

Budgeting and Public Financial Management

Challenges and Responses

Where the focus of the budget process is revenue, budgeters will be concerned with curbing the rise in expenditures and with finding revenues to fund current programs (Anton, 1966, cited in Wildavsky, 1986, p. 223). Participants respond to the certainties of reduced wealth and definite expenditure responsibilities with incremental changes and repeated budget revisions. “Revenue budgeting” describes the responses of budgeters at all levels of the U.S. government since about 2000. In response to the twin constraints of the 2007–09 financial collapse and recession and premature fiscal austerity imposed by the Congress, budgeters have had to cut programs, services, and projects.

To achieve fiscal discipline at the national level, cuts have been mostly crude, across the board with little concern for effects other than meeting legal targets of balance and political targets for deficits and debts. The tools used in response to such austerity requirements as sequestration involve simple attainment of percentage reductions. Decisions have been innovative to the extent that they used gimmicks to stave off reductions and achieve targets. In addition to controlling outlays, budgeting requires attention to allocation of resources between programs and competing claims in order to maximize results, including consistency with strategic planning objectives. Budget systems should encourage analysis of costs and consequences of each fiscal option selected. At the operations level, budgeting should also be able to ensure regular flows of cash to deliver services and predict costs and consequences on important variables such as demand, cost, revenues, and physical results for users. While value for

money and performance-based budgeting systems have been installed formally in many jurisdictions, evidence of their use by elected officials to formulate fiscal policies is scant. Some exceptions will be noted. Nevertheless, further efforts are needed to find incentives to use rational budgeting techniques (for funding increases as well as decreases) that would appeal to both executive fiscal experts and elected officials.

The Budgetary Function

Budgeting is the art of using technical definitions to allocate and control resources. Retiring Washington, D.C., CFO Natwar Gandhi wants to be remembered as not just a “humble bean counter” or accountant but “as a poet” (DeBonis, 2013). Successful budget practitioners need to have enough artistic imagination to use the available technical methods and to employ fiscal definitions skillfully and creatively to improve the fiscal conditions of their jurisdictions. And to the bane of students and practitioners, definitions abound. General agreement exists on larger items such as budget formats. An object of expenditure budget looks the same regardless of level of government or difference in state or local jurisdiction. At the operational management level, however, definitions may be based on accounting and economic concepts or simply driven by politics. The latter often lead to deliberate obfuscation and use of “gimmicks.” Definitional variation is useful when trying to maintain discipline and control budgetary balances. In a field drowning in data, through the skillful use of legal definitions, it is possible to hide expenditures and reduce the amount of fees and taxes required for balance. For instance, outlays might be classified as off-budget spending. They might have been made by a city or state enterprise and excluded from totals from a narrow budget reporting perspective. From a consolidated accounting perspective, though, they would have to be included and separated out by fund for audit and control. Similarly, distinctions between major and minor maintenance expenditures are flexible, often allowing minor maintenance to be financed with debt and excluded from the annual operating budget that must be balanced and state and local levels. More progressive jurisdictions respond to public doubts on budget figures as gimmickry with greater fiscal transparency. For example, Gaston County (NC) a smaller county of 208,000 population next to Charlotte includes a “reader’s guide to the budget” and comprehensive glossary in its annual budget (Figure 1.1).

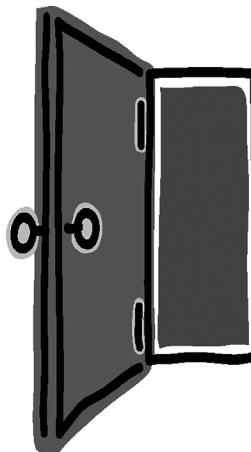
Reader's Guide



Welcome

Gaston County thanks you for your interest in your local government and encourages you to use this document to expand your knowledge about our community. Included on the following pages are descriptions of county departments, the services they provide, and how much it costs to provide those services. We hope this information is useful to you and answers your questions about your county government.

Feel free to contact the **Gaston County Budget & Purchasing Department** at (704)-866-3038 or via e-mail at bryant.morehead@co.gaston.nc.us with your budget questions, as well as your comments about how we can improve this document.



What's in Here?

This document is divided into numerous sections. The *Budget Highlights* section immediately follows. Here you'll find basic information on what's included in Gaston County's budget.

The *Budget Preparation & Amendment* section is next. This section outlines the planning processes, budget procedures, and official actions that led to the adoption of the FY 2013-2014 budget.

Following the *Budget Preparation & Amendment* section is the *Budget Summary* section. This section provides numerous schedules of revenues and expenditures for the current and several previous fiscal years.

After the *Budget Summary* section, you'll find sections describing the county's revenues and expenditures, personnel changes, capital requests, fund balances, financial policies, and debt.

Next, you'll find profiles of Gaston County's departments, which comprise the largest section of this budget document. Gaston County's departments fall into the following function categories, each of which is divided into several departments:

- General Government
- Human Services
- Public Safety
- Community Services
- Education
- Support Services

On each department page you will find a profile describing the department, along with tables listing the department's budget information.

Figure 1.1. Fiscal Transparency: Gaston County (NC) Readers Guide and Glossary.



Reader's Guide

The **sources of funds** section of each department budget table identifies the amount of money received by a department from the federal and state governments, local, and other revenues. Local funds come from the property tax, unearmarked sales tax revenues, interest earnings, and so on.

The **expenditures** for each department are also presented in a summary format and include amounts budgeted for personnel costs, operational expenses, and outlays for major capital expenditures.

Figures in the **2010-2011 Actual** column and **2011-2012 Actual** column list revenues and expenditures received or spent by the department in the noted fiscal years. The county's fiscal year begins on July 1 of each year and ends on June 30 of the following year.

The next column, **2012-2013 Adopted** lists the budgeted revenues and expenditures as adopted by the Board of Commissioners for the 2012-2013 fiscal year. As of the date of publication, actual expenditures and revenues amounts for FY 2012-2013 were not available.

The **2013-2014 Requested** column lists the expenditure amounts requested by the individual departments. It is common for some amounts in the **Requested** column to be different from amounts in the **Recommended** column, sometimes substantially higher or lower. This is because the budget process is dynamic up to the date of the budget presentation. For instance, some requests such as fuel and utilities expenses and debt payments are calculated centrally by the Budget Department. Between the **Requested** and the **Recommended** phases of the budget process, projections for these expenditures are often refined and therefore changed in the **Recommended** phase to reflect the more accurate projections.

The **2013-2014 Recommended** column lists the expenditure and revenue amounts proposed by the County Manager for the 2013-2014 fiscal year.

The **2013-2014 Approved** column lists the expenditure and revenue amounts the Board of Commissioners adopted for the 2013-2014 fiscal year.

The **% Change** column indicates by what percentage the expenditures or sources of funds figures changed from **2012-2013 Adopted** to **2013-2014 Approved**.

Also on the department pages you'll find descriptions of the department, a discussion of the department's budget highlights, a list of goals and objectives, and a table showing performance measurement data totals for the past four fiscal years.

Finally, at the end of this document you'll find a glossary of technical terms used in this document, as well as the budget ordinance.

Figure 1.1. Continued.



Glossary

Accrual Basis of Accounting: The primary basis of recording assets, liabilities, revenues, and expenses for a government's business-like activities. Under the accrual basis, revenues are recognized in the accounting period when earned and expenses are recognized in the period that they are incurred.

Adopted Budget: The budget formally adopted by the Board of Commissioners for the upcoming fiscal year.

Appropriation: The Board of Commissioner's authorization, per the budget ordinance or a budget amendment, to spend money for a specific purpose.

Assessed Value: The value of real estate or personal property as determined by tax assessors and used as a basis for levying taxes.

Balanced Budget: According to North Carolina law, a budget is balanced when the sum of estimated net revenues and appropriated fund balance is equal to appropriations.

Basis of Accounting: This refers to the methods that determine when revenues, expenditures, and associated assets and liabilities, are recognized in the government's accounting system and reported in its financial statements.

Board of Commissioners: The elected governing body of a county in North Carolina. Gaston County has a seven member Board of Commissioners.

Bond Rating: A rating that indicates the credit worthiness of a government's debt. The major rating agencies, such as Moody's Investor Service or Standard and Poor's, are responsible for determining a government's bond rating. Governments with favorable bond ratings are able to obtain financing with low interest rates.

Bond: A written promise to repay a specific amount of money with interest within a specific time period, usually long-term.

Budget: North Carolina law defines a budget as a plan for raising and spending money for specified programs, functions, activities, or objectives for a fiscal year.

Budget Amendment: An adjustment to the budget ordinance made by the Board of Commissioners, or, in certain cases, the County Manager.

Budget Message: A message that North Carolina law requires the County Manager to include with his recommended budget. According to the law, the budget message should contain a concise explanation of the governmental goals fixed by the budget for the budget year, should explain important features of the activities anticipated in the budget, should set forth the reasons for stated changes from the previous year in program goals, programs, and appropriation levels, and should explain any major changes in fiscal policy.

Figure 1.1. Continued.



Glossary

Budget Ordinance: The ordinance that the Board of Commissioners adopts that levies taxes and appropriates revenues for specified purposes, functions, activities, or objectives during a fiscal year.

Capital Improvement: Major construction, acquisition, or renovation activities which add value to a government's physical assets or significantly increase their useful life.

Capital Improvement Program: A long term plan of proposed capital improvement projects which includes estimated project costs and funding sources.

Certificate of Participation (COP): A form of loan to a government where investors are entitled to a share in the periodic payments made by the government under an installment financing agreement.

Debt Service: According to North Carolina law, the sum of money required to pay installments of principal and interest on bonds, notes, and other evidences of debt accruing within a fiscal year.

Department: A basic organizational unit of the county that is functionally unique in its delivery of services. Some departments are divided into divisions.

Expenditures: Money that the government spends.

Fire District: Gaston County's unincorporated areas are divided into twenty volunteer fire districts. Each fire district has its own tax rate, which the Board of Commissioners approves. The tax revenues for each fire district support the volunteer fire department in each district in order to provide fire protection service for county citizens living in unincorporated areas.

Fiscal Year: The period that the government uses for accounting purposes and preparing financial statements. Gaston County's fiscal year starts on July 1 and ends on June 30 of the following year. The phrases "fiscal year 2013-2014," "FY 2013-2014," and "FY 2014" all refer to the period starting July 1, 2013 and ending June 30, 2014.

Function: A group of related departments. For instance, the General Government function includes, among others, the County Manager, Finance, and Human Resources departments.

Fund: An independent fiscal and accounting entity with a self-balancing set of accounts recording its assets, liabilities, fund balance, revenue, and expenditures

Fund Balance: The difference between a fund's assets and liabilities. Fund balance mostly includes cash and investments, but can also include non-spendable items, such as inventories.

GAAP: Generally accepted accounting principles. The standard accounting rules and practices used to record transactions and prepare financial statements.

Figure 1.1. Continued.

At the federal level, terms such as “tax expenditure” or “statutory revenue losses for a public purpose” are also subject to definitional alchemy and gimmickry. Elected leaders with a leftist bent view them as subsidy expenditures from the budget. If cut they could be viewed as an expenditure reduction. Elected leaders of a rightist bent often view their elimination as tax increases on beneficiary groups (e.g., property taxpayers if the federal mortgage interest deduction were eliminated) and therefore a violation of their antitax, antigovernment agenda. In fact, tax expenditures should be viewed as a transparency tool since they contain both expenditures and taxes. Without them, the taxpayer pays the tax but simultaneously receives a government grant equal to the amount of tax in that provision (Mikesell, 2014, p. 590). Given the definitional flexibility of the field, it is critical that students know the core concepts and definitions as well as how they have been used and misused in practice. Only in that way can public funds be allocated and controlled clearly and precisely.

To begin with simpler concepts and definitions, then, budgets have multiple purposes. Whether developed for individuals, firms, or governments, they are plans with accurate price tags; in addition, they express dominant political values and policy preferences; and they indicate in narratives and figures who gets what for what purpose and who pays (Axelrod, 1988, p. 1). Budgets record the annual outcome of political conflict between *guardian* roles who want to control spending, for example, to meet deficit and debt targets, and *advocates* who want to expand staff and resources to achieve more results for



Figure 1.2. Leadership and Budget Priorities. DILBERT © 2008 Scott Adams.
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their departments, activities, or programs (Wildavsky, 1984, p. 160). How well budgets achieve any or all of these purposes depends on their transparency—how much relevant data and information they provide for analysis and conclusions by decision makers. In any jurisdiction, the quality of budgets depends in large part on the institutional and political process of making them. LeLoup notes that “[b]udgeting encompasses a range of decisions, participants and concurrent policy processes” (1988, p. 13). The annual budget process is the singular opportunity to compare means-ends for whole governments or their component parts as: departments, subnational governments, programs, projects by sector, and services. With comparative performance information from programs and projects in similar jurisdictions, the budget process is useful for highlighting the successes and failures of service delivery. In the last decade at the federal level, the budget process has accomplished few if any of these objectives and has not even produced an approved budget on time. Nevertheless, in many state and local jurisdictions, the process of analyzing the financial, labor, and material resources to be allocated for the year has worked well. The budget function continues to be carried out by professionals according to an annual calendar. How well or badly this process works affects the ability of the budget function to plan and control public spending.

The *budget process* consists of a cycle that covers about three years. Calendars vary, but the timing and sequence are the same regardless of governmental level. As is evident from the example of the U.S. budget *calendar*, and cycle below, the four phases of the cycle take place simultaneously, in what is known as a “scrambled cycle.” For state-local governments, the importance of the federal process is to plan and gauge the levels of grants flowing to their core sectors, such as education, roads, bridges, water and sewerage, and public transit. Failure to anticipate cuts or delays in approval and release of these funds from Washington can disrupt state and local services.

U.S. Government Budget Cycle

1. Formulation: e.g., November 2013

FY '16 (preparation); FY '15 (approval); FY '14 (execution); FY '13 (audit). The formulation phase is called Spring Planning Review and takes place normally from March at the agency and OMB levels.

2. Approval

The president's budget is submitted to Congress in January and hearings-actions continue through September. Actions include the two-step authorization appropriation to produce *budget authority* (BA) for agency commitments. About 66 percent of budget authority consists of outlays outside the annual appropriations process. The forms of BA for this are: (a) *contract authority* or contracts that require BA for that fiscal year (e.g., multiyear sewerage project contracts that require contract authority later), (b) *borrowing authority* based on appropriations that require Treasury funds, sale of agency debt securities, or funds from the Federal Financing Bank through sale of agency securities, and (c) *entitlement authority* to pay for mandatory spending, the largest of which are Social Security, Medicare, and Medicaid (Mikesell, 2011, p. 119). The remaining 34 percent of the budget is funded by normal BA *appropriations authority* through the formal budget process. This portion is for *discretionary* funds; but roughly 16 percent of that is defense.

3. Execution (10/1–9/30 FY)

BA is allotted by the OMB, which allows departments to *commit* or *encumber* funds that turn into *outlays*. The OMB pulls control levers here to: vary rates of expenditures by:

- a. Allotment: This process releases funds and transfers to departments and subunits. BA is then apportioned to agencies by time (i.e., quarter) and activity (i.e., project);
- b. Pre-Audit: This ongoing phase controls the flow of commitments, outlays, and to maintain balances. OMB relies on departmental internal controls (rules and systems to safeguard spending), and inspectors general (IGs) that pre-audit compliance with appropriations acts.
- c. Cash Management and Variance Analysis: are mechanisms through which the OMB monitors and analyzes outlays throughout the year and tries to ensure that sufficient funds are on hand to pay commitments.

4. Audit/Control

Postexpenditure audits focus on the legality and appropriateness of making payments, and the efficiency of operations. These activities take about one to two years beyond the end of the FY and are performed by state legislative audit units, local government auditors or private firms, and the GAO for the U.S. government. This phase completes the thirty-six-month budget cycle and results in an Annual Financial Report, which is a final audit of the two previous fiscal years.

To develop the annual plan and budget, it is critical that other policy documents must be used to estimate resource needs. At the state and local levels, these include the strategic plan, the land use plan, financial trend monitoring reports, and capital improvement plans (GFOA, 1994, p. 5). For example, the budget calendar that guides the annual process of the City of Milwaukee begins with budget formulation for about five months (January–May), and the fiscal year runs from January 1 to December 31. See: www.city.milwaukee.gov/budgetdocs/plan and the activity calendar for the annual budget in Figure 1.3.

Professional budgeting is needed to ensure accountability and control of the public finances and to link public funds with policy results. The *budget function* evolved from a diffuse municipal context in the nineteenth century where many directors had minimal responsibility for planning and managing core functions, to a more integrated model in the twenty-first century where a multiplicity of public financial management functions became the responsibility of a single department headed, typically, by a CFO. Public budgeting is considered one of ten core *public financial management* (PFM) functions including: accounting, cash management, debt administration, internal audit, procurement, capital investment, revenue collection, personnel, pensions, and payments or treasury. It is recognized that within PFM, the budgetary function should ensure (1) *liquidity* or availability of cash to meet obligations when due, (2) *cost control* or reducing the costs of internal transactions, services provided by state-local government, and interest burdens on borrowed money, (3) *productivity* or ensuring service efficiency and effectiveness and maximum socioeconomic returns on capital investments, and (4) *control of budget execution*, which means that budgeting is dependent on accounting for basic information (Lehan, cited in Petersen & Strachota, 1991, pp. 36–40). Because of the importance of these four requirements, budgeting is often considered the main PFM function. Past GFOA surveys have concluded that small to medium-sized cities integrate budgeting with the other PFM functions and have more centralized and vertical command structures under a chief finance officer or CFO (Lehan, cited in

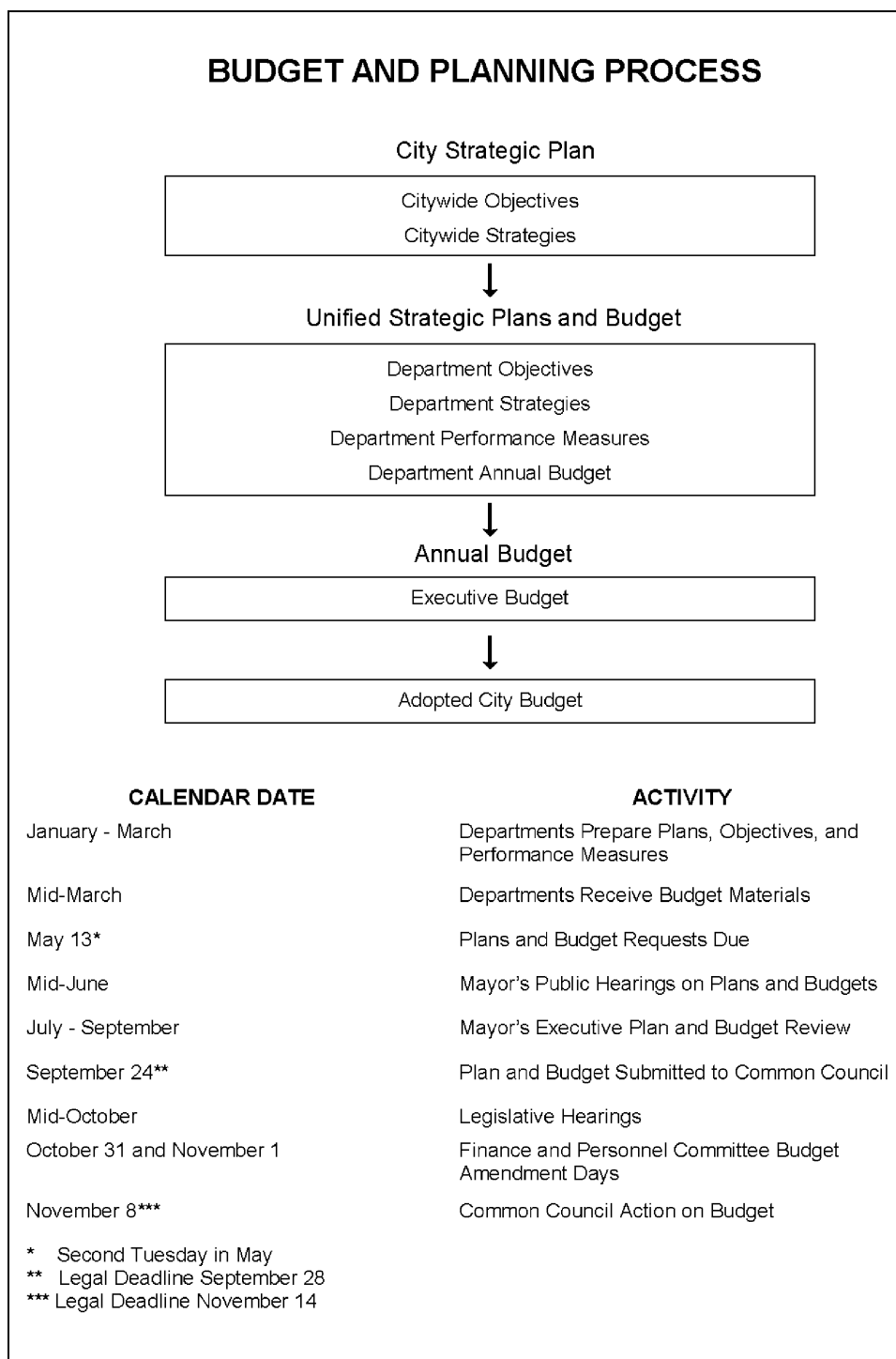


Figure 1.3. Milwaukee 2003 Budget and Planning Process.

Petersen & Strachota, 1991, p. 33). Under this arrangement, those responsible for the various PFM functions report to a CFO. Larger cities seem to eschew the centralized and superdepartment model in favor of a more fragmented organizational structure.

The City of Milwaukee is a medium to large-sized city (population 597,000) and fits the hybrid pattern—the budgetary function is the sub-responsibility of a larger administration department. As indicated in Figure 1.4, the finance function is largely in the Department of Administration, whose overall responsibilities are: administration, budget analysis, capital financing and debt management, and purchasing (2003, p. 48). The Head of the Budget and Management Division reports to the Director of Administration; IT is a separate division; debt policy is shared between the Budget and Management Division and the Public Debt Commission; tax collections and responsibility for investments are with the City Treasury. Milwaukee includes departmental operating budgets (and their generated revenues) by object of expenditure and usefully breaks out personnel positions by main object of expenditure for additional transparency (see Figure 1.4).

One indicator of robust institutions is the functioning of checks and balances to prevent financial misbehavior and abuse of political power. Checks and balances are an important part of PFM effectiveness, and problems occur when, for example, internal controls and treasury payments are not clearly separated, resulting in uncontrolled and often illegal tax refund payments. Poorly designed and monitored PFM institutions can eliminate such checks. Fragmentation of vertical command authority and horizontal responsibility can wipe out firewalls and politicize the public finances. In Washington, D.C., the independent CFO office played an important role in restoring the city to fiscal health and producing a \$1.5b fund balance for FY 12. Prior to CFO establishment in 1985, city finances were plagued by gimmickry and wasteful spending that led to the imposition of a federal control board (*Washington Post*, 2013). CFO resistance to 2012 mayoral intrusions to modify his department's revenue and expenditure projections resulted in the CFO's resignation. The mayor is now attempting to abolish the CFO office and return to the days when elected officials were directly responsible for the finance function.

Advances in information technology have made it more feasible to integrate PFM functions. In 1975 Moak and Hillhouse noted that “computer technology was ‘forcing major changes in the organization of financial management’” (Lehan, cited in Petersen & Stachota, 1991, p. 30). Today it is clear that driven by the availability and high performance computerized PFM systems known variously as: Government Financial Management Information Systems (GFMIS),

BUDGET SUMMARY

| | 2001 ACTUAL EXPENDITURES | 2002 ADOPTED BUDGET | 2003 ADOPTED BUDGET | CHANGE 2003 ADOPTED VERSUS 2002 ADOPTED |
|-----------------------------------|--------------------------------|---------------------------|---------------------------|--|
| PERSONNEL | | | | |
| FTEs - Operations and Maintenance | 78.05 | 81.60 | 75.43 | -6.17 |
| FTEs - Other | 31.80 | 36.65 | 33.92 | -2.73 |
| Total Positions Authorized | 135 | 132 | 119 | -13 |
| DLH - Operations and Maintenance | 140,495 | 146,880 | 135,774 | -11,106 |
| DLH - Other Funds | 57,245 | 65,970 | 61,056 | -4,914 |
| EXPENDITURES | | | | |
| Salaries and Wages | \$4,622,851 | \$4,669,776 | \$4,477,706 | \$-192,070 |
| Fringe Benefits | 1,560,436 | 1,587,724 | 1,656,752 | 69,028 |
| Operating Expenditures | 1,053,826 | 1,187,492 | 1,039,095 | -148,397 |
| Equipment | 85,407 | 76,400 | 22,880 | -53,520 |
| Special Funds | 951,268 | 1,166,615 | 1,301,836 | 135,221 |
| TOTAL | \$8,273,788 | \$8,688,007 | \$8,498,269 | \$-189,738 |
| REVENUES | | | | |
| Charges for Services | \$3,646,215 | \$3,474,200 | \$3,605,500 | \$131,300 |
| Miscellaneous | 251,189 | 153,500 | 146,500 | -7,000 |
| TOTAL | \$3,897,404 | \$3,627,700 | \$3,752,000 | \$124,300 |

CAPITAL PROJECTS - Includes \$1,811,500 for the following projects:

- Technology Fund - \$1,000,000
- Fire Suppression - North Computer Room - \$153,000
- Air Conditioning - North Computer Room - \$183,500
- Capital Needs Study - \$50,000
- Uninterrupted Power Supply System - \$425,000

ORGANIZATION CHART

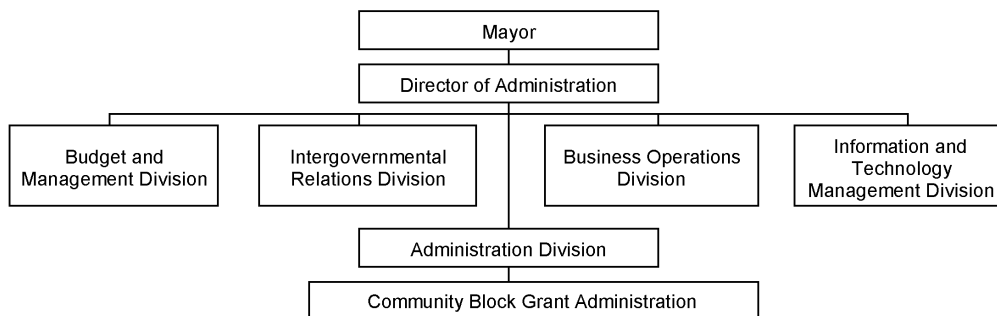


Figure 1.4. Milwaukee Department of Administration.

Evaluation of Financial Condition

The thrust of this book is that practitioners need skills in three related areas: (1) budget and fiscal condition analysis, (2) problem spotting or gap analysis, and (3) critical evaluation of proposed or existing public expenditures. Before practitioners can analyze or evaluate expenditures or revenues, they must be capable of measuring them. Databases must be reliable and valid; measurement and analytic skills are needed for exercise of proper guardianship and advocacy roles as well as to improve the efficiency and effectiveness of public financial management. First, we examine the institutional *demand* for such skills; then we move to the *supply* side and to the topic of fiscal data and information.

The primary demand for fiscal analysis and evaluation is the need to ensure sound fiscal condition. This means determining whether a government can meet its financial obligations (Berne & Schramm, 1986, p. 71). Determination requires the skill to gauge how expenditure pressures relate to available resources. Expenditure pressures arise from the costs and demands for current services and from past commitments for debt and pensions. A government that has the *fiscal space* to raise additional resources to meet past and current spending obligations is in good fiscal condition. Revenue pressures derive from limited capacities to raise revenues from own-sources (e.g., property, sales taxes, and fees) and external sources such as the local economy and other governments (e.g., state or federal level grants or revenue sharing). They also arise from limits on internal resource liquidity, for example, low reserves, payables exceeding receivables, and poor investment performance of short-term assets (1986, p. 73). Additionally, if a government faces high costs in providing current services or excessive demands for service quantity or quality, it may be in bad fiscal condition if available resources do not permit response to these demands. The financial condition analytic framework is shown in Figure 1.6 on page 16.

Gaston County uses a financial condition framework to monitor solvency indicators. For example, one indicator is the ratio of revenue shortfalls to net operating revenues for the six period of 2006–2012 (Figure 1.7, page 17).

How to Read a Budget

Initiating fiscal condition assessment should begin with expenditure measures and classification (for the expenditure side of the budget). It is essential to establish a common terminology and conceptual baseline—budgetary classifica-

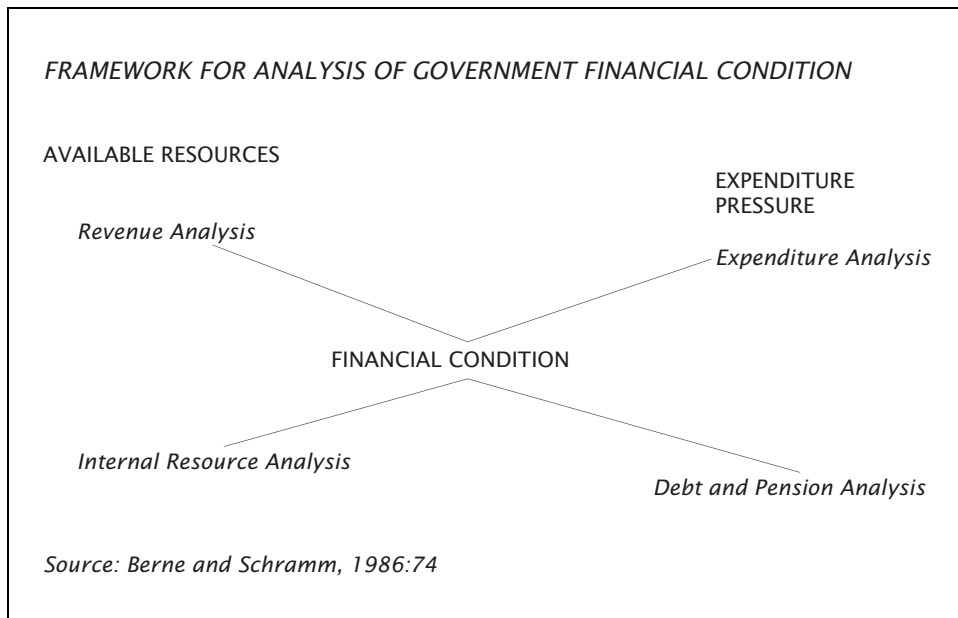


Figure 1.6. Financial Condition Framework.

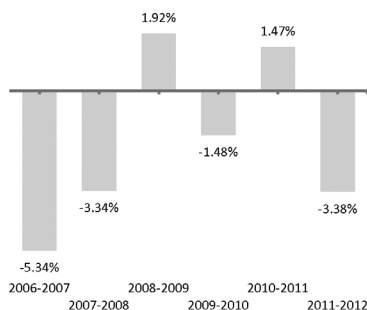
tion serves this purpose. From item by item measurement based on valid and reliable figures, analysis can proceed and remain consistent with the needs of fiscal and policy decision makers. The importance of consistent nomenclature and fiscal definitions to avoid budgetary gimmickry was noted above. The level of wages/salaries paid, for example, can be measured in dollars, percentages of total expenditures, and per capita ratios. From here, analysts in the educational finance office, for instance, can zero in on particular issues such as the ratio of administrative positions and staff to teaching position or students. These can be compared to similar jurisdictions within states or between them to provide more comprehensive analysis. In chapter 3, we explore expenditure analysis for decision making in greater depth; in the next chapter, we review measures and method of revenue analysis. Budgets have been difficult to read and interpret intelligently because they are opaque, meaning vague, contradictory, or otherwise confusing. If budgets are opaque, it is difficult to assess the revenue and expenditure pressures faced by state and local governments; it is difficult to assess financial condition. Here are some common obstacles to comprehension:



Financial Condition & Outlook

of Deeds fees, Building Inspections fees depend on the real estate market, which has gradually started to improve in Gaston County since the last recession.

Revenue Shortfalls



Description:

Revenue shortfalls as a percentage of actual net operating revenues

Calculation:

$$\frac{\text{Revenue shortfalls}}{\text{Net operating revenues}}$$

Warning Trend:

Increase in revenue shortfalls as a percentage of actual net operating revenues

This indicator depicts the differences between revenues budgeted and actually received during the fiscal year. Ideally, at the end of the fiscal year the government will have earned more revenues than budgeted. When the government earns less revenues than budgeted, then the government experiences a revenue shortfall. It is important to identify if the government is continually earning less revenues than budgeted, as this can indicate, for instance, unrealistic revenue forecasting techniques or the drying up of certain revenue sources.

This indicator is calculated as follows. The actual net operating revenues for a year are subtracted from the budgeted net operating revenues for that year. If the resulting number is negative, that means the actual net operating revenues for that year were higher than the budgeted revenues. If the number is positive, the opposite is true. This number is then divided into the actual net revenues for the year in question, which shows the revenue surplus or shortfalls as a percentage of actual net operating revenues. On the graph above, negative numbers indicate a revenue surplus; positive numbers indicate a revenue shortfall.

Gaston County's General Fund experienced revenue shortfalls for only two of the five years indicated on the chart. In addition, the amount of the shortfall was small. For FY 2009, the total revenue shortfall was 1.92% of actual expenditures, and for FY 2011 the revenue shortfall was 1.47% of actual expenditures.

The data for this indicator do not indicate a warning trend of persistent, or even growing, revenue shortfalls—a token of Gaston County's practice of generating conservative revenue projections.

Figure 1.7. Financial Condition Indicator for Gaston County: Revenue Shortfalls.

1. Sometimes there is too much *data* and not enough useful *information*. Finance offices might publish raw fiscal data online without breaking them down into percentages and ratios of total expenditures. It is hard to ask intelligent questions on raw data. Converting data into information through use of trends, ratios, percentages, and narrative indication of operating assumptions is very important for financial condition analysis. Examples include: expenditures/capita, debt service/net operating revenues, and personnel/capita.
2. Finance offices may not include interyear comparisons in the annual budget. The standard budget consists of planned allocations for the budget year. So, budget analysts might ask how this compares to the past two years of actual expenditures? This could give one an idea of expenditure trends by category and total. Since “people tend to think about what is put in front of them” (Lehan, 1981, p. 2), without this kind of basic information, there is little to be asked. As will be explained further below, “Budget classifications tend to define reality for budget-makers and reviewers, channeling their thoughts and attention” (ibid.). With interyear figures, they may now ask about trends and the reasons for shifts.
3. Operating assumptions are often not included. Budgeting is all about discerning what is included and excluded from estimates and why. For instance, most state-local budgets are in nominal or current terms. But both program advocates and budgetary guardians need to know proposed expenditures in real terms and inflation rates to be used for calculations. If inflation is increasing, nominal requests by departments may shortchange their service beneficiaries. Planning baselines and information on the accuracy of past revenue and expenditure forecasts need to be made explicit. These assumptions and definitions are often either missing or unclear. This requires time-consuming review by the media, legislators, public interest groups, and external auditors to reveal the basis of calculations. Only if this information is made explicit (even as footnotes in annual budgets) can intelligent inquiry begin on budgets at any of the four stages of the process noted above.
4. The budget often consists of several documents, making it difficult to integrate totals and track trends. For instance, the capital

budget is often separate; and there may be additional and separate budgets for city enterprises (e.g., Chicago Transit Authority). Indeed, the efficiency of the overall budget process is often affected by the fact that several separate departments prepare and monitor the implementation of these budgets, for instance, Department of Public Works. Since there are substantial interfund transfers between the general fund (including core government operations such as police and health) and special funds (including proprietary funds for enterprises such as water/sewer and public transit), these interfund flows need to be tracked and assessed. The financial condition risk is that city enterprises are like parallel governments and may be able to avoid direct controls from the city finance department despite receipt of substantial subsidies from the central budget. Since they are institutionally separate, it is important to examine the scope of central control over expenditures as well as liability for city enterprise debts.

5. Budget transparency only improves from the outside pressure of checks and balances. To counter institutional and political tendencies to hide assumptions and make totals serve in-house objectives such as maintaining balance, public interest groups, the media, and professional organizations monitor budgets and provide incentives for greater fiscal transparency. The Government Finance Officers Association of the United States and Canada (GFOA), for example, offers an annual award for the best presentation. Milwaukee (population 597,000) has a long history of public sector innovation, including the first school choice voucher experiment in 1990. The larger Montgomery County (MD) (population 971,000) has a similar type of fiscal administration: bold and innovative with high quality public services. Their GFOA award is indicated in Figure 1.8 on page 20.

GFOA evaluates budget quality on four criteria of whether: (1) the budget serves as an *Operating Statement* that includes activity measures and statistics; (2) it is useful for *Expenditure Planning*, including multiyear projections of both revenues and expenditures for critical items like debt and capital plans; (3) it is a realistic *Communications Device*, including clear narrative descriptions of issues faced and attempted remedies; and (4) it serves as a good *Policy Document*, setting out core programs and policies and activities in terms of problems

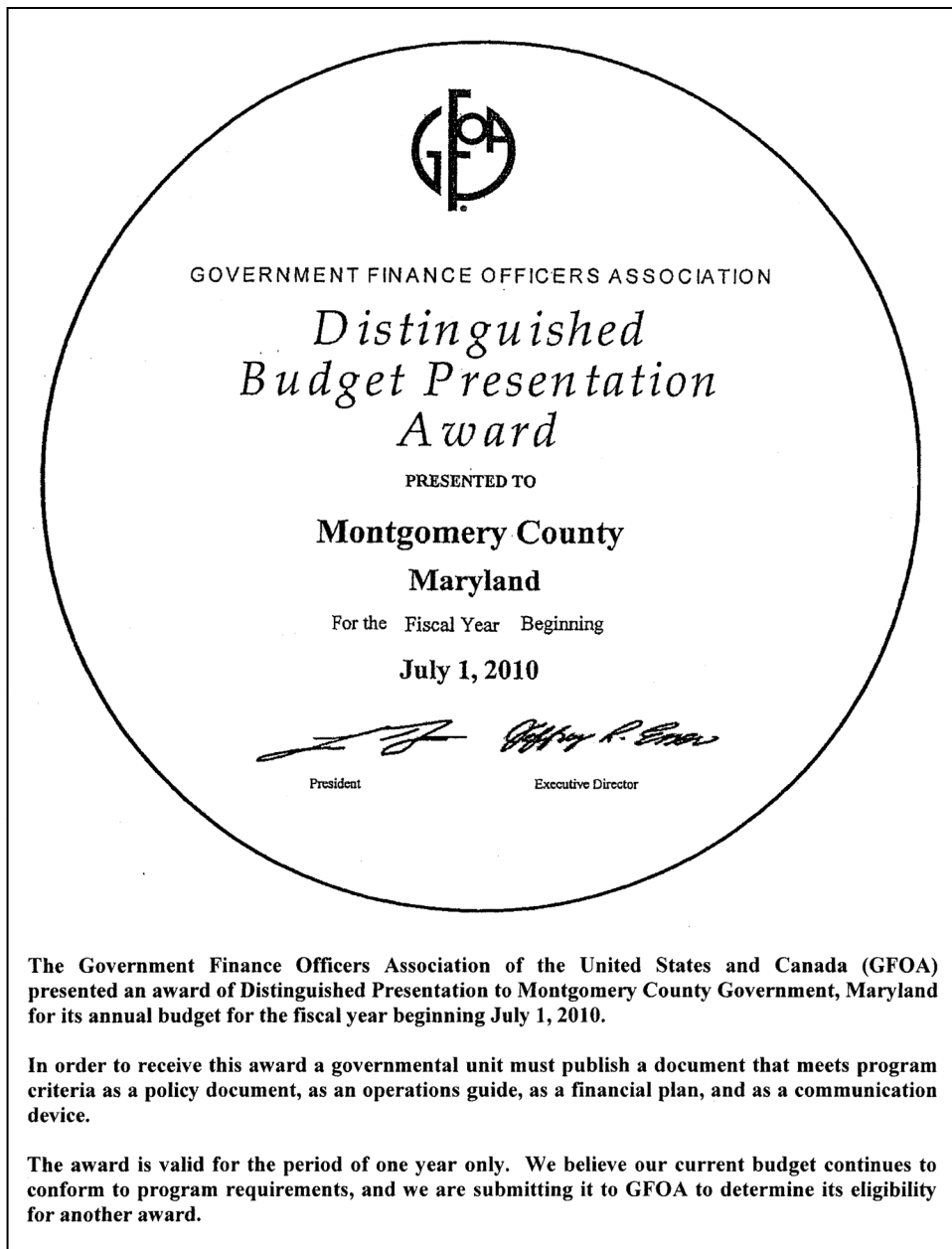


Figure 1.8. Montgomery County (MD) 2010 GFOA Budget Award.

faced, measures taken, and results in outputs and outcomes. GFOA also considers whether revenue, expenditure, and debt policies are formalized and publicly available. They also look for clear annual budget messages that relate policy needs and actions to fiscal data (Strachota, 1994, pp. 155–60).