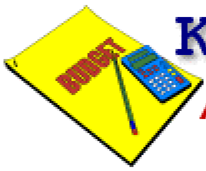

KNOWING THE NUMBERS:
A GUIDE TO PUBLIC BUDGET ANALYSIS

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AFSCME Department of Research and Collective Bargaining Services, 2004

Introduction

Budgets are political documents that reflect the priorities and interests of those who write them. They are also financial documents used to account for funds expected to be received and spent during the year. A budget is never "etched in stone." During the year, most budgets will be amended. In some jurisdictions, amendments or changes will require the approval of the governing board, council, or legislature. In others, the chief executive has the power to move money around within overall limits.

Employers frequently plead poverty when it comes to increasing our wages and benefits. Do not listen to these pleas without first taking your own look at their finances. Often, a simple review of a jurisdiction's finances will raise doubts concerning the merits of these pleas. This guide will help the union conduct this review and develop the questions.

A note of caution before we proceed. While finding the money for a wage or benefit is important, the discovery alone will not get the union the wage increase. Unless the union can convince the employer that workers deserve an increase and have the power to get it, they will simply use the new found funds elsewhere. This is the difference between the *ability* to pay and the *willingness* to pay. Budget analyses address the former, not the latter.

When in negotiations, budget analyses can help provide:

- **Ammunition for the Bargaining Table**

  By analyzing the budget and other financial materials, the union can determine the financial condition of the jurisdiction and identify any "slack" in the budget. The union can use this information to counter or verify management arguments of inability to pay.

- **New Insights Into the Jurisdiction's Operations and Plans**

  Analyzing the finances of a jurisdiction will improve the union's understanding of the jurisdiction's operations and future plans. As a result, the union can be more forceful in discussing budgetary and other financial issues with management.

- **The "Demonstration Effect"**

  The union's interest in detailed budget information and the questions resulting from the union's analysis will demonstrate to management that the union will scrutinize the jurisdiction's finances and will not accept unsubstantiated claims of poverty or tight finances. The answers to the questions flowing from the budget analysis may expose or prevent "bluffing" behavior by management.

The Budget Calendar

The union's involvement in the budget process should begin well before there is a written budget. It is much easier to have the union's interests represented while developing a proposed budget than to lobby for changes in a budget that has been fought over, carefully crafted, and finally adopted.

In most jurisdictions the budget cycle begins seven to nine months before the start of the new fiscal year. A fiscal year is the twelve month period used by the jurisdiction for budgeting purposes. Often, it will be different from a calendar year. In the early stages of the process, information may be limited to policy statements and projections of employment levels by the jurisdiction's chief executive (mayor, city manager, county executive, or governor). In the later stages, you can use the techniques discussed in this guide to analyze the executive's proposed budget and the final approved budget. Additional information on the budget process is provided in Appendix II.

Information Required

At a minimum, you will need the following information to undertake a budget analysis:

- The adopted budget for the current fiscal year, providing revenue estimates and expenditures appropriations.
- The proposed budget for the upcoming fiscal year, if available;
- Actual departmental revenue and expenditure data for the current fiscal year to date; and
- The most recent audited financial statement. This is also referred to as the Comprehensive Annual Financial Report (CAFR). If the statement is not for the last completed fiscal year, ask to be sent a copy of the new statement when it is available.
- While not essential, budgets and financial statements from previous years can be useful for analyzing trends.

You should be able to obtain these items from the jurisdiction's budget office. Budget offices go under different names including the following: Finance Department, Budget and Planning Office, Division of Budget and Accounting, and Office of Financial Management.

Budgets and financial statements are published public documents and should be readily available. Year-to-date revenue and expenditure data is generally available in the form of a computer printout or as a periodic internal report to senior management and the legislative body.

Public sector budgets are divided into different funds that are separate accounting entities. You should obtain financial information for all funds controlled by the jurisdiction. At a minimum, information should cover the major operating fund, normally called the General Fund, and any funds from which bargaining unit members are paid. The various types of funds are listed in Appendix III.

General Indicators of a Jurisdiction's Financial Condition

The union can develop a general assessment of a jurisdiction's overall financial condition and budgeting practices by examining its financial statement and budget documents.

Adequacy of Financial Reserves

An important indicator of a jurisdiction's financial condition is the size of its *fund* balance in relation to the size of its budget. The fund *balance* constitutes a jurisdiction's financial reserves, which are the accumulated funds left over from previous years. The audited financial statement contains information on the size of the fund balance at the end of the last completed fiscal year. In the financial statement, a "balance sheet" can be found. It will list a fund's *assets* (the dollar value of its cash and investments and the money it is owed) and its *liabilities* (debts to be paid). The amount left over when the value of a fund's liabilities is subtracted from the value of its assets is the fund balance.

The fund balance is usually divided into *reserved funds* (money legally set aside for specific future uses) and *unreserved funds*. The unreserved portion of the fund balance can be used as the jurisdiction sees fit. While unreserved funds may be "designated" for specific uses, these designations are not legally binding under generally accepted accounting standards.

The Government Finance Officers Association (GFOA) recommends that a government jurisdiction maintain an unreserved fund balance in the range of 5 percent to 15 percent of operating revenues.[1] An unreserved fund balance within this range is one sign of fiscal health, while a balance lower than 5 percent suggests a lack of financial flexibility.

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[1] To calculate the fund balance percentage, divide the unreserved portion of the fund balance, by operating revenues for the previous year. The result is the fund balance stated as a

In cases where the fund balance is large, management often argues they need a sizable fund balance to maintain an adequate cash flow. For example, many local jurisdictions rely heavily on revenues from property taxes for operating funds. However, property tax revenues are not received in a constant stream throughout the year; they are received once or twice a year coinciding with tax payment deadlines. Since a jurisdiction's expenditures must be paid more-or-less evenly throughout the year, there will be times where the money going out exceeds the money coming in due to the timing of revenues. Management will therefore argue that it needs a large fund balance to ensure that there is always enough cash on hand to pay the bills.

While a large fund balance may allow a jurisdiction to meet its cash flow needs without short-term borrowing, this should not occur at the expense of the union. A temporary shortage of cash due to the scheduling of tax payments is not a sign of poverty. If management argues that they cannot draw upon their reserves because of cash flow needs, you should ask for documentation.

Documentation includes monthly projections of cash needs and historic monthly reports showing actual cash receipts and cash disbursements. With these documents you may be able to identify ways to even out demands for cash. Also ask if management has considered short-term borrowing to cover any periods of cash shortage. Workers should not be forced to accept a poor settlement just for the sake of management's financial convenience.

Presence of a Deficit or Surplus

Another indicator of a jurisdiction's financial performance is whether there have been deficits (where expenditures exceed revenues) or surpluses (where revenues exceed expenditures) in recent years. While a jurisdiction with a large unreserved fund balance may intentionally budget for expenditures to exceed revenues in order to use a portion of the fund balance to bridge the gap, an unplanned deficit is a sign of fiscal stress.

You can determine the presence of a surplus or deficit by comparing revenues and expenditures for a given fiscal year. If a jurisdiction has a surplus, its fund balance grows. If there is a deficit, the fund balance shrinks. Information on previous years' actual revenues and expenditures can be found in the financial statement. Budget documents generally provide revenue estimates and budgeted expenditures (appropriations) for the current year and the upcoming year.

Accuracy of Budgeting Revenues and Expenditures

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percentage of budgeted revenues. For example, if a jurisdiction had an unreserved fund balance of $1 million, with revenues of $10 million, the fund balance amounts to one-tenth, or ten percent of revenues.

If a jurisdiction has had a tendency to underestimate its revenues (collect more than was estimated) and/or overestimate its expenditures (spend less than budgeted), there is a good chance of finding slack in the current or upcoming year's budget. On the other hand, a jurisdiction that regularly overestimates revenues or underestimates expenses is headed for trouble. You can examine this budgeting behavior by comparing actual expenditures and revenues for previous fiscal years with *budgeted* expenditures and revenues for the same years.

Identifying Available Funds

Having developed a general overview of the jurisdiction's financial health and practices, the next step is to review specific techniques to identify available funds.

Analyzing Revenue Estimates

Your goal in analyzing revenue estimates for the upcoming instances in which managers either have significantly underestimated or completely ignored sources of revenue. The accuracy of the revenue projections is measured by comparing actual revenue for the current fiscal year with future projections and the jurisdiction's past experience.

The annualizing process is simple. Divide the actual current fiscal year’s expenditures by the number of months it represents, and then multiply that figure by 12 to obtain the anticipated end-of-year expenditure estimate. For example, if $270,000 has been spent in nine months, you would divide $270,000 by 9 and multiply the answer ($30,000 average monthly expenditures) by 12, resulting in an estimated annual expenditure of $360,000. If the jurisdiction's budget estimate was $300,000, then the annualized figure of $360,000 suggests that expenditures for this item may have been underestimated.

Compare the upcoming fiscal year's budget estimate of revenue with the past fiscal year's actual revenue. Question any revenue source which is forecast to decrease, increase less than the annual rate of inflation, or which has been dropped.

The rate of inflation is usually defined as the percentage change in the Consumer Price Index (CPI) over the previous 12 months. The rate of change is published each month by the U.S. Department of Labor, Bureau of Statistics, or can be obtained from the AFSCME International Department of Research and Collective Bargaining Services.

Revenue Sources

When you review the revenue projections, pay particular attention to the following major revenue sources:

Property Tax

Property taxes are a major source of funds for many governmental units. Ask these questions when reviewing property tax revenue estimates:

Does the forecasted revenue increase by roughly the same proportion as in the previous year?

Does the estimated revenue increase at least as much as the rate of inflation?

Does the estimated revenue appear to reflect increased revenues from any new development, such as housing, office or commercial construction? You may obtain information on new developments from local newspapers.

Abatements

If property tax revenue estimates are lower than you expected, abatements may be the cause. Abatements are complete or partial waivers of taxes or fees that businesses would otherwise owe to a jurisdiction. Public officials in communities attempting to slow the erosion of their tax bases often offer businesses subsidies and tax abatements in order to encourage them to locate or remain in the jurisdiction. Most of these schemes take the form of "tax holidays" or a reduction in the assessed value of the property below the fair market value for a given number of years.

Although they may sound like good ideas, tax abatements should be discouraged. When tax abatements reduce the amount of revenue to the jurisdiction, a higher proportion of the property tax burden is forced onto individuals. In addition, evidence is growing that while firms will take abatements when offered, the business tax structure is not a very important consideration in the development plans of businesses. Of greater concern to businesses are the availability of a skilled labor force, access to raw material and consumer markets, and the quality of the transportation network. These are conditions that the jurisdiction should work to improve rather than offering tax giveaways.

Delinquent Taxes

The tax revenue portion of the budget often will contain an entry for uncollectible taxes. If this does not appear, the jurisdiction may have reduced its revenue estimate by the percent that it does not expect to collect. According to *A Revenue Guide for Local Government* (published by the International City Management Association), "as a general rule, local governments responsible for collecting property taxes should achieve at least 95 percent of the current levy. That is, no more than 5 percent of the current levy should become delinquent." Thus, a jurisdiction that collects less than 95 percent should be criticized as inefficient. If a jurisdiction is collecting $25 million from property taxes, an increase of only 2 percent would add another $500,000 to available revenue. The collection rate can be improved by a "get tough" policy.

Such a policy would include publishing the names of delinquents in the local newspaper, phone calls, and, if all else fails and the amount of back taxes warrant it, elimination of services to the delinquent taxpayer.

User Fees

User fees are a significant source of locally generated income for local governments. Typical user fees are public parking garage charges, water and sewer service charges, recreational charges, and use charges for public buildings and facilities. The fees should cover the full cost of providing the service or operating the facility. If user fee revenues are not keeping pace with inflation, you should ask if the fees are covering costs.

Surpluses

If there is a general fund surplus at the end of a fiscal year, it can be carried over as available revenue for the next year. The actual amount of the surplus, which is generally not available until a few months after the close of the fiscal year, should be compared with the estimated surplus, if any, in the budget. If the actual surplus is greater than budgeted, the additional revenue is available for any purpose. Not all jurisdictions include surplus funds in the revenue portion of the next year's budget. Some retain this money to increase the fund balance. Surpluses also accumulate in independent funds including internal service funds, enterprise funds and special revenue funds. A description of these funds is provided in Appendix III.

Depending on the jurisdiction and laws governing the use of money in the independent funds, surplus money may be transferred to the general fund. If management argues that these monies cannot be transferred to the general fund or otherwise used for wage and benefit increases, ask under what authority these funds are restricted. If the jurisdiction established the restriction, it is likely the jurisdiction has the power to lift the restriction. Information on these funds and their restrictions is usually provided in the footnotes of the financial statement.

If transfers from the funds are prohibited legally and a surplus has accumulated, a jurisdiction may consider transferring eligible functions supported by the general fund to the restricted funds. This transfer will release general fund resources for other activities. For example, road maintenance functions that are currently paid from the general fund might be eligible for inclusion in a special revenue road fund supported by gas tax revenues dedicated to road maintenance. The general fund also may be able to “bill" the independent funds for services, such as personnel, police, fire, or general administrative overhead.

Interest on Investments

Many localities possess significant cash assets that earn interest. Budget planners often underestimate interest in the budget. A comparison between actual and budgeted interest from previous years and for the year-to-date will highlight this situation. Because expenditures are spaced evenly throughout the year, jurisdictions should invest the idle resources, striving to achieve the maximum return at the minimum risk, while allowing for ready access to invested funds. Short-term U.S. Treasury Notes and Money Market Funds are two common investments. One approach is to pool the idle balances of several local governments into larger amounts of investable funds. This can increase revenues by increasing the rate of return on investments.

Analyzing Expenditure Estimates

Managers often overestimate expenditures. By doing this, they appear more efficient when they provide services at less than "projected" costs. Also, if budget reductions become a necessity, enough "fat" exists to allow for the cuts. By carefully reviewing expenditures, the union can identify this fat and fight for it to be used to fund its demands.

The union can identify questionable expenditure estimates by comparing budgeted expenditures to either the actual expenditures of the past year or to the annualized expenditures of the current fiscal year. For example, if you are analyzing the FY 1999 proposed budget and you are currently seven months into FY 1998, you can annualize the year-to-date FY 1998 expenditures (annualization explained on page 6) and compare those with the proposed expenditures for next year (FY 1999). Calculate both percentage and dollar increases.

If the annualized FY 1997 figures are significantly less that the FY 1998 budget, there may be additional funds left over. If the annualized figures for FY 1997 are significantly less than the proposed expenditures for FY 1998, you may wish to question the proposed expenditures. Management may be attempting to pad the budget.

If you can't get recent year-to-date figures for the current fiscal year (FY 1998), compare the FY 1998 budget with actual expenditure figures for the last completed fiscal year. You will want to use actual proposed, expenditure figures since the jurisdiction may have spent less than budgeted. Besides comparing the proposed budget with the current or past years' budgets, you also may want to question large dollar increases and percentage increases above the rate of inflation. For example, if a utility line item is increased 20 percent when inflation is expected to increase only 4 percent, this may be questioned.

Other Expenditure Issues

When reviewing the expenditure portion of the budget, you should pay particular attention to potential salary savings, contingency funds, misallocated capital projects, and evidence of contracting out.

Salary Savings

Salary expenditure estimates often do not consider attrition and turnovers. During the year, positions may go unfilled, saving money that had been allocated for their pay and benefits. Experienced workers may be replaced with new hires at lower rates over the year. As a result, salary and benefit expenditures are often 3 to 5 percent below budget. This planned overbudgeting for salaries is a frequent source of support for wage increases.

Contingency Funds

Jurisdictions create contingency funds to provide flexibility in meeting unforeseen and unbudgeted expenses. Scanning previous year's budgets often shows that these funds go unused for many years and can be reduced or eliminated. These funds can then be used to support wage and benefit increases. A budget may contain several contingency funds throughout the budget. They can be called a variety of names including reserves, departmental executive reserve, emergency authorization, unallocated appropriations and unappropriated expenditures.

Capital Projects and Equipment

The budget is an operating guide for the fiscal year and should only contain revenues and expenses for the year. Non-operating expenditures benefiting the jurisdiction for more than one year are often incorrectly charged against a single year's revenue. Capital items such as road resurfacing, park and recreation improvements or sewer line installations should be financed over their useful lives. Financing should be used for major equipment purchases, especially large vehicles. These long-term expenses may be financed using long-term bonds or short-term notes, depending on the useful life of the improvement or equipment.

Consulting Services and Contracting Out

Contracting out with private firms to provide public services is one of the greatest threats to public employment. Frequently, the first warning sign is an increase in expenditures for items such as "consulting contracts" or "purchased services" or "contract services." Always question increases in these line items. They can also include proposals to study or undertake contracting out. The AFSCME Department of Research and Collective Bargaining Services will provide information and assistance on fighting contracting out.

In addition to providing a source of funds for contracting out, many agencies use the consulting category as a seldom-questioned hiding place for funds.

Questioning Priorities

Besides reviewing revenue and expenditure data, you should consider the appropriateness of management's priorities. If money is short, you may wish to question the continued existence of appointed boards and commissions (Regional Development Boards, Beautification Commissions, etc.) or contributions to non-governmental organizations. Increases in items such as management travel, membership dues, advertising, and periodical subscriptions are difficult to justify if layoffs are being proposed or wage concessions demanded.

Mid-Year Crises

Jurisdictions are increasingly crying poverty in mid-year. Managers argue that revenue shortfalls are causing deficits. Never accept these claims without documentation. Use the revenue and expenditure annualization technique to make your own assessment of the jurisdiction's health. If you confirm a shortfall is likely, you can question management's proposed solutions and use your knowledge of the budget and reserve funds to propose alternatives.

Other Sources of Information

Budget Analyses and Other Reports

In some jurisdictions, the staff of the legislative branch of the government prepare an independent analysis of the annual budgets recommended by the jurisdiction's chief executive. These staff analyses can offer useful historical information and independent analyses of current fiscal year revenue and expenditure trends. Additional analyses may be available from business, taxpayer, and public-interest organizations.

Finally, don't overlook newspapers and magazines as valuable sources of information on budget deliberations and other aspects of the jurisdiction's financial outlook.

AFSCME Department of Research and Collective Bargaining Services

Additional information on conducting budget analyses and answers to questions may be obtained, through your council, from the AFSCME Research Department and Collective Bargaining Services.

APPENDIX I

A BUDGET ANALYSIS CHECKLIST

When analyzing a jurisdiction's budget you should be alert for:

Revenues

(1) questionable projections in individual revenues for the upcoming fiscal year;

(2) the failure to collect a high enough proportion of property or other taxes because of abatements, exemptions, or lack of enforcement;

(3) user fees that are not covering the total cost of the services provided;

(4) general fund surpluses which should be carried over as revenue available for the next year;

(5) surpluses that have accumulated in self-sufficient or separate funds that should be included in or transferred to the general fund; and,

(6) the possibility of additional revenue from interest on investments.

Expenditures

(1) questionable projections in expenditure items for the upcoming fiscal year;

(2) monies appropriated in the current fiscal year that are unlikely to be spent;

(3) overestimates of wage costs because of turnover and attrition savings;

(4) contingency funds;

(5) capital improvements or purchases paid for out of current fiscal year revenues, rather than through longer-term financing;

(6) unexplained professional services or consulting expenses, especially as related to the contracting out of public services; and,

(7) transfers from the general fund to funds that should be self-sufficient.

The Need to Question Priorities

While an analysis of revenues and expenditures frequently uncovers financial flexibility, a critical review of management's spending priorities may also be necessary.

APPENDIX II

THE BUDGET PROCESS

The following phases of the budget cycle are usually crucial as "points of access" for presenting the union's priorities:

Seven to nine months before the new fiscal year

The jurisdiction's chief executive (mayor, county executive, or governor) releases projections of revenues and expenditures for the upcoming fiscal year. At this point, the union can make general recommendations concerning wage increases, staffing levels, and types of public services delivered.

Six months before the new fiscal year

Departments submit their "wish lists" to the jurisdiction's budget official. The union should try to present its priority list to the budget official and staff responsible for the relevant parts of the budget.

Four months before the new fiscal year

The chief executive finalizes and approves the executive budget and accompanying budget message. Budget briefings can be requested as a means of exchanging opinions between the executive and the union.

Three months before the new fiscal year

The executive budget is being debated by the legislative branch (city council, county council, or state legislature) and public hearings are scheduled. Legislative members should be contacted and made aware of the union's position. Testimony for public hearings should be carefully prepared so that it is clear which issues are being supported and which opposed. The union should lobby sympathetic members of the legislative body to introduce amendments that prevent budget cuts or additional funding.

These are the general steps followed by most jurisdictions. Some jurisdictions may offer additional opportunities for union input.

APPENDIX III

DEFINITIONS OF FUNDS

The ***General Fund*** (sometimes called the "Current Fund") is a jurisdiction's main operating fund. This fund accounts for resources devoted to the general purpose and general services of the jurisdiction. These include general administration, general services, supporting services, and general operation and maintenance of facilities. The general fund usually accounts for all financial resources except those required to be accounted for in another fund.

Generally, local unions are most interested in the general fund, because it is out of that fund that most services are offered and salaries are paid. However, you need to be aware of the existence of other types of funds and their purposes. There will be times that an analysis should include these funds, especially when bargaining unit members are employed outside of the general fund, or when reserves or balance in other fund may be used to fund union demands.

Special Revenue Funds are used to account for the proceeds of specific revenue sources that are legally restricted to expenditures for specific purposes.

Capital Projects Funds account for financial resources to be used for the acquisition or construction of major capital facilities (land, buildings, or major equipment).

Debt Service Funds account for the payment of interest and principal on long-term debt.

Special Assessment Funds account for special assessments levied to finance public improvements or services deemed to benefit the properties against which the assessments are levied.

Enterprise Funds account for operations that are financed and operated in a manner similar to private business enterprises, where the costs of providing goods are financed in the form of user charges. Examples are water, gas, and electric utilities, swimming pools, airports, parking garages, and transit systems.

Internal Service Funds account for the provision of services to other funds, departments of the same unit, or other governmental units on a cost-reimbursement basis. Examples are funds used to account for printing, computer services, and vehicle maintenance.

Trust and Agency Funds or ***Fiduciary Funds*** accounts for assets held in trust or agency by the governmental unit for an individual, private organization, or other governmental unit. The jurisdiction does not have absolute title to the assets to which their use is restricted.