Municipal Budgeting

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MUNICIPAL BUDGETING

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Municipal Budgeting

A Topic of Concern for Over 60 Years

“Too much importance cannot be attached to the preparation of the budget. No municipality is too small to meet such an important forecast and guide. ... A properly prepared budget will result in the elimination of unnecessary expenditures, increased efficiency in the methods of collecting revenues and preservation of the credit of the municipality.”

(C.M. Wrenshall, Municipal Administration and Accounting, 1937 p. 44-45)
The Purpose of Municipal Budgets

"Municipal budgets should be designed to achieve the following objectives:

- to provide for the management of financial control;
- to provide information essential for useful and efficient management decisions;
- to improve program and financial planning."

(Harry Kitchen, "Management Issues Affecting Expenditure Controls" 2001, p.5)

Local budgeting should take place within the structure of a medium-term expenditure framework, both to ensure the proper financing of investment projects, and to reduce the scope for short-term political manipulation of budgets.

(Richard M. Bird, "Setting the Stage: Municipal and Subnational Financial Management" 2000, p.122)

General Rules

Budgeting and Intergovernmental Finance

"The budget law must be clear, and it must be enforced. ... it is critical to local fiscal discipline that the amount of revenue from intergovernmental transfers be predetermined, and not subject to political re-negotiation during the budgetary year; local governments must not be able to depend on central government bail-outs of imprudent financial decisions such as unsustainable borrowing or expenditure increases."

(Richard M. Bird, "Setting the Stage: Municipal and Subnational Financial Management" 2000, p.122)

Ontario has a well-developed set of rules related to municipal borrowing and accounting.

Ontario municipalities are not permitted to budget for a surplus or a deficit. Borrowing to cover an operating deficit is not permitted. Any operating surplus or deficit must be taken into account in the following year’s estimates.

The actual budget process and budget methodology is not regulated.

Ontario is the first Province to enshrine benchmarking in statute and has initiated a provincial-local process for implementation.
What is the Municipal Budget?

The Municipal Budget
- Budget is a projection of future revenues and expenditures
- At a minimum, used to control financial transactions
- Should also be used as a management and planning tool

Types of Operating Budgets

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Operating Budget (Recurrent Budget)
- Concerned with the regular operation of services:
  - salaries
  - pension contributions
  - purchase of short-life equipment
  - repair and maintenance
  - servicing of long-term debt (principal and interest)

Capital Budget
- Concerned with creation of long term assets

The Budget as a Management Tool for Public Expenditures
- Customary form of local municipal budget divided according to organizational breakdown of authority
- Amount allocated to each unit/subunit further divided into line-items of expenditure
- Under performance based budgeting
- Expenditures grouped by program serving major objectives
- Expenditure control and forecasting
- Allocating funds on a quarterly basis can help with financial controls
- Quarterly budget allocations must be made in conjunction with aggressive cash flow management
Capital Budget

- Capital budgets should be set up on a long term plan: that is, a plan which is to be carried out during a number of years, partly during the current year and partly at certain later periods. Each improvement should be considered as a separate unit and no work should be decided on without taking into account its relation to the balance of the programme from both the financial and physical standpoints.

- In order to maintain control over the budget for permanent works, definite plans must be laid and carried out. A haphazard undertaking of expensive works can only result in confusion and in top-heavy financing. In many of the defaulting municipalities much of their trouble has been caused by unwise and unnecessary construction work.

Components of the Capital Budget

- Inventory of Capital Assets
- Developing a Capital Investment Plan (CIP)
- Developing a Multi-Year CIP
- Developing a Financing Plan
- Implementing the Capital Budget

- Public participation and Acceptance of the Capital Budget is Crucial
  - Degree of Urgency
  - Benefits Derived
  - Cost and Financial Impact
  - Acceptability

Benefits of Multi-year CIP

- Programming scarce resources
- Selection of cost-effective solutions
- Engage in prudent borrowing and other debt policies
- Avoid common failure to provide for Operating & Maintenance expenditure
- Avoid Underutilization/Deterioration of infrastructure

Budget Process

Characteristics of an Effective Budget

- Accurate, Periodic, Authoritative, Timely and Transparent (Richard M. Bird)
- Accountability, Comprehensiveness, Constraint, Cooperation, Honesty, Judgement, Legitimacy, Perception, Responsiveness, Timeliness, Transparency (Michael Schaeffer)
Budget Process
Characteristics Adversely Impacting Budget Performance
- Extrabudgetary funds,
- Earmarking,
- Unpredictability,
- Unreliable information

Budget as a Conflict Resolution Process
- Kitchen (2001) identifies four stages:
  - initial requests at the departmental level
  - departmental budget requests and development of the revenue constraint
  - adoption of the budget
  - execution of the budget
- “After frantic pleading by department heads or their delegates, requests may be denied, rearranged or the financial constraint expanded. Ultimately, the chief financial officer arrives at a budget that is then presented to the budget committee of the municipal council.”

Preparation/Planning Stage
- Service Plans - objectives-results oriented, measurable within a given time, related to the overall department goal
- Relationship to performance measures
- Budget instructions
- Policy guidelines
- Agency requests

Integration
- Role of CAO, Treasurer, the Senior Management Team or a Budgets Division
- Past program performance evaluation
- Independent forecast of service needs (Is the program needed?)
- Relative cost effectiveness - this program compared to an alternative way of solving the same problem or an alternative use of the resources to solve another problem
- Efficiency analysis (Is this the least cost way to solve the problem?)
- Workload data
- Council or citizen-group demand for the program
Communication/Adoption/Implementation

- Budget documents/numbers/policy choices
- Execution/feedback

Financial Management Techniques

- Establishing monthly or quarterly spending plans and monitoring progress against them
- Reporting actual expenditures against detailed budgets
- Reviewing and recommending departmental requests to transfer funds between appropriation lines
- Position and payroll expenditure control
- Monitoring revenues on a periodic basis
- Instituting procedures necessary to adjust budgets to reflect changes in revenue availability or changed service requirements
- Surplus management

Methodology

Incrementalism vs. Program Based Budgeting

- “Incrementalism...provides no mechanism for assessing the benefits from existing expenditures and, therefore, no rationale for encouraging local officials to allocate their resources in an efficient manner. “In essence control budgeting is important but it often creates a narrow and cumbersome financial management system, characterized by paperwork, detail, duplication, complexity, and inflexibility. It also lacks the truly relevant information necessary for proper planning and efficient management of local government activities.”

Methodology

Rethinking of Budget Design

- reflect both past and projected expenditures on outputs or goals rather than on costs of inputs.
- targets decisions on budgeted expenditures not solely on the basis of costs but rather on the basis of costs (efficiency) with some notion of returns (effectiveness)
- performance measures linked to the budgetary process.
**Methodology**

Incrementalism vs. Program Based Budgeting

The features of PPB:
- defining objectives and programs to achieve those objectives,
- appropriation by programs,
- use of performance indicators to measure program outputs, and
- use of cost/benefits or other forms of analysis.

**Aid to planning and decision making**

- Allocative efficiency requires adequate and accurate information on the effectiveness and social outcomes of the programs.
- Operational efficiency may be achieved by allowing line managers significant discretion, within budgetary cash limits, to reallocate funds among inputs, or even across budgetary periods, subject to attaining predefined operational (performance) goals and to complying with appropriate internal and external financial control and audit systems.

*Bird, 2000, 122*

**Benchmarking and Performance Indicators**

**Performance Measurement**
- Controls costs
- Compares processes
- Maintains standards
- Compares sectors
Benchmarking and Performance Indicators

Type of Indicator | Definition | Example
--- | --- | ---
Input Indicator | Measure of Resources Employed | Equipment Needed, Employees Required, Supplies Used
Output Indicator | Quantity of Service Provided | Number of projects, Number of classes, Number of people served
Effectiveness/outcome indicator | The degree to which the intended objective of the service is being met | Percentage increase in employment, Decrease in crime rate
Efficiency Indicator | Cost per Unit of Output | Cost of water delivered by household

(Schaeffer 2000a,42)

Recent Canadian Experience with Performance Measurement

Canadian Cities
- Calgary, Winnipeg, Toronto, Ottawa, Thunder Bay, Burlington, Guelph, Regions of York and Peel
- Ontario has taken the initiative.
- First province to require municipalities to measure and report annually to taxpayers on their performance in service delivery.
- 35 performance measures-nine core municipal service areas-garbage, sewage, water, transportation, fire, police, local government, land-use planning and social services

Recent Canadian Experience with Performance Measurement

- Advantages- monitor activity over time
- Strengthen accountability, managerial accountability, staff creativity and productivity
- The Ministry of Municipal Affairs and Housing has also set up an advisory committee with representatives from key municipal stakeholders and the ministry.
- The committee recommended which measures municipalities would report on this year and will advise the ministry on how to further enhance the program for year 2 and beyond.
- It will also look into the idea of creating a Centre of Municipal Best Practices on Performance Measurement.

Municipal Act, 2001

- Municipalities are accountable for their budget processes.
  - Municipalities are required to prepare a balanced budget each year, and to provide for any surplus or deficit of the previous year.
  - Municipal budgets set out major activities, service levels, related costs, and how best to deliver services. Municipalities are required to discuss and approve their annual budgets in public meetings. Budget documents and staff reports are routinely made public before the political decision-making process begins.
  - Municipalities are required to submit an annual Financial Information Return to the Ministry of Municipal Affairs and Housing. The return also includes all local boards within the municipality’s jurisdiction.
  - The new Municipal Act also requires municipalities to publish their annual audited financial statements 90 days after the audit is completed.
Municipal Act, 2001

- Municipalities are accountable for the way they deliver services.
  - The Municipal Performance Measurement Program requires municipalities to collect data on 35 measures and, as of September 2001, they were required to report to the public on 16 of those measures. The program will be expanded in the future.
  - The Municipal Act requires a municipality to provide the Minister of Municipal Affairs and Housing with designated information related to the efficiency and effectiveness of the municipality’s operations.
  - The Minister can require municipalities to report these results to taxpayers.
  - Municipalities must report to taxpayers annually on any service delivery improvements, and on any

Interrelationship between Budgeting and Accounting Systems

- “While the budget is the heart of municipal resource administration, municipal accounting systems and practices and their subsequent reports are central to the budget-making process.”

(Kitchen, 2001, 11)

Accounting and Financial Reporting

- Three prominent objectives of financial reporting:
  - Financial reporting should assist in fulfilling government's duty to be publicly accountable and should enable users to assess that accountability
  - Financial reporting should assist users in evaluating the operating results of the government entity for the year (and, year over year)
  - Financial reporting should assist users in assessing the level of services provided by the local municipality and its ability to meet these obligations as they are due.

Accounting and Financial Reporting

- Modified accrual accounting most commonly used - adopts the same principles and approach as accrual accounting with the exception that depreciation and a return on capital are not included as costs. Instead, interest costs and principal repayments are recovered directly in the year in which they are due through user fees and local taxes. These are generally set to generate revenues in excess of expected operating and maintenance costs and debt service costs, thus resulting in operating surpluses which are transferred to a capital fund to finance ongoing investments or into reserves or reserve finds to finance planned future investments. Because principal repayments are recovered directly each year as chargeable expenses, municipalities are less likely to face cash flow problems. Capital finance does not, therefore depend on the flow of funds from a
PSAB Initiative

- As of January 1, 2000, local governments in Ontario are required to follow recommendations in the PSA Handbook published by the Public Sector Accounting Board of the Canadian Institute of chartered Accountants (CICA). The Handbook recommendations retain the modified accrual basis of accounting.
- Provide reliable, understandable, timely and consistent information that meets the needs of persons for whom the statements are prepared.
- Provide an accounting of the full nature and extent of the financial affairs and resources for which local government is responsible.
- Demonstrate the accountability of local government for the financial affairs and resources entrusted to it.
- Account for the sources, allocation, and uses of financial resources in the period.
- Provide information that shows the state of local government's finances.

US Move to Full Accrual Accounting

- "The requirement for full accrual accounting by local government was established by the US Government Accounting Standards Board (GASB) in GASB Statement No. 34, which concluded reporting infrastructure assets is essential to provide information for assessing financial position and changes in financial position, and for reporting the costs of programs or functions. Asset reporting requirements are retroactive to 1980 for large municipalities but not for those with less than $10 million in annual revenues."
  - Requires an assessment of physical condition
  - Quantifying the Unknown
  - Issue of training - accounting backgrounds of staff

No Safe Government without Budget Control

- Without a proper budget there can be no true economy of expenditure, and without departmental appropriations itemized by administrative unit and object of expenditure, there can be no effective control. Estimates which are used only as a basis for determining the tax rate and not as a basis for itemized appropriations for accounting and administrative control, do not constitute a budget; neither can the determination of a tax rate first, and spreading out the revenues afterwards. Without a proper budget, the foundation of a real budget, nor can this procedure really control expenditures. Estimates on either of these bases can hardly be more than pious wishes and may be thoroughly deceptive documents, especially if the estimates are placed below what council knows is actually required.

(C.M. Wrenshall, Municipal Administration and Accounting, 1937, p. 56)