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The budgeting process is one of the most important responsibilities of local elected officials. Use of budgets to set priorities and manage the fiscal well-being of your municipality is a power entrusted to governing bodies and can determine the financial course of a community for a generation. This article provides an overview of the budgeting process that Wisconsin municipalities go through every year and attempts to demystify some of the budget terms and concepts that may pop up during the process.

Wisconsin State Statutes 65.90 sets forth the requirements for municipal budgets, including what content is required and certain deadlines that each municipality must meet. The budget process often begins as soon as the prior year audit is reviewed by the governing body. This is a logical place to start, since you now have a glimpse at the financial health of your community and the historical trends that have led you to where you are now. Like your audit, your budget is split into fund categories – this is done not only for accounting purposes but also to provide a layer of transparency when analyzing your tax levy. Understanding that you have separate budgeting funds for enterprise revenues (or revenues generated from user fees such as water or sewer utilities), internal services, capital projects, and others in addition to your general fund, allows you to see what line items truly impact tax levy versus other revenue sources.

In advance of the budget preparation process it is important for elected leaders to communicate expectations and objectives for tax levy, service levels or delivery optimization, capital projects and deferred maintenance, as well as debt financing and use of fund balance. Having financial policies and plans to guide these major budget considerations is helpful and can provide longer term financial consistency. Financial policies, including debt management plans, are a way to memorialize the community’s fiscal philosophy. They allow for your strategic financial vision to be perpetuated to future generations, and they help to make the day-to-day management of your government more efficient. Some typical plans and policies governing bodies develop that inform the budget process include:

- **Capital Improvements Plans (CIP)** – A CIP provides a long-range view of the capital needs for your municipality, whether they are equipment, facilities, or infrastructure. Analyzing your capital needs over multiple years provides you with the ability to anticipate financing needs, the option of using cash or reserves to pay for items, and a strategic plan for addressing ongoing capital needs. For example, using a five-year CIP means you can know how much borrowing and levy is needed to manage a road improvement schedule, a fire truck replacement schedule, or upgrade phones and networking technology at a desired interval.

- **Financial Management Plans (FMP)** – The objectives of an FMP is similar to your annual personal finances: it would be great if we could know that there will be no emergencies, no economic downturns, no car repairs, or we could easily save exactly what we needed to replace our furnace the day it dies without ever thinking about it – but that’s not always possible and certainly not practical. Instead, we must rely on reasonable assumptions and strategic savings. The key to this is to look forward as far as possible. For your community’s finances, there’s no difference; unforeseen expenditures will occur and there will be important future capital expenses to pay for. Creating and maintaining a financial plan that provides you the accountability to know how your tax dollars are being spent and the flexibility to adjust for changing strategy is important to the budgeting process. An FMP can combine your operating budgets used to provide day-to-day services with your CIP that identifies capital needs to develop an integrated budgeting model. A long-range financial plan typically looks ahead five years (but can be more) and takes your past audited financials into consideration to understand exactly where your budgeting has gone and where it is going. Assumptions are built around historical trends, backed by data, and informed by those who will oversee the plan. A long-range plan takes your financial policies and your financial data and shows them in action so that you can plan for fund balance savings or uses, and you can structure debt to maintain stable debt service while also being able to provide sufficient funding for your capital improvements. Like financial policies, FMPs are another tool to help your governing body be proactive.
• **Debt Management Policy** – A Debt Management Policy memorializes the guidance and restrictions your governing body will place on borrowing money. Doing this provides a layer of management and accountability for your debt issuance needs. Debt Management Policies (or Plans) should be adopted by your governing body after consideration of the financial needs of your municipality; it is important to look ahead and understand what the implications of placing these requirements on borrowing money could mean for flexibility going forward. A formal Debt Management Policy is valuable for credit rating agencies to know that your community has taken the proper steps to ensure repayment of and prudent use of debt.

• **Fund Balance Policy** – A Fund Balance Policy provides guidance on the use of fund balance for your municipality’s budget. A Fund Balance Policy should address under what circumstances fund balance can be used, and the process or implications of using it. Like a Debt Management Policy, this will be valuable for credit rating agencies and the capital markets because it displays responsible financial management.

The months leading up to budget preparation and consideration are a good time to update these plans and review policies to make sure they reflect current priorities and objectives. In advance of budget preparation, it is also important to understand how two key limitations may impact revenue raising ability and expenditures:

• **Levy Limits** – the state has imposed levy limits on municipal budgets so that the amount your tax levy number can grow over the prior year’s levy cannot exceed an allowable number without referendum. The allowable levy considers information such as your net new construction, debt service, and other various adjustments to determine the final maximum permitted number. If the tax levy determined through the budget process exceeds the allowable tax levy, your governing body must reduce expenses to meet the levy. Starting the process early by anticipating what the allowable tax levy will be is important to avoiding this problem.

• **Expenditure Restraint** – Wisconsin’s Department of Revenue manages the Expenditure Restraint Program (ERP) for municipal governments. This program is intended to award local governments who limit the rate of growth for their expenses by providing a payment of unrestricted aid. Governments are eligible to apply for the ERP if 1) their tax rate is at least 5 mills (or $5 for every $1,000 of assessed value) and 2) their budgeted general fund expenditures are no greater than the prior year’s budgeted general fund expenditures plus an inflation and valuation factor which the DOR releases each October. The calculations also take into consideration debt service payments, which are excluded, and transfers from the general fund to other funds which are included. For eligible governments, a payment will be distributed along with the state aid payment each year.

Once the designated staff or officials have prepared a proposed budget it will be presented to the governing body for review, refinement, and action. Statutes require that the governing body hold a public hearing to allow for constituent input on the proposed budget. The process then concludes with budget approval typically in November so that the tax levy is set in time for tax bills to be sent in December.

This is a good place to make an important distinction between tax rate and tax levy. Tax levy is the total dollar amount needed to balance your budget, the net difference of your expenses less your revenues. Tax rate is the product of dividing your tax levy by your municipality’s assessed value and then multiplying it by 1,000. The resulting rate is the amount a property owner will pay for every $1,000 of assessed value for local government services. Oftentimes a community will assess budgetary impacts in terms of the projected cost on an average valued home in the municipality.

The potential use of fund balance often comes up in conversations related to budgeting. Your annual audit will provide a validated amount of cash and fund balances in each of your funds after the prior year’s close. It can act as a reserve for General Fund expenses, to provide flexibility for unforeseen expenses and it can be used to cash fund projects without debt. GFOA recommends a minimum of two months of operating expenditures in fund balance, other common recommendations are 25% of annual expenditures (3 months) or any other threshold that can be defined in your financial policies. Having adequate fund balance is particularly important for bond ratings.

Accessing fund balance to pay for annual operating costs should be done with caution as the community will find itself in the same operating deficit position during the next budget year absent other new revenue or reductions in expense. In cases where fund balances have grown and may exceed what should be reasonably maintained, typical advisable uses include cash funding of capital projects, debt reduction, or payment of other non-recurring expenses.

Preparation of thoughtful annual budgets based on local priorities, policies, and plans, and balancing community needs with available revenues from taxes and other sources is a challenging but impactful way that elected officials can guide the fiscal health and development of their communities.

About the Author:

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Jonathan lives in Waukesha with his wife and daughter. Originally from the Chicago area, he and his family have loved getting to know all that Wisconsin has to offer. From golfing and hiking to amazing food and sports, they love spending time enjoying the Badger state (just don’t ask about sports allegiances!). Contact Jonathan at JSchatz@ehlers-inc.com

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