

Governmental Budgeting

By Stephen W. Blann, CPA, CGFM

Operating on revenue streams that are dependent on the prime economic indicators of personal/business income and property values, governments are often in the unenviable position of needing to provide increasing levels of critical public services on an ever diminishing budget. What's more, the public often doesn't understand the complexities of the governmental budgeting process, which causes frustration for citizens and elected officials alike.

Why governmental budgets are unique

The Governmental Accounting Standards Board (GASB) is the body responsible for setting the accounting rules for state and local governments. In its Concepts Statement No. 1, Objectives of Financial Reporting, the GASB points out that, "many believe the budget is the most significant financial document produced by a governmental entity." There are several reasons for this.

First, governmental budgets are an expression of public policy. They result from a legislative process in which various views about how public funds should be raised and expended are presented and discussed. In Michigan, every local government is required to hold a public hearing prior to adopting its annual operating budget — giving taxpayers the opportunity to have a say in the government's use of their money.

Second, governmental budgets serve not only as a financial plan, but also as a legal appropriation for the expenditure of public funds. Most local governments require some form of "balanced budget" in which approved expenditures are matched to available resources.

Finally, governmental budgets are used as a basis for evaluating performance. Comparisons of the original and final amended budgets are included in the audited financial statements of local governments and are made available to the public for inspection. Unlike many private organizations which view their budgets as internal operating guidelines, governments must update their budgets throughout the year as new information becomes available and report on their compliance with the adopted budget.

Depending on the type of entity, a local government may have dozens (or even hundreds) of individual programs that must be separately managed, accounted for and reported through the use of separate funds or departments. Each of these activities must be budgeted in accordance with state law, and in most cases, funds intended for one program cannot arbitrarily be redirected by management for another purpose. Consequently, governments must occasionally make cuts from more critical functions that are financed through diminishing revenues, while maintaining higher levels of expenditure in comparatively less critical areas, simply because of restrictions on the revenues received.

As our state and national economies continue to suffer, organizations of every size and type are faced with the necessity to “do more with less.” This is particularly true for governmental entities.

in a Recession

What's happening with property taxes?

Michigan's tax system has several safeguards in place to protect taxpayers from rapid increases in property taxes. One of those safeguards was the introduction in 1994 of Taxable Value (TV) as the basis for assessing property taxes. Initially based on the State Equalized Value (SEV), which approximates 50 percent of the true assessed value of property, increases in TV are limited annually to five percent or the rate of inflation, whichever is less. Over time, the SEV of property in Michigan grew at a faster rate than the related TV. Recently, however, Michigan's SEV has started to fall. But as long as the taxable value of properties are less than the equalized values, TV can continue to grow even as SEV is declining. This has been a source of concern for some taxpayers who have seen the values of their homes fall significantly only to find their tax bills still increasing.

While personal and business income taxes have declined more rapidly, property taxes (which represent the bulk of most local government funding) have been slower to react to the downturn in the economy. As illustrated in the charts at right, Michigan's SEV has been in a period of decline for several years, while its TV has just begun to level out. What this means for local governments is that the real reduction in revenues is still to come. Accordingly, these governments need to be prepared for a continued diminution of their funding for some time.

What Local Governments Can Do

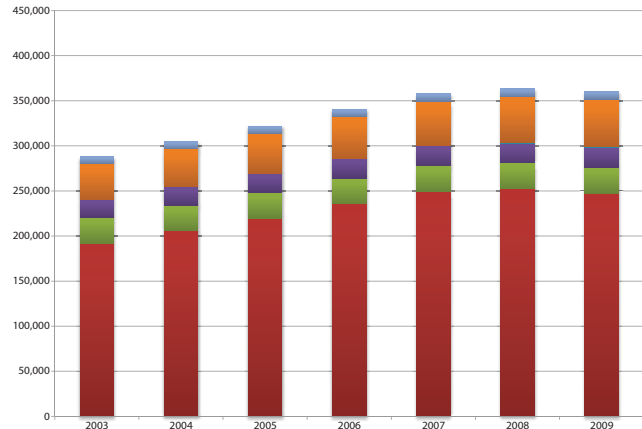
The vast majority of governmental spending comes in the form of personnel costs (salaries and related fringe benefits). As much as 80-85 percent of a local government's non-capital spending can be tied up in payroll. As a result, governments typically turn to salaries first when looking to balance the budget.

Some governments have elected to make cuts through attrition. Others have resorted to layoffs or furlough days. Still others have reconsidered the fringe benefits offered to their employees — scaling back on insurance plans, pensions and/or postemployment healthcare benefits. Through careful examination of governmental contracts and purchasing practices, other cost savings can be found as well.

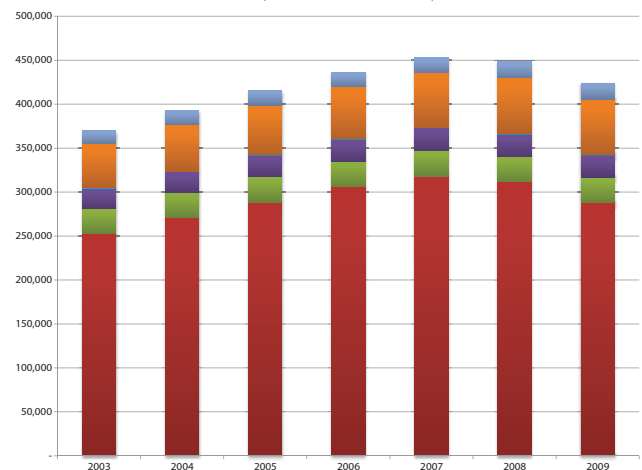
As stated earlier, governments often have restricted revenue streams which are perversely unaffected by economic conditions. For that reason, across-the-board cuts are not always a practical option for governments. Similarly, some governments may find themselves making large “discretionary” purchases with restricted funds while simultaneously having to cut back on other key services. Unfortunately, there is no magic solution to the difficulties faced by governments through this process, and there is likely more than one “right” way for elected officials to seek to balance their budgets.

Perhaps the best thing citizens can do is to let elected officials know what priorities matter to them and participate in the public forums established during the budgetary process. Remember that local governments exist to serve the needs of their citizens and are working hard to operate in this economy too. 📌

Michigan Taxable Values (TV)
(amounts in millions of dollars)



Michigan State Equalized Values (SEV)
(amounts in millions of dollars)



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