

# **FTMS**

## **Financial Trend Monitoring System**

***For Fiscal Year Ending June 30, 2015***



## **Town of Payson, Arizona**

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Prepared by the Financial Services Department

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# **Town of Payson**

## **Evaluating Financial Condition**

### **Introduction**

This handbook provides the Town of Payson with a method for monitoring the Town's financial condition. You can use this handbook to:

- Better understand the Town's financial condition--the forces that affect it and the obstacles associated with measuring it.
- Identify existing and emerging financial problems.
- Develop actions to remedy these problems.

The evaluation of financial condition is accomplished through the Financial Trend Monitoring System (FTMS), which identifies and organizes the factors that affect financial condition so that they can be measured and analyzed.

The handbook suggests that the completed analysis of financial condition be compiled and presented in a report to be made available to the Town's policy makers as well as citizens, committees, employees, bond rating agencies, and others interested in the Town's financial health. It also suggests that each year the indicators should be updated so that the monitoring of financial condition is ongoing. Automating the FTMS with spreadsheet software makes this task much easier

#### **What is financial condition?**

The term financial condition has many meanings. In a narrow accounting sense, it can refer to a government's ability to generate enough cash over thirty or sixty days to pay its bills. This definition of financial condition can be called cash solvency. Financial condition can also refer to a government's ability to generate enough revenues over its normal budgetary period to meet its expenditures and not incur deficits. This is often referred to as budgetary solvency. In a broader sense, financial condition can refer to a government's ability in the long run to pay all the costs of doing business, including expenditures that normally appear in each annual budget, as well as those that will appear only in the years in which they must be paid. Pension costs and payments for accrued employee leave are examples of the second type of expenditures. Although these costs will eventually appear in a budget or otherwise make them known, a short-run financial analysis (one to five years) may not reveal them. This long-run balance between revenues and costs warrants separate attention and is referred to here as long-run solvency.

Finally, financial condition can refer to a government's ability to provide services at the level and quality that are required for the health, safety, and welfare of the community and that its citizens desire. This will be referred to as service-level solvency. A government lacking service-level solvency might in all other respects be in sound financial condition, but be unable to support police and fire

services at an adequate level, and suffer cash, budgetary or long-run solvency problems if it tried to provide adequate services.

Because few local governments face such severe and immediate financial problems that they are likely to default on loans or fail to meet current obligations, this handbook uses a broad definition of financial condition that encompasses all four types of solvency. The handbook is designed for any local government that finds itself in one or more of the following situations:

- The government is under the strain of a few identifiable financial problems and wishes to gain a broader perspective on these problems.
- The government senses that financial problems are emerging but is having difficulty pinpointing their origin or developing a strategy for coping with them.
- The government is in good financial condition but needs a systematic way to monitor changes and anticipate future problems.

In summary, financial condition can be broadly defined as a local government's ability to (1) maintain existing service levels, (2) withstand local and regional economic disruptions, and (3) meet the demands of natural growth, decline, and change.

### **Maintaining existing service levels**

Local governments in sound financial condition can afford to continue paying for the services they now provide. In addition to basic services funded by local revenues, this would include the ability to maintain programs that are currently funded by external sources such as federal grants. Current service levels also include the maintenance of capital facilities, such as streets and buildings, in a manner that protects the initial investment and keeps the facilities in usable condition. Finally, continued provision of services requires funds for future liabilities that may currently be undaunted, such as pension, employee leave, debt, and lease-purchase commitments.

### **Withstanding economic disruption**

Sound financial condition also implies the ability to withstand local, regional, and national economic disruption. An example would be the end of the Cold War, with the related decrease in defense spending by the federal government, which affects the industries, employment patterns, and tax base in many local economies. The recession of the early 1990's that saw many companies go out of business, raising unemployment rates, contributing to tax delinquencies, and reducing the investment income of local governments by lowering interest rates, is another example of an economic disruption.

### **Meeting demands of growth and demand**

Even stability can create financial pressure: a population that remains stable but that changes composition, becoming poorer or older, for example, can have an impact on a local government's financial health. An older population can require

new government programs, with expensive start-up costs; older taxpayers may be less willing to support a tax increase if their income is limited to pensions and Social Security. A growth in the number of younger residents, on the other hand, can lead to demands for higher expenditures in areas such as education and recreation.

The basic questions that officials must address are Can the local government continue to pay for what it is now doing? Are there reserves or other vehicles for financing emergencies? Is there enough financial flexibility to allow the government to adjust to change? If a government can meet these challenges, it is in sound financial condition. If it cannot, it is probably experiencing or can anticipate problems.

### **Obstacles to measuring financial condition**

Is your local government in good financial condition? To answer this, you first need to be able to measure financial condition. If we had chosen a definition of financial condition that considered only cash and budgetary solvency, we would narrow the range of issues, but the conclusions about your local government's long run financial condition would be incomplete. Although including long run and service-level solvency helps us to achieve a more accurate picture of overall financial condition, it also creates a number of problems. These problems are related to (1) the nature of a public entity, (2) the state of municipal financial analysis, and (3) the character of municipal accounting practice.

### **The nature of a public entity**

Private firms can easily determine whether they are financially sound. The basic test is dollar profit, which roughly translates into efficiency. For the public entity, profit is not a motive and efficiency is only one of many objectives. A public entity's objectives include health and welfare," "political satisfaction," and other qualities that can be measured only subjectively. We must recognize that including service-level solvency in our definition of financial condition renders our measurements less exact.

### **Municipal financial analysis**

Public finance practitioners and researchers are primarily concerned with cash and budgetary solvency and have given little attention to long run and service-level solvency. The exception has been the investment community, but it has concerned itself more specifically with debt-carrying capacity. Although many analysts have broadened their concerns during the last decade, the Financial Trend Monitoring System used in this handbook remains the most comprehensive, practical way to evaluate the financial condition of an individual local government.

Another concern for conducting municipal financial analysis is the lack of normative standards for the financial characteristics of a local government. What, for example, is a healthy per capita expenditure rate, level of reserves, or



amount of debt? The credit-rating industry has many benchmarks for evaluating local government, but these benchmarks have to be considered in combination with more subjective criteria, such as the diversity of the government's tax base or its proximity to regional markets. Some attempts have been made to develop standards by averaging data for various local governments or otherwise comparing one community to another. But communities differ widely, in characteristics such as size, geography, demographics, revenue structure, and responsibility or authority to provide services. Because of the uniqueness of each jurisdiction and the lack of sufficient objective data, these interjurisdictional comparisons have not gained authoritative acceptance.

### **Municipal accounting practices**

Local government accounting systems have long been based on "audibility" and on giving high visibility to the dollars passing through government accounts. Accounting systems typically stress legal compliance and tracking the path of each dollar in and out of the local treasury. Thus, fund accounting has been regarded as more important than program cost accounting and the measurement of long-term financial health.

As a result, most local governments produce budgets showing revenues and expenditures, and most states require municipalities to balance their budgets in one fashion or another. Most governments also produce year-end financial statements that include balance sheets and operating statements. These reports show the flow of dollars in and out of the government during a particular year, but they do not provide the information needed to evaluate long-run financial condition. Generally, financial statements and budgets do not show in detail the costs of each service provided, nor do they show on an annual basis all costs that are being postponed to the future. Financial statements and budgets do not necessarily show the accumulation of unfunded pension liabilities or employees benefit liabilities. They do not show the reductions in purchasing power caused by inflation or the decreasing flexibility in the use of funds that results from increasing state and federal mandates. Financial statements and budgets do not show the erosion of streets, buildings, and other fixed assets. Nor do they relate economic and demographic change to changes in revenue and expenditure rates. Finally, these reports are prepared only for a one-year period and do not show in a multiyear perspective the emergence of favorable or unfavorable conditions.

### **What is the Financial Trend Monitoring System?**

Evaluating a jurisdiction's financial condition is a complex process that involves sorting through a number of factors. The factors include the national economy, actions of the state and local government, population level and composition of the community, the local business climate, and the internal finances of the local government. Not only are there a large number of factors to evaluate, many of them are also difficult to isolate and quantify.

Relations between the factors add to the complexity. Some are more important than others are, but often this cannot be determined until all the factors have been assembled. For example, absolute revenues may be higher than ever and may be exceeding expenditures by a comfortable margin. However, if local officials do not consider that inflation for the last ten years has cut purchasing power by well over half, and that street maintenance has been deferred as a result, they may be lulled into thinking that the community's financial condition remains as healthy as ever.

In the face of this complexity, the lack of complete accounting data, and the lack of accepted theories and normative standards, one might ask, is it possible to rationalize the evaluation of financial condition?

The answer is yes. Regardless of the obstacles, local officials can still collect a great deal of useful information, even if this information is only part of what there is to know. Although medical science has learned little about the human body compared to what remains to be learned, this does not prevent doctors from using what they do know to diagnose and prevent disease.

The Financial Trend Monitoring System (FTMS) identifies the factors that affect financial condition and rationally arranges them to facilitate analysis and measurement. It is a management tool that pulls together information from a government's budgetary and financial reports. Combines it with economic and demographic data, and creates a series of financial indicators that, when plotted over time, can be used to monitor changes in financial condition and alert the government to future problems. The indicators deal with thirty-six separate issues, including external revenues, fund balances, liquidity, unfunded liabilities, and business activity.

The trend monitoring system is designed to help a local government make sense of the many factors that affect financial condition and develop quantifiable indicators. It will also help the local government use these indicators to:

- Gain a better understanding of the government's financial condition
- Identify emerging problems before they reach serious proportions
- Identify existing problems of which local officials may be unaware
- Present a straightforward picture of the government's financial strengths and weaknesses to elected officials, citizens, credit-rating firms, and other groups with a need to know
- Introduce long-range considerations into the annual budgeting process
- Provide a starting point for elected officials in setting financial policies.

The particular advantages of this approach are that the trend monitoring system:

- Offers a way to quantify a significant amount of information
- Relies on data that already exist in a government's records or are otherwise reasonably available



- Is designated for "in-house" use and does not require complicated mathematical techniques or computer procedures (although a personal computer can be used to perform calculations and generate graphs)
- Places the events of a single year into a longer perspective and permits local officials to follow changes over time
- Incorporates benchmarks normally used by credit-rating agencies.

The system cannot explain specifically why a problem is occurring, nor does it provide a single number or index to measure financial health. What it does provide are flags for identifying problems, clues about their causes, and time to take anticipatory action.

Analyzing trends in an orderly manner may help clarify what policies should be recommended for implementation to reverse an adverse trend. Caution should be exercised to make sure you don't adopt a new policy that then leads to unintended consequences. Systematic analysis will permit the manager or administrator to begin to understand what is necessary to effect a needed change.

# **FACTOR 1**

## **Revenue Indicators**

## **Factor 1**

### **Revenue Indicators**

Revenues determine the capacity of a local government to provide service. Important issues to consider in revenue analysis are growth, flexibility, dependability, diversity, administration, and elasticity. (Definition: an elastic revenue can be defined as one that directly responds to changes in inflation and the economic base; i.e., as inflation and the economic base increase, elastic revenues increase in roughly the same or greater proportion, whereas, if inflation declines or the economic base shrinks, elastic revenues drop in proportion.)

Under ideal conditions, revenues would grow at a rate equal to or greater than the combined effects of inflation and expenditures. They would be sufficiently flexible (free from spending restrictions) to allow adjustments to changing conditions. They would be balanced between elastic and inelastic in relation to inflation and the economic base; that is, some would grow with inflation and the economic base and others would remain relatively constant.

Analyzing revenue structure will help to identify the following types of problems:

- Deterioration of revenue base
- Practices or policies that may adversely affect revenue yields
- Poor revenue-estimating practices
- Inefficiency in the collections and administration of revenues
- Over dependence on obsolete or intergovernmental revenue sources
- User fees that are not covering the cost of services
- Changes in the tax burden on various segments of the population

# **Town of Payson**

## **Evaluating Financial Condition**

### **Indicator 1 Analysis**

#### **Revenues per Capita**

Examining per capita revenues shows changes in revenues relative to changes in population size. As population increases, it might be expected that revenues (and the need for services) would increase proportionately, and therefore that the level of per capita revenues would remain constant in real terms. If per capita revenues are decreasing, the government may be unable to maintain existing service levels unless it finds new revenue sources or ways to save money. This reasoning assumes that the cost of services is directly related to population size.

**Warning trend:** Decreasing net-operating revenues per capita.

A key part of this indicator is that it adjusts for inflation (i.e., current dollars are converted to “constant dollars”) and then calculates the revenues per capita. This indicator also introduces the concept of “net operating revenues,” a combination of revenues from several different funds to determine which revenues are available for general government operations.

#### **Suggestions for analysis:**

If the warning trend is observed, try to identify the causes (Why is it happening?), assess the significance (Is it important?), and devise action strategies (What can be done?). The following are starting points for this analysis.

#### **If revenues are decreasing, the following issues should be considered:**

- Is the community experiencing general economic decline? Is the decline a temporary or continuing trend? See indicator 28, Community Needs and Resources.
- Is the decline related to changes in population, such as a decrease in population groups that historically generated the largest portions of revenue? See indicators 28-31.
- Is the decline due to problems inherent in the revenue structure, such as over-dependence on elastic revenues during a period of inflation? See indicator 4, Elastic Tax Revenues
- Are state or local restrictions (such as tax limitations) preventing the community from instituting the appropriate taxes, fees, or charges?
- Can revenues be increased by any of the following measures?
  1. Revising revenue collection procedures,
  2. Reducing tax delinquencies,
  3. Instituting or increasing service charges, fines and penalties, license and permit fees,
  4. Instituting or increasing charges for use of facilities, equipment or personnel,
  5. Updating property assessments,

6. Establishing special assessment districts,
7. Investing a greater proportion of idle cash,
8. Selling surplus property or equipment,
9. Securing special-purpose or grant funding from public or private agencies.

**If revenues per capita are increasing, the following issues should be considered:**

- Is it reasonable to assume that the increased level of revenues will continue? If these revenues are being used for new programs that will require continued funding, what plans does the government have for the time when these revenues are no longer available?
- Is the increase in revenues per capita a sign that costs will increase in future years-as would be the case, for example, if the new revenues were derived from an increase in building construction? Will the additional revenues cover the additional costs? If not, is there a plan for funding these costs?
- Is the increase in revenues per capita due to a decline in population rather than to an increase in revenues? If so, will the decline in population eventually create a decline in revenues? Is the decline in population accompanied by an increase in the number of smaller households, which can result in higher service costs to the jurisdiction? See indicators 28, Population, and 29, Population Density.
- Do the increased revenues per capita represent an increase in the tax burden measured by comparing changes in revenues per capita to changes in personal income, business income, or other measures of community wealth? If the tax burden is increasing, will residents and business owners be less able to pay? Might they be tempted to relocate to a jurisdiction that has a lower tax burden?

**Suggestions for further analysis**

When analyzing revenues, officials should develop trend lines for both (1) total revenues per capita and (2) any individual revenue source that makes up 5 percent or more of total revenues, such as property taxes, business licenses, transient occupancy taxes, fines and user fees. Within the typical local government's accounting records, these revenues may be segregated into their own fund or grouped within a larger fund such as a general or a special revenue fund. Accordingly, each fund should be broken down into its component revenues so that the revenues can be examined individually. If the government organizes its revenues into specific groups, such as restricted, unrestricted, or self-supporting, then these groups can also be a focus of additional analysis.

You may also want to consider whether the revenue structure has changed over the past five years. This can tell you if some revenue sources are growing faster than others, if the revenue burden is shifting from one segment of the population to another (e.g., from property owners to utility consumers), and if the growth in the rates of some revenues has not been keeping pace with that of others. Any such changes in revenue structure should probably receive attention from policy makers. To examine changes in revenue structure, construct a table listing all

major revenues (e.g., those over 5 percent of total operating revenues) for each of the years you want to examine.

Can revenues be increased by? :

- Revising revenue collection procedures
- Reducing tax delinquencies
- Instituting or increasing service charges, etc.
- Instituting or increasing user fees for facilities and equipment
- Updating property assessments
- Establishing special assessment districts
- Investing a greater proportion of idle cash
- Selling surplus property or equipment
- Securing special-purpose grant funding

Is it reasonable to assume that the increased level of revenues will continue? Is an increase in revenues per capita a sign that costs will increase in future years--as would be the case, for example if the new revenues were derived from an increase in building construction?

### **Suggestions for policy statements**

Policy statements can be developed to suggest procedures for budgeting and analyzing revenues. The following policy statements can help local officials relate this indicator to their financial decision making.

- A diversified and stable revenue system will be maintained to shelter the government from short-run fluctuations in any one revenue source.
- Revenues for the next \_\_\_\_ years will be projected and updated annually. Each existing and potential revenue source will be re-examined annually.



## Town of Payson Evaluating Financial Condition

### INDICATOR 1

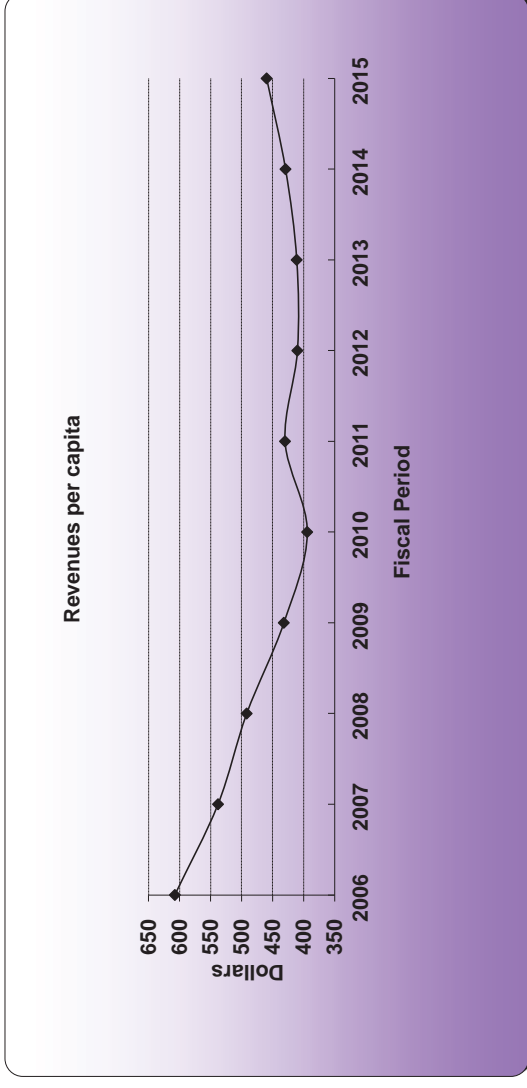
#### Revenues per Capita

##### Warning Trend:

Decreasing net operating revenues per capita  
(constant dollars)

##### Formula:

$$\frac{\text{Net operating revenues* (constant dollars)}}{\text{Population}}$$



	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
<b>Fiscal year:</b>										
Net operating revenues*	19,023,668	18,772,135	18,255,637	16,100,439	14,848,715	14,851,694	14,398,635	14,608,304	15,592,416	17,058,036
Consumer price index	202.9	208.4	218.8	215.7	218.0	225.7	229.5	233.5	238.3	238.6
Net operating revenues* (constant dollars)	9,375,884	9,007,742	8,343,527	7,464,516	6,812,431	6,579,640	6,274,517	6,256,233	6,543,188	7,148,080
Current population	15,430	16,742	16,965	17,281	17,281	15,301	15,301	15,215	15,245	15,551
<b>Net operating revenues per capita (constant dollars)</b>	<b>607.64</b>	<b>538.03</b>	<b>491.81</b>	<b>431.95</b>	<b>394.22</b>	<b>430.01</b>	<b>410.07</b>	<b>411.19</b>	<b>429.20</b>	<b>459.65</b>

\* Net operating revenues include revenues from all Governmental Funds except Capital Project Funds & LE Property Purchase Program (Fund 217)

##### Description:

Examining per capita revenues shows changes in revenues relative to changes in population size and rate of inflation. As population increases, it might be expected that revenues and the need for services would increase proportionately, and therefore that level of per capita revenues would remain at least constant in real terms. If per capita revenues are decreasing, the government may be unable to maintain existing service levels unless it finds new revenue sources or ways to save money. This reasoning assumes that the cost of services is directly related to population size.

# **Town of Payson**

## **Evaluating Financial Condition**

### **Indicator 2 Analysis**

#### **Restricted Revenues**

**Warning trend:** Increasing amount of restricted operating revenues as a percentage of net operating revenues.

#### **Suggestions for analysis:**

If the warning trend is observed, try to identify the causes (Why is it happening?), assess the significance (Is it important?), and devise action strategies (What can be done?). The following are starting points for this analysis.

- Is the trend due to a decrease in unrestricted revenues? If so, see indicator 1, Revenues per Capita.
- If restricted revenues are supporting new programs or a higher level of service, will the revenues continue to be available, or will the local government have to assume the responsibility for the programs or services in the future?
- Are unrestricted sources subsidizing restricted revenue programs?
- Is the local government using a portion of the restricted revenues to support central accounting, personnel, and other overhead services?
- Can revenue restrictions be removed by local choice, such as a charter revision or council policy? If not, can the local government join with other jurisdictions to persuade federal, state, or other authorities to remove the restrictions?

#### **Suggestions for further analysis:**

You may want to specify the services supported by the restricted revenues, which would tell you where the government is vulnerable to changes in the restricted revenues, you could construct a chart containing the following criteria:

*Restricted revenue* - List each of the restricted revenues and identify the service or expense area to which it contributes, including any overhead activities such as accounting or personnel.

*Service it funds or contributes to-*

*Is service essential? (Rate 1-5)* - Assess how essential this service is to local government and its citizens. Rate the service from 1 (very essential) to 5 (not very essential).

*Other possible revenue sources* - List other revenue sources that could fund the service if the restricted revenue source were withdrawn.

*Will Revenue Continue? (Rate 1-5)* - Rate the likelihood that the revenue source will continue: Is legislation proposed or pending? Are "public Interest" or "industry" organizations offering vocal support for, or opposition to, the revenue? Rate the likelihood from 1 (very likely) to 5 (not very likely).

**Suggestions for policy statements:**

There are no benchmarks for setting the amount of restricted revenues desirable in a budget; you will need to consider the above set of criteria and decide when the level of restricted revenues--and their areas of use--appears to be threatening your government's financial health in the short or longer term.

## Town of Payson Evaluating Financial Condition

### INDICATOR 2

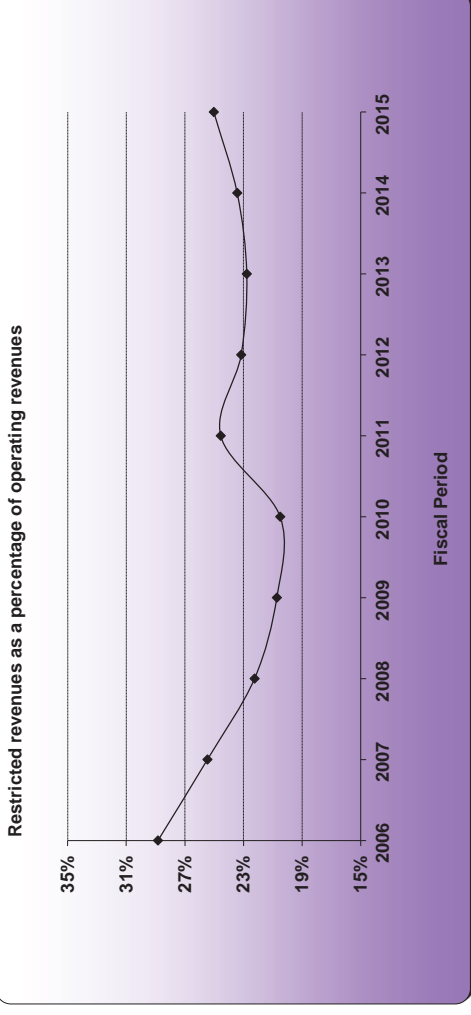
#### Restricted Revenues

##### Warning Trend:

Increasing amount of restricted operating revenues as a percentage of net operating revenues.

##### Formula:

$$\frac{\text{Restricted operating revenues}}{\text{Net operating revenues}^*}$$



Fiscal year:	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Net operating revenues*	19,023,668	18,772,135	18,255,637	16,100,439	14,848,715	14,851,694	14,398,635	14,608,304	15,592,416	17,058,036
Restricted operating revenues	5,486,088	4,779,055	4,059,894	3,335,556	3,042,190	3,646,072	3,333,875	3,326,438	3,652,496	4,268,567
Restricted operating revenues as a % of net operating revenues	28.84%	25.46%	22.24%	20.72%	20.49%	24.55%	23.15%	22.77%	23.42%	25.02%

\* Net operating revenues include revenues from all Governmental Funds except Capital Project Funds & LE Property Purchase Program (Fund 217)

##### Description:

A restricted revenue is legally earmarked for a specific use, as may be required by state law, bond covenants, or grant requirements. For example, many states require that gas tax revenues be used only for street maintenance or construction.

From one perspective, it would seem that many of these restrictions, especially those relating to outside funding should not affect a local government's financial health. The government has the option of not accepting the revenue and not providing the service. This option, however, is not always easy to exercise: governments develop economic and political dependencies on these revenues and on the programs they support. Moreover, many governments finance their own essential services with intergovernmental revenues, which makes it doubly hard to cut them out.

As the percentage of restricted revenues increases, a local government loses its ability to respond to changing conditions and to citizens' needs and demands. Increases in restricted revenues may also indicate over-dependence on external revenues and signal future inability to maintain service levels.

# **Town of Payson**

## **Evaluating Financial Condition**

### **Indicator 3 Analysis**

#### **Intergovernmental Revenues**

Intergovernmental revenues (revenues received from another government entity) are important because an over-dependence on such revenues can be harmful. The federal and state governments have struggled with their own budgetary problems in the last decade, and frequently they have withdrawn or reduced payments to local governments as one of their cutback measures.

Local governments with budgets largely supported by intergovernmental revenues have been particularly harmed during this period, but almost all have shared the pain. The reduction of intergovernmental funds leaves the municipal government with the dilemma of cutting programs or funding them from general fund revenues.

Nevertheless, a municipality might want to maximize its use of intergovernmental revenues, consistent with its service priorities and financial condition. For example, a city might want to rely on intergovernmental revenues to finance a federally or state mandated service or to fund a one-time capital project. The primary concern in analyzing intergovernmental revenues is to know and monitor the local government's vulnerability to reductions of such revenues, and to determine whether it is controlling its use of the external revenue - or whether these revenues are controlling local policies.

***Warning trend:*** Increasing amount of intergovernmental operating revenues as a percentage of gross operating revenues.

#### **Suggestions for analysis:**

If the warning trend is observed, try to identify the causes (Why is it happening?), assess the significance (Is it important?), and devise action strategies (What can be done?). The following are starting points for this analysis.

- Does your local government depend on intergovernmental revenues to fund ongoing, basic services? Do you have contingency plans in case the revenues are significantly reduced or discontinued?
- Have fixed-term grants for special programs been accepted? Will the local government be able to continue the special programs when such grants end? What will be the political, social, and economic consequences if such programs are discontinued?
- Are matching funds for intergovernmental revenues increasing as a percentage of operating expenditures? What is the local government's dollar commitment in matching funds, additional reporting requirements, or unreimbursed overhead costs? Have all these costs been anticipated, budgeted, and recorded?

- Are intergovernmental revenues authorized by ongoing agreements, as in the sharing of sales tax by a state and city? Do the agreements suggest that the revenues will continue, and at what level?

### **Suggestions for further analysis:**

To demonstrate the role of intergovernmental revenues in your government's financial health, you might want to create tables, bar graphs, or pie charts showing the major sources and uses of such revenues and any expected changes in the revenues you receive.

### **Suggestions for policy statements:**

While it would be difficult to set definitive policy guidelines on levels or kinds of inter-governmental revenues, it is feasible to set guidelines on procedures to be followed-before grants and other revenues are accepted. The following policy statements can help local officials relate this indicator to their financial decision making.

- All potential grants shall be carefully examined for matching requirements (both dollar and level-of-effort matches). The funds necessary to match intergovernmental grants shall not exceed \_\_\_\_\_percent of net operating revenues.
- Intergovernmental revenues used for operating purposes shall not exceed \_\_\_\_\_ percent of net operating revenues.
- Intergovernmental assistance shall be used to finance only those capital improvements that are consistent with the capital improvement plan and local government priorities, and whose operating and maintenance costs have been included in operating budget forecasts.



## Town of Payson Evaluating Financial Condition

### INDICATOR 3

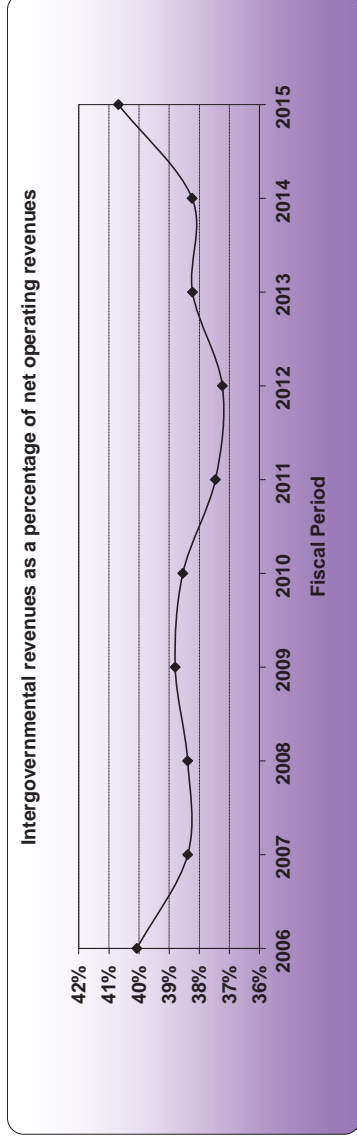
#### Intergovernmental Revenues

##### Warning Trend:

Increasing amount of intergovernmental operating revenues as a percentage of net operating revenues

##### Formula:

Intergovernmental operating revenues  
Net operating revenues\*



Fiscal year:	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Intergovernmental operating revenues	7,623,574	7,205,813	7,008,009	6,247,098	5,724,066	5,564,428	5,361,632	5,584,398	5,962,555	6,940,259
Net operating revenues*	19,023,668	18,772,135	18,255,637	16,100,439	14,848,715	14,851,694	14,398,635	14,608,304	15,592,416	17,058,036
Intergovernmental operating revenues as a percentage of net operating revenues	40.07%	38.39%	38.39%	38.80%	38.55%	37.47%	37.24%	38.23%	38.24%	40.69%

\* Net operating revenues include revenues from all Governmental Funds except Capital Project Funds & LE Property Purchase Program (Fund 217)

##### Description:

Intergovernmental revenues (revenues received from another governmental entity) are important because an over-dependence on such revenues can be harmful. The federal and state governments are struggling with their own budgetary problems, and frequently they have withdrawn or reduced payments to local governments as one of their cutback measures. Local governments with budgets largely supported by intergovernmental revenues have been particularly harmed during this period, but almost all local governments have shared the pain. The reduction of intergovernmental funds leaves the municipal government with the dilemma of cutting programs or funding them from general fund reserves.

Nevertheless, a municipality might want to maximize its use of intergovernmental revenues, consistent with its service priorities and financial condition. For example, a local government might want to rely on inter-governmental revenues to finance a federally or state mandated service or to fund a one-time capital project. The primary concern in analyzing intergovernmental revenues is to know and monitor the local government's vulnerability to reductions of such revenues, and to determine whether the local government is controlling its use of the external revenue--or whether these revenues are controlling local policies.

**Town of Payson**  
**Evaluating Financial Condition**  
**Indicator 4 Analysis**  
**Elastic Tax Revenues – Sales Tax**

*Sales taxes* should be considered separately from other revenues because most local governments rely heavily on it. A decline or a diminished growth rate in taxes can have a number of causes. First, it may reflect an overall decline in national, state, or local economic health; a decline in total number of households; or the movement of retail or industrial operations to other communities. Second, it may result from sales taxpayers moving their base of operations to other jurisdictions.

***Warning trend:*** *Decline in tax revenues.*

This is a “health of the community” indicator. Depending on state statutes and home rule charters, local governments overwhelmingly use property and/or sales taxes as a major source of general governmental revenues. If property taxes and/or sales taxes are a significantly large resource for your government, you need to be especially attuned to any changes in this indicator and to try to understand their causes.

**Suggestions for analysis:**

If the warning trend is observed, try to identify the causes (Why is it happening?), assess the significance (Is it important?), and devise action strategies (What can be done?). The following are starting points for this analysis.

- Do revenues rely heavily on inelastic tax sources? Can more elastic taxes, such as income or sales tax, be instituted or increased?
- If the local government has a sales tax, can it be extended to goods and services whose sales and prices respond more directly to changes in economic conditions?
- Has general economic decline or the out-migration of population or business created the decline in the elastic portion of the city's revenue base? Could redevelopment programs help?
- Do local restrictions on taxes (e.g., on the source taxed or the amount collected) limit the elasticity of the revenue structure?
- Can inelastic taxes and fees be made more elastic by more frequent property assessments; routine increases in user fees or similar local legislative and administrative modifications?

*For Sales Taxes –*

- Are the levels of sales taxes levied in the community driving consumers to shop in other communities?
- Are retail outlets relocating outside the community or are new retail stores outside the community attracting consumers?

- Are retail companies properly reporting all sales taxes collected from sales in the community?
- Can an economic development strategy be designed that will increase the taxable property values, number of retail businesses, or level of income in the community?

**Suggestions for policy statements:**

It would be difficult to set an exact target for the proportion of elastic to inelastic revenues, but the following policy statements can help local officials relate this indicator to their financial decision making.

- A balance will be sought in the revenue structure between the proportions of elastic and inelastic revenues. New sources of revenue will be sought to achieve the desirable balance.
- Each time a new revenue source or a change in the rate of an existing source is considered, the effect of this change on the balance of elastic and inelastic revenues will be thoroughly examined.

## Town of Payson Evaluating Financial Condition

### INDICATOR 4

#### Elastic Tax Revenues(Local Sales Tax)

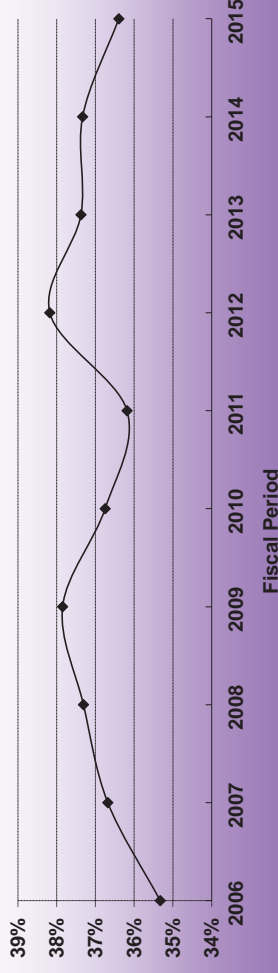
##### Warning Trend:

Decreasing amount of elastic operating revenues  
as a percentage of net operating revenues

##### Formula:

$$\frac{\text{Elastic operating revenues}^*}{\text{Net operating revenues}}$$

Elastic revenues as a percentage of net operating revenues



Fiscal year:	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Net operating revenues	19,023,668	18,772,135	18,255,637	16,100,439	14,848,715	14,851,694	14,398,635	14,608,304	15,592,416	17,058,036
Elastic operating revenues *	6,720,498	6,885,779	6,811,025	6,093,607	5,456,786	5,373,898	5,497,226	5,459,630	5,820,803	6,208,485
<b>Elastic operating revenues as a percentage of net operating revenues</b>	<b>35.33%</b>	<b>36.68%</b>	<b>37.31%</b>	<b>37.85%</b>	<b>36.75%</b>	<b>36.18%</b>	<b>38.18%</b>	<b>37.37%</b>	<b>37.33%</b>	<b>36.40%</b>

\* Elastic operating revenues are revenues from taxes that have a taxable base which are expected to reflect general economic changes in the short term.

##### Description:

The yields of elastic revenues are highly responsive to changes in the economic base and inflation. As the economic base expands or inflation goes up, elastic revenues rise in roughly proportional or greater amounts, and vice versa. A good example is sales tax revenue, which increases during good economic periods with the increase in retail business and declines during poor times, even though the tax rate remains the same. Yields from inelastic revenue sources, such as license fees or user charges, are relatively unresponsive to changes in economic conditions and require that government officials change fees or charges to obtain a change in revenue. The yields from these revenues lag behind economic growth and inflation because local legislative bodies are reluctant to increase them each year.

Property taxes can be elastic or inelastic depending upon the local government involved. If properties are reassessed frequently, then this source of revenue can be considered elastic. If a local government has a set tax rate and properties are not reassessed frequently, property tax revenues may be inelastic, especially in times of economic growth. If a local government levies a specific property tax dollar amount each year, property tax revenues are again inelastic, unless the policy making body has a policy of increasing taxes to track inflation on an annual basis.

A balance between elastic and inelastic revenues mitigates the effects of economic growth or decline. During inflation, it is desirable to have a high percentage of elastic revenues because inflation pushes up revenue yield, keeping pace with the higher prices the government must pay. If the percentage of elastic revenues declines during inflation the government becomes more vulnerable because inflation pushes up the price of services but not the yields of new revenues. The reverse is also true--during a recession, a high percentage of inelastic revenues is an advantage. This insulates the tax base to some degree from the reduced yield it can receive during a recession.

# **Town of Payson**

## **Evaluating Financial Condition**

### **Indicator 5 Analysis**

#### **One-Time Revenues**

**Warning trend:** Increasing use of one-time operating revenues as a percentage of net operating revenues.

#### **Suggestions for analysis:**

If the warning trend is observed, try to identify the causes (Why is it happening?), assess the significance (Is it important?), and devise action strategies (What can be done?). The following are starting points for this analysis.

- Are one-time revenues being used to fund ongoing expenditures as opposed to one-time expenditures? What is the probability that these revenues will cease to be available? Is there a contingency funding plan?
- If one-time revenues are being used for one-time expenditures, such as a new building, are there other, ongoing revenues to pay the operating expenses of the building and the programs it will house?
- Is the use of reserves or balances from prior years significantly reducing the government's ability to weather unexpected financial problems, such as natural disasters or a surge in inflation?
- Is the government experiencing operating deficits (i.e., an excess of current expenditures over current revenues)? See indicator 14, Operating Deficits.

#### **Suggestions for further analysis:**

If the trend analysis shows a high or increasing level of reliance on one-time revenues, you may want to pinpoint what the one-time revenues are, how they are being used, and what the prognosis is for their continued availability. A chart containing the following information would be helpful:

*Source of revenue* - List the sources of one-time revenues and identify the service or expense area to which they contribute.

*Service it funds or contributes to-*

*Is service one-time or continuing-* determine whether the service is a one-time expense (such as a special clean-up program) or an ongoing program?

*Is service essential (Rate 1-5)* - Note how essential this service is to the local government and its citizens. Rate the service from 1 (very essential) to 5 (not very essential).

*Other possible revenue sources* - List the revenues or decreases in expenditures that could replace the one-time revenue if necessary.

**Suggestions for policy statements:**

While it would be difficult to set target levels for one-time revenues in your revenue structure, policy statements can be developed for procedures in the use of one-time revenues. The following policy statements can help local officials relate this indicator to their financial decision-making.

- One-time revenues will be used only after an examination determines whether they are subsidizing an imbalance between operating revenues and expenditures, and then only if a long-term (three-to-five-year) forecast shows that the operating deficit will not continue.
- One-time revenues will be used only for one-time expenditures.



## Town of Payson Evaluating Financial Condition

### INDICATOR 5

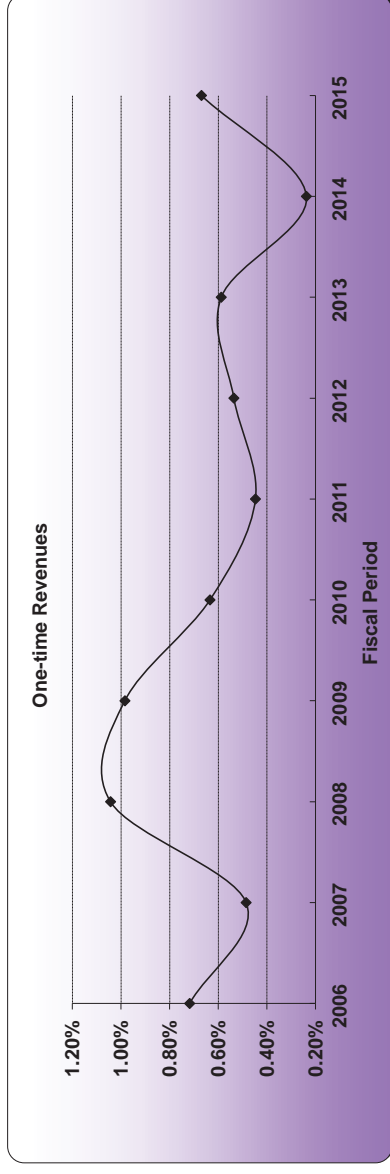
#### One-time Revenues

##### Warning Trend:

Increasing use of one-time operating revenues  
as a percentage of net operating revenues

##### Formula:

One-time operating revenues  
Net operating revenues\*



Fiscal year:	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Net operating revenues*	19,023,668	18,772,135	18,255,637	16,100,439	14,848,715	14,851,694	14,398,635	14,608,304	15,592,416	17,058,036
One-time operating revenues	136,568	91,197	190,414	158,429	94,187	66,455	77,186	85,903	37,115	114,170
One-time operating revenues as a percentage of net operating revenues	0.72%	0.49%	1.04%	0.98%	0.63%	0.45%	0.54%	0.59%	0.24%	0.67%

\* Net operating revenues include revenues from all Governmental Funds except Capital Project Funds & LE Property Purchase Program (Fund 217)

##### Description:

A one-time revenue is one that cannot reasonably be expected to continue, such as a single-purpose federal grant, an inter-fund transfer, or use of a reserve. Continual use of one-time revenues to balance the annual budget can indicate that the revenue base is not strong enough to support current service levels. It can also mean that the government is incurring operating deficits and would have little room to maneuver if there were a downturn in revenues (such as occurs during a regional or national recession or because of the sudden expenditures occasioned by a natural disaster). Use of one-time revenues increases the probability that the government will have to make large cutbacks if such revenues cease to become available, as may happen when the federal government reduces a major grant program or when reserves are depleted.

**Town of Payson**  
**Evaluating Financial Condition**  
**Indicator 6 –A&B Analysis**  
**Sales Tax and Property Tax Revenues**

*Property and sales taxes* should be considered separately from other revenues because most local governments rely heavily on them. A decline or a diminished growth rate in taxes can have a number of causes. First, it may reflect an overall decline in property values; a decline in national, state, or local economic health; a decline in total number of households; or the movement of retail or industrial operations to other communities. Second, it may result from default on property taxes by property owners or an inefficient assessment or appraisal process for property. Third, it may result from sales taxpayers moving their base of operations to other jurisdictions. Finally, a decline can be caused by deliberate default by property owners who realize that delinquency penalties are less than short-run interest rates and that nonpayment is thus an economical way to borrow money. Likewise, citizens who owe income taxes may deliberately delay payment.

This is a “health of the community” indicator. Depending on state statutes and home rule charters, local governments overwhelmingly use property and sales taxes as a major source of general governmental revenues. If property taxes and sales taxes are a significantly large resource for your government, you need to be especially attuned to any changes in this indicator and to try to understand their causes. Note, again, that this indicator calculates the trend of tax revenues over the years in constant dollars. When presenting this indicator, you should show it for each of the three types of taxes, if applicable, and also in both constant and current dollars to help display the impact of inflation on tax revenues.

For property taxes, whether they are increasing or decreasing, you could construct a table that shows property taxes by type (real vs. personal) and by class (residential, commercial, industrial) for the period you have chosen. The table should enable you to identify sectors in which change has occurred. To demonstrate the impact of changes, you could also compute the rate of change in property tax revenues (current year minus prior year; remainder divided by prior year) and graph these figures.

**Warning trend:** Decline in tax revenues (includes General and Debt) (Constant dollars)

**Suggestions for analysis:**

If the warning trend is observed, try to identify the causes (Why is it happening?), assess the significance (Is it important?), and devise action strategies (What can be done?). The following are starting points for this analysis.

- Have market values declined due to poor economic conditions? In which sectors -- residential, commercial, or industrial--has the decline occurred? Can an economic development strategy be designed that will increase taxable property values? See indicator 32, Property Value.
- Has the assessed value of properties or classes of properties dropped as a percentage of market value? If so, is the drop caused by an inefficient assessment system or by the fact that reassessments are not sufficiently frequent? Can assessed value be increased without putting an unreasonable burden on property owners?
- Is the percentage of nontaxable property increasing? Is this due to an increase in government ownership or other tax-exempt status or to an increase in tax incentives designed to attract or retain businesses? In the first case, can payments in lieu of taxes be instituted? In the second case, what are the projected long-term revenue impacts of the incentive policies?
- Are property tax delinquencies increasing? See indicator 7, Uncollected Property Taxes.

### **Suggestions for further analysis:**

Whether property tax revenues are increasing or decreasing, you may want to construct a table that shows property taxes by type (real vs. personal) and by class (residential, commercial, industrial) for the period you have chosen. The table should enable you to identify sectors in which change has occurred. To demonstrate the impact of any changes, you could also compute the rate of change in property tax revenues (current year minus prior year; remainder divided by prior year) and graph these figures. Finally, you could use fiscal impact analysis to try to predict future property tax revenues.

### **Suggestions for policy statements:**

Policy statements could be developed to suggest both levels of increase in property tax revenues and procedures for raising revenues through the property tax. The following policy statements can help local officials relate this indicator to their financial decision-making.

- Sound appraisal procedures will be maintained to keep property values current. Property will be assessed at \_\_\_\_ percent of full and fair market value.
- The year-to-year increase of actual revenue from property tax will not exceed \_\_\_\_ percent.
- All property will be reassessed at least every \_\_\_\_ years.

## Town of Payson Evaluating Financial Condition

### INDICATOR 6

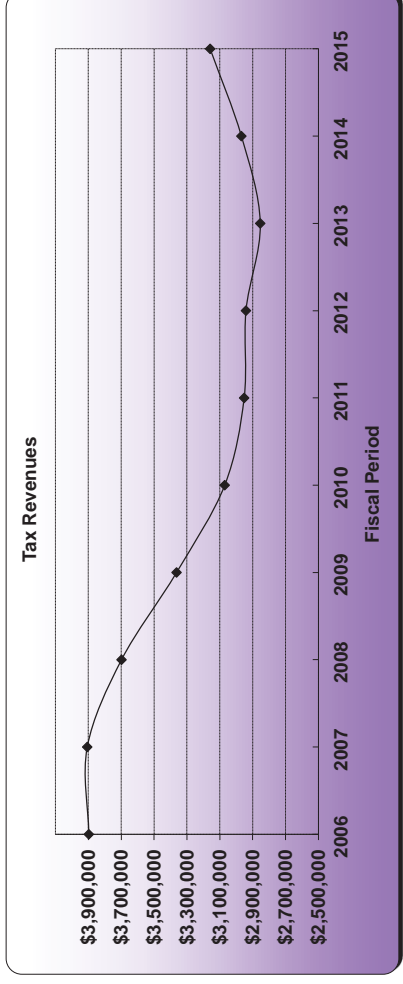
#### Tax Revenues

##### Warning Trend:

Decline in tax revenues (includes General & Debt)  
(constant dollars)

##### Formula:

$$\frac{\text{Tax revenues}}{\text{(constant dollars)}}$$



Fiscal year:	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Tax Revenues	7,907,761	8,138,093	8,091,923	7,254,572	6,693,229	6,662,714	6,749,750	6,664,045	7,074,822	7,527,881
Consumer price index	202.9	208.3	218.8	215.7	218.0	225.7	229.5	233.5	238.3	238.3
Tax revenues (constant dollars)	3,897,369	3,906,910	3,698,319	3,363,269	3,070,289	2,952,022	2,941,068	2,853,981	2,968,872	3,158,993

##### Description:

Property and sales tax revenues should be considered separately from other revenues because most local governments rely heavily on them. A decline or a diminished growth rate in property taxes can have a number of causes. First, it may reflect an overall decline in property values; a decline in national, state or local economic health; a decline in the total number of households; or the movement of retail or industrial operations to other communities. Second, it may result from default on property taxes by property owners or an inefficient assessment or appraisal process for property. Third, it may result from sales or income taxpayers moving their base of operations to other jurisdictions. Finally, a decline can be caused by deliberate default by property owners, who realize that delinquency penalties are less than short-run interest rates and that nonpayment is thus an economical way to borrow money. Likewise, citizens who owe income taxes may deliberately delay payment.

## Town of Payson Evaluating Financial Condition

### INDICATOR 6

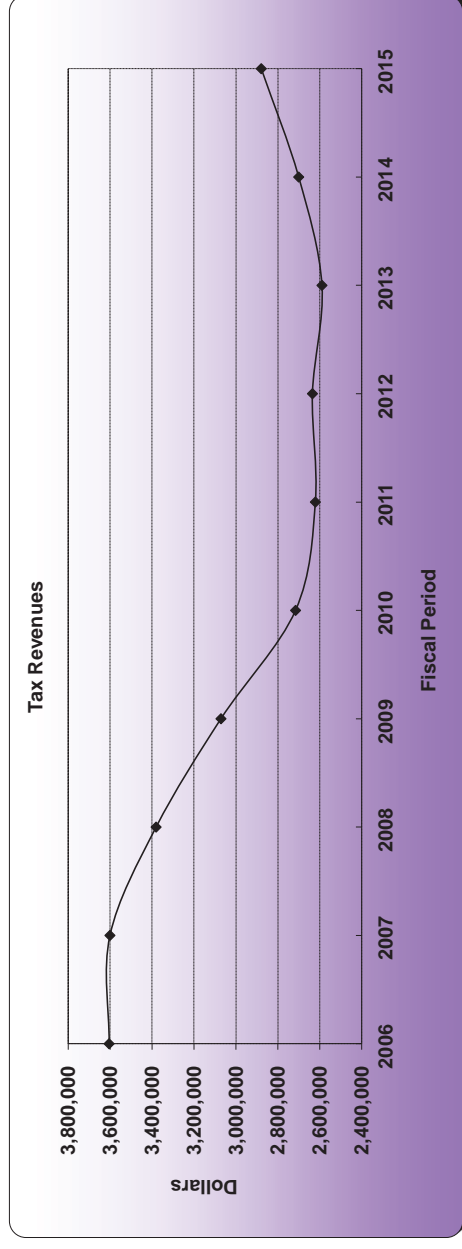
#### Tax Revenues (A) Sales Tax

##### Warning Trend:

Decline in tax revenues (includes General & Debt)  
(constant dollars)

##### Formula:

$$\frac{\text{Tax revenues}}{(\text{constant dollars})}$$



Fiscal year:	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Tax Revenues	7,314,067	7,503,852	7,396,678	6,624,711	5,919,923	5,915,905	6,047,629	6,047,114	6,435,777	6,870,982
Consumer price index	202.9	208.4	218.8	215.7	218.0	225.7	229.5	233.5	238.3	238.6
Tax revenues (constant dollars)	3,604,764	3,600,697	3,380,566	3,071,261	2,715,561	2,621,136	2,635,132	2,589,770	2,700,704	2,879,249

##### Description:

Property and sales tax revenues should be considered separately from other revenues because most local governments rely heavily on them. A decline or a diminished growth rate in property taxes can have a number of causes. First, it may reflect an overall decline in property values; a decline in national, state or local economic health; a decline in the total number of households; or the movement of retail or industrial operations to other communities. Second, it may result from default on property taxes by property owners or an inefficient assessment or appraisal process for property. Third, it may result from sales or income taxpayers moving their base of operations to other jurisdictions. Finally, a decline can be caused by deliberate default by property owners, who realize that delinquency penalties are less than short-run interest rates and that nonpayment is thus an economical way to borrow money. Likewise, citizens who owe income taxes may deliberately delay payment.

## Town of Payson Evaluating Financial Condition

### INDICATOR 6

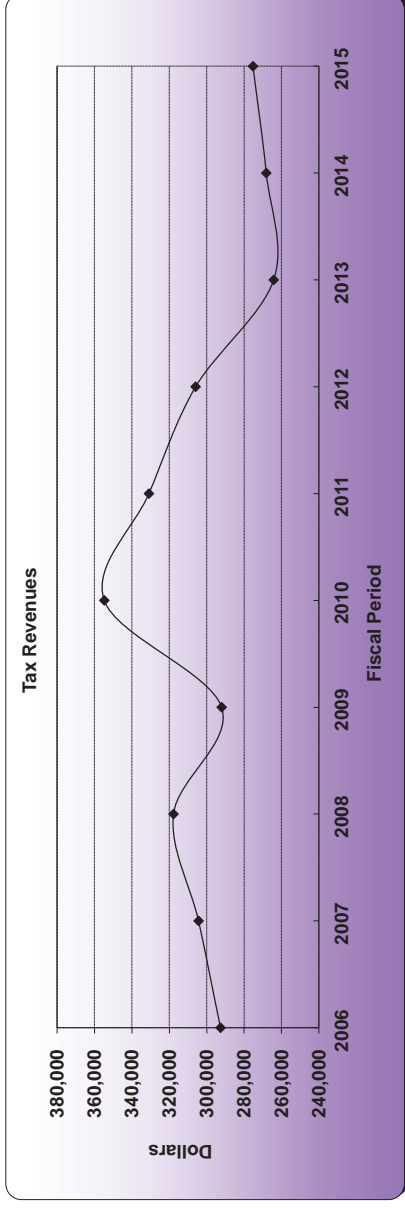
#### Tax Revenues (B) Property Tax

##### Warning Trend:

Decline in tax revenues (includes General & Debt)  
(constant dollars)

##### Formula:

$$\frac{\text{Tax revenues}}{\text{(constant dollars)}}$$



Fiscal year:		2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Tax Revenues		593,694	634,241	695,245	629,861	773,306	746,809	702,121	616,931	639,045	656,899
Consumer price index		202.9	208.4	218.8	215.7	218.0	225.7	229.5	233.5	238.3	238.6
Tax revenues (constant dollars)		292,604	304,338	317,754	292,008	354,728	330,886	305,935	264,210	268,168	275,270

##### Description:

Property and sales tax revenues should be considered separately from other revenues because most local governments rely heavily on them. A decline or a diminished growth rate in property taxes can have a number of causes. First, it may reflect an overall decline in property values; a decline in national, state or local economic health; a decline in the total number of households; or the movement of retail or industrial operations to other communities. Second, it may result from default on property taxes by property owners or an inefficient assessment or appraisal process for property. Third, it may result from sales or income taxpayers moving their base of operations to other jurisdictions. Finally, a decline can be caused by deliberate default by property owners, who realize that delinquency penalties are less than short-run interest rates and that nonpayment is thus an economical way to borrow money. Likewise, citizens who owe income taxes may deliberately delay payment.



# **Town of Payson**

## **Evaluating Financial Condition**

### **Indicator 7 Analysis**

#### **Uncollected Property Taxes**

*Uncollected Property Taxes* – Every year, a percentage of property owners are unable to pay property taxes. If this percentage increases over time, it may indicate overall decline in the local government's economic health. Additionally, as uncollected property taxes rise, liquidity is decreased, and there is less cash on hand to pay bills or to invest.

Credit-rating firms (Standard & Poor's, Moody's Investor Service, and Fitch's Investor Service) assume that a local government normally will be unable to collect 2 to 3 percent of its property taxes within the year that the taxes are due. If uncollected property taxes rise to more than 5 to 8 percent, rating firms consider this to be a negative factor because it signals potential instability in the property tax base. An increase in the rate of delinquency for two consecutive years is also considered a negative factor.

If uncollected property taxes are rising, further investigation is needed to determine which classes of property taxpayers are not paying; whether nonpayment's are rising in commercial, industrial, or residential properties; whether certain neighborhoods are experiencing more trouble than others; and whether one demographic group, for example, the elderly, is having more trouble than others. If, for example, the investigation shows that uncollected property taxes are high among low-income elderly, it might make sense to examine the possibility of instituting tax-relief programs that allow property taxes to be deferred until they can be paid from estate proceeds.

**Warning trend:** Increasing amount of uncollected property taxes as a percentage of net property tax levy.

#### **Suggestions for analysis:**

If the warning trend is observed, try to identify the causes (Why is it happening?), assess the significance (Is it important?), and devise action strategies (What can be done?). The following are starting points for this analysis.

- Is general economic decline affecting taxpayers' ability to make their tax payments? Is a growing proportion of low or fixed-income property owners having difficulty paying property tax bills? Would optional installment payments lessen the impact of one or two large payments?
- Is the proportion of distressed properties within the municipality increasing? Can rehabilitation programs be initiated? Can new uses be found for property whose original use is no longer economically viable?
- Are collection procedures adequate, especially in regard to delinquent taxes?
- Is the percentage of uncollected taxes higher than is assumed in revenue estimates?

**Suggestions for further analysis:**

If uncollected property taxes are rising, further investigation is needed to determine which classes of property taxpayers are not paying; whether non-payments are rising in commercial, industrial, or residential properties; whether certain neighborhoods are experiencing more trouble than others; and whether one demographic group, for example, the elderly, is having more trouble than others. If, for example, the investigation shows that uncollected property taxes are high among low-income elderly, it might make sense to examine the possibility of instituting tax-relief programs that allow property taxes to be deferred until they can be paid from estate proceeds.

**Suggestions for policy statements:**

Policy statements could suggest both an acceptable levels of uncollected property taxes and procedures for collecting property taxes. The following policy statements can help local officials relate this indicator to their financial decision making.

- The annual level of uncollected property taxes will not exceed \_\_\_\_\_ percent.
- An aggressive policy of collecting property tax revenues will be followed.

## Town of Payson Evaluating Financial Condition

### INDICATOR 7

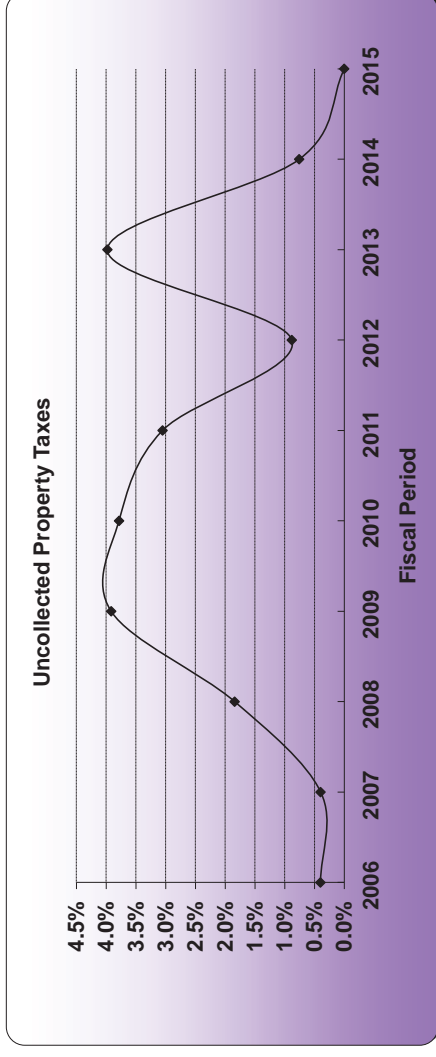
#### Uncollected Property Taxes

##### Warning Trend:

Increasing amount of uncollected property taxes as a percentage of net property tax levy

##### Formula:

$$\frac{\text{Uncollected property taxes}}{\text{Net property tax levy}}$$



Fiscal year:	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Total property tax levy	588,279	641,740	703,207	647,200	790,354	751,315	680,975	623,716	633,680	642,903
Uncollected property taxes	2,349	2,550	12,947	25,342	29,903	22,932	5,997	24,819	4,795	-
Uncollected property taxes as a percentage of property tax levy	0.40%	0.40%	1.84%	3.92%	3.78%	3.05%	0.88%	3.98%	0.76%	0.00%

##### Description:

Every year, a percentage of property owners is unable to pay property taxes. If this percentage increases over time, it may indicate overall decline in the local government's economic health. Additionally, as uncollected property taxes rise, liquidity is decreased and there is less cash on hand to pay bills or to invest.

# **Town of Payson**

## **Evaluating Financial Condition**

### **Indicator 8 Analysis**

#### **User Charge Coverage**

**Warning trend:** Decreasing revenues from user charges as a percentage of total expenditures for related services.

#### **Suggestions for analysis:**

If the warning trend is observed, try to identify the causes (Why is it happening?), assess the significance (Is it important?), and devise action strategies (What can be done?). The following are starting points for this analysis.

- Are revenues from fees and user charges lower than the cost of providing the service? If so, is this for any of the following reasons:

Were the full (direct and indirect) costs not calculated when rates were set?

Is the charge not reviewed frequently enough to take inflation and other economic pressures into account?

Is there a conscious decision not to cover 100 percent of the service costs?

Are there social reasons not to increase the charge? Do state or other laws inhibit charge adjustment?

- Is user charge coverage declining because the demand for service is decreasing? Is decreased demand due to any of the following causes:

A decrease in the need for services?

A decrease in the quality of services provided?

An increase in user fees or charges?

Inadequate marketing?

- Are cost control and revenue collection procedures effective?

#### **Suggestions for further analysis:**

If overall user charge coverage of costs is decreasing, a detailed analysis of each charge should be made to pinpoint the causes. In municipalities where tax limitations are in effect, switching to (or increasing) user charge funding could help generate additional revenues. It would therefore be useful in association

with this indicator to examine new areas in which user charges could be initiated. Analysis could also be undertaken to see if non-residents who are using government services could be charged for their use of those services. The impact of user charges on low-income residents is another area for possible study.

### **Suggestions for policy statements:**

Policy statements could be developed to suggest both a desirable level of user charge coverage and procedures for analyzing coverage in the future. The following policy statements can help local officials relate this indicator to their financial decision making.

- For each service associated with a user fee or charge, fees and charges will cover a set percentage of direct and indirect costs (e.g., 50 percent, 75 percent, and 100 percent). Fees and charges will be set to ensure that the specific level of coverage is met.
- The full costs of user-fee-supported activities will be recalculated each year to determine the impact of inflation and other cost increases.
- User charges will be revised automatically each year, with (or without) the review of the governing board, to adjust for cost increases or decreases.

## Town of Payson Evaluating Financial Condition

### INDICATOR 8

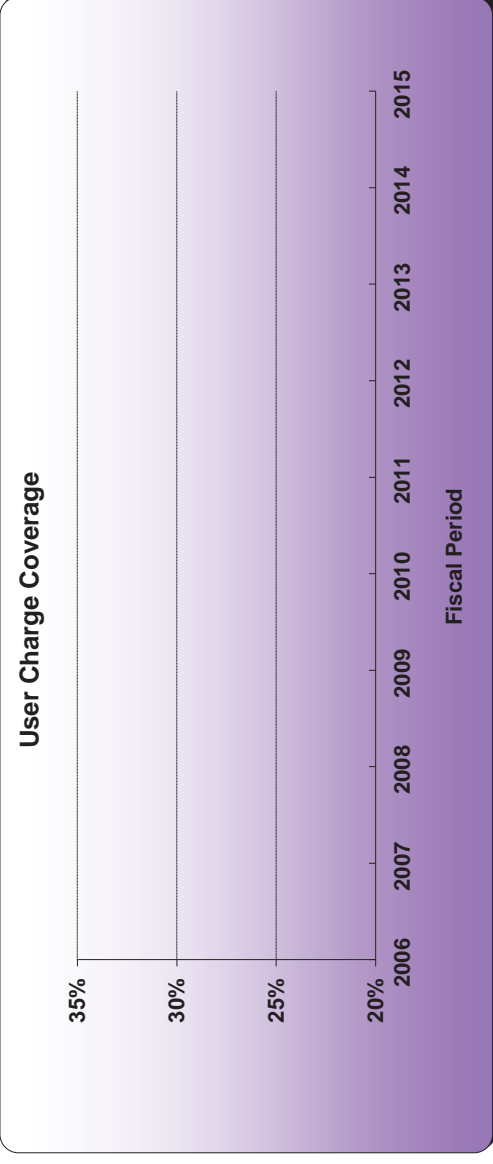
#### User Charge Coverage

##### Warning Trend:

Decreasing revenues from user charges as a percentage of total expenditures for related services

##### Formula:

$$\frac{\text{Revenues from user charges}}{\text{Expenditures for related services}}$$



Fiscal year:	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Revenues from user charges	-	-	-	-	-	-	-	-	-	-
Expenditures for services	-	-	-	-	-	-	-	-	-	-
Revenues from user charges as a percentage of total expenditures for related service	#DIV/0!	#DIV/0!	#DIV/0!	#DIV/0!	#DIV/0!	#DIV/0!	#DIV/0!	#DIV/0!	#DIV/0!	#DIV/0!

Note: Data is not currently available. The method for calculating this indicator is being re-evaluated to provide more meaningful information.

##### Description:

The term "user charge coverage" refers to the use of fees and charges to cover the cost of providing a service. This indicator focuses only on general fund programs (such as recreation or inspection services) and not on enterprise services, which are examined in indicator 16, Enterprise Operating Position. If the user charges cover all the costs, the coverage is 100 percent. If charges cover only half the costs, the coverage is 50 percent. As coverage declines, the burden on other revenues to support the services increases. Because the typical municipal accounting system does not employ cost-accounting techniques, it is easy for inflation and other factors to erode user charge coverage without being noticed.

# **Town of Payson**

## **Evaluating Financial Condition**

### **Indicator 9 Analysis**

#### **Revenue Shortfalls**

**Warning trend:** Increase in revenue shortfall as a percentage of actual net operating revenues

#### **Suggestions for analysis:**

If the warning trend is observed, try to identify the causes (Why is it happening?), assess the significance (Is it important?), and devise action strategies (What can be done?). The following are starting points for this analysis.

- Does a deteriorating revenue base cause this trend?
- Is it due to adverse regional or national trends or to a local problem? Can the problem be identified? See indicator 1, Revenues per Capita.
- Is the trend due to state or federal initiatives?
- Is the trend due to ineffective estimating procedures?
  - Centralizing the organizational responsibility for preparing the estimates
- Are collection and accounts receivable procedures adequate? See indicator 17, Liquidity.
- Are revenue estimates made optimistically high in order to balance the budget?

#### **Suggestions for further analysis:**

If revenue shortfalls are increasing in frequency or size, a detailed analysis of each revenue source should be made to pinpoint the cause.

#### **Suggestions for policy statements:**

Policy statements can be developed to suggest procedures for forecasting revenues and adjusting for shortfalls. The following policy statements can help local officials relate this indicator to their financial decision making.

- All revenue forecasts shall be conservative.
- Regular reports comparing actual to budgeted revenues will be prepared by the \_\_\_\_\_ (e.g., finance director, treasurer) and presented to the \_\_\_\_\_ (e.g., manager, governing board).



## Town of Payson Evaluating Financial Condition

### INDICATOR 9

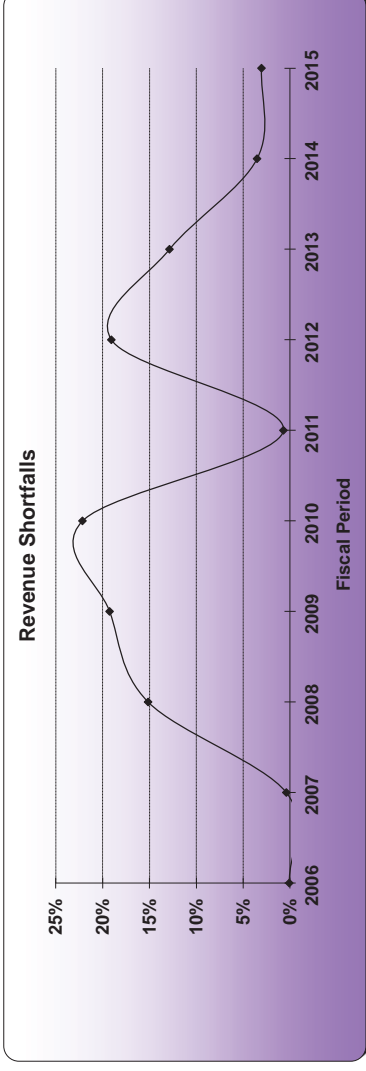
#### Revenue Shortfalls

##### Warning Trend:

Increase in revenue shortfalls as a percentage of actual net operating revenues

##### Formula:

$$\frac{\text{Revenue shortfalls}}{\text{Net operating revenues}^*}$$



Fiscal year:	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Actual net operating revenues	19,023,668	18,772,135	18,255,637	16,100,439	14,848,715	14,851,694	14,398,635	14,608,304	15,592,416	17,058,036
Budgeted net operating revenues	19,039,990	18,846,924	21,021,730	19,201,700	18,138,888	14,957,200	17,145,101	16,488,600	16,141,900	17,578,400
Revenue shortfalls	16,322	74,789	2,766,093	3,101,261	3,290,173	105,506	2,746,466	1,880,296	549,484	520,364
Revenue shortfalls as a percentage of actual net operating revenues	0.09%	0.40%	15.15%	19.26%	22.16%	0.71%	19.07%	12.87%	3.52%	3.05%

\* Actual net operating revenues and Budgeted net operating revenues include figures from all Governmental Funds except Capital Project Funds & LE Property Purchase Program (Fund 217)

Note: In the past few years, the turmoil from the economic downturn coupled with the unforeseen delays in the college campus project presented numerous challenges in forecasting revenues, especially those related to construction activities and local sales tax.

##### Description:

This indicator examines the differences between revenue estimates and revenues actually received during the fiscal year. In some cases, a shortfall or surplus is observed because the local government has not amended its revenue budget during the course of the year when new programs are implemented or other major operational changes take place. Major discrepancies that continue year after year can indicate a changing economy or inaccurate estimating techniques. Shortfalls may indicate inefficient collection procedures, or that high revenue estimates are being made to accommodate political pressures. If revenue shortfalls are increasing in frequency or size, a detailed analysis of each revenue should be made to pinpoint the source.

# **FACTOR 2**

## **Expenditure Indicators**

## **Factor 2**

### **Expenditure Indicators**

Expenditures are a rough measure of a local government's service output. Generally, the more a local government spends in constant dollars, the more services it is providing, although this axiom does not take into account how effective the services are or how efficiently they are delivered.

To determine whether a government is living within its revenues, the first issue to consider is expenditure growth rate. Because most local governments are required to have a balanced budget, it would seem unlikely that expenditure growth would exceed revenue growth. Nevertheless, the annual budget can be balanced in a number of subtle ways that will create a long-run imbalance in which expenditure outlays and commitments grow faster than revenues.

Some of the more common ways are to borrow, use reserves, use bond proceeds for operations, or siphon small amounts from intergovernmental grants. Other ways are to defer maintenance on capital stock or to defer funding of a future liability such as a pension plan. In each of these cases, the annual budget remains balanced, but the long-run budget develops a deficit. Although long-run deficits might, conceivably, be made up through windfalls such as state grants or revenue surges created by inflation, allowing such deficits to develop is risky.

A second issue to consider is expenditure flexibility. Expenditure flexibility is a measure of a local government's freedom to adjust its service levels to changing conditions, and considers the level of mandatory or fixed costs. Ideally, a government's expenditure growth rate will not exceed its revenue growth rate, and the government will have maximum flexibility to adjust spending. An increase in mandatory costs such as debt service, matching requirements, and pension benefits renders a government less able to adjust to change.

Analyzing your government's expenditure profile will help you to identify the following types of problems:

- Excessive growth of overall expenditures as compared to revenue growth or growth in community wealth (personal and business income)
- An undesirable increase in fixed costs
- Ineffective budgetary controls
- A decline in personnel productivity
- Excessive growth in programs that create future expenditure liabilities.
- Expenditures per Capita Changes in per capita expenditures reflect changes in expenditures relative to changes in population.
- Increasing per capita expenditures can indicate that the cost of providing services is outstripping the community's ability to pay, especially if spending is increasing faster than the residents' collective personal income.

From a different perspective, if the increase in spending is greater than can be accounted for by inflation or by the addition of new services, it may indicate

declining productivity - that is, that the government is spending more real dollars to support the same level of services.

# **Town of Payson**

## **Evaluating Financial Condition**

### **Indicator 10 Analysis**

#### **Expenditures per Capita**

In communities where revenues are not growing rapidly, local government officials have found that they must focus their attention on the expenditure side of the budget, so that they can analyze the trends in this indicator carefully.

This indicator uses the concept of “net operating expenditures,” which is similar to the concept of net operating revenues used in previous indicators.

**Warning trend:** Increasing net-operating expenditures per capita.

#### **Suggestions for analysis:**

If the warning trend is observed, try to identify the causes (Why is it happening?), assess the significance (Is it important?), and devise action strategies (What can be done?). The following are starting points for this analysis.

- Is the increase caused by increased levels of existing services or by the addition of new services? Are there increased revenues to pay for these increased services? Can user charges be instituted or increased to pay for these services? If not, should services be reduced?
- If the increase cannot be explained by the addition of new services, is personnel productivity or service efficiency declining? Can changes in management practices or technology deal with this?
- Is the local government’s employee base aging? Older senior employees get higher pay. Can changes in management practices or technology deal with this trend?
- Is the increase linked to an increase in fixed costs, or is it due to increases in programs that can be cut back at the discretion of the municipality?
- Is the increase due to an increase in externally funded programs that are now fully funded and will be for their duration? Or is it due to externally funded programs for which only seed money has been supplied, and for which the local government will have to assume future funding responsibility? In the second case, how will these programs be funded in the future?
- Is the increase due to an increase in mandated services? Can the level of government that mandates the services provide funding?
- Is the increase due to construction of capital facilities that were funded by debt meaning that the expenditure burden will be spread out over many years? Will the debt service plus operating costs of the new facilities strain future budgets?
- Are per capita expenditures rising faster than per capita revenues? Is this straining the government's ability to pay? Are fund balances and reserves being used to balance the budget?
- Are per capita expenditures rising faster than personal income or business activity? Is this straining citizens' and businesses' ability to pay taxes?

- Can expenditures be reduced by any of the following means?
  - Consolidating support services to achieve economies of scale,
  - Cross-training personnel to avoid duplicating functions and reduce idle time,
  - Contracting services or replacing full-time technical staff with consultants or service bureaus. (Note: services should be contracted out only after a thorough analysis has determined contracting out to be the less costly option. In some cases, the local government can still provide services at a lower cost than any private contractor could.)
  - Using more advanced management controls, information systems, or technologies
  - Transferring functions to other levels of government
  - Eliminating programs that are no longer important
  - Pooling funds with other jurisdictions for self-insuring, investing idle funds, etc.
  - Entering into mutual aid, service, or cooperative purchasing agreements with other jurisdictions.

### **Suggestions for further analysis:**

Like the analysis of per capita revenues, analysis of per capita expenditures should focus first on total expenditures and then on changes in individual expenditure categories. Expenditures can be evaluated based on fund (e.g., general fund, special revenue fund), function (e.g., police, fire), or organizational unit (personnel, public works).

### **Suggestions for policy statements:**

Policy statements can be developed to suggest procedures for monitoring expenditures. The following policy statements can help local officials relate this indicator to their financial decision-making.

- Reports comparing actual revenues and expenditures to budgeted amounts will be prepared regularly.
- Where possible, performance measures and productivity indicators will be integrated into the budget.

## Town of Payson Evaluating Financial Condition

### INDICATOR 10

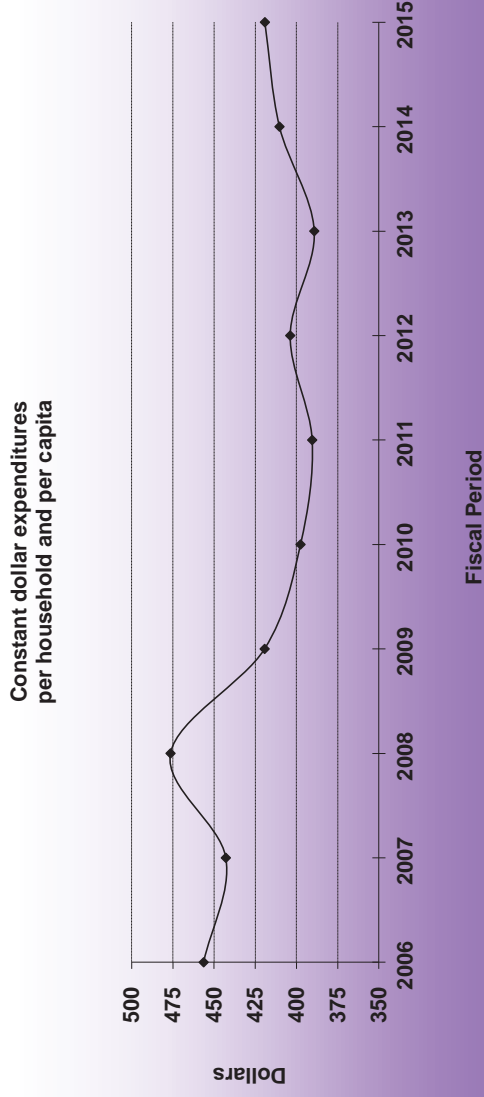
#### Expenditures per Capita

##### Warning Trend:

Increasing net operating expenditures per capita  
(constant dollars)

##### Formula:

Net operating expenditures (constant dollars)  
Population



Fiscal year:	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Net operating expenditures	14,285,912	15,450,957	17,683,485	15,629,903	14,975,753	13,484,284	14,179,530	13,826,909	14,905,534	15,554,885
Consumer price index	202.9	208.4	218.8	215.7	218.0	225.7	229.5	233.5	238.3	238.6
Net operating expenditures in CPI base-year	7,040,863	7,414,087	8,082,032	7,246,130	6,869,611	5,974,428	6,178,444	5,921,588	6,254,945	6,518,193
Estimated population	15,430	16,742	16,965	17,281	17,281	15,301	15,301	15,215	15,245	15,551
Net operating expenditures per capita (constant dollars)	456.31	442.84	476.39	419.31	397.52	390.46	403.79	389.19	410.29	419.15

Note: Although every department has experienced dramatic cuts in their budgets during the past few years, the costs of utilities, good, and services as well as employee benefits including health insurance and retirement contributions continue to rise. Every effort has been made to allocate appropriate resources to satisfy the needs and demands of a fluctuating population that is trying to adjust to the personal effects of the current economic challenges.

##### Description:

Changes in per capita expenditures reflect changes in expenditures relative to changes in population. Increasing per capita expenditures can indicate that the cost of providing services is outstripping the community's ability to pay, especially if spending is increasing faster than the residents' collective personal income. From a different perspective, if the increase in spending is greater than can be accounted for by inflation or the addition of new services, it may indicate declining productivity--that is, that government is spending more real dollars to support the same level of services.



**Town of Payson**  
**Evaluating Financial Condition**  
**Indicator 11 A&B&C&D&E Analysis**  
**Expenditures by Function**

**Warning Trend:** Increasing operating expenditures for one function as a percentage of total net operating expenditures.

**Suggestions for analysis:**

If the warning trend is observed, try to identify the causes (Why is it happening?), assess the significance (Is it important?), and devise action strategies (What can be done?). The following are suggested starting points for this analysis.

- Is the increase in the functional area caused by increased services or by the addition of new services? Are there increased revenues to pay for those increased services
- If the increase cannot be explained by the addition of new services, is personnel productivity or service efficiency declining? Can changes in management practices deal with this?
- Is the increase due to an increase in mandated services? Is there any funding available?
- Are there alternatives available for reducing services?

**Suggestions for further analysis**

Another way of analyzing the expenditure by function data is to calculate the increases by percentage in each function from one year to the next. This will show which functional areas are receiving the largest increases and help to stimulate further discussion.

**Suggestions for policy statements**

Policy statements can be developed to suggest procedures for monitoring functional areas expenditures. The following policy statement could help local officials relate this indicator to their financial decision-making.

- Expenditure levels in constant dollars will be held constant in the functional areas of \_\_\_\_\_, \_\_\_\_\_, \_\_\_\_\_. Service level increases in the functional areas of \_\_\_\_\_, \_\_\_\_\_, \_\_\_\_\_ may result in increase in expenditure levels in constant dollars.

## Town of Payson Evaluating Financial Condition

### INDICATOR 11

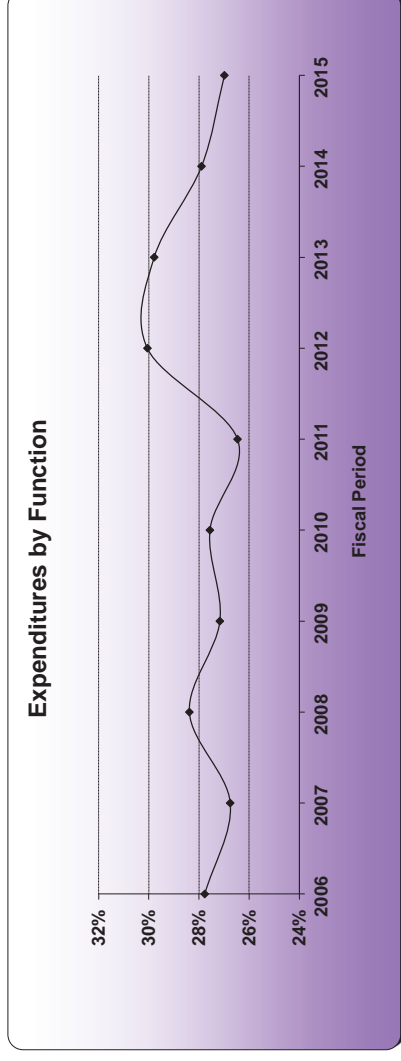
#### Expenditures by Function (A) General & Administration

##### Warning Trend:

Increasing operating expenditures for one function as a percentage of total net operating expenditures

##### Formula:

Operating expenditures for one function  
Total net operating expenditures



	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Fiscal year:										
Operating expenditures for General & Admin	3,967,139	4,133,694	5,018,872	4,246,206	4,127,767	3,568,102	4,261,562	4,118,149	4,158,235	4,197,642
Total net operating expenditures	14,285,912	15,450,957	17,683,485	15,629,903	14,975,753	13,484,284	14,179,530	13,826,909	14,905,534	15,554,885
General & Admin expenditures as a percentage of total net operating expenditures	27.77%	26.75%	28.38%	27.17%	27.56%	26.46%	30.05%	29.78%	27.90%	26.99%

##### Description:

Expenditures by function shows a more detailed breakdown of a local government's general governmental funds expenditures. Users of the FTMS may want to use this indicator to provide further analysis of the trend line developed for Indicator 10, Expenditures per Capita. The information is available in the statistical section of the Comprehensive Annual Financial Report (CAFR). Expenditures by function will help to analyze the cause of the increases in governmental spending over time.

General & Administration Expenditures are the Town's primary operating expenses from Community Development, Town Clerks, Human Resources, Computer Information Services, Finance, Legal, Town Council, and General Government Administration.

**Town of Payson**  
**Evaluating Financial Condition**

**INDICATOR 11**

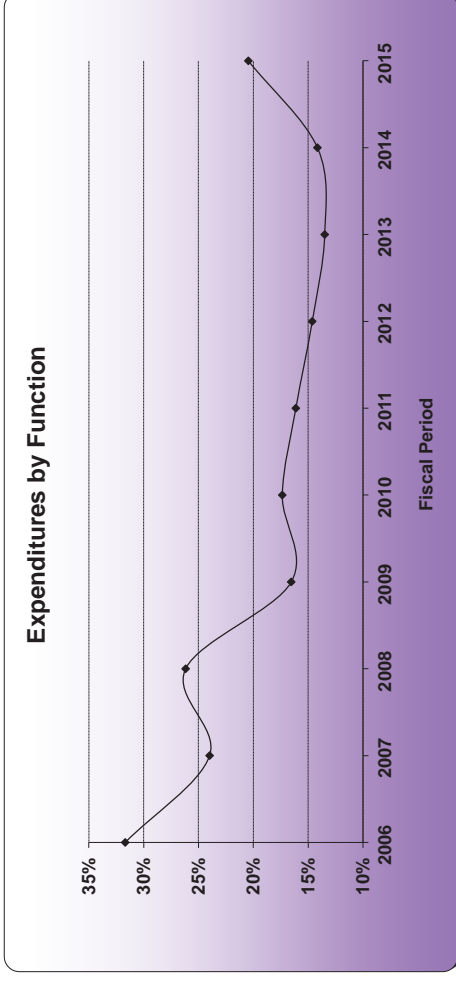
**Expenditures by Function (B)**  
**Highways and Roads, Public Works**

**Warning Trend:**

Increasing operating expenditures for one function as a percentage of total net operating expenditures

**Formula:**

$$\frac{\text{Operating expenditures for one function}}{\text{Total net operating expenditures}}$$



Fiscal year:	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Operating expenditures for Highway & Roads	4,526,180	3,705,640	4,627,564	2,585,497	2,599,518	2,173,759	2,074,324	1,865,303	2,109,648	3,181,325
Total net operating expenditures	14,285,912	15,450,957	17,683,485	15,629,903	14,975,753	13,484,284	14,179,530	13,826,909	14,905,534	15,554,885
Highway, Road and Public Works expenditures as a percentage of total net operating expenditures	31.68%	23.98%	26.17%	16.54%	17.36%	16.12%	14.63%	13.49%	14.15%	20.45%

In 2015, expenditures increased due to the availability of Glia RDX tax extension funds.

**Description:**

Expenditures by function shows a more detailed breakdown of a local government's general governmental funds expenditures. Users of the FTMS may want to use this indicator to provide further analysis of the trend line developed for Indicator 10, Expenditures per Capita. The information is available in the statistical section of the Comprehensive Annual Financial Report (CAFR). Expenditures by function will help to analyze the cause of the increases in governmental spending over time.

Highway and Roads and Public Works expenditures are the expenses for the operations of the Street Maintenance Department and the Airport.

#### INDICATOR 11

##### Expenditures by Function (C) Public Safety

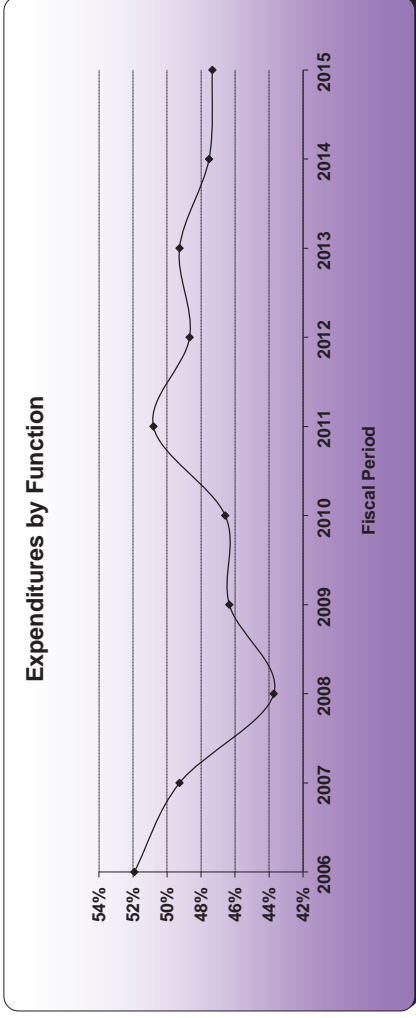
###### Warning Trend:

Increasing operating expenditures for one function as a percentage of total net operating expenditures

###### Formula:

Operating expenditures for one function  
Total net operating expenditures

##### Town of Payson Evaluating Financial Condition



Fiscal year:	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Operating expenditures for Public Safety	7,417,846	7,612,207	7,731,920	7,242,658	6,975,344	6,850,095	6,901,327	6,811,922	7,084,652	7,362,613
Total net operating expenditures	14,285,912	15,450,957	17,683,485	15,629,903	14,975,753	13,484,284	14,179,530	13,826,909	14,905,534	15,554,885
Public Safety expenditures as a percentage of total net operating expenditures	51.92%	49.27%	43.72%	46.34%	46.58%	50.80%	48.67%	49.27%	47.53%	47.33%

###### Description:

Expenditures by function shows a more detailed breakdown of a local government's general governmental funds expenditures. Users of the FTMS may want to use this indicator to provide further analysis of the trend line developed for Indicator 10, Expenditures per Capita. The information is available in the statistical section of the Comprehensive Annual Financial Report (CAFR). Expenditures by function will help to analyze the cause of the increases in governmental spending over time.

Public Safety expenditures are the expenses for the operations of the Police and Fire Departments.

## INDICATOR 11

### Expenditures by Function (D) Health & Welfare / Culture & Recreation

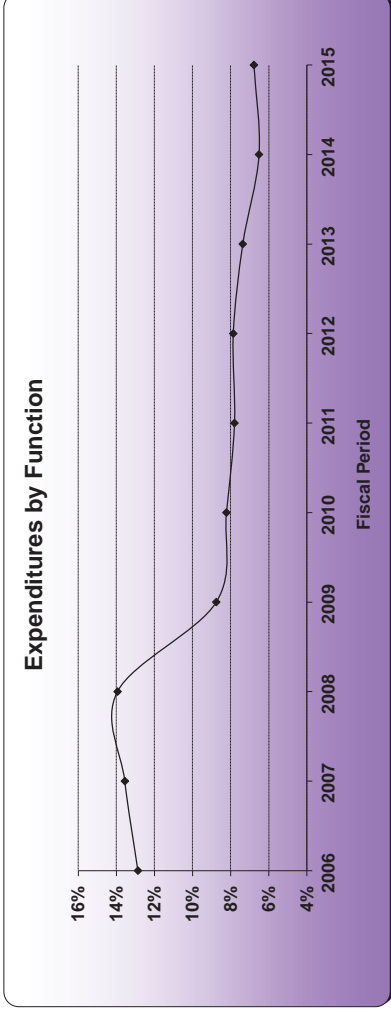
#### Warning Trend:

Increasing operating expenditures for one function as a percentage of total net operating expenditures

#### Formula:

$$\frac{\text{Operating expenditures for one function}}{\text{Total net operating expenditures}}$$

### Town of Payson Evaluating Financial Condition



Fiscal year:	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Operating expenditures for Health & Welfare / Culture & Rec*	1,837,732	2,093,694	2,464,067	1,368,395	1,231,155	1,051,603	1,114,932	1,018,437	970,857	1,054,613
Total net operating expenditures	14,285,912	15,450,957	17,683,485	15,629,903	14,975,753	13,484,284	14,179,530	13,826,909	14,905,534	15,554,885
Health & Welfare, Culture & Rec. expenditures as a percentage of total net operating expenditures	12.86%	13.55%	13.93%	8.75%	8.22%	7.80%	7.86%	7.37%	6.51%	6.78%

#### Description:

Expenditures by function shows a more detailed breakdown of a local government's general governmental funds expenditures. Users of the FTMS may want to use this indicator to provide further analysis of the trend line developed for Indicator 10, Expenditures per Capita. The information is available in the statistical section of the Comprehensive Annual Financial Report (CAFR). Expenditures by function will help to analyze the cause of the increases in governmental spending over time.

\*Operating expenditures for Health & Welfare / Culture & Recreation include expenses for the Parks & Recreation Department, Payson Library, animal control, and contributions to non-profits.

### INDICATOR 11

#### Expenditures by Function (E) Debt Service

##### Warning Trend:

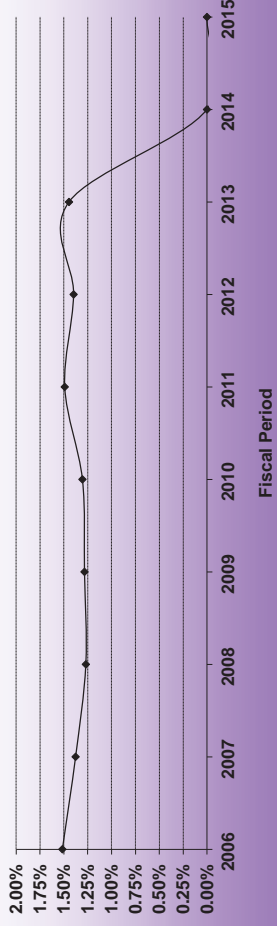
Increasing operating expenditures for one function as a percentage of total net operating expenditures

##### Formula:

$$\frac{\text{Operating expenditures for one function}}{\text{Total net operating expenditures}}$$

#### Town of Payson Evaluating Financial Condition

##### Expenditures by Function



Fiscal year:	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Operating expenditures for Debt Service	216,596	212,795	224,578	200,719	195,533	201,088	198,250	200,000	0	0
Total net operating expenditures	14,285,912	15,450,957	17,683,485	15,629,903	14,975,753	13,484,284	14,179,530	13,826,909	14,905,534	15,554,885
Debt Service expenditures as a percentage of total net operating expenditures	1.52%	1.38%	1.27%	1.28%	1.31%	1.49%	1.40%	1.45%	0.00%	0.00%

##### Description:

Expenditures by function shows a more detailed breakdown of a local government's general governmental funds expenditures. Users of the FTMS may want to use this indicator to provide further analysis of the trend line developed for Indicator 10, Expenditures per Capita. The information is available in the statistical section of the Comprehensive Annual Financial Report (CAFR). Expenditures by function will help to analyze the cause of the increases in governmental spending over time.

Debt Service expenditures account for the interest, principal, and fees incurred due to the general obligation and special assessment debt of the Town except those accounted for in a proprietary fund.

**Town of Payson**  
**Evaluating Financial Condition**  
**Indicator 12 Analysis**  
**Employees per 1000 Capita**

**Warning trend:** Increasing number of municipal employees per 1,000 population

**Suggestions for analysis:**

If the warning trend is observed, try to identify the causes (Why is it happening?), assess the significance (Is it important?), and devise action strategies (What can be done?). The following are starting points for this analysis.

- Is employee productivity decreasing? Can measures be developed to evaluate and improve productivity?
- Has loss of grant funding required the local government to pay for workers previously hired under the grants? If not, might this happen in the future?
- Have the community's population characteristics changed necessitating higher service levels? See indicators 28-31.

**Suggestions for further analysis:**

The overall trend in local government employment may mask important underlying trends. For example, while overall government employment may appear steady or even to have decreased slightly, it may actually be on the rise. Let us say, for example, that employment in public safety is increasing while employment in public works is decreasing. The net effect appears to be stability. But if the jobs in public works have been contracted out, the government is indirectly employing additional people. Additional analysis can identify such patterns by (1) examining changes in employment patterns by department or service area, and (2) examining decreases in employment to see whether contracting out has substituted private-sector workers for government employees.



## Town of Payson Evaluating Financial Condition

### INDICATOR 12

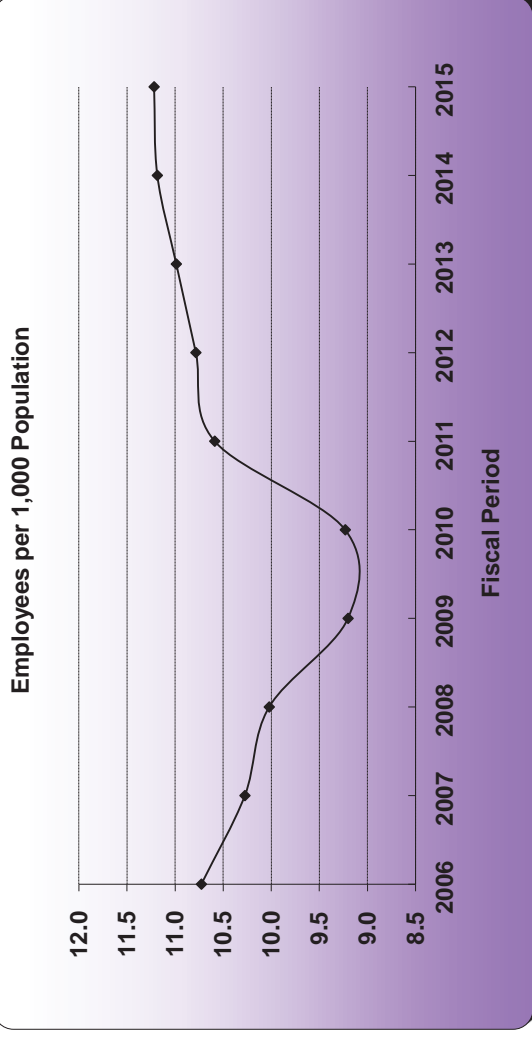
#### Employees per 1,000 population

##### Warning Trend:

Increasing number of municipal Employees  
per 1,000 population

##### Formula:

$$\frac{\text{Number of municipal employees}}{\text{Population}/1,000}$$



Fiscal year:	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Number of municipal employees	166	172	170	159	160	162	165	167	170	175
Current population per 1,000	15.4	16.7	17.0	17.3	17.3	15.3	15.3	15.2	15.2	15.6
Number of municipal employees per 1,000 population	10.73	10.27	10.02	9.20	9.23	10.59	10.78	10.99	11.18	11.22

##### Note:

2009-2015 figures represent authorized positions less positions frozen pending economic recovery  
Employee count includes Mayor and 6 Council Members

##### Description:

Because personnel costs are a major portion of a local government's operating budget, plotting changes in the number of employees per capita is a good way to measure changes in expenditures. An increase in employees per 1,000 population might indicate that expenditures are rising faster than revenues, that the government is becoming more labor intensive, or that personnel productivity is declining.

## Town of Payson

### Evaluating Financial Condition Indicator 13 Analysis Fixed Costs

**Warning trend:** Increasing fixed costs as a percentage of net operating expenditures.

#### **Suggestions for analysis:**

If the warning trend is observed, try to identify the causes (Why is it happening?), assess the significance (Is it important?), and devise action strategies (What can be done?). The following are starting points for this analysis.

- If increases are due to services mandated by other governmental units, can funding be obtained from the units mandating the services? Can the quantity or quality of these services be reduced?
- For externally mandated services for which funding is provided, are all reimbursable charges (including overhead) consistently billed at actual cost?
- Is external funding for mandated services decreasing, or not keeping pace with inflation and other cost increases?
- Are increases in fixed costs created by increases in debt service? Will old bonds be paid off soon thereby reducing fixed costs? Can debt service schedules be modified through long-term refunding? See indicator 20, Debt Service.
- Are increases in fixed expenditures due to previous decisions, such as debt commitments, over which the government no longer has control, or are they due to yearly decisions over which it has future control?
- If increases are due to past decisions, are all the cost implications of these decisions clear for the current and future years? Is there a plan for funding these costs? Are new decisions that will commit the government to future spending similarly analyzed?

#### **Suggestions for further analysis:**

Either an increase or a decrease in fixed costs can be a signal for further investigation. For example, if a local government postpones issuing new debt for much-needed capital projects, fixed costs for debt service will decrease as old debt is paid off, and this may appear to be a favorable sign. But if money that should be used to meet new debt service is being used for operating expenses, it may be difficult to issue the new debt as planned. Any decreases in fixed costs should therefore be carefully examined to ensure that important goals are not being deferred.

**Suggestions for policy statements:**

Policy statements can be developed to suggest procedures for analyzing future fixed costs. The following policy statements can help local officials relate this indicator to their financial decision-making.

- Before the government undertakes any agreements that create fixed costs, the cost implications (both operating and capital) of such agreements will be fully determined for this and future years.
- All externally mandated services for which funding is available will be fully costed out (including overhead) to allow for complete reimbursement of expenses.

## Town of Payson Evaluating Financial Condition

### INDICATOR 13

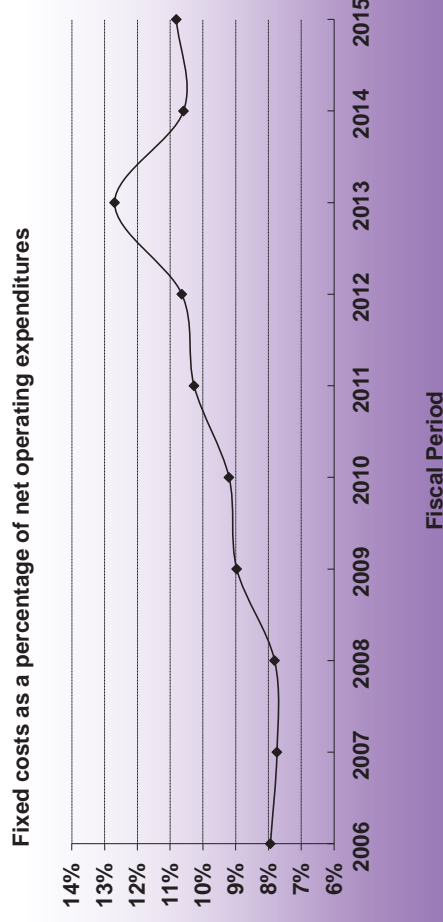
#### Fixed Costs

#### Warning Trend:

Increasing fixed costs as a percentage of net operating expenditures

#### Formula:

$$\frac{\text{Fixed costs}}{\text{Net operating expenditures}}$$



Fiscal year:	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Fixed costs	1,135,243	1,196,765	1,382,448	1,402,486	1,379,008	1,385,310	1,509,604	1,755,490	1,579,103	1,682,110
Net operating expenditures	14,285,912	15,450,957	17,683,485	15,629,903	14,975,753	13,484,284	14,179,530	13,826,909	14,905,534	15,554,885
Fixed costs as a percentage of net operating expenditures	7.95%	7.75%	7.82%	8.97%	9.21%	10.27%	10.65%	12.70%	10.59%	10.81%

#### Description:

The operating expenditures of every government are composed in part of mandatory and fixed expenditures over which officials have little short-run control. These include expenditures to which the government is legally committed (such as debt service and pension benefits), as well as expenditures imposed by higher levels of government (for example, for wastewater treatment facilities).

The higher the level of fixed expenditures, the less freedom local officials have to adjust spending in response to economic change. Fixed costs become especially important during periods of financial retrenchment, since mandatory expenditures such as debt service are usually unaffected by a reduction in service levels.

# **Town of Payson**

## **Evaluating Financial Condition**

### **Indicator 14 Analysis**

#### **Fringe Benefits**

**Warning Trend:** Increasing fringe benefit expenditure as a percentage of salaries and wages.

#### **Suggestions for analysis:**

If the warning trend is observed, try to identify the causes (Why is it happening?), assess the significance (Is it important?), and devise action strategies (What can be done?). The following are starting points for this analysis.

- What is the origin of the increase? Have new fringe benefits been provided? Has the quality or quantity of existing fringe benefits been increased? Do the government's records make this information explicit?
- Has the cost of current benefits increased? Can the government reduce or control such costs?
- Has the government begun programs to reduce the cost of health insurance benefits, such as self-funding insurance, direct contracting for services, implementing wellness efforts, or switching to managed care health plans for employees?
- Are non-salary benefits, such as vacation pay, holiday pay, and educational incentives, being costed on a dollar basis and included in the budget?
- If the government is assuming a greater share of fringe-benefit contributions, can these costs be isolated and negotiated separately with employee groups?
- Are accumulated leave benefits funded on a current basis (i.e., fully funded)? If not, is there a plan for funding them when they are due to be paid? See indicator 24, Accumulated Employee Leave.

#### **Suggestions for further analysis:**

If fringe benefits are increasing as a percentage of salaries and wages, you may want to review major negotiations over the four-year period covered, showing any state or federally mandated increases. You could also mention any cost savings efforts that have been initiated.

#### **Suggestions for policy statements:**

Policy statements can be developed to suggest procedures for analyzing future costs of fringe benefits. The following policy statements can help local officials relate this indicator to their financial decision-making.

- All nonsalary benefits, such as vacation pay, holiday pay, and educational incentives, will be costed out, and their impact on future budgets will be assessed.

- All compensation negotiations will focus on total compensation: direct salary plus employer share of fringe benefits.
- Cost analysis of salary increases will include the effect of such increases on employer share of related fringe benefits.

# **FACTOR 3**

## **Operating Position**



## **Factor 3**

### **Operating Position**

The term “operating position” refers to a local government’s ability to (1) balance its budget on a current basis, (2) maintain reserves for emergencies, and (3) have sufficient liquidity to pay bills on time.

#### **Balancing a current budget**

During a typical year, a local government generates either an operating surplus or an operating deficit. An operating surplus develops when current revenues exceed current expenditures, an operating deficit when the reverse occurs. An operating surplus or deficit can be created intentionally, by a policy decision, or unintentionally, because of the difficulty of precisely predicting revenues and expenditures or trends in the underlying local or national economies. Deficits are usually funded from unreserved fund balances, surpluses are usually used to increase fund balances.

#### **Reserves**

The accumulation of operating surpluses builds reserves, which provide a financial cushion against the loss of a revenue source; an economic downturn; unanticipated expenditures required by natural disasters, insurance loss, and the like; unexpected large-scale capital expenditures or other nonrecurring expenses; an uneven cash flow; and similar events.

Reserves may be budgeted in a contingency account or carried as a part of one or more fund balances. If they are carried as an unappropriated part of a fund balance, they may never appear in the local governments budget or be discussed during the budget deliberations.

#### **Liquidity**

Liquidity refers to the flow of cash in and out of the Towns’ treasury. Local governments often receive their revenues in large installments at infrequent intervals during the year. If revenues are received before they need to be spent, the government will have a positive liquidity or cash flow position. Excess liquidity or “cash reserves” are a valuable cushion against unexpected financial pressures. If a government has a negative cash flow and no cash reserves, it must borrow on short-term notes or put off paying its bills.

An analysis of operating position can help to identify the following situations:

- A pattern of continuing operating deficits
- A decline in reserves
- A decline in liquidity
- Ineffective revenue forecasting techniques
- Ineffective budgetary controls

# **Town of Payson**

## **Evaluating Financial Condition**

### **Indicator 15 Analysis**

#### **Operating Deficit or Surplus**

**Warning trend:** Increase in general fund operating deficit or surplus as a percentage of net operating revenues.

#### **Suggestions for analysis:**

If the warning trend is observed, try to identify causes (Why is it happening?), assess the significance (Is it important?), and devise action strategies (What can be done?). The following are suggested starting points for this analysis.

- Was the deficit anticipated during the budget preparation? Is it expected to continue in future years? Will surpluses or other sources of funding be available?
- Is borrowing from surpluses in other funds funding the deficit? Can these other funds afford the loan without creating problems later?
- Was the deficit due to revenue shortfalls?
- Was the deficit caused by expenditure overruns? Were these due to inaccurate expenditure estimates at budget time or to ineffective expenditure controls during the fiscal year?
- Was the deficit caused by an emergency? Are sufficient reserves left for future emergencies? See Indicator 17, Fund Balances.

#### **Suggestions for policy statements**

Policy statements could be developed to define budgetary procedures that would help prevent operating deficits. The following policy statements can help local officials relate this indicator to their financial decision-making.

- All current operating expenditures will be paid for with current operating revenues. (*Town of Payson has such a policy for the General Fund*)
- Budgetary procedures that fund current expenditures at the expense of future needs, such as postponing expenditures, accruing future revenues, or rolling over short-term debt, will be avoided.

# **Town of Payson**

## **Evaluating Financial Condition**

### **Indicator 16 Analysis**

#### **Enterprise Operating Position**

**Warning trend:** Reductions in working capital (constant dollars) or recurring operating income losses

#### **Suggestions for analysis:**

If the warning trend is observed, try to identify the causes (Why is it happening?), assess the significance (Is it important?), and devise action strategies (What can be done?). The following are starting points for this analysis.

- Are operating efficiency and productivity decreasing?
- Are revenue rates high enough to cover costs? Are they periodically reviewed? Is analysis performed for each class of customer to determine costs?
- Are cost controls adequate?
- Is the demand for enterprise services decreasing for any of the following reasons?
  - Decreased need for services
  - Decreased quality of services
  - Increased prices
  - Inadequate marketing
  - Competition from other providers
- Are retained earnings dropping lower than the government considers desirable?
- Are retained earnings being used to subsidize operating losses?
- Are reserves being used for purposes other than those originally intended?

#### **Suggestions for policy statements:**

A policy statement could be developed to suggest a level of fees and charges that would prevent enterprise programs from operating at a deficit. The following policy statement can help local officials relate this indicator to their financial decision making.

- All fees and charges for each enterprise fund will be set at a level that fully supports the direct and indirect cost of the activity. Indirect costs include annual depreciation.

# **Town of Payson**

## **Evaluating Financial Condition**

### **Indicator 17 Analysis**

#### **Fund Balances**

**Warning trend:** Declining unreserved fund balances as a percentage of net operating revenues.

#### **Suggestions for analysis:**

If the warning trend is observed, try to identify the causes (Why is it happening?), assess the significance (Is it important?), and devise action strategies (What can be done?). The following are starting points for this analysis.

- Are fund balances dropping lower than is considered desirable? Can they be rebuilt?
- Are fund balances being used to subsidize operating deficits? See indicator 14, Operating Deficits.
- Are reserves being used for purposes other than those they were originally set aside for?

#### **Suggestions for policy statements:**

There are no set rules for determining the appropriate level of reserves. Much depends on circumstances, such as the kinds of natural disasters or hardships that the jurisdiction is subject to and the adequacy of its insurance coverage, the flexibility of the jurisdictions revenue base, the overall financial health of the local government, state regulations, and national economic conditions. The following policy statements can help local officials relate this indicator to their financial decision-making.

- A reserve will be established to cope with emergencies. This reserve will be maintained at \_\_\_\_\_ percent of the general operating fund. (*Town of Payson has established a 8-10% reserve of operating revenues*)
- A contingency reserve fund will be established to provide for nonrecurring unanticipated expenditures, or to meet unexpected small increases in service delivery costs. This reserve will be maintained at \_\_\_\_\_ percent of the general operating fund. (*The Town of Payson has budgeted a \$300,000 Contingency Account in the General Fund as a matter of policy*).

# Town of Payson

## Evaluating Financial Condition

### Indicator 18 Analysis

#### Liquidity

**Warning trend:** Decreasing amount of cash and short-term investments as a percentage of current liabilities.

#### **Suggestions for analysis:**

If the warning trend is observed, try to identify the causes (Why is it happening?), assess the significance (Is it important?), and devise action strategies (What can be done?). The following are starting points for this analysis.

- Are current expenditures higher than can be supported by current revenues? See indicator 1, Revenues per Capita; indicator 10, Expenditures per Capita; and indicator 14, Operating Deficits.
- Is there an efficient system in place for generating bills for money owed to the government?
- Are bills collected promptly? Is there a good system for identifying overdue accounts?
- Are reimbursements for grant expenditures and other intergovernmental payments requested and paid promptly?
- Does the government's reporting system show monthly cash availability?
- Are cash needs anticipated early enough to acquire the cash?
- Are projected expenditures and revenues routinely compared? Can large expenditures be scheduled to coincide with revenue flows?

#### **Suggestions for policy statements:**

Policies could be set both for levels of liquidity and cash management procedures. The following statements can help local officials relate this indicator to their financial decision-making.

- A cash-flow analysis will be made of all funds on a regular basis. Disbursements, collection, and deposition of all funds will be scheduled to ensure maximum cash availability. (*Financial Services Department policy*)
- The account system will provide regular information about cash position and investment performance. (*Accounting system policy*)
- When permitted by law, cash from several different funds will be pooled for investment. (*Financial Services Department Policy*)
- At least \_\_\_\_\_ percent of all idle cash will be continuously invested. (*Financial Services Department staff are directed to maximize investment levels by covering all checks when they are issued and leave only enough cash in the bank account to cover the bank fees related to each account.*)

# **FACTOR 4**

## **Debt Indicators**

## **Factor 4**

### **Debt Indicators**

Debt is an effective way to finance capital improvements to even out short-term revenue flows, but its misuse can cause serious financial problems. Even a temporary inability to repay debt can damage a government's credit rating, which can in turn increase the cost of future borrowing.

Local governments usually use short-term debt to make up for uneven cash flows. Revenue shortfalls or over expenditures may occasionally prevent repayment of a short-term debt in the year in which it was borrowed, in which case the government may choose to repay the loan and then reborrow the money. The original loan is, in effect, repaid from the proceeds of the new loan. This is called "rolling over" the debt into a long-term debt. If this practice continues over a numbers of years, the amount of outstanding debt increases each year, it may be an indication the debt is being used to financing operating deficits – a sure sign of financial problems.

The most common forms of long-term debt are general obligation, special assessment, and revenue bonds. Even when these types of debt are used exclusively for capital projects, local governments need to ensure that their outstanding debt does not exceed their ability to repay as measured by the wealth of the community (property value or personal and business income). Another way to evaluate ability to repay is to consider the amount of principal and interest, or debt service, that the government is obligated to repay each year. Also be considerate of overlapping debt and other jurisdictions' debts against which the government has pledged its full faith and credit.

Under the most favorable circumstances, a local government's debt is proportional in size and rate of growth to its tax base; does not extend past the useful life of the facilities that it finances; is not used to balance the operating budget; does not require repayment schedules that put excessive burdens on operating expenditures; and is not so high as to jeopardize the government's credit rating.

An examination of the Town's debt structure can reveal the following:

- Inadequacies in cash management procedures or expenditure controls
- Increasing reliance on long-term debt
- Decreasing expenditure flexibility (due to increased fixed costs in the form of debt service)
- Use of short-term debt to finance current operations
- Sudden large increases or decreases in future debt service
- The amount of additional debt that the Town can absorb

**Town of Payson**  
**Evaluating Financial Condition**  
**Indicator 19 Analysis**  
**Current Liabilities**

**Warning trend:** Increasing current liabilities at the end of the fiscal year as a percentage of net operating revenues.

**Suggestions for analysis:**

If the warning trend is observed, try to identify the causes (Why is it happening?), assess the significance (Is it important?), and devise action strategies (What can be done?). The following are starting points for this analysis.

- Is short-term debt being used to fund an operating deficit? See indicator 15, Operating Deficits.
- Are accounts payable being postponed to cope with revenue shortfalls or over expenditures? See indicator 18, Liquidity.
- Are the account receivables that may be securing short-term debt valid and currently collectible?
- Are techniques for collecting accounts receivable effective? Are there procedures for prompt recognition and collection of money owed to the government?
- Are techniques for managing and projecting cash flow accurate and efficient?
- Are expenditure overruns causing increased borrowing?

**Suggestions for policy statements:**

Policies could be developed to suggest both levels of outstanding short-term debt and procedures for using and retiring short-term debt. The following policy statements can help local officials relate this indicator to their financial decision making.

- Tax anticipation debt will be retired annually, and bond anticipation notes will be retired within six months of the completion of the project.
- Short-term debt outstanding at the end of the year will not exceed 5 percent of net operating revenues (including tax anticipation notes but excluding bond anticipation notes).



# **Town of Payson**

## **Evaluating Financial Condition**

### **Indicator 20 Analysis**

#### **Long-Term Debt**

**Warning trend:** Increasing net direct bonded long-term debt as a percentage of assessed valuation, population, or personal income.

#### **Suggestions for analysis:**

If the warning trend is observed, try to identify the causes (Why is it happening?), assess the significance (Is it important?), and devise action strategies (What can be done?). The following are starting points for this analysis.

- Is assessed valuation, population, or another primary revenue base declining? See indicator 28, Population, and indicator 32, Property Value.
- Is long-term debt increasing? If so, consider the following questions:
  - Is the municipality becoming more reliant on long-term debt to finance capital projects?
  - How much additional debt will need to be incurred in the next three-to-five years?
  - Are debt proceeds being used to fund ongoing operations?
  - Is the increase a trend, or is it caused by a debt issued for a one-time-only capital project, such as a new municipal building?
- What was the amount of long-term debt before the increase? Was it low to moderate, or was the amount already straining the jurisdictions ability to pay? See indicator 20, Debt Service.

#### **Suggestions for policy statements:**

A number of policy statements can--and probably should--be set to suggest desirable levels of overall net debt as well as procedures for issuing new debt. For example, statements could be developed to match the credit industry benchmarks (e.g., overall net debt will not exceed 10 percent of assessed valuation, or overall net debt per capita will not exceed 15 percent of per capita personal income). Of course, tougher limits than those suggested by the credit industry benchmarks could also be set. The following policy statements can help local officials relate this indicator to their financial decision-making.

- Proceeds from long-term debt will not be used for current, ongoing operations.
- Long-Term borrowing will be confined to capital improvements too large to be financed from current revenues.
- Bonds will be paid back within a period not to exceed the expected useful life of the capital project.
- Where possible, special assessment, revenue, or other self-supporting bonds will be used instead of general obligation bonds.

- Good communication with bond rating agencies will be maintained, and a policy of full disclosure on every financial report and bond prospectus will be followed.

**Town of Payson**  
**Evaluating Financial Condition**  
**Indicator 21 Analysis**  
**Debt Service**

**Warning trend:** Increasing net direct service as a percentage of net operating revenues.

**Suggestions for analysis:**

If the warning trend is observed, try to identify the causes (Why is it happening?), assess the significance (Is it important?), and devise action strategies (What can be done?). The following are starting points for this analysis.

- Is the increase caused by an increase in long-term or short-term debt? If so, review indicators 19 and 20, Current Liabilities and Long-Term Debt.
- Is the increase due to increases in the interest rate rather than to increases in principal? Can the government improve its credit rating to reduce interest rates in the future?
- Can debt issued at a relatively high interest rate be refinanced at an appreciably lower rate to reduce the annual amount of debt service?
- What are the projected debt service requirements over the next ten years? Will they increase or decrease dramatically at any point?

**Suggestions for policy statements:**

Policy statements could be developed to suggest desirable levels of debt service as well as procedures for analyzing future debt service. The following policy statements can help local officials relate this indicator to their financial decision-making.

- Total debt service for general obligation debt will not exceed 10 percent of net operating revenues.
- Before bonded long-term debt is issued, the impact of debt service on total annual fixed costs will be analyzed.

# **Town of Payson**

## **Evaluating Financial Condition**

### **Indicator 22 Analysis**

#### **Overlapping Debt**

**Warning trend:** Increasing long-term overlapping bonded debt as a percentage of assessed valuation.

#### **Suggestions for analysis:**

If the warning trend is observed, try to identify the causes (Why is it happening?), assess the significance (Is it important?), and devise action strategies (What can be done?). The following are starting points for this analysis.

- To what extent is your government directly liable for the debt of other governmental units or agencies?
- Are overlapping governmental units financially healthy? If one were to default, would your government be under pressure to assist it financially or to provide the service?
- Can debt planning by overlapping governmental units be better coordinated?

#### **Suggestions for further analysis**

Several other figures can be substituted for assessed valuation in the denominator of this indicator. Per capita personal income is an alternate measure of ability to repay debt. Population can be another choice, if your community does not rely heavily on property taxes. Where the total population is decreasing but the number of households is stable, "per household" can be substituted for population.

# **FACTOR 5**

## **Unfunded Liability Indicators**

## **Factor 5**

### **Unfunded Liability Indicators**

An unfunded liability is one that has been incurred during the current year or a prior year, that does not have to be paid until a future year, and for which reserves have not been set aside. It is similar to long-term debt in that it represents a legal commitment to pay at some time in the future. If such obligations are permitted to grow over a long period of time, they can have a substantial effect on a local government's financial condition.

Two types of unfunded liability can be considered: pension liability and post employment benefits (compensated employee's leave upon termination and health insurance benefits for retirees). Both can have significant potential to affect a local government's financial condition because (1) they do not show up in the ordinary financial records in a way that makes their impact easy to assess, and (2) they accumulate gradually over time. Pensions and post employment benefits liabilities may go unnoticed until they have created severe problems. Because the Town of Payson currently participates in the Arizona State Retirement System, we do not have any unfunded pension liability. We do book and track the unfunded liability for unused vacation pay and sick leave per employee.

An analysis of a government's unfunded liabilities can answer the following questions:

- Is the amount of unused vacation and sick leave per employee increasing?
- Are policies for the payment of unused vacation and sick leave realistic compared to the government's ability to pay?
- Are the costs of future health insurance premiums for retirees a significant future obligation for the local government?

## **Town of Payson Evaluating Financial Condition Indicator 25 Analysis Accumulated Employee Leave**

**Warning trend:** Increasing number of unused vacation and sick leave days per Town employee.

### **Suggestions for analysis:**

If the warning trend is observed, try to identify the causes (Why is it happening?), assess the significance (Is it important?), and devise action strategies (What can be done?). The following are starting points for this analysis.

- Has the increase been created by changes in policies on accumulated leave? Are long-term costs of changes in benefit packages estimated before agreements are confirmed?
- Is the increase caused by a greater accumulation of leave under existing leave policies? Do workloads or cash-out policies discourage employees from taking vacation and thus contribute to the accumulation of these benefits?
- Are there reports that show the current amount of accumulated leave benefits?

### **Suggestions for further analysis:**

Changes in municipal accounting standards now suggest that the balance sheet reflect a total dollar amount for both the current portion and long-term portion of accumulated annual and sick leave. If you have this information in dollars, you might consider creating an alternative indicator--"average dollar amount of annual and sick leave per employee." The formula for this alternative indicator would be total dollar amount of annual and sick leave, divided by the number of municipal employees.

### **Suggestions for policy statements:**

Policy statements could be developed to specify maximum allowable levels of accumulated annual leave and procedures for cash-out of vacation benefits. The following policy statements can help local officials relate this indicator to their financial decision making.

- Employees are allowed to accumulate a maximum of \_\_\_\_\_ hours of vacation leave, after which additional leave must be used or forfeited. (This policy statement may vary depending on the class of employee.)

- Employees may apply for cash payments for accumulated vacation leave only if at least \_\_\_\_\_ hours of vacation leave have been taken in the preceding twelve months.



# **FACTOR 6**

## **Capital Plant Indicators**

## **Factor 6**

### **Capital Plant Indicators**

Most of local government's wealth is invested in its physical assets or capital plant – streets, buildings, utility networks, and equipment. If these assets are not properly maintained or are allowed to become obsolete, the results are often (1) decreasing usefulness of the assets, (2) increasing cost of maintaining and replacing them, and (3) decreasing attractiveness of the community as a place to live or do business.

Local governments often defer capital plant expenditures because this is a relatively painless way to temporarily reduce expenditures and ease financial strain. Continued deferral can, however, create serious problems that are made even more serious by the size of the investment that capital facilities represent. Some of problems associated with continued deferred maintenance are the following:

- Safety hazards and potential liability risks that may result, for example, from a cracked sidewalk.
- Reduction in residential and business property values
- Loss of efficiency that can result, for example, when an obsolete truck is more often in the garage for repairs than on the street working.
- An increase in the cost of bringing the facility up to acceptable standards – if for example, resurfacing has been delayed for so long that a street has to be completely reconstructed.
- The potential for a huge future obligation created by a maintenance and replacement backlog.

# **Town of Payson**

## **Evaluating Financial Condition**

### **Indicator 26-A Analysis**

#### **Maintenance Effort - Streets**

**Warning trend:** Declining expenditures for maintenance of general fixed assets per unit of asset (constant dollar)

#### **Suggestions for analysis:**

If the warning trend is observed, try to identify the causes (Why is it happening?), assess the significance (Is it important?), and devise action strategies (What can be done?). The following are starting points for this analysis.

- Is maintenance of fixed assets being deferred to such a degree that any of the following are occurring?
  - Unit costs for repair and replacement are increasing.
  - The useful life of an asset is being reduced.
  - Business activity or property value is decreasing.
  - Operating costs are increasing.
- How large is the potential future cost caused by deferred maintenance? Is there a plan for funding it?
- Are future maintenance costs projected before new capital facilities are built?
- Is there a schedule that shows the cost and timing of future maintenance and replacement needs for all government assets?
- Are operating costs also taken into consideration?

#### **Suggestions for policy statements:**

Policy statements could be developed to suggest levels of spending as well as budgeting procedures for maintaining fixed assets. The following policy statements can help local officials relate this indicator to their financial decision making.

- The budget will provide sufficient funding for adequate maintenance and orderly replacement of capital plant and equipment.
- All assets will be maintained at a level that protects capital investment and minimizes future maintenance and replacement costs.
- All equipment replacement and maintenance needs for the next five years will be projected and the projection will be updated each year. A maintenance and replacement schedule based on this projection will be developed and followed.
- Future maintenance needs for all new capital facilities will be fully costed out.

**Town of Payson**  
**Evaluating Financial Condition**  
**Indicator 26-B Analysis**  
**Maintenance Effort - Parks**

**Warning trend:** Declining expenditures for maintenance of general fixed assets per unit of asset (constant dollar)

**Suggestions for analysis:**

If the warning trend is observed, try to identify the causes (Why is it happening?), assess the significance (Is it important?), and devise action strategies (What can be done?). The following are starting points for this analysis.

- Is maintenance of fixed assets being deferred to such a degree that any of the following are occurring?
  - Unit costs for repair and replacement are increasing.
  - The useful life of an asset is being reduced.
  - Business activity or property value is decreasing.
  - Operating costs are increasing.
- How large is the potential future cost caused by deferred maintenance? Is there a plan for funding it?
- Are future maintenance costs projected before new capital facilities are built?
- Is there a schedule that shows the cost and timing of future maintenance and replacement needs for all government assets? Are operating costs also taken into consideration?

**Suggestions for policy statements:**

Policy statements could be developed to suggest levels of spending as well as budgeting procedures for maintaining fixed assets. The following policy statements can help local officials relate this indicator to their financial decision making.

- The budget will provide sufficient funding for adequate maintenance and orderly replacement of capital plant and equipment.
- All assets will be maintained at a level that protects capital investment and minimizes future maintenance and replacement costs.
- All equipment replacement and maintenance needs for the next five years will be projected and the projection will be updated each year. A maintenance and replacement schedule based on this projection will be developed and followed.
- Future maintenance needs for all new capital facilities will be fully costed out.

# **Town of Payson**

## **Evaluating Financial Condition**

### **Indicator 27 Analysis**

#### **Capital Outlay**

**Warning trend:** A three or more year decline in capital outlay from operating funds as a percentage of net operating revenues.

#### **Suggestions for analysis:**

If the warning trend is observed, try to identify the causes (Why is it happening?), assess the significance (Is it important?), and devise action strategies (What can be done?). The following are starting points for this analysis.

- Is needed capital outlay being deferred? Is this leaving your government with worn or obsolete equipment?
- Can improved maintenance extend the efficiency and life of the equipment? For example, does your government have official maintenance and replacement schedules, and are such schedules developed for each new piece of equipment?
- Is the decline due to an inability to make large-scale purchases in a single year? Can an internal service fund be established to charge departments a lease fee covering operating and replacement costs, thereby building a replacement fund over a number of years? Or can a simple reserve fund be established for the same purpose?
- Is the decline in capital outlay due to the recent acquisition of equipment with a relatively long life, or the acquisition of more efficient equipment that reduces overall needs for equipment replacement?

#### **Suggestions for further analysis**

If a major portion of your government's equipment purchases is made through an internal service, enterprise, or capital projects fund, then that fund should be analyzed separately, perhaps in conjunction with indicator 25, Maintenance Effort.

#### **Suggestions for policy statements:**

See the suggested policy statements under indicator 25, Maintenance Effort.

# **FACTOR 7**

## **Community Needs & Resources Indicators**

**Town of Payson**  
**Evaluating Financial Condition**  
**Factor 7**  
**Community Needs and Resources Indicators**

The community needs and resources indicators encompass economic and demographic characteristics including population, personal income, property value, and employment and business activity. Tax base and economic and demographic characteristics are treated as different sides of the same coin. On the one side, tax base determines a community's wealth and its ability to generate revenue (that is the level of personal, commercial and industrial income). On the other side are economic and demographic characteristics that affect community demands, such as demands for public safety, capital improvements, and social services.

Changes in community needs and resources are interrelated in a continuous, cumulative cycle of cause and effect. For example, a decrease in population or jobs lowers the demand for housing and causes a corresponding decline in market value of housing; this in turn reduces property tax revenues. The initial population decline also has a negative effect on retail sales and personal income, causing local revenues to drop even further. But because of fixed costs in its expenditure structure that are impervious to declines in population or business activity, the government cannot always balance the revenue loss with a proportionate reduction in expenditures. The government may, in fact, be forced to raise taxes to make up for the lost revenues; this puts a greater burden on the remaining population. As economic conditions decline and taxes rise, the community becomes a less attractive place to live and the population may decline even further. The cycle continues.

Community needs and resources are difficult to translate into indicators because data are not easy to gather. We have included those indicators that we were able to gather data.

An examination of local economic and demographic characteristics can identify the following situations:

- A decline in the tax base as measured by population, property value.
- A need to shift public service priorities because of a change in age or income of residents or in the type or density of physical development.
- A need to reassess public policies if, for example, the national or regional economic conditions have changed.

Changes in economic and demographic characteristics are most useful for long-run financial analysis.

# **Town of Payson**

## **Evaluating Financial Condition**

### **Indicator 28 Analysis**

#### **Population**

**Warning trend:** Rapid change in population size.

#### **Suggestions for analysis:**

If the warning trend is observed, try to identify the causes (Why is it happening?), assess the significance (Is it important?), and devise action strategies (What can be done?). The following are starting points for this analysis.

- If population is declining, consider the following questions:
  - Is out-migration due to poor job opportunities or other adverse economic or social conditions? For example, is the tax burden on businesses relatively high compared to that of nearby communities? Are young adults out-migrating?
  - Has the rate of in-migration decreased because of housing or job scarcity?
  - Has demand for industrial and commercial real estate decreased?
  - Might governmental action reverse this trend? See indicators 32, 34, and 36: Property Value, Vacancy Rates, and Business Activity.
  - Has the number of smaller households increased, thereby creating additional service costs to the government? If so, are smaller households increasing in number because there are fewer families with children?
  - Are housing construction patterns providing more multifamily units or smaller units?
- Can local officials address the population decline by any of the following means:
  - Encouraging more housing starts by reducing building code restrictions, development fees, or other land-use restrictions?
  - Zoning to encourage residential development?
  - Developing or improving a program for marketing available land for development?
- If population is increasing, consider the following questions:
  - Is the increase due to the annexation of developed land, housing redevelopment, or new housing construction?
  - Is the cost of servicing the new residents' equal to revenues obtained from them? Is the level of business activity growing along with the increase in residential development? See indicator 33, Residential Development.
  - Is growth straining one or more of the following: water supply, sewer system capacity, traffic circulation, off-street parking capacity, electric and other utility capacities, waste disposal capacity, quality of atmosphere, or



- open space resources? What are the capital costs of enlarging the infrastructure of these services? What are the new operating costs?
- Should developer fees, user fees, land dedication, or construction requirements be instituted or increased to ensure that new development pays its way?
  - Can and should local officials institute growth controls?

### **Suggestions for further analysis**

Many communities experience temporary or seasonal population growth that is not reflected in the U.S. census data. If this is true of your community, you may want to develop ways to track these temporary population changes, and to determine any increase in service demands or revenues associated with them.

**Town of Payson**  
**Evaluating Financial Condition**  
**Indicator 29 Analysis**  
**Population Density**

***Warning trend:*** Decreasing population density

**Suggestions for analysis**

If the warning trend is observed, try to identify the causes (Why is it happening?), assess the significance (Is it important), and devise action strategies (What can be done?). The following are suggested starting points for this analysis.

- If the population density appears low, are other indicators such as Indicator 10, Expenditures per Capita, and Indicator 12, Employees per Capita, higher than expected or when compared to other communities.
- If the population density appears high, are there ways to achieve productivity reductions in public services through consolidation of activities.

**Suggestions for policy statements**

A policy statement could be developed to suggest the benefits of in-fill development for geographic areas where streets, utilities, and other infrastructure are already in place.

**Town of Payson**  
**Evaluating Financial Condition**  
**Indicator 30 Analysis**  
**Median Age**

***Warning trend:*** Increasing median age of population

**Suggestions for analysis:**

If the warning trend is observed, try to identify the causes (Why is it happening?), assess the significance (Is it important?), and devise action strategies (What can be done?). The following are starting points for this analysis.

- Is the increase in median age due to a net out-migration of young families with children? If this pattern is undesirable, can the community be made more attractive to young families?
- Is the increase in median age due to a net out-migration of young adults? Can local officials help create better opportunities for this age group?
- Is the increase in median age due to the in-migration of older citizens? Is this in-migration creating needs for a higher level or a different mix of services?

**Town of Payson**  
**Evaluating Financial Condition**  
**Indicator 31 Analysis**  
**Personal Income per Capita**

**Warning trend:** Decline in the level, or growth rate, or personal income per capita (constant dollars)

**Suggestions for analysis:**

If the warning trend is observed, try to identify the causes (Why is it happening?), assess the significance (Is it important?), and devise action strategies (What can be done?). The following are starting points for this analysis.

- Is the decline due to a general decline in economic conditions over which local officials have little control?
- Is the decline being felt throughout the region or only in your community? Can economic development strategies be devised to attract and retain higher-income households? Can government powers be used to encourage development of higher value housing? Can services and capital infrastructure be upgraded to make the community a more desirable place to live and do business?
- Is the decline due to an out-migration of middle or upper-income households? Will the community be left with a population that needs a higher level of services but that provides a lower level of per capita revenue? See indicator 1, Revenues per Capita.
- Is the decline due to an in-migration of low-income households? See indicator 31, Poverty Households or Public Assistance Recipients.
- Is the decline in personal income creating a decline in governmental revenues? If so, can a proportionate change in expenditures be made? If not, are there sufficient resources for maintaining existing service levels, or are there plans for future cutbacks?

# **Town of Payson**

## **Evaluating Financial Condition**

### **Indicator 33 Analysis**

#### **Property Value**

**Warning trend:** Declining growth or drop in market value of residential, commercial, or industrial property (constant dollars)

#### **Suggestions for analysis:**

If the warning trend is observed, try to identify the causes (Why is it happening?), assess the significance (Is it important?), and devise action strategies (What can be done?). The following are starting points for this analysis.

- Is the decline due to regional trends over which local officials have no control? Will the decline have a negative effect on revenues? Are contingency plans being made?
- Is the decline due to a decline in population or business activity? See indicators 28 and 36, Population and Business Activity.
- Is the decline due to a deterioration of the capital plant? Can any of the following means be used to upgrade the capital plant?
  - An improved maintenance and replacement program.
  - New or better construction.
  - Redevelopment and other long-term financing.
  - The use of one-time grants dollars.
  - The use of impact fees for improvement of roads, parks, water, or sewer facilities
  - Stimulation of private investment.
- Is the decline due to deterioration in the housing stock? Can any of the following means be used to upgrade the housing stock?
  - Redevelopment programs
  - Rehabilitation loans
  - Housing grants
  - Mortgage subsidies
  - Code enforcement
  - Special assessment districts
  - Incentives for new development or rehabilitation.

#### **Suggestions for further analysis**

Rapidly increasing property value, as well as rapidly decreasing property value, can be a sign of potential trouble. If property value is growing significantly faster than personal or median income, and reassessment is capturing this growth, more citizens may become unable to pay their property taxes--especially older citizens on fixed incomes. To assess the potential for this situation, compare the

**Town of Payson  
Evaluating Financial Condition  
Indicator 34 Analysis  
Top Five Taxpayers**

**Warning trend:** High percentage or increasing percentage of overall assessed valuation owned by a few taxpayers.

**Suggestions for analysis**

If the warning trend is observed, try to identify the causes (Why is it happening?), assess the significance (Is it important?), and devise action strategies (What can be done?). The following are starting points for this analysis.

- Are there opportunities to diversify the community's property tax base through economic development efforts?
- Are the top taxpayers considered financially stable? Do their needs for services dovetail with the needs of the broader community, or do they conflict?
- Could other services of revenue be expanded or added to diversify the overall stream of revenues?

**FACTOR 8 to 12**

**Additional Indicators**

**Town of Payson**  
**Evaluating Financial Condition**  
**Factor 8**  
**Intergovernmental Constraints**

By virtue of state and federal constitutions, local governments are creatures of the state in which they are incorporated. Even in states where local governments are incorporated by charter, the state often dictates the form of charter. In addition to incorporation laws, local governments are affected by other intergovernmental constraints ranging from cooperative inter-local agreements to federal restrictions. These constraints can affect local government structure, service responsibilities, and financing powers. Local government officials may find that such constraints limit the flexibility of their decision-making.

In recent years, both the federal government and many state governments have mandated new services and/or spending levels for programs. Simultaneously, these higher levels of government have reduced aid to local governments as a mechanism for coping with their own budget woes. These actions have severely harmed many local governments' financial condition.

Intergovernmental constraints are difficult to measure because they are a highly subjective and variable factor. The following questions can, however, help you to analyze the effect of intergovernmental constraints on your government's financial condition.

- What is the level of revenues from intergovernmental sources? What is the level of expenditures for matching requirements for these grants? What are the administrative costs of these grants? See indicator 3, Intergovernmental revenues.
- What is the level of expenditures for mandated programs? See indicator 12, Fixed Costs.
- How close is your government to its tax rate ceiling, if applicable?
- How close is your government to its debt ceiling, if applicable?



**Town of Payson**  
**Evaluating Financial Condition**  
**Factor 9**  
**Natural Disasters and Emergencies Risk**

Natural disasters include fires, earthquakes, hurricanes, blizzards, floods, tornadoes, and similar events that require significant local government expenditures, and can devastate the local economy. To the extent that they can be anticipated, such events can be budgeted for, thereby lessening their impact on financial condition. A policy to maintain adequate reserves for emergencies and a high-quality risk management program can help protect the local government financially. But when the natural disaster is of a huge scale, it can burden the government with substantial costs that will probably not be fully alleviated by intergovernmental assistance.

Natural disasters and emergencies can cause financial harm in many ways. First, they may damage or destroy government equipment, capital facilities, and property. Second, they may require the local government to provide emergency police, fire, sanitation, and general welfare services. Third, the local government may have to help the community replace or repair lost private property. Fourth, the natural disaster may temporarily undermine the health of the local business community. If business activity and employment decrease, governmental revenues may drop and expenditure pressures may increase until the commercial sector can recover. And last, if the disaster is of large enough proportion residents and businesses may leave the area permanently, altering the economic and demographic base of the community.

While a local government cannot predict the exact timing and magnitude of a natural disaster, planning and preparation will help if and when one does occur. The questions that follow can help you to evaluate the impact of a natural disaster or emergency on your government's financial condition.

- Has your government analyzed its needs for reserves to respond to a natural disaster or emergency?
- Does your government have a comprehensive emergency operations plan?
- If your community has suffered damage from past disasters, have steps been taken to reduce the potential of future damage in those areas (for example, restriction of development in flood zones)?
- Is your government's insurance coverage adequate? Have its insurance needs been evaluated recently? If little insurance coverage is available, has this issue been discussed with appropriate officials?

**Town of Payson**  
**Evaluating Financial Condition**  
**Factor 10**  
**Political Culture**

Political culture refers to the community's attitudes toward taxes and services. Of all the factors that affect financial condition, local political culture is perhaps the most difficult to analyze, primarily because it is influenced by the interaction of individuals and by their varying economic, ethnic, religious, and social backgrounds.

In addition to social and demographic characteristics, other issues to be considered are:

- The manner of political representation
- The extent of citizen participation
- The structure of the government organization
- The decision-making process
- The content of political issues
- The age, size, and density of the community

Because political culture is highly subjective, this handbook does not include indicators or evaluation questions for measuring it. However, a careful assessment of these issues, based on your own knowledge, is valuable in relating this factor to an evaluation of financial condition.

# **Town of Payson**

## **Evaluating Financial Condition**

### **Factor 11**

#### **External Economic Conditions**

External economic conditions include trends in inflation, employment, economic wealth, interest rates, and business activity. By and large, these conditions are beyond the control of local governments, which can usually only react to them. Anticipation and preparation are the best means of adjusting to changes in external economic conditions.

In the long run, this means building a local economic base that is protected from sudden downturns in the business cycle but that can still take advantage of upturns. To build such a base, a community must spend enough on the development and maintenance of its capital plant and provide a level of services that will encourage businesses to stay and expand. It must also have a stable, revenue-producing commercial and industrial sector whose markets will not diminish during national recessions. The community must carefully apply land-use controls and other government powers. Tax rates should be competitive with those of other jurisdictions providing similar services, so that businesses and residential development are not drawn away. The community needs a nearby labor force that suits the available jobs, access to capital for expansion, plus other resources such as transportation routes providing good access to business markets. The availability of natural resources such as oil and minerals also influences the economic strength of some industries.

The lack of easily collected data and the existence of deficiencies in analytical procedures make it difficult to measure accurately the impact of external economic conditions at the local level. Because most of the current techniques are costly and require expertise not usually available to local governments, assessing these factors is generally not cost effective. Although it does provide directions for making inflation adjustments for some of the thirty-six indicators, this handbook does not include indicators that explicitly measure the impact of external economic conditions at the local level.

While you may not be able to explicitly measure the influence of such conditions on your community, the following questions can help you evaluate how well your local government may be able to adjust to changes in external conditions.

- What is the composition of your community's tax base? How sensitive is it to changes in the national and state economy? To help you answer these questions see the following indicators: 1, Revenues per Capita; 2, Restricted Revenues; 4, Elastic Tax Revenues; 6, Property Tax Revenues; 28, Population; 35, Employment Base; and 36, Business Activity.
- What is the level of revenues from intergovernmental sources? See indicator 3, Intergovernmental Revenues.
- What mix and level of services is your government required by state law or local practice to provide?

- What is the level of fixed costs in your government's budget? See indicator 12, Fixed Costs.
- In the past, have officials made necessary budget decisions (e.g., raised taxes, cut expenditures) during adverse economic change? See factor 12, Management Practices and Legislative Policies.

**Town of Payson**  
**Evaluating Financial Condition**  
**Factor 12**  
**Management Practices and Legislative Policies**

In many respects, management practices and legislative policies are the most critical influences upon financial condition. The response of a local government's management and legislative body to environmental influences can have a crucial effect on financial condition, as highlighted in figure 1. Figure 1 is shown to illustrate the fact that management practices and legislative policies are central to the flow of influence and information. A local government's response to changes in environmental factors (left side) is filtered through the organizational factors to result in the financial factors (right side).

Management practices and legislative policies are often regarded as the most critical influences on financial condition because a local government can theoretically adjust to environmental changes by changing its expenditure pattern. This assumes that the governmental unit will have enough notice of problems, that it understands their nature and extent, that it knows what to do, and that it is willing to do it. While these assumptions may be optimistic, practices and policies are the factors over which a local government has control. It is through practices and policies that a government can exert leverage when wrestling with financial problems.

When credit rating firms evaluate the financial condition of local governments, they consider management practices and legislative policies to be very important. For example, they assess the "professionalism" of management by examining the quality of financial reporting and capital planning, and by checking to see whether the government has used any financial gimmickry. They determine the responsiveness of the legislative body by considering whether elected officials have been willing to raise tax rates when needed. In short, sound financial practices and policies enable a local government to maintain good financial condition and to avoid financial emergencies. Because these influences are subjective, this handbook does not include indicators for measuring this factor. Instead, the two sections that follow are designed to help you to (1) determine whether your local government is using management practices that can inadvertently jeopardize its financial condition, and (2) assess your government's legislative policies as a means of keeping the government in good financial condition.

**Evaluating financial management practices**

There are too many management practices and they are too varied to be completely evaluated in this handbook. It is possible, however, to assess fairly quickly whether your government is relying on practices that, while not inherently bad, can damage its financial condition if they are used for too long. These practices fall into three categories:

- Repeated use of one-time revenue sources, such as prior years' reserves or proceeds from the sale of assets, to balance the budget
- Deferring a large amount of current costs to the future: deciding, for example, to postpone maintenance of capital assets or to defer pension liabilities
- Ignoring long-range or full-life costs of a liability. Deciding, for example, to purchase a capital asset without calculating the full-life costs of owning, operating, and maintaining the asset.

Most local governments recognize the danger of such practices and would not ordinarily use them. In times of stress caused by financial problems or political pressures, however, local officials may find themselves tempted or even forced to use them.

As interim strategies, these practices can resolve temporary problems and provide time to find long-run solutions to financial troubles. For example, deferring maintenance costs for one year may allow the initiation of new cost-cutting programs and adjustments in service. But continued use of such practices can harm a local government's financial condition in three ways.

First, these practices can create problems. A community may already have a few financial problems, but if it does not take into account the full-life cost of a new program or project, it may commit itself to future expenditure obligations that it cannot meet. This can happen, for example, if the government grants employees additional fringe benefits without first costing out the benefits in dollars and projecting their impact on future budgets.

Second, these practices may compound existing problems. For example, when a government defers a current expenditure by postponing maintenance on capital equipment, the effectiveness and efficiency of operations may go down, thereby causing service delivery costs to go up. Moreover, the equipment may deteriorate until it becomes more expensive to repair than if it had been regularly maintained.

Finally, these practices may delay recognition of existing problems. This is the most dangerous result, because it permits problems to persist and to grow to serious proportions. Eventually, solving the problem may be much more costly and difficult than it would have been at an earlier phase. For example, if over several years a local government does not fund accrued pension liabilities, pension costs can eventually become a large percentage of fixed costs at a time when revenues are no longer growing, forcing an ill-timed and disruptive reduction in services.

Discovering how or to what extent these practices may be jeopardizing a government's financial health is not always easy. To evaluate whether such practices are harming your government's financial condition, read the description of the practices contained in this section of the handbook; if an indicator is associated with the practice, examine the indicator to see whether it shows a reliance on the financial management practice in question.

After reviewing the practices and indicators, use the questions in figure 2 to conclude your evaluation and summarize the results.

### **Practices that sustain an operating deficit**

An operating deficit occurs when current expenditures exceed current revenues. This may occur even though the annual budget is balanced, because one-time revenue sources (such as a surplus from a previous year) can be used to supplement current revenues.

An operating deficit in any one-year may not be cause for concern, but frequent and increasing deficits can be a warning sign. If an operating deficit is allowed to continue to grow, two questions should be asked:

- Is the government continuing a level of services and expenditures that it may not be able to afford in the long run?
- Is the government ignoring the underlying cause of the deficit, such as a declining revenue base or decreased productivity, and thereby compounding the problem?

Local officials may have trouble spotting an operating deficit because most municipal accounting systems do not provide information that would make an operating deficit obvious. That is, municipal accounting systems do not use cost accounting, nor are revenues and expenditures fully accrued. These two circumstances prevent officials from obtaining precise information on the government's operating position. Nevertheless, telltale signs can point to the existence of an operating deficit. These signs are the repeated use of the following practices: using reserves (fund balances) from prior years, short-term borrowing, internal borrowing, selling assets, and one-time accounting changes.

### **Use of reserves**

For most governments, surpluses from prior years are a cushion that allows them to meet current cash flow needs, temporary revenue shortfalls, or unexpected expenditure demands--without suddenly adjusting tax rates or cutting expenditures during the budget year. Fund balances can also help local governments avoid short-term borrowing, thereby saving interest costs (although the opportunity to earn interest on a fund balance is lost).

A consistent decline in fund balances over several years is one indication that the government may be sustaining an operating deficit. Relying on reserves to sustain the deficit can be damaging in two ways: first, the government is left with fewer resources to cope with a financial emergency; second, relying on reserves may affect the government's credit rating, because credit rating firms examine the history of fund balances.

To determine whether your government is using reserves to balance the budget, see indicator 14, Operating Deficits, and indicator 16, Fund Balances.



## **Short-term borrowing**

In short-term borrowing, the government incurs a debt that it must pay back within twelve months. When revenues and previous surpluses (fund balances) do not provide enough cash to meet expenditures during the fiscal year, tax anticipation notes (TAN's) can be issued to obtain cash. When the taxes are collected, these notes are redeemed. Similarly, bond anticipation notes (BANs) can be issued in anticipation of bond issues.

Lending institutions and the community generally regard such borrowing as an acceptable fiscal procedure as long as it is temporary and tax collections are clearly large enough to repay the debt within the fiscal year. At times, however, revenue shortfalls or over-expenditures may render a local government unable to repay short-term borrowing within this time period. In this event, the government may choose to repay the loan and then re-borrow the money, or simply to pay only the interest on the loan and not the principal. This practice, called "rolling over" short-term debt, can in effect turn short-term debt into long-term debt. Some analysts spot financial troubles by looking at the level of short-term debt outstanding at the end of the fiscal year as a percentage of revenues. Rolling over short-term debt can create several problems for a local government:

- Interest rates are added for the time the debt remains outstanding.
- The government's credit rating may be affected; when assessing the investment worthiness of a municipality, investors and bond rating firms look more and more closely at short-term debt.
- Unless revenues increase or the debt is rolled over yet another year, the government is forced to reduce service levels or raise revenues in the next fiscal year to pay off the debt.

To determine whether your government is using short-term borrowing to balance the budget, see indicator 14, Operating Deficits, and indicator 18, Current Liabilities.

## **Use of internal borrowing**

Internal borrowing occurs when one fund runs out of money and the fund "borrows" from other funds rather than an outside source. In private business, the entire business is treated as a single entity. But in municipal accounting, revenues and expenditures are recorded in different funds, each with its own balance sheet and operating statement; money can therefore be transferred from one fund to another.

Not all inter-fund transfers are "borrowing"; some occur regularly as a matter of explicit policy. For example, if an enterprise activity is generating a surplus, the surplus may be transferred periodically to the general fund to subsidize other expenses; there is no intention of repaying the money later. Similarly, a government may shift money into an internal service fund to reflect the value of services provided by one government department to another. Inter-fund



"borrowing" occurs when money is transferred from a fund that has been accumulating money for a special purpose, such as capital improvements, to another fund, and there is an intention to repay at a later date.

Because borrowing internally is usually less expensive than borrowing externally, internal borrowing can save a local government money. Internal borrowing can also be easier and quicker because it involves fewer actors.

Repeated use of internal borrowing, however, can create a future liability that the local government may not have the resources to meet--which can in turn force a disruptive reduction in services or cause a shortage in the fund from which the money was borrowed. If, for example, money borrowed from a capital improvement fund cannot be repaid, improvements may have to be delayed or forgone. If money is borrowed from a self-insurance fund, the government jeopardizes its ability to absorb large losses from liabilities. To determine whether your government is relying on internal borrowing to balance the budget, see indicator 14, Operating Deficits, and indicator 16, Fund Balances.

### **Selling assets**

Most local governments own property or facilities, such as vacant land or unused buildings, that would be valuable to other local governments or to private interests. Selling such assets can bring in one-time revenue. For example, a city might sell its sewers to an independent authority and use the proceeds for general city operating expenses. When one-time revenues are used for current operating expenditures instead of for one-time needs, they are sustaining an operating deficit. Aside from sustaining an operating deficit, selling an asset may harm the local government's long-run financial condition in the following ways:

- Flexibility in service delivery capacity may be reduced because the government loses control of how service is provided.
- If it sells under the pressure of immediate revenue needs, the government may accept a lower price than it would otherwise have received for the property.
- If the government decides to reacquire the asset, doing so may be more expensive at a future date.
- The sale of utility or recreational facilities may make the community dependent on someone else for prices and availability.

To determine whether your government is relying on the sale of assets to balance its budget, see indicator 5, One-time Revenues, and indicator 14, Operating Deficits.

### **One-time accounting changes**

Accounting methods can be manipulated to make a budget appear balanced. For example, if a payroll day falls on the last day of a fiscal year, the local government may be tempted to wait one day to record those expenses, thus

making expenses for the current year appear smaller. An end-of-year surplus could thereby be made to look larger or a deficit smaller (or nonexistent).

Three commonly used one-time accounting changes are (1) postponing current costs to future periods, (2) accruing revenues from a future fiscal year to the current fiscal year (to make the current revenues appear higher), and (3) extending the length of the fiscal year. For example, from twelve to thirteen months--so those revenues in the thirteenth month can be counted as revenues for the current year.

Many local governments that have had financial problems have relied on one-time accounting changes to balance their budgets, but these techniques do not solve under-lying problems; they only disguise them. Credit rating firms and other analysts look unfavorably on such practices. Even if they do not violate the letter of accounting standards and state laws, one-time accounting changes are considered unsound because they almost always violate the intent of these laws and standards.

### **Practices that defer current costs**

A local government is deferring current costs when it does not meet all its expenditure needs in the current budget. Two examples of the kinds of costs that can be postponed are contributions to employee pension funds and expenditures for the maintenance of capital plant. Deferring current costs has several general drawbacks:

- It sustains a level of services and expenditures that the government may not be able to afford in the long run.
- It can affect a government's bond rating. Credit rating organizations consider non-funded liabilities an unfavorable sign.
- Because these costs do not ordinarily show up on municipal financial records, their effect may not be recognized until the problem is serious.

Two kinds of deferred costs will be considered here: Deferred pension liabilities and deferred maintenance of capital assets.

### **Deferred pension liabilities**

A pension liability is a legal commitment a government has made to pay benefits to its employees at some point in the future. There are two basic ways to fund this liability. The first way is "full funding," which means reserving money in a special fund as benefits are accrued. The "pay-as-you-go" method requires that current pension payments be made from the general fund as benefits become due.

Many local governments choose the pay-as-you-go method because it requires less spending from the current budget. This method is successful as long as the money is available when needed. The problem created by deferral, however, may be more serious than the problem it was intended to avoid, especially if

accrued benefits increase rapidly while revenues remain stable or decline. As more employees become entitled to benefits, and as inflation increases the cost of benefits, pension costs can become a large fixed cost in the operating budget.

The analysis of non-funded pension liability is highly technical. Developing indicator 22, Unfunded Pension Liability, can help you to determine whether and to what extent your government is deferring pension liability.

### **Deferred maintenance expenditures**

A government's capital assets include its streets, buildings, utility networks, and equipment. If these assets are not adequately maintained or if they are allowed to become obsolete, efficiency drops, maintenance and replacement costs go up, and the community becomes a less attractive place to live and do business.

In times of financial strain, local officials often see deferred maintenance as a relatively painless, short-run way to reduce expenditures. Continued deferral, however, can create serious problems because of the huge sums of money invested in capital facilities. Following are some of the potential problems created by deferral:

- Safety hazards and other liability risks created, for example, by an unrepaired street
- Decline in residential and business property values
- Loss of efficiency of equipment if, for example, an obsolete truck spends more time in the garage than on the street
- An increase in the cost of repairing a capital asset (for instance, when street repair is postponed so long that the street has to be completely reconstructed).

To check on your government's deferral of maintenance expenditures, see indicator 25, Maintenance Effort.

### **Practices that ignore full-life costs**

A local government that fails to consider the long-range costs of a liability can jeopardize its financial condition by building a future imbalance between revenues and expenditures. Many communities do this by granting labor agreements without costing out nonsalary benefits, or by arranging to construct or purchase a capital asset without calculating the full-life operating and maintenance costs.

### **Nonsalary employee benefits**

Nonsalary benefits include pension plans, health and life insurance, vacation, sick and holiday leave, deferred compensation, disability insurance and educational provisions. The cost of these benefits is difficult to assess because their value often varies from one employee or group of employees to another. Benefits depend on variables such as occupation and length of employment.

Translating the costs into budget dollars requires a special analysis. But if nonsalary benefits are not calculated, a local government may face the following problems:

- It may not be able to accurately budget enough money for benefit costs in the current budget.
- It may have trouble making long-range expenditure forecasts, and thus will be unable to anticipate and prepare for increases as they occur.
- It may find itself in a weak position in negotiating with labor unions: without good information on the exact cost of a proposal, it is difficult to judge competing proposals.
- It may not be able to predict the budget impact of increases or decreases in personnel.

### **Capital assets**

A community's capital assets are long-term investments with high initial costs. During the capital planning and budgeting process, local officials usually consider carefully how to finance assets. Often overlooked, however, are the long-range costs of owning and maintaining the asset--the "full-life" costs. These costs are overlooked because capital and operating budgets are generally developed separately, and the operating costs of owning and using the asset are not planned for. These costs can also change over time. For example, the cost of using an older asset may be much less than the cost of using its replacement; the higher cost of the new asset might not be anticipated when the old asset is replaced.

Here are some disadvantages of not calculating total costs:

- The government may not be able to budget accurately the operating costs of the asset.
- The government may have incomplete information when choosing which capital asset to obtain. For example, since the cost of owning and maintaining a fleet of garbage trucks is high, it may be cheaper to contract for solid waste services.
- The government may have trouble forecasting long-range expenditure needs.

### **Evaluating legislative policies**

This section is designed to help you evaluate the usefulness of your government's legislative policies in protecting and improving its financial position. This section also includes suggestions on how to develop or improve policy statements. Although a broad range of statements, decisions, and activities could be construed as financial policies, financial policies are defined here as goals for the financial operation of a local government. Setting goals is important for financial health because it gives local officials a long-range perspective on their current approach to financial management. It also helps officials agree on the kind of financial condition they want for their government.

In most communities, policies already exist in budgets, in capital improvement plans, in the general or comprehensive plan, in a charter, in a grant application, in council resolutions, and in administrative practices. When financial policies are scattered among these kinds of documents, are unwritten, or are developed case-by-case, decisions are often made without consideration of other current policy decisions, past policy decisions, or future policy alternatives. This kind of policy making can lead to the following:

- Conflicting policies. The governing body may be making decisions that conflict with each other.
- Inconsistent policies. The governing body follows certain policies on one issue, and then reverses itself on a similar issue.
- Incomplete policies. The governing body may not be making any policy at all on some aspects of financial management.

A formal set of policies can help the chief executive and the governing body discover conflicts, inconsistencies, and gaps in their financial policies. It also can help the manager and governing body develop similar expectations regarding both managerial and legislative financial decision making.

Here is a list of some other benefits to establishing financial policy:

- Publicly adopted policy statements can contribute greatly to the credibility of (and to public confidence in) the government. Such statements show the credit rating industry and prospective investors a government's commitment to sound financial management and fiscal integrity.
- Established policies can save the manager and elected officials time and energy. Once certain policies are set, the issues do not need to be discussed each time a decision is made.
- The process of developing overall policies directs the attention of management and elected officials to the government's total financial condition rather than to single issues. Moreover, this process requires that long run financial planning be linked to day-to-day operations.
- As overall policies are developed, the process of tying issues together can bring new information to the surface and reveal additional concerns that need attention.
- Discussing financial policy can educate elected officials by making them more aware of their role as policy makers in maintaining good financial condition.
- Discussing financial issues and adopting a formal position can help the government to prepare for a financial emergency and to avoid relying on short-run solutions. (See the section entitled "Practices that sustain an operating deficit" for examples of short-run solutions.)
- Setting policies can improve fiscal stability by helping local officials look down the road, plan tax rates and expenditures two to three years ahead, and be consistent in their approaches to planning.
- Finally, explicit policies contribute to continuity in the government's financial affairs. Local officials may change over time, but policies can continue to guide whoever manages the government.

To evaluate your government's policy statements, you will need to take four steps:

1. Pull together existing explicit and implicit financial policies. Internal documents and manuals are probably the best starting place for this task. Local and state laws that apply to financial management also need to be included.
2. Organize current policy statements. You may want to group these by functional area: budgeting, accounting, capital programming, debt management, and cash management. Or you may want to group them according to the financial factors used in this handbook: revenues, expenditures, operating position, debt structure, unfunded liabilities, and condition of physical plant.
3. Check for conflicting policies. In looking over current policies, check for direct or indirect conflict.
4. Check for incomplete policies. Your government may lack policy statements in major areas of financial administration. You can use several approaches to check for this.

Use the thirty-six indicators found in factors 1-7. Most indicators include suggestions for policy statements; work through these to see whether any apply to areas in which the government lacks policy statements.

Review the policy statements of other local governments. Ask department heads to review the policy statements. They may have ideas for new policy statements and for changes in existing policies. The finance director especially should be active in this process.

Once you have gone through these steps, you should have a fair sense of the adequacy of existing financial policies and good ideas for changes. But to be really effective, legislative policies must be publicly adopted and endorsed by your local government's legislative body. Once you have evaluated current policies, noting omissions and areas needing change, you are ready to present your findings to elected officials. Explain the process you used to identify the policy statements (steps 1-4 above). Then, encourage the officials to reaffirm the useful policies and to adopt new ones where necessary.

Finally, no matter how good your policy statements are, they will be of little value unless they are actually used in financial decision making. Here are three suggestions for using policies to protect your government's financial condition.

- Incorporate policies into your written or oral evaluation of financial condition. In your presentation, compare the trend for each indicator that you have developed with the corresponding guidelines in the statements. If your government is within its own guidelines, this will help the reader (or listener) interpret the indicator. If an indicator deviates from the targets set in the policy statements, then you know that the government needs to make plans

to improve its future financial management or that the targets in the policy statements need to be reevaluated.

- Incorporate policies into the budgeting process. In reviewing each budget section and the budget totals, do some preliminary analysis to see the effect on your policy targets of adopting that budget section.
- Incorporate policies into your capital budget and capital improvement plan. You might have a section under each item called "Comparison with Policy Statement," in which you say whether this item is in accord with the adopted policy statement.



**Town of Payson  
MANAGEMENT PRACTICES**

<b>Management Practices</b>	<b>1. Has the practice been used for two or more consecutive years during the last five years or for any three of the last five years?</b>	<b>2. If yes, has use of the practice created or compounded financial problems?</b>	<b>3. If yes, have plans been made to deal with the problem?</b>	<b>4. Has more than one practice been used in any one of the last three years? Is there a pattern of use of these practices?</b>
	<b>Yes No Not sure</b>	<b>Yes No Not sure</b>	<b>Yes No Not sure</b>	<b>Yes No Not sure</b>
<b>Using reserves to balance the budget</b>	<b>No</b>			<b>No</b>
<b>Using short-term borrowing to balance the budget</b>	<b>No</b>			<b>No</b>
<b>Using internal borrowing to balance the budget</b>	<b>No</b>			<b>No</b>
<b>Selling assets to balance the budget</b>	<b>No</b>			<b>No</b>
<b>Using one-time accounting changes to balance the budget</b>	<b>No</b>			<b>No</b>
<b>Deferring pension liabilities</b>	<b>No</b>			<b>No</b>
<b>Deferring maintenance expenditures</b>	<b>Yes</b>	<b>No</b>	<b>Yes</b>	<b>No</b>
<b>Not cost out nonsalary employee benefits</b>	<b>No</b>			<b>No</b>
<b>Ignoring full-life costs of capital assets</b>	<b>No</b>			<b>No</b>



## Town of Payson Evaluating Financial Condition Analytical techniques

Town officials can use the five analytical techniques described in this section to obtain comprehensive financial information and to improve their financial decision-making. The techniques can be used either in conjunction with the Financial Trend Monitoring System or independently of the system. This section does not provide detailed descriptions of how to use each technique; it does

- Introduce the techniques
- Explain how they can improve financial decision making
- List the kinds of information that the techniques require
- Describe the types of calculations that users will need to make.

Financial issue	Related indicator	Analytical technique
What effect has inflation had on the government's budget?	1 Revenues per capita 2 Property tax revenues 10 Expenditures per capita 15 Enterprise losses 25 Maintenance effort 30 Personal income per capita 32 Property value	<b>Adjusting for inflation</b>
Will increases in revenues keep pace with increases in expenditures? What are future revenue needs?	1 Revenues per capita 9 Revenue shortfalls 10 Expenditures per capita	<b>Forecasting revenues and expenditures</b>
What is the impact of community growth and change on the operating and capital budgets? What is the impact of alternative zoning decisions?	1 Revenues per capita 6 Property tax revenues 10 Expenditures per capita	<b>Fiscal impact analysis</b>
What percentage of service costs are user charges recovering?	8 User charge coverage	<b>Costing local government services</b>
Does the local government have enough reserves to protect its financial condition?	16 Fund balances	<b>Analyzing reserves</b>

## **Figure 1 Financial issues, related indicators, and applicable analytical techniques**

As presented in this handbook, these five techniques have two purposes. First, when used in conjunction with the indicators in FTMS, they can help town officials analyze and interpret trends. For example, if indicator 16, Fund Balances, shows a decrease in available unreserved fund balances, the section entitled "Analyzing Reserves" can help officials decide whether that trend is threatening their government's financial health.

Second, these analytical techniques complement the FTMS by requiring information beyond that called for by the indicators. For example, the trend worksheets rely only on historical data and do not ask users to collect information about future financial condition. But by combining the indicators on property taxes, population, property value, and residential development with forecasts of revenues and expenditures and fiscal impact analysis, town officials can better predict the kinds of pressure the government may be facing--and can gain more time in which to decide how best to face those pressures.

Figure 1 shows the relationship between aspects of a local government's financial health, selected indicators, and the techniques described in this section.

The discussion of each technique includes at least three elements: (1) a description of the technique, (2) a description of the process or calculation that the technique requires, and (3) a discussion of how the technique can be used by town government. Although this section will acquaint town officials with some of the financial management techniques available to them, it does not provide detailed information on how to use the techniques. Additional information about the techniques can be obtained by consulting the references listed at the end of this section.

### **Adjusting for inflation**

Adjusting for inflation translates current dollars into constant dollars to show how much of what appears to be growth is due to inflation. This information can be used in several ways:

- To help develop the indicators in the Financial Trend Monitoring System
- To help plan the annual budget, taking account of the effects of inflation on revenues and expenditures
- To help anticipate the impact of inflation on contracts which have an escalation provision, such as collective bargaining agreements, long-term rental agreements, etc.

- To detect price trends so that purchasing and contracting decisions can minimize the impact of inflation
- To measure inflation's impact on the government's budget over time.

Adjusting for inflation involves three steps: (1) selecting a price index, (2) selecting a base year as the starting point for comparison, and (3) dividing the figures for each year by the price index.

### **Selecting a price index**

A price index shows how prices for goods and services change over time. By comparing the cost of the same bundle of goods and services at two different times, we can calculate the impact of inflation. The most familiar price index is the consumer price index (CPI), which tracks the prices of goods and services purchased by the average urban wage earner and average urban clerical worker. Among the items included are food, housing, clothing, transportation, and health and recreation. Although the CPI is familiar and easily available, it can give local governments only an approximate indication of inflation's effects, because local government expenditures are not necessarily the same as those used in the CPI.

Another price index produced by the federal government is the "implicit price deflator for state and local government purchases of goods and services." This price deflator is developed by using payroll data and data on full-time equivalent employment, adjusted to reflect the changing composition of the government work force. Many analysts favor this price index over the CPI as it focuses more closely on traditional municipal-type goods and services. However, it is not as familiar to most people as the CPI. (The implicit price deflator for state and local governments can be found in various issues of the Survey of Current Business, U.S. Department of Commerce).

The municipal cost index (MCI), another possible price index for local government use, was developed by American City and County magazine, and is published there monthly. The MCI shows the effect of inflation on the costs of typical municipal services. It focuses on items that make up the bulk of municipal expenditures--wages, materials and supplies, and services provided by contractors. The MCI draws from the CPI to measure the upward pressure expected in municipal wage rates, and from the producer price index for industrial commodities (PPI) to track the cost of goods usually purchased by local governments, such as trucks, office machines, gasoline, and concrete. Finally, the MCI draws on the construction cost indexes published by the U.S. Department of Commerce. For local governments, the most significant construction expenses are those for capital construction. The advantages of the MCI are that it focuses on municipal expenditures and is readily available. The disadvantage is that it shows price changes on the national level only, and prices may vary significantly across the country.

In some states a municipal price index (MPI) has been or is being developed based on the goods and services commonly purchased by local governments in

that state. In states where an MPI is available, it will probably provide the most accurate inflation indicators for local governments. A university or a municipal league usually calculates the municipal price indexes.

### **Selecting a base year**

An index generally includes an index level for each year, starting with a base year for that index. Beginning with the release of data for January 1988, the standard reference base for the CPI was changed from 1967=100 to 1982-84 = 100. The Bureau of Labor Statistics, U.S. Department of Labor, took this action in keeping with the federal government's long-standing policy that index bases should be updated periodically. Index levels for years following show the average annual rate of price increases since 1982-84.

Although the index can be used as it stands, with 1982-84 as the base years, comparing today's costs with those of a decade ago may not be helpful. To make the numbers more useful, you may want to establish a new base year. For example, if you are developing an indicator for the five-year period from 1989-1993, you might want to set 1989 as your base year. To create a new index using 1989 as the new base year, you need to do the following calculations:

1. Set 1989 to 100.
2. Calculate the index numbers for each subsequent year. Multiply the prior year's 1989-based index number by the current year's 1982-84-based index number; then divide that result by the prior year's 1982-84-based index number.

### **Converting each year to constant dollars**

After you have chosen or adjusted a price index to obtain index numbers for each year, you need to convert dollars to constant dollars. If you are making this adjustment in conjunction with FTMS, specific directions on how to complete the calculations are included in the trend worksheets.

The technique of adjusting for inflation can also be used to prepare future spending plans in both constant and inflated dollars. To do this, you would project current inflation rates into the future and make some "best case" and "worst case" guesses about where price indexes will be.

### **Forecasting revenues and expenditures**

Town officials can use multiyear forecasting of revenues and expenditures in several ways:

- In annual budget preparation, forecasting can help to reveal a potential revenue gap, i.e., a shortfall between revenues and expenditures.
- In planning the capital budget, forecasting can help to identify potential excess revenues, which could be used, for example, for capital

projects or to cover debt service for funds borrowed for capital purchases.

- Forecasting can help to clarify the impact of various financial decisions on the budget, especially the impact of long-term decisions such as collective bargaining agreements, lease-purchase agreements, and capital planning decisions.

Most local governments already forecast revenues and expenditures twelve months into the future as part of their budget process. Preparing forecasts for three or five years ahead can provide earlier notice of emerging deficits and surpluses. These forecasts do not provide precise numbers; they only show trends. But if town officials are aware of the direction in which the government is headed, they can prepare budgets and set financial policies to reflect likely changes in revenues and expenditures.

There are four basic methods of forecasting: expert judgment, trend analysis, deterministic techniques, and econometric techniques.

### **Expert judgment**

Expert judgment, also known as "best guess," relies on the expertise of someone in the government who can fairly accurately predict, based on experience, the government's revenue and expenditure flows. Little can be suggested here about how to conduct this type of forecasting because the key ingredient is the expert, not any particular methodology. The major advantages of this approach are that it is quick and inexpensive. The primary drawback is that it depends on the subjective views of the forecaster; it may be difficult, for example, for the forecaster to explain why revenues or expenditures will be higher or lower than in previous years. Another drawback is that even if the expert's forecasts are generally accurate, if he or she leaves, the government loses the technique as well.

### **Trend analysis**

Apart from expert judgment, trend analysis is the simplest and easiest forecasting method, especially for smaller local governments. It works best when applied to revenues and expenditures that are fairly stable or likely to change only slowly, because trend analysis is based solely on time; that is, it assumes that the future growth rate of revenue and expenditures will be the same as in the immediate past. The steps in a trend forecast are as follows:

1. Analyze the present revenue structure. Break down revenues into whatever categories are most useful in your situation. Some major sources of revenue, such as the property tax, may remain relatively stable or change at a fairly steady rate. Others, such as sales and income taxes, may vary with business cycles. Still others cannot be relied on indefinitely; these may include grants or assistance from other levels of government.

For trend analysis, concentrate on the relatively stable and permanent sources. If there are several minor revenue sources, lump them together, their fluctuations are likely to cancel each other out.

2. Analyze the present expenditure profile. Break down spending into salary expenditures--which will probably be the largest single item--and non-salary expenditures. The second category can be further broken down into categories such as materials and supplies and equipment. Analyze the costs of debt service separately.

3. Develop a historical picture of revenues and expenditures. For each category of revenue that you developed in step 1, plot changes during the last five years. Do the same for the expenditure categories you developed in step 2. Be sure to "clean" the data to eliminate the effects of any changes your local government made in the way it treats each type of revenue or expenditure. For example, the government may have made a major reassessment of property values, causing a sudden jump in revenues from the property tax. Do not assume that those revenues will continue to grow at the same high rate; instead, try to estimate their rate of growth as if the reassessment had not occurred.

4. Try to predict how each type of revenue and expenditure will change in the future. To do this, you will have to choose which of the following three assumptions seems most reasonable for each revenue and expenditure category:

The variable will not change. For example, if on the average a certain number of business licenses were issued at a certain fee for the last five years, a reasonable assumption might be that this would not change during the next five years.

The variable will change by the same average absolute amount as in past years. For example, if sales tax revenues increased an average of \$100,000 each year during the last five years, you might assume that this pattern would continue for the next five years.

The variable will have the same rate of change in future years as in the past years. For example, if property tax revenues in previous years increased by 2.5 percent each year, you might assume that property taxes would continue to increase at the same rate.

The primary drawback of trend analysis is that it cannot predict a turning point; in other words, it will continue to project increases or decreases throughout the projection period regardless of what might actually happen to the economy. Furthermore, the approach is almost useless for policy analysis. It cannot be used to answer "what if" questions, such as, What might happen if the community were to undergo major demographic or economic change? Trend analysis is, however, a fairly inexpensive and quick forecasting approach,



especially for local governments that do not have an analyst familiar with statistical approaches.

### **Deterministic techniques**

Deterministic techniques, which are especially good for forecasting expenditures, begin with the same basic information as trend analysis, but take into account changes caused not only by time but also by such factors as the following:

- Internal changes: any definite plans the government may have to raise or lower taxes or fees, to change the level or types of services, or to start capital projects.
- External changes: changes in the environment, such as inflation, population shifts, or the gain or loss of grant funding. Although most such changes are beyond local control, assumptions about the external environment are reviewed and incorporated into the forecast.

While deterministic techniques require more work and time than expert judgment or trend analysis, they will produce more detailed data and take into account more of the important influences on a local government's financial future.

### **Econometric techniques**

Econometric techniques, also known as statistical forecasting, are sophisticated methods that go a step beyond deterministic techniques by taking into account the simultaneous effects of a great many factors. Essentially, econometric approaches hypothesize that revenues or expenditures depend on one or more factors, called independent (or casual) variables. Data on past revenues or expenditures are collected, and a statistical relationship is determined between those data and the independent variables. For example, if the forecaster is trying to predict sales tax revenues, personal income might be hypothesized as an independent variable. In reviewing past data, the forecaster might find a statistical relationship between personal income and sales tax revenues. This relationship would enable the forecaster to predict future sales tax revenues based on expectations about changes in personal income.

Generally, econometric techniques require a person skilled in economics and statistics; they also require a large amount of data and a personal computer. Because of these requirements, econometric techniques are generally not used by small to midsize local governments. It is also not clear that they produce better information than sound deterministic techniques.

### **Automating municipal forecasting**

With the exception of the expert judgment approach, the forecasting approaches cited above could all be automated in order to make them easier, faster, and more accurate to use. Finance offices in most local governments have access to a desktop computer and can obtain forecasting software programs from various

sources (e.g., state offices of municipal affairs, professional associations, etc.). To begin such an approach, however, requires the same initial commitment of time and staff to develop, standardize, and aggregate a meaningful database of financial and non-financial information, as does the Financial Trend Monitoring System. Local officials who are contemplating beginning either form of financial analysis may want to consider approaching them jointly to minimize duplication of effort, and to optimize the potential results from either effort,

### **Fiscal impact analysis**

Fiscal impact analysis is a method for estimating the effect on municipal finances of community growth. Local governments use this approach primarily to assess the impact of development or annexation proposals or rezoning requests, to choose between alternative land-use proposals, and to help in making economic development decisions. By clarifying the financial costs and benefits involved in these kinds of decisions, fiscal impact analysis can help local officials to decide which forms of growth to encourage and which policies to pursue.

Information on the costs and revenues created by growth can be used to make immediate budgeting decisions as well as long-range plans. In the short term, fiscal impact analysis can gauge the effects of growth on the capital and operating budgets by looking at the impact of a new development on tax rates and bonding capacity. In the long term it can help the community balance development with the community's ability to support itself.

Estimating revenues that can be expected from a development, annexation, or land-use proposal is a fairly straightforward task involving relatively simple multipliers or ratios. For example, to estimate how much money the local government will gain in property taxes from a proposed residential development, do the following:

1. Multiply the average market value per unit by an equalization ratio. (The equalization ratio is the ratio of assessed value to the true market value of real property).
2. Multiply that product by the local tax or mill rate.
3. Multiply that product by the number of units to be built.

Calculating the impact of growth on the expenditure side of the budget is usually more difficult. The three most commonly used techniques for estimating the costs attributable to residential development are the per capita multiplier technique, the case study technique, and the service standard technique. The choice of technique depends on the characteristics of the growth being evaluated and on the circumstances of the community.



## **The per capita multiplier technique**

The per capita multiplier technique is the most frequently used in local government. The method is particularly useful because it provides a fast approximation of the costs of new development based on readily available local data. It is usually applied to new single or multifamily subdivisions being developed in communities with a relatively established service infrastructure.

To project the additional cost generated by proposed residential development, multiply the current per capita cost of providing municipal residential services by the projected number of new residents. To determine the current per capita cost of providing residential services, follow these steps:

1. Break down expenditures into categories (usually five) such as general government services, fire services, and police services.
2. Use budgetary analysis to determine how much the government spends each year on each category.
3. From this figure, subtract the portion that is attributable to nonresidential uses such as industrial parks and shopping centers.
4. Divide the remainder by the current population. This figure is the current per capita cost of providing municipal residential services.

The advantages of the per capita multiplier technique are that it is versatile, easily understood, and simple to implement. The primary disadvantage is that the results are not especially detailed.

## **The case study method**

After the per capita multiplier technique, the case study method is the most frequently used. Rather than focusing on average cost, which is the basis for the per capita multiplier method, the case study method focuses on marginal cost. Marginal cost is the cost of only the services that need to be added as a result of new development. Marginal cost can differ from average cost either because existing services have excess capacity or because services are already strained to capacity.

If excess capacity is available, there is no need to provide more facilities or serve more people. This would be the case, for example, if the community had already built new fire stations in anticipation of population growth. When people did start to move in, the community would already have the buildings in place and would only have to add firefighters and equipment. If, by contrast, the community's capacity were already over-burdened, it would have to spend considerably more money to accommodate new residents because it would have to build new facilities. This might be true, for example, in a small rapidly growing community. In either example, the actual additional cost would differ from the average cost

calculated in the per capita multiplier method. In the first case, the actual cost would be less than the average cost; in the second, it would be greater.

In the case study technique, areas of excess or deficient service capacity are identified through interviews with department heads or other staff members familiar with the need for future service extensions or retrenchments. The results of these interviews allow future operating and capital needs to be determined. Calculations of future operating costs are based on salaries for employees who are expected to be hired and on the costs of the materials those employees will need. Calculations of capital outlay to accommodate the new development are based either on the cost of the construction or on the debt service for bonds issued to finance the outlay.

The case study method provides more detail about future costs than does the per capita multiplier technique because it not only predicts the financial consequences of growth, but also assigns the costs of growth to operating and capital facilities by service category. On the other hand, the case study method is complex and costly.

### **The service standard technique**

The service standard technique uses averages of manpower and capital facility service levels for municipal and school districts of similar size and geographic location. (The averages are obtained from U.S. census data.) This technique determines the number of additional employees by service function (financial administration, general government, police, fire, highways, sewerage, sanitation, water supply, parks and recreation, and libraries) that will be required as a result of growth. The analyst determines the local operating costs for additional personnel, adding local operating outlay (salary, equipment) per employee by service function. Capital costs are based on capital-to-operating services ratios derived from census data.

Like the per capita multiplier technique, the service standard method is also an average cost approach, but it provides more detailed data and can reveal specific changes for each service category. It is also a fairly straightforward and inexpensive technique. However, to the extent that local conditions differ from the average (due to variations in local wealth, excess or deficient service capacity, or local traditions), the service standard technique can overestimate or underestimate true local costs.

There are three other fiscal impact analyses techniques, which are used much less frequently than the three just described. The comparable city method, a marginal cost approach, uses population size and growth rates of comparable cities to make long-term financial projections or to predict the impact of large-scale development. The proportional value technique and the employment anticipation technique are both used to determine the municipal service costs for incoming nonresidential facilities.

## Selecting a methodology

Most local governments find the case study approach preferable, using the per capita average cost approach as a supplement where data are not readily available or where it is difficult to define the service level relationship on a true marginal basis.

## Using fiscal impact data

Once the fiscal impact analysis has been completed, the local government will understand the financial impact of the proposal under consideration. If a deficit is forecast as a result of a new development or land-use alternative, officials can then consider the administrative and financial feasibility of adding new revenue sources, including user fees, impact fees, system development fees, etc.

## Costing local government services

Costing local government services is a technique that can help to identify the full costs of municipal services. The technique can help to answer several kinds of questions about municipal services, such as the following:

- If user fees are charged for municipal services, what percentage of the costs of the service do they cover? Under what circumstances should fees be increased?
- What would it cost to increase service levels? How much could be saved by reducing services?
- Could private firms provide some municipal services more efficiently?

Costing is not a precise science. There are relatively few established rules, and there is considerable leeway for judgment. The costing process presented here has six major steps:

1. Determining the purpose of the study
2. Determining the time period for the study
3. Identifying the resources used in providing the service
4. Choosing appropriate units of measurement
5. Collecting cost information
6. Using cost information

## Determining the purpose of the study

Specifying the purpose of the study is the first step in costing out a service because the purpose influences the type of data to be collected. Figure 2 shows five kinds of costing analysis, each with a different purpose.

Purpose of analysis	Type of analysis	Example
To determine the total cost of all resources used to provide a service	Full cost	The cost of all resources from all departments needed to provide landfill services
To use cost as a basis for user fees	Average unit cost	The cost for the town clerk to process one marriage license
To analyze the cost of performing one job	Job cost	The cost of repairing one vehicle
To analyze the cost of expanding a service	Incremental cost	The additional cost of opening a branch library one evening per week
To determine the cost savings if some or all of a service were dropped, or if a different service method (e.g., contracting) were used	Avoidable cost	Costs that would be saved if a fire station were closed or if the ambulance service were contracted out

**Figure 2 Five types of costing analysis and examples of their use**

## Determining the time period for the study

The appropriate time period for data gathering depends on the purpose of the study. If the goal is to determine the annual cost of providing a service, cost information will be needed for an entire fiscal year. Sometimes this information can be extrapolated based on a representative period. For example, to find out the cost of a road repair program, a special cost study might have employees keep track of labor, material, and equipment used for road repairs over a two-week period. If the level of activity during these two weeks is typical for the year as a whole, the annual cost of the program can be derived from the costs incurred during the time of the special study. If the level of activity is not typical, four or five two-week periods scattered throughout the year may be used.

## **Identifying resources used in providing the service**

Resources used to provide a service include labor, supplies, equipment, facilities, and purchased services. Within these categories, there are direct and indirect resources. Direct resources are clearly identifiable and attributable to a specific service, such as the salaries paid to the personnel running a program and the supplies used in that program. Indirect resources, which are not directly attributable to a specific service or budget, include indirect operating and administrative resources. An example of indirect operating resources would be the municipal offices used by the staff of a program. Indirect operating resources are not usually charged directly to a program. An example of indirect administrative resources would be the time and effort applied to government-wide administration by the city or county manager. A complete costing study should include the costs of both direct and indirect resources.

## **Choosing appropriate units of measurement**

Choosing appropriate units of measurement requires that you determine how you will measure output and the unit cost of the service. Output describes the amount of a service being provided (e.g., miles of road paved, number of inspections conducted). If output is reasonably standard from case to case, it can be expressed as the total of all units of service provided. A unit of output is simply one instance of the service, and unit cost is the average cost of providing one unit of service. For municipal services that are one-time jobs or for which the effort required varies greatly from job to job, units of output are not standard and average unit cost is not a valuable measure; a more useful calculation is the cost of each job or a range of costs per job.

The key to calculating output and unit cost is to choose measures that provide useful information for the particular purposes of the study.

## **Collecting cost information**

The primary source of cost data is expenditure records: general and subsidiary ledgers, warrants for payment, debt service records, and expenditure reports. Information may also be found in budgets and in non-financial records such as equipment purchase and maintenance records, building records, mileage reports, and payroll and personnel records. The ease with which cost information can be collected depends on the level of detail in expenditure records and budgets.

Here are two suggestions for ensuring that you have listed all the appropriate costs:

- Include expenses rather than expenditures. Expenses are the costs of resources used to provide a service over a given time period; expenditures are cash transactions made when these resources are purchased. Thus, if you are collecting data on costs for recreational services in fiscal year (FY) 1993, be sure to include all costs incurred in FY 1993. If a building was rented for a recreational event in FY

1993, but the bill was not presented and paid until FY 1994, it was still an expense of FY 1993, and should be included in your cost data. Note that an expense can also be incurred after expenditure is made. For example, if recreational equipment was purchased in FY 1991 and expected to be used for five years, then the figure that should be used in an annual cost analysis is the prorated cost for each year the equipment is in use.

- Be sure to include direct and indirect costs where appropriate. Depending on the purpose of the costing study, it may not, for example, be appropriate to include all indirect costs. If the purpose of the study is to set user fees to cover all program costs, then the data should take account of all indirect costs. If the purpose is to consider expanding a service, for example, by keeping recreational facilities open for several extra hours per week, then most of the indirect administrative costs are already fixed and will not be affected. In this case, only indirect operating costs (e.g., facilities maintenance and fee collection) might increase and should therefore be included in the data.

### **Using cost information**

The uses of the cost data are determined by the purpose of the study and the kind and quality of the data collected. As was noted in the opening of the section, cost data can clarify the various costs of municipal services being delivered or considered, and this information is useful in analyzing the efficiency of a service and in budget planning. Cost data can also identify the cost of one unit of a service, which can help in determining the level of user fees necessary to recover costs. And cost data can help officials compare alternative methods of service delivery.

Although costing is a useful tool for managers and policy makers when used for any of these purposes, it is important to remember that it represents only one aspect of decision making. Factors such as the following must also be considered:

- Local traditions: How have services been provided in the past?
- Political acceptability: Will a change be acceptable to both providers and users of the service?
- Legal constraints: Is the change permissible under state law?
- Employee relations: Does the municipal labor contract allow the change?

Costing municipal services is a complex task. For step-by-step directions on how to undertake a costing study, consult one of the references listed at the end of this section.

## Analyzing reserves

Most communities include some kind of reserves in their annual budget to enable them to adjust to unexpected events or emergencies and to the usual unevenness in revenue-expenditure patterns. There are four basic kinds of reserves:

- Operational reserves. Also known as contingency funds, these reserves are usually appropriated in the annual budget. Their purpose is to meet unexpected small increases in service delivery costs, such as might be caused by extra snow removal.
- Catastrophic reserves. These reserves are usually not appropriated each year but are held in a special fund or as a part of the general fund. Their purpose is to provide emergency funds for use in the event of a major calamity such as a flood or fire.
- Replacement reserves. These reserves are held to provide for the purchase of operating equipment such as trucks or machinery. They may be kept as part of fund balances or in a special equipment replacement fund. Replacement reserves are often replenished each year to allow for the continuing depreciation or replacement of equipment.
- Liquidity reserves. Liquidity is an accounting term that refers to the amount of cash and easily sold securities a local government has at any one time. Liquidity reserves are the cash and securities that the government can use to adjust to the normal unevenness of revenues and expenditures.

There are no rules for determining which kinds of reserves a government should have or what level of funding should be in any reserve. Much depends on the kinds of natural disasters or hardships that the jurisdiction is subject to and the adequacy of its insurance coverage, the flexibility of the jurisdiction's revenue base, the overall financial health of the local government, state regulations, and national economic conditions.

The need for reserves is determined primarily by the degree of risk associated with revenues and revenue sources, and by the likelihood of major contingencies and the amount of funds required to respond to them. The following are questions managers can ask to see how well their community is protected against risk, as well as how much flexibility is available to meet special needs.

- What is the potential for revenue shortfalls--that is, how stable is the tax base in the face of adverse economic conditions?
- How much of the budget now depends on inter-governmental funds, and what are the chances that these funds might be terminated?



- What is the present policy on equipment replacement? Would replacement of a large item, such as a fire truck or a road grader, severely distort the budget or disrupt service?
- What kind of insurance protects the government against loss from legal suits or destruction of assets? Will the insurance cover all the loss or only a portion of it?
- What kinds of losses might the government suffer from natural disasters? What federal or state programs can help?
- How much and how quickly could the government borrow in the event of a problem?
- How much liquidity is usually available in the government's accounts?