levels or shifting resources.

With the requisite high-side estimates, service caps, and work plans, one is back to the ever-present estimation of objects of expenditure. One useful categorization here is fixed and variable costs. Certain costs are going to be incurred regardless of service levels. Others will vary with activity levels.

New-Predictable

Where an activity is new but predictable, one deals with three cost estimating problems:

- The uncertainty of work activity levels
- The need for a comprehensive assessment or listing of expenditure objects
- The increased difficulty in estimating costs.

For example, if a city buys a computer system, estimating activity work levels is more uncertain. One can commit to a work level and then find that the requirements have been underestimated by overestimating what can be produced. About all that can be done is either set an expenditure level and see what happens on the workload side, or find a similar jurisdiction or two that has experience with a particular case.

With new cases, estimation error is more likely due to a lack of familiarity with the prices of objects of expenditure. Some cost object will probably be overlooked. A slightly greater fudge factor is justified in such a case.

New-Unpredictable

Where an activity is new and unpredictable, one is in a position to apply all the techniques discussed above. For example, a county may establish a new welfare program. The uncertainty, because of the newness and activity levels, suggests additional caution and use of a larger fudge factor.

Summary

In summary, estimating expenditures requires several preparatory steps. First, the budget officer must assess the relevant factors, and second, he/she needs a view of the expenditure estimating problems. Third, the type of case must be identified in order to estimate cost changes in expenditure objects. The rules of reasonableness and fudging are usually used in cost prediction, and some degree of error should be expected.

Exercise 1: Identify Relevant Factors

Directions: Match the relevant factors on the right with the budgeting situations on the left.

Note: More than one factor may apply in a specific situation.

- | | |
|---|----------------------------|
| _____ 1. 100 citizens at meeting demanding more traffic signals | a. Politics |
| _____ 2. Change in operations | b. Policy Shift |
| _____ 3. Change in student-teacher ratios | c. Technological Changes |
| _____ 4. A new fire prevention program | d. Workload Predictability |
| _____ 5. Pothole repair | e. Cost Changes |
| _____ 6. New jurisdiction vehicles | |
| _____ 7. Mayor and council vote not to increase expenditures | |

Exercise 2: Estimate Expenditures

Directions: You are the Director of Administrative Services who is preparing budget estimates for the coming budget year. Below are last year's budget estimates as appropriated and your current nine-month expenditures to date. After studying the figures, answer the questions on the following page.

Maverick, Nebraska FY 198X
 Department of Administrative Services

Object Classification Summary

Classification	FYXX Budgeted	Nine Months To Date
Personnel	\$ 82,900	\$61,550
Contractual Services	8,600	6,300
Supplies	10,100	8,550
Equipment	1,150	650
Totals	\$102,750	\$77,050

Object Detail by Classification

Personnel Classification

Director	\$ 25,000	\$18,750
Assistant Director	15,000	11,250
4 Clerks 1	12,000	9,000
2	10,000	7,500
3	9,000	6,750
4	8,000	6,000
Clerk Overtime	3,900	2,300
Totals	\$ 82,900	\$61,550

Contractual Services

Electricity	\$ 1,300	\$ 800
Natural Gas	3,500	1,700
Telephone	1,700	1,500
Machine Maintenance Contracts	900	900
Training—4 Clerks to Admin. Services School	1,200	1,400
Totals	\$ 8,600	\$ 6,300

Supplies

Forms 1	\$ 1,500	\$ 1,000
2	3,000	2,800
3	900	700
Machine Ribbons	300	250
Paper	1,400	1,100
Miscellaneous	3,000	2,700
Totals	\$ 10,100	\$ 8,550

Equipment

Typewriter	\$ 700	\$ 650
Calculator	300	0
Chair	150	0
Totals	\$ 1,150	\$ 650

Questions:

1. Where were your previous year's estimates especially good and especially poor?

2. Following the rule of reasonableness, where should you put your greatest efforts in estimating for next year?

3. Following the fudge rule, where would you fudge the percentage of new estimates? Where would you fudge them the most?

4. Assuming no major changes, what would you do to estimate the following items:
 - Clerk Salaries
 - Natural Gas
 - Calculator
 - Miscellaneous Supplies

5. Assuming no other changes, what would you do to estimate the following changes:
 - Retirement and replacement of assistant director
 - Acquisition and use of a minicomputer
 - Acquisition of the budget management responsibility

Interpretation of Exercises

Exercise 1:

1. a, b, and maybe c and d
2. b and maybe d
3. c and e
4. b, d, and maybe c
5. d and e
6. e
7. a and maybe b

Exercise 2:

1. Especially good: Salaries and Machine Maintenance Contracts are precisely correct, while Form 3, Paper, and Typewriter are reasonably close.
Especially poor: Telephone, Training, Form 2, and Miscellaneous are higher than they should be, while Natural Gas is substantially lower than budgeted.

Clerk Overtime, Calculator, and Chair look like bad estimates but are probably not. Overspending in Personnel Overtime is not common and can be saved to the last quarter, while the Director may choose not to expend for a calculator or chair.

2. Contractual Services and Supplies—particularly Natural Gas, Training, Form 2, and Miscellaneous.
 3. Telephone, Training, Form 2, and Miscellaneous.
 4. Clerk Salaries—Find salary increase and add it to the line items.
Natural Gas—Determine what were the factors causing the overestimation and whether they are likely to occur for the upcoming fiscal year and check the expected rates for the same period.
Calculator—Price it again.
Miscellaneous Supplies—Break out the details and estimate based on price checks or inflate the fudge factor.
 5. Retirement and replacement of assistant director—Estimate the cost of a new person.
Acquisition and use of minicomputer—Estimate cost of the machine and related factors which might include a service contract, personnel training costs, increased personnel costs, and increased supply costs. Also, estimate the reduction in other costs which might include personnel (fewer people or less overtime), and equipment (calculator and typewriter).
Acquisition of the budget management responsibility—Predict work level, develop work plan, and a list of objects of expenditure and their costs.
-

CHAPTER V

BUDGET REVIEW

Introduction

Budget review by executives and legislators follows preparation by departments. In budget review, administrators and legislators question what is presented in order to acquire more information and insight into the requests for funds. The kinds of questions asked follow the emphases towards budgeting discussed in Chapter I: policy, control, management, planning, and public relations. Individual reviewers will be consistently concerned with particulars, e.g., particular item costs, general expenditure levels, and particular programs or policies. A wise administrator or executive learns quickly that the same types of questions come up again and again.

Current and proposed changes in requests for funds are the most common focus of review questioning. Elements of budgets settled in previous years are generally taken for granted.

Although specific questions vary in each budget review, common questions with various emphases are asked.

Review Questions

Policy Questions

Policy oriented questions tend to seek answers that provide general statements of purpose, resource allocation, work plans, impacts, and relationships such as:

- What are goals (purposes) of the unit?
- What is the unit planning to accomplish?
- How much is allocated to this as compared to that?
- How is the unit going to accomplish its goals?
- What impact will this have on that?
- How does this relate to that?

Policy questioners essentially want answers that fit into the formula: The policy of this government is to _____." Policy questioners are oriented toward deciding "what to do"; therefore, they tend to want justifications of budget proposals.

Control Questions

Control oriented questions tend to seek answers that require specific performances by line departments and administrators. Control questioners want every detail pinned down in order to keep administrators under their control. Also, control oriented questioners tend to emphasize economy in government. Common questions are:

- Precisely how much is going to be spent on X (item or service)?
- Precisely what is the department or unit going to do?

Some control questioners may go to extremes. They might ask administrators to give unreasonable commitments or performances. Also, control oriented people tend to request as detailed estimated expenditures as possible. For example, the budget line of office supplies is likely to draw a request for more specific information.

Management Questions

Management oriented questioners seek to ascertain how efficient government operations are. Therefore, they ask typical efficiency questions as:

- Is this operating method or piece of equipment better?
- What is the unit cost?
- How do operating costs and outputs compare year by year?
- What are the unit's plans?

Management questioners look for evidence of good or improved operating efficiency.

Planning Questions

Planning oriented questions seek answers to concerns that address current and future plans. Common questions are:

- Is this fulfilling a current plan?
- What is the long-range impact?
- If the unit does this, can it do that in following years?

Planning questioners are future oriented and seek to avoid crisis management that might occur later because of a failure to look at the long-range impact of current decisions.

Public Relations Questions

Public relations questions seek answers concerning how the public might feel or respond to particular budgeted items. The essential public relations question is:

What will the public think?

Preparation for Budget Review

The various possible types of review questions suggest courses of action for budget reviewers and preparers. Reviewers should pursue those questions that provide the kind of information with which they are concerned. Also, reviewers should use a variety of the types of review questions to gain broader and deeper understandings of proposed budgets. A tendency exists among local government elected officials to raise only control questions. Other types of review questions provide useful information that is too often overlooked.

Budget preparers can use two approaches in understanding and preparing their budgets. First, they can get ready to respond to all types of review questions. Anticipation of all types will make for well thought out budget proposals and a facility for answering all types of review questions. Second, budget preparers should anticipate actual questions. That is, preparers should be able to respond to probable questions. For example, preparers should plan to answer control type questions because they tend to be asked more than others. If the preparer has planned adequately, he/she should be able to both satisfy a reviewer on a particular question and add information from other areas. For example, the preparer could answer a control type question by first responding to it directly and then elaborating on it by adding policy and planning information.

Information Needs

To prepare for review, one must first *acquire*

information to answer expected questions. Second, after particular information is acquired, he/she must *organize* it to improve the basis for preparation.

Policy questions are based on previous or current discussions of what to do. If the budget officer is proposing a change, he/she will get and should be able to answer policy questions.

Preparing answers to *control questions* is more difficult. The expenditure breakdowns are tedious and time consuming, and details on operating outputs are harder to come by. Unfortunately, answering control questions completely may not be possible because events are unpredictable and the desire for control may overstep the bounds of what is possible.

Management questions require a great deal of information of a cost accounting nature. To answer efficiency questions, the budget officer has to record what input factors are used to produce what outputs. In the aggregate, this is easier where outputs that are easily measured are available. The more outputs produced, the greater the difficulty. Recording all outputs and resource allocations takes long-term commitment and a great deal of effort. Especially difficult is recording the utilization of personnel. Evaluating the efficiency of different operating approaches is likewise time consuming.

Planning questions require some knowledge of current plans, some attention to probable future trends, and attention to what future plans may be.

Information acquisition and organization for budget review should not be done on an ad hoc basis. It requires planning and systematic attention.

Summary

Budget review involves questioning prepared budgets to gain further information and insights from particular perspectives. Changes in requests draw the most review attention. Answers to review questions require that information be organized. Anticipating and preparing for particular types of review questions can better enable one to provide good answers. Careful review by preparers and reviewers can lead to a broader and better understanding of budget decisions.

Exercise: Review a Budget

Directions: You are reviewing the Department of Administrative Services. Since you are an informed reviewer, you decide to ask one question from each of the various orientations about a specific item or items. Using the detailed estimates and expenditures in Chapter IV, Exercise 2, and the proposed changes in Question 5, what specific questions will you ask?

1. Policy

2. Control

3. Management

4. Planning

5. Public Relations

Interpretation of Exercise

Likely questions are:

1. Policy
 - What are you planning to accomplish with a minicomputer?
 - How does a minicomputer relate to other machines and other departments?
 - How are you going to accomplish budget management?

 2. Control
 - What is in the miscellaneous supply line, precisely estimated and actual?
 - Why did you overspend on training and on what?
 - Are you going to overspend on telephone, Form 2, miscellaneous supplies, and ribbon?
 - Why did you not buy a calculator or chair? Since you did not buy them, why should we authorize them again?
 - Precisely how much will be expended on a minicomputer and budget responsibility?
 - Can we get an assistant director for less?

 3. Management
 - Why this minicomputer rather than some other?
 - Will a minicomputer lower unit costs?
 - What is your budget management work plan?

 4. Planning
 - How does a minicomputer relate to our long-term data processing needs?
 - If we get this minicomputer, can we expand it later?

 5. Public Relations
 - How can we justify to the people increased expenditures on a minicomputer?
 - What do you suppose the public thinks of overspending on these so-called "training programs"?
-

CHAPTER VI

BUDGET EXECUTION

Introduction

When legislators pass appropriations, much of the anticipation and drama of the budget process subsides, but much serious business remains in executing a budget. Major budget execution responsibilities include apportionment and allotment, pre-audit and disbursement, record keeping, and reprogramming.

Apportionment and Allotment

Legislative bodies extend budget appropriations to the departments to carry out programs. Appropriations are not made to the executive or chief administrator except to carry out the particular activities for which they are directly responsible. In all cases, however, before any department incurs obligations or makes expenditures, two steps, apportionment and allotment, take place.

Apportionment

The major purpose of apportionment is to *force department heads to plan their expenditures over the budget year and regularize the rate of obligation to correspond with income*. In this way the need for deficiency or supplementary appropriations or short-term borrowing can be eliminated.

The procedure itself has two steps:

Step 1. Forms, breaking down the fiscal year into four quarters, are distributed to the department heads by the chief financial officer. Each appropriation to the department is listed, and the department head is required to indicate by quarter how much of the appropriation is to be spent during each. This does not mean that the department heads merely divide the appropriations into fourths and enter the figures. Some departments whose workload is evenly distributed throughout the year may be able to do this, but others cannot. A public works department, for example, may

have a large part of its work program determined by seasonal factors. That is, if it is planning a program of street resurfacing, the winter quarter and part of the spring quarter may cause a shut-down in this activity because of the weather. Therefore, the summer and part of the fall quarter may be the time when it will spend most of its appropriation. Table 7 gives an example.

Step 2. Once all department heads have completed their apportionment requests, the chief financial officer adds up all the cash needs for each quarter and matches it with estimated income figures to analyze the cash flow needs for the budget year. If this is done properly, surplus funds can be invested in short term obligations and cashed in when needed to meet cash outflow needs.

Two other facets of apportionment should be remembered:

- If allotted funds are not spent in a quarter, they carry over into the remaining quarter or quarters.
- If more funds are expended than originally planned in any of the first three quarters, a department can request reapportionment of its remaining funds.

Some jurisdictions, in addition to requiring apportionment by quarters, also set aside a reserve from the appropriation. That is, the department will be told to request apportionment of their appropriation less a percentage (i.e., 5 percent). This is often done when some uncertainty exists about the revenue projections. For example, in poor economic times, the delinquency rate may be higher than predicted. If the revenue received meets the projections, the reserve will be released during the third and fourth quarters.

Allotment

Allotment follows apportionment. It is the process of releasing the apportioned funds, i.e., departments are granted authority to expend funds

TABLE 7
APPORTIONMENT REQUEST FORM

Maverick, Nebraska
Department: Administrative Services

Appropriations
Line Categories

Personnel.	\$120,000
Contractual Services.	15,000
Supplies.	20,000
Equipment.	<u>3,000</u>
Total	\$158,000

Instructions: Fill out the apportionment request form by line categories and quarters. Apportion no more than 95% of appropriations. The remaining 5% of appropriations will be released late in the fourth quarter, conditions permitting.

Line Categories	Quarters				Total
	1	2	3	4	
Personnel	30,000	30,000	30,000	30,000	120,000
Contractual Services	7,000	1,000	3,000	1,100	12,100
Supplies	5,000	4,000	4,000	4,000	17,000
Equipment	<u>1,000</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>1,000</u>
Totals	43,000	35,000	37,000	35,100	150,100
				Total	
				Apportionment	
				Requested	

appropriated to them. Allotments are generally made on a quarterly basis, and the allotment corresponds to the amount apportioned for the quarter.

Pre-audit and Disbursement

When funds are appropriated, apportioned, and allotted, the legal and administrative authority to incur obligations is extended. The actual paying out of money (disbursement) is carried out by a financial department or financial officer after some form of extra-departmental pre-audit, a review of allotted appropriations to determine whether monies can be disbursed.

Pre-audit of expenditures can occur prior to incurring an obligation or merely prior to disbursement. An administrator ordinarily checks to see that he or she has legal and administrative

authority to incur obligations for particular expenditures. In many cases, an administrative requirement exists that all or certain kinds of expenditures be pre-audited by a financial office or officer prior to the obligation of monies. Often this takes the form of requesting an authorized purchase order or invoice number. A pre-audit prior to disbursement is commonly done by a financial officer, chief administrator, or legislative body.

The purpose of pre-auditing obligations and disbursement is to insure that departments do not overstep, intentionally or not, their legal and administrative authority in the expenditure of public monies.

Record Keeping

While a budget is in the process of being executed, records of expenditures are kept on a regular

basis. Record keeping prevents violation of laws allowing expenditures and facilitates any required adjustments in expenditures. Budgets are sets of expenditure estimates that are imperfect in practice. Whoever is in the position of making or proposing adjustments in expenditures has to have access to accurate records of obligations and expenditures.

The precise nature of recorded and easily available information depends on the type of accounting and pre-audit practices. Also, some necessary information may not be recorded in the accounting system. This includes adjusted work plans and adjusted expenditure projections at the department level. If each element is discussed in turn, the availability and source of collection for various types of information can be indicated.

The types of accounting practices in Nebraska local governments are differentiated by *when* expenditure information is recorded. They include:

- Cash Accounting—Expenditures recorded when money is paid out
- Encumbrance—Expenditures recorded when the decision to spend is made
- Accrual—Expenditures recorded when the obligation to expend money is incurred.

The availability and sources for the types of accounting practices are shown in Figure 6.

Generally, accounting and pre-audit records are sufficient to ascertain the current situation. When expenditures outstrip estimates or revenue falls short, major adjustments may be necessary. In such cases, further information may be required. Such information includes the complete extent of current obligations, departmental expenditure, and departmental work plans.

As a result of the general need to consider adjustments in expenditures, department administrators keep track of obligations, work plans, and expenditure plans for their own purposes and for their superiors among administrative and political officials.

Frequently, financial offices and officers provide monthly or quarterly and fiscal year to date summaries of expenditure information for use by administrators and political officials. The particular character of such summaries varies according to the needs and desires of those officials.

FIGURE 6 SOURCES OF ACCOUNTING PRACTICES	
Type	Availability/Source
Cash Accounting	Because a gap exists between current accounting information on one hand and bills and commitments on the other, the budget officer must go beyond the accounting system.*
Encumbrance	Accounting information is sufficient except where a need exists to adjust departmental expenditure authority on encumbered monies.
Accrual	Accounting information is sufficient except where departmental plans may be pertinent in making interdepartmental adjustments.
<p>*Where cash accounting exists (most local governments in Nebraska), the pre-audit records supplement accounting information. Where pre-audit occurs prior to disbursement, pre-audit records provide information on disbursement payments issued within a month. Where pre-audit occurs prior to obligation, pre-audit records and accounting information provide information on all expenditures that will be made in the near future.</p>	

Reprogramming

Reprogramming is changing expenditure and work plans from their original forms. Generally, the reasons for reprogramming are:

- Expenditures need cutting because of revenue shortfall.
- Expenditures go over what was estimated.
- An unanticipated opportunity comes along (for example, a good deal on a police communication system).
- Expenditures are less than estimated.

Work plan reprogramming may not show up in expenditure records, but reprogramming of expenditures from one line item to another will. Therefore, some sort of authorization is required to adjust actual expenditures from what was appropriated. The five common adjustments in actual

expenditures are:

- Not expending any or as much money on a line item
- Over-expending on a line item
- Shifting expenditures from one line to another
- Shifting expenditures from one category to another
- Shifting expenditures from one department to another.

Often adjustments are allowed to department

administrators, chief administrators, and executives within specified percentage or dollar limits to avoid a constant stream of requests for legal authorization to adjust expenditures being brought to the legislative body.

Examples of expenditure adjustments commonly found are underexpending on one line item to overexpend on another and a general reduction in allotted expenditure authority to cope with revenue shortfalls.

Exercise: Figure Apportionment and Allotment

Directions: Using the following appropriation figures, answer the questions below.

Maverick, Nebraska		FYXX
Snow Plowing		
Line Categories		
Personnel.	\$	700,000
Contractual Services.		100,000
Supplies.		100,000
Equipment.		100,000
Total		\$1,000,000

1. As the chief administrator, executive, or finance officer, how much will you allow to be apportioned? _____
2. As administrator for the budget presented above, fill out the following apportionment request form.

Line Categories	Quarters				Line Category Totals
	1 July 1-Sept. 30	2 Oct. 1-Dec. 31	3 Jan. 1-March 31	4 April 1-June 30	
1.					
2.					
3.					
4.					
Quarter Totals					Total

Interpretation of Exercise

1. A fiscally conservative amount to apportion and allot would be \$950,000 where a 5 percent reserve of expenditure authority is kept.
2. Based on the \$950,000 figure, a sample apportionment would be:

Line Categories	Quarters				Line Category Totals
	1 July 1-Sept. 30	2 Oct. 1-Dec. 31	3 Jan. 1-March 31	4 April 1-June 30	
Personnel	50,000	270,000	330,000	15,000	665,000
Contractual Services	5,000	20,000	55,000	15,000	95,000
Supplies	25,000	50,000	20,000	—	95,000
Equipment	25,000	30,000	30,000	10,000	95,000
Quarter Totals	105,000	370,000	435,000	40,000	950,000 Total

Points to be made:

1. Snow does not normally fall in July and August in Nebraska.
 2. Snow mostly occurs in the second and third quarters.
 3. The first quarter apportionment is higher than the fourth quarter because larger amounts of supply and equipment purchases to prepare for the snow plowing are planned. Also, first quarter allotments automatically carry over into later quarters, while fourth quarter allotments are not easily brought forward into the second and third quarters.
 4. The particular figures here are based on an expenditure and work plan; other plans could likely end up with different apportionment requests. However, any apportionment request should take into account the points made above.
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APPENDIX

THE NEBRASKA BUDGET ACT

(b) APPLICABLE TO ALL POLITICAL SUBDIVISIONS

23-921. Purpose of act. The purpose of this act is to require governing bodies of this state to which this act applies to follow prescribed budget practices and procedures and make available to the public pertinent information pertaining to the financial requirements and expectations of such governing bodies so that intelligent and informed support, opposition, criticism, suggestions, or observations can be made by those affected; *Provided*, that this act shall not apply to governing bodies which have a budget of less than five thousand dollars per year.

Source: Laws 1969, c. 145, § 1, p. 669; Laws 1971, LB 157, § 1.

23-922. Terms, defined. As used in this act, unless the context otherwise requires:

(1) Governing body shall mean, in the case of a city, the council; in the case of a village, cemetery district, community hospital for two or more adjoining counties, mosquito abatement district, road improvement district, sanitary and drainage district, or sanitary and improvement district, the board of trustees; in the case of a county, the county board; in the case of a township, the town board; in the case of a school district, the school board; in the case of a rural and suburban fire protection district, reclamation district, natural resources district, or hospital district, the board of directors; in the case of a health district, the board of health; in the case of a regional library, the regional library commission; in the case of an educational service unit, the board; in the case of an area vocational technical school, the school district board of education or the governing board of the area vocational technical school; in the case of an airport authority, the airport authority board; and in the case of a weed eradication and control district, the district supervisors;

(2) Levying board shall mean any governing body which has the power or duty to levy a tax;

(3) Fiscal year shall mean the twelve-month period used by each governing body in determining and carrying on its financial and taxing affairs;

(4) Tax shall mean any general or special tax levied against persons, property, or business, for

public purposes, as provided by law, but shall not include any special assessment;

(5) Auditor shall mean the Auditor of Public Accounts;

(6) Cash reserve shall mean funds required for the period before revenue would become available for expenditure;

(7) Public funds shall mean all money, including nontax money, used in the operation and functions of governing bodies; and

(8) Adopted budget statement shall mean a proposed budget statement which has been adopted or amended and adopted as provided in section 23-925; and such term shall include additions, if any, to an adopted budget statement made by a supplemental budget which has been adopted as provided in section 23-929.

Source: Laws 1969, c. 145, § 2, p. 669; Laws 1972, LB 537, § 1; Laws 1977, LB 510, § 6.

23-923. Budget statement; contents. Each governing body shall prepare in writing and file with its secretary or clerk, in the year of its organization and each year thereafter, not later than the first day of August of each year on forms prescribed and furnished by the auditor following consultation with representatives of such governing bodies or as otherwise authorized by state law, a proposed budget statement containing the following information, except as provided by state law:

(1) For the immediate prior fiscal year, revenue from all sources, other than revenue received from taxation, allocated to each of the several funds and separately stated as to each such source, and for each fund the unencumbered cash balance thereof at the beginning and end of the year, the amount received by taxation allocated to each fund, and the amount of actual expenditure for each fund;

(2) For the current fiscal year, actual and estimated revenue, from all sources, other than revenue received from taxation, and separately stated as to each such source, allocated to each of the several funds, and for each fund the actual unencumbered cash balance available at the beginning of the year, the amount to be received from taxation allocated to each fund, and the amount of actual and estimated expenditures, whichever is applicable; and

(3) For the immediate ensuing fiscal year, an estimate of revenue from all sources, other than revenue to be received from taxation, and separately stated as to each such source, to be allocated to each of the several funds, and for each fund the actual or estimated unencumbered cash balances, whichever is applicable, to be available at the beginning of the year, amounts proposed to be expended during the year plus the amount of cash reserve, based on actual experience of prior years, which cash reserve shall not exceed fifty per cent of the total budget adopted exclusive of capital outlay items.

Source: Laws 1969, c. 145, § 3, p. 670; Laws 1971, LB 129, § 1.

23-924. Budget statement; estimated expenditures; unencumbered balances; estimated income. The estimated expenditures plus the required cash reserve for the ensuing fiscal year less all estimated and actual unencumbered balances at the beginning of the year and less the estimated income from all sources other than taxation shall equal the amount to be received from taxes, and such amount shall be shown on the proposed budget statement filed pursuant to section 23-923. The amount to be raised from taxation, as determined above, plus the estimated revenue from sources other than taxation and the unencumbered balances shall equal the estimated expenditures, plus the necessary required cash reserve, for the ensuing year.

Source: Laws 1969, c. 145, § 4, p. 671.

23-925. Proposed budget; notice; hearing; adoption; certify to board; exceptions. Each governing body, after the filing of the proposed budget statement with its secretary or clerk, shall each year conduct a public hearing on such proposed budget statement. Notice of place and time of such hearing, together with a summary of the proposed budget statement, shall be published at least five days prior to the date set for hearing, in a newspaper of general circulation within the governing body's jurisdiction or by direct mailing of the notice to each resident within the community; *Provided*, that when the total operating budget, not including reserves, does not exceed ten thousand dollars per year, the proposed budget

summary may be posted at the governing body's principal headquarters. After such hearing, the proposed budget statement shall be adopted, or amended and adopted as amended, and a written record shall be kept of such hearing. The amount to be received from taxation shall be certified to the levying board after the proposed budget statement is adopted, or is amended and adopted as amended, and if the levying board shall represent more than one county, a member or a representative of the governing board shall appear and present its budget at the hearing of each county in which is located a major area of the county affected by its budget. If the adopted budget statement reflects a change from that shown in the published proposed budget statement, a summary of such changes shall be published within twenty days after its adoption in the manner provided in this section, but without provision for hearing, setting forth the items changed and the reasons for such changes.

Source: Laws 1969, c. 145, § 5, p. 672; Laws 1971, LB 129, § 2; Laws 1973, LB 95, § 1.

23-926. Levy increase; budget statement; show. When a levy increase has been authorized by vote of the electors, the adopted budget statement shall indicate the amount of the levy increase.

Source: Laws 1969, c. 145, § 6, p. 672.

23-927. Budget statement; final adjusted valuation; certify; levy; limitation; exceptions. After publication and hearing thereon and within the time prescribed by law, each governing body shall file with and certify to the levying board on or before August 25 and file with the auditor a copy of the adopted budget statement, together with the amount of the tax to be levied. Proof of publication shall be attached thereto. The governing body shall certify an amount of tax to be levied by the levying board, which levy shall not exceed the maximum levy prescribed by state law; *Provided*, the governing body, in certifying the amount to be so levied, may make allowance for delinquent taxes not exceeding five per cent of the amount to be levied, plus the actual percentage of delinquent taxes for the preceding tax year. Except for such allowance, a governing body shall not certify,

nor a levying board levy, an amount of tax greater than the amount determined under section 23-924. Each governing body empowered to levy or certify a levy shall use the final adjusted valuation as provided by the county assessor pursuant to section 23-927.01 for the current year in setting or certifying the levy. Each governing body may designate one of its members to perform any duty or responsibility required of such body by this section.

Source: Laws 1969, c. 145, § 7, p. 672; Laws 1971, LB 391, § 1; Laws 1979, LB 178, § 1.

Effective date August 24, 1979.

23-927.01. County Assessor; certify current valuation; when. On or before August 15 of each year, the county assessor shall certify to each governing body or board empowered to levy or certify a mill levy the current valuation of all property subject to the applicable levy. Current valuation shall mean that valuation established by the county assessor and equalized by the county board of equalization and the State Board of Equalization and Assessment.

Source: Laws 1977, LB 391, § 3.

23-928. Emergencies; transfer of funds; violation; penalty. Whenever during the current fiscal year it becomes apparent to a governing body that due to unforeseen emergencies there is temporarily insufficient money in a particular fund to meet the requirements of the adopted budget of expenditures for that fund, the governing body may by a majority vote, unless otherwise provided by state law, transfer money from other funds to such fund. No expenditure during any fiscal year shall be made in excess of the amounts indicated in the adopted budget statement, except as authorized in section 23-929, or by state law. Any officer or officers of any governing body who obligates funds contrary to the provisions of this section shall be guilty of a Class V misdemeanor.

Source: Laws 1969, c. 145, § 8, p. 673; Laws 1977, LB 40, § 95.

23-929. Emergency; hearing; warrants; issuance. (1) Unless otherwise provided by state law, whenever during the current fiscal year it becomes

apparent to a governing body that there is an emergency and that because of unforeseen circumstances either the revenue of the current fiscal year for any fund thereof shall be insufficient or additional expenses are to be incurred which could not reasonably have been anticipated at the time the budget for the current year was adopted such governing body may propose to supplement the previously adopted budget statement, and shall conduct a public hearing on such proposal. Notice of a place and time of such hearing shall be published at least five days prior to the date set for hearing in a newspaper of general circulation within the governing body's jurisdiction. Such published notice shall set forth (a) the time and place of the hearing, (b) the amount in dollars of additional money required and for what purpose, (c) a statement setting forth the nature of the emergency, and reasons why the previously adopted budget of expenditures cannot be reduced during the remainder of the current year to meet the need for additional money in that manner, and (d) a copy of the summary of the originally adopted budget previously published.

(2) At such hearing any taxpayer may appear or file a written statement protesting such application for additional money. A written record shall be kept of all such hearings.

(3) Upon conclusion of the public hearing on the proposed supplemental budget, and approval of the proposed supplemental budget by the governing body, the governing body shall file with the county clerk of the county or counties in which such governing body is located and with the auditor, a copy of the supplemental budget, as adopted, and shall certify the amount of additional tax to be levied. The governing body may then issue warrants in payment for expenditures authorized by the adopted supplemental budget. Such warrants shall be referred to as registered warrants, and shall be repaid during the next fiscal year from funds derived from taxes levied therefor.

Source: Laws 1969, c. 145, § 9, p. 673.

23-930. Budget statement; taxpayer; contest; basis; time for filing. A taxpayer upon whom a tax will be imposed as a result of the action of a governing body in adopting a budget statement, as

herein required, may contest the validity of the budget statement so adopted by the governing body by filing an action in the district court of the county in which the governing body is situated. Such action shall be based either upon a violation of or a failure to comply with the provisions and requirements of this act by the governing body. In response to such action the governing body shall be required to show cause why the budget statement should not be ordered set aside, modified or changed. The action herein authorized shall be tried to the court without a jury and the same shall be given priority by the district court over other pending civil litigation, and by the Supreme Court on appeal, to the extent possible and feasible to expedite a decision therein. Such action shall be filed within thirty days after the adopted budget statement is required to be filed by the governing body has violated or failed to comply with the levying board. If the court finds that the governing body has violated or failed to comply with the requirements of this act, the court shall, in whole or in part, set aside, modify, or change the adopted budget statement, tax levy, or mill rate, as the justice of the case may require.

The remedy provided hereby shall not be exclusive but shall be in addition to any other remedy provided by law.

Source: Laws 1969, c. 145, § 10, p. 674.

23-931. State Board of Equalization and Assessment; adjustment of valuations; duty of levying body. If the State Board of Equalization and Assessment adjusts valuations in any county or counties, the county board of equalization and assessment or other levying body in such county or counties shall adjust its levies proportionally to the valuation change.

Source: Laws 1969, c. 145, § 48, p. 701.

23-932. Act; exceptions. The provisions of this act shall not apply to cities under home rule charter and county agricultural societies with an annual budget of less than fifty thousand dollars.

Source: Laws 1969, c. 145, § 49, p. 701; Laws 1975, LB 378, § 3.

23-933. Act, how cited. This act may be cited as the Nebraska Budget Act.