



Audit, Finance and Enterprise Committee Report

Date: April 2, 2015
To: Audit, Finance and Enterprise Committee
Through: Michael Kennington, Chief Financial Officer
From: Candace Cannistraro, Management and Budget Director
Subject: Overview of Annual Budget Process and Legal Requirements

Strategic Initiatives



Purpose: This report provides an overview of the process for the adoption and management of the City's annual budget as well as an overview of the legal requirements that impact the process.

THE BUDGET PROCESS

The Budget Cycle

Creating a budget is a process that requires planning and review. Figure 1 outlines the steps in the budget cycle starting with forecasting revenues and expenditures.



Figure 1: The Budget Cycle

The steps in the Budget Cycle in more detail:

1. Forecast Revenues and Expenditures

Annually, prior to the start of the budget process, the Office of Management and Budget (OMB) prepares a preliminary multi-year forecast of revenues and expenditures. The forecast process is the City’s best effort to understand and predict its financial future. Historical trends, current events, and predictions of future economic indicators are incorporated into the forecast. An accurate and comprehensive forecast process helps prepare for potential adverse events and circumstances. It provides a framework that assists Mesa’s elected officials and executive team in making important decisions about the direction of the City.

Analyzing historical financial data allows for the identification of seasonal patterns. The data provides context to the City’s current financial state. Historical data helps the City anticipate when, and to what extent, to expect different revenues and expenditures during the course of the fiscal year.

Once identified, these patterns are considered in relation to current events on the national, state, and local levels. Considering these events and their effects on the City’s

financial situation is another important part of forecasting future conditions. Federal fiscal policy, state budget decisions, and local housing permit levels are all examples of factors that impact the City's budget.

In addition, data predicting future economic trends is incorporated into the City's forecast model. Through a partnership with the University of Arizona's Eller College of Management, the City analyzes a variety of economic factors predicted for the next thirty years. These long-term factors, along with an understanding of current and past conditions, provide a framework for the forecast.

While preparing a forecast generally follows an annual schedule, it is also a continuous process. Forecasting models and the information on which they are based are constantly updated in an effort to provide the best predictions possible. City staff work to supply the Council and City Manager with accurate information from which decisions can be made.

2. City Council Reviews Strategic Plan and Establishes Budget Priorities

An updated forecast is presented at a Strategic Planning Workshop held with the City Council, City Manager, and the City's Executive team. The purpose of the workshop is to review the City's Long-Term Strategic Plan, provide updates to Council on the status of the current fiscal year's initiatives, and receive direction from Council on priorities for the upcoming budget cycle.

3. Base Budget Guidelines Established

Based on the citywide forecasted resources available, departments are allocated a portion of those resources in order to fund their operations. Typically, departments are allocated an amount equal to their previous year's ongoing expenditures plus additional personnel costs that have been updated with expected salary, benefits and supplemental pay.

4. Departments Prepare Operational Plans

Departments develop annual operational plans that identify the planned work (action plan), and the personnel, materials, and capital items needed to conduct that work for one year. The operational plan identifies who will do what and with what resources. These plans identify a means to evaluate progress and achievement of desired outcomes.

5. Departments Submit Base Budget and Funding Requests

Departments allocate their base budget to core business processes based on the resources apportioned to their department each year. Departments submit to the City Manager, through the Office of Management and Budget (OMB), requests for additional resources if applicable. The requests may be for one-time or ongoing budget

adjustments. Based on available funding and Council priorities, the City Manager includes additional funding allocations.

6. OMB/City Manager Review Department Budgets and Performance Plans

The Office of Management and Budget (OMB) and the City Manager review the budget submissions to ensure that Council priorities are followed, legal regulations are adhered to and City functions are properly supported. Budget submissions are reviewed for alignment with available resources.

7. City Council Reviews Department Budgets and Significant Issues

OMB provides preliminary budget information to the City Council through a combination of reports and presentations. The City Council receives additional information from departments as needed. The City Council provides direction on issues and projects included in the upcoming budget.

8. City Manager Submits Budget to City Council

Based on feedback received from the City Council, the City Manager submits a balanced budget to the City Council for consideration.

9. City Council Establishes Tentative Budget

Per state statute, the City Council adopts a Tentative Budget, which sets a legal ceiling or maximum for the Final budget.

10. City Council Seeks Public Input

The City Council requests public input during one or more public hearings.

11. City Council Adopts Final Budget

Final feedback is incorporated into the budget and the City Council adopts a Final budget.

12. Departments Review Progress toward Achieving Plan Desired Outcomes

Departments review their progress toward achieving their plans' desired outcomes. They determine what assisted them in exceeding performance targets or what contributed to not achieving departmental goals. They decide on actions to build on success or correct steps in the process to meet goals in the future.

Budget Management

The adoption of the budget by the City Council sets the maximum expenditures that can be made during the fiscal year. The dollar amount is set based on the anticipated activity during the time period. Much of the activity not related to personal services is presented to the City Council for review and consideration before it is acted upon. Some examples are: construction contracts, purchase contracts, service contracts over a set amount, agreements to accept grant funds and intergovernmental agreements with other governmental entities.

Budget management is an on-going process and involves not only the review and oversight of the financial aspect of the budget but also of the progress toward the desired outcomes of the various programs.

Budget to Actual Financial Review

The Office of Management and Budget (OMB) and the Financial Services Department monitor budget to actual spending and provide reports to city management. Central staff works with department staff monthly to review spending patterns and ensure proper posting and reporting of transactions.

Target to Actual Performance Review

Departments track actual performance measure results against targeted results. OMB's Performance Excellence Team works with department staff to align measures with goals and objectives and to assist with proper reporting of data.

MesaStat Meetings

The City Manager meets with each department on a regular basis to review financial information, to review progress on achieving desired outcomes, and to receive a general status update.

Budget Amendments/Modifications

In order to achieve the desired outcomes, department directors have the authority to realign resources within their departments. Budget adjustments between departments or between funding sources must be presented to the Office of Management and Budget (OMB) for verification of budget capacity and the appropriateness of the funding source.

The annual budget includes contingency funding to provide spending authority for unexpected events or other unforeseen needs that arise during the course of the fiscal year. Examples include natural disasters, new unfunded mandates, or the receipt of

unanticipated grant funding. If unable to cover an unexpected cost within their department budget, directors may submit a request for contingency funding to OMB for review and processing. The City Manager's Office considers the request in context of the priorities and needs of the City as well as available funding.

Contingency funding is supported by unrestricted fund balance reserves. The needs of the City are balanced with the needs of maintaining adequate reserves.

New positions and additions to the fleet result in future financial obligations. Therefore, these requests are submitted to the City Manager's Office for review and consideration regardless of the department's ability to cover the current year's cost within their budget allocation.

BUDGET REQUIREMENTS AND LIMITATIONS

The City of Mesa is bound by the requirements of the Arizona Constitution, various state statutes, the City Charter, generally accepted accounting principles (GAAP), and City financial policies. Restrictions include limitations on the amount of annual expenditure appropriation, as well as limitations on actual expenditures. There are also requirements for the issuance, type and amount of debt; budget calendar dates; and the number and type of public notices that must be made as part of the budget process.

The Arizona Constitution requires the adoption of a balanced budget, which is "all-inclusive" (Title 42 Arizona Revised Statutes (ARS)). This means that budgeted revenues and other resources must be equal to budgeted expenditures and that no expenditure may be made without appropriation. Because of this, it is incumbent on the City to ensure that the budget includes sufficient appropriation and contingency for unanticipated revenues (e.g., unanticipated grant awards) that may become available during the fiscal year as well as unanticipated expenses.

The Arizona Constitution and state statutes also establish an expenditure limitation for all cities and towns. Unless the City Council and the voters of a city approve an expenditure limitation alternative, the State imposed limitation applies for the fiscal year in question. The State expenditure limitation is based on the City's budget as of FY 1979/80 adjusted for inflation and population. As a result of this regulation, even if the City were to have resources in excess of the expenditure limitation, they would not be able to appropriate or spend these monies. In November 2010, the voters of Mesa passed a Locally Controlled Alternative Expenditure Limitation, also known as the "Home Rule" Option. The Home Rule Option allows the City to determine its own expenditure limitation, within available revenues and other resources. The Home Rule Option remains in effect for the four fiscal years following its passage by the voters. In the case of Mesa's 2010 Home Rule option, this includes FY 2011/12 through FY 2014/15. In November 2014, the voters of Mesa passed a continuance of the Home Rule option which includes FY 2015/16 through 2018/19.

The amount of primary property tax that a county, city, town or community college district may levy is limited by the Arizona Constitution. Each taxing entity's limit was established in 1980, and that limit can increase by 2% each year, plus any new construction. As the City of Mesa does not levy a primary property tax, the City is not subject to the requirements for limiting primary property tax levies.

Secondary property taxes in Arizona may only be levied for voter-approved budget overrides, special districts, or to pay for bonded indebtedness. The City first instituted a secondary property tax levy for the repayment of bond debt associated with the 2008 bond election. The first receipts of secondary property tax occurred in FY 2009/10. Since then the levy has been updated based on the authorization of additional general obligation bonds by Mesa voters.

Financial Policies

Beyond the requirements set by the State of Arizona, the City of Mesa has also adopted a set of financial policies. These policies identify and outline the financial aspirations of the City of Mesa. They are intended to serve as guidelines for the City Council and City staff alike in the decision-making processes related to the City's financial operations and the development of financial forecasts, the annual budget, and capital improvement plans.

Below are highlights of the financial policies of the City of Mesa. The policies identify guidelines applicable to ten specific areas that support greater fiscal responsibility.

- Financial Policy 1 **The Annual Budget:** the adopted budget needs to be balanced, monitored and include performance measures. The City Manager may institute changes to the operating budget during the fiscal year as budget trends dictate.
- Financial Policy 2 **Fund Balances and Contingency Fund Targets:** the adopted budget will maintain an unrestricted fund balance of 8-10% per fiscal year in key funds.
- Financial Policy 3 **Fees and Charges:** the policies to provide a consistent, stable, fair and appropriate means to fund public services.
- Financial Policy 4 **Debt Issuance and Management:** the policies and guidelines to appropriately issue debt according to state and federal guidelines.
- Financial Policy 5 **Capital Improvement Program (CIP) and Asset Replacement:** the provision for a rolling five-year projection of the city's capital projects to identify future financial requirements as part of the overall financial forecast.
- Financial Policy 6 **Investments and Cash Equivalents:** the policies for the investment of City resources to balance risk and return while preserving sufficient liquidity.

- Financial Policy 7 **Financial Reporting:** the policies to report the City's finances in a way to satisfy both the management and transparency needs of government.
- Financial Policy 8 **Long Range Planning and Forecasting:** the policies to accurately assess future finances to allow resource allocation adjustments as necessary.
- Financial Policy 9 **Risk Management:** the policies designed to protect against losses that would affect the ability to provide ongoing services and reduce risk overall.
- Financial Policy 10 **Amending and Updating Financial Policies:** these policies are subject to regular review and will be revised as needed.

Summary of Major Steps and Legal Deadlines in the FY 2014/15 Budget Process

Action Required	City Charter Deadlines	Arizona State Statute Deadlines	Date Completed
Operational Budget Process			
City Council adopts tentative budget	None	On or before the third Monday in July	May 5, 2014
Publish summary of tentatively adopted budget and notice of public hearing which must precede final adoption.	None	Once a week for two consecutive weeks following tentative adoption and before final adoption.	May 10, 2014 May 17, 2014
City Council holds public hearing and adopts final budget	None	On or before the 14th day before a tax levy is adopted	May 19, 2014
City Council adopts secondary property tax levy.	None	On or before the 3rd Monday in August.	June 2, 2014
Capital Improvement Program Process			
Publish summary of the Five Year Capital Improvement Program and notice of public hearing which must precede final adoption	One publication at least two weeks prior to public hearing.	None	May 3, 2014
City Council holds public hearing and adopts the Five Year Capital Improvement Program	Not less than 2 weeks after the publication	None	May 19, 2014
Utility Rate Process			
City Council adopts a Notice of Intention to adjust utility rates and sets a public hearing	None	At a regular Council Meeting at least 30 days prior to public hearing	April 7, 2014
Utility Rate Adjustment written report submitted to the City Clerk's office	None	30 days prior to the public hearing	April 17, 2014
Publish Notice of Intention and notice of public hearing for utility rate adjustments	None	One publication at least 20 days before the public hearing	April 12, 2014
City Council introduces utility rate adjustment ordinances	Ordinance is required for all utility rate adjustments and must be introduced at a regular Council Meeting	Only water and wastewater are included in state statute and may use either an ordinance or resolution	May 5, 2014
City Council holds public hearing on utility rate adjustments	At least 6 days after the publication	Not less than 30 days after the adoption of the notice of intent	May 19, 2014
City Council adopts utility rate adjustment ordinances and resolutions	After the public hearing	After the public hearing	May 19, 2014
Utility rate adjustments become effective	30 days after adoption of ordinance or any later date specified in the ordinance	30 days after adoption of ordinance	July 1, 2014

Figure 2: Summary of Major Steps and Deadlines in Budget Process