

National Advisory Council on State and Local Budgeting Practice

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A FRAMEWORK FOR IMPROVED STATE AND LOCAL GOVERNMENT BUDGETING AND RECOMMENDED BUDGET PRACTICES

PREFACE

The National Advisory Council on State and Local Budgeting (NACSLB) was formed in the spring of 1995. The Council was established with a three-year mission to improve state and local government budgeting through identification and dissemination of good budget principles and practices. The Council is composed of representatives from the eight original co-founding organizations as well as representatives from academic institutions, public employees' organizations, and the public finance industry.

This document presents a framework describing critical issues that must be addressed to improve the budgeting practices of state and local governments. It provides a definition and a mission of a good budget process. It also defines principles and elements of the budget process that serve as a means to categorize budget practices. The recommended budget practices identified by the NACSLB are essential components of each budget element. These practices may change over time in response to changing conditions and experience, and should be periodically reviewed and updated as necessary. It is intended that these practices will assist governments in evaluating and improving their own budget policies and procedures and provide a foundation for further budget research and experimentation.

DEFINING AN IMPROVED BUDGET PROCESS

Governments allocate scarce resources to programs and services through the budget process. As a result, it is one of the most important activities undertaken by governments. As the focal point for key resource decisions, the budget process is a powerful tool. The quality of decisions resulting from the budget process and the level of their acceptance depends on the characteristics of the budget process that is used.

A budget process that is well-integrated with other activities of government, such as the planning and management functions, will provide better financial and program decisions and lead to improved governmental operations. A process that effectively involves all stakeholders—elected officials, governmental administrators, employees and their representatives, citizen groups, and business leaders—and reflects their needs and priorities will serve as a positive force in maintaining good public relations and enhancing citizens' and other stakeholders' overall impression of government.

The National Advisory Council on State and Local Budgeting (NACSLB) was created to provide tools for governments to improve their budgeting processes and to promote their use. In fulfilling that role, the NACSLB has set forth a framework that has provided the context for development of a set of budget practices for state and local governments. The budget practices identified by the NACSLB take into account, and respect, the differences in state and local laws, the impact of the political aspects of government, and the management needs of government. The practices are appropriate for a variety of management and political styles.

As a result of the evolving nature of good budgeting practice, these practices are not intended as mandatory prescriptions for governments. Rather, practices are set forth as recommendations only, and can serve as a blueprint for governments that want to make improvements to their budget processes. Implementation of these practices is expected to be an incremental process that will take place over a number of years.

The framework presents a definition and mission statement for the budget process. It also presents a structure for the overall budget process consisting of principles and budgetary elements. Budgetary elements are essential components of each principle. This structure allows practices to be categorized in a useful manner. The framework and the compendium of good budget practices are intended to serve as tools to assist governments in improving their budget process. Among the benefits are:

- Educating governments and budget participants about the potential of budget systems,

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- Helping governments assess the adequacy of their own budgetary systems,
 - Providing guidance to governments that want to improve their budget processes, and
 - Promoting education, training, and further experimentation and research on techniques that work.
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A DEFINITION OF THE BUDGET PROCESS

The budget process consists of activities that encompass the development, implementation, and evaluation of a plan for the provision of services and capital assets. A good budget process is far more than the preparation of a legal document that appropriates funds for a series of line items. Good budgeting is a broadly defined process that has political, managerial, planning, communication, and financial dimensions. The following definition recognizes the broad scope of the budget process and provides a base for improvement of the budget process.

The budget process consists of activities that encompass the development, implementation, and evaluation of a plan for the provision of services and capital assets.

Several essential features characterize a good budget process. A good budget process:

- Incorporates a long-term perspective
- Establishes linkages to broad organizational goals
- Focuses budget decisions on results and outcomes
- Involves and promotes effective communication with stakeholders
- Provide incentives to government management and employees

These key characteristics of good budgeting make clear that the budget process is not simply an exercise in balancing revenues and expenditures one year at a time, but is strategic in nature, encompassing a multi-year financial and operating plan that allocates resources on the basis of identified goals. A good budget process moves beyond the traditional concept of line item expenditure control, providing incentives and flexibility to managers that can lead to improved program efficiency and effectiveness.

THE MISSION OF THE BUDGET PROCESS

The mission statement below identifies the central goal of the budget process. It incorporates both political and managerial aspects, as well as a responsibility to report and account for the provision of services and use of resources. Communication and involvement with citizens and other stakeholders is stressed. The broad nature of the mission allows issues to be addressed that have limited the success of budgeting in the past.

The mission of the budget process is to help decision makers make informed choices for the provision of services and capital assets and to promote stakeholder participation in the decision process.

COMMUNICATION AND INVOLVEMENT

A company is not likely to remain in business if it does not stay in touch with its customers. While governments that are not in touch and do not have involved citizens may remain in business, the results are often not pleasant for the citizens or the government. Apathy is a serious illness of government. It is in the best interests of government to have involved "stakeholders."

The term "stakeholder" refers to anyone affected by or has a stake in government. This term includes, but is not limited to: citizens, customers, elected officials, management, employees and their representatives (whether unions or other agents), businesses, other governments, and the media.

It is vital that the budget process include all stakeholders. The budget process should accomplish the following:

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- Involve stakeholders,
- Identify stakeholder issues and concerns,
- Achieve stakeholder buy-in to the overall budgeting process,
- Achieve stakeholder buy-in to decisions related to goals, services, and resource utilization,
- Report to stakeholders on services and resource utilization, and
- Serve generally to enhance the stakeholders' view of government.

The importance of this aspect of the budget process cannot be overstated. Regular and frequent reporting is necessary to provide accountability, educate and inform stakeholders, and improve their confidence in the government. Communication and involvement is an essential component of every aspect of the budget process.

PRINCIPLES OF THE BUDGET PROCESS

The budget process consists of several broad principles that stem from the definition and mission described above. These principles encompass many functions that cut across a governmental organization. They reflect the fact that development of a budget is a political and managerial process that also has financial and technical dimensions.

The functions or activities covered by these principles generally are sequentially ordered, but they can often be performed concurrently to some extent. Moreover, information obtained from one activity or function can aid in achieving an earlier one. The process can be iterative, and is intended to be so. Some functions may also be accomplished by linkage to other processes rather than as an explicit part of a formal budget process. For example, developing broad goals and identifying the services that are needed to accomplish the goals could be part of a separate strategic planning process. As long as there is an appropriate linkage, these functions do not need to be a formal component of the budget process. Governments do need to give adequate attention to these linkages, however, and ensure that those affected are appropriately involved. The budget should be the centerpiece of a thoughtful, ongoing, decision-making process for allocating resources and setting priorities and direction.

The principles of the budget process are shown as follows:

DEVELOP BROAD GOALS TO GUIDE GOVERNMENT DECISION MAKING

A government should have broad goals that provide overall direction for the government and serve as a basis for decision making.

DEVELOP APPROACHES TO ACHIEVE GOALS

A government should have specific policies, plans, programs, and management strategies to define how it will achieve its long-term goals.

DEVELOP A BUDGET CONSISTENT WITH APPROACHES TO ACHIEVE GOALS

A financial plan and budget that moves toward achievement of goals, within the constraints of available resources, should be prepared and adopted.

ASSESS PERFORMANCE AND MAKE ADJUSTMENTS

Program and financial performance should be continually assessed, and adjustments made, to encourage progress toward achieving goals.

ELEMENTS OF THE BUDGET PROCESS

Each principle of the budget process comprises a number of elements that represent achievable results. These elements help translate the guiding principles into action components. Individual budgetary practices are derived from these elements and are a way to accomplish the elements. The elements of each guiding principle are identified below. The principles and elements provide a structure to categorize

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budgetary practices. A more detailed explanation of the principles and elements is provided in the appendix.

ESTABLISH BROAD GOALS TO GUIDE GOVERNMENT DECISION MAKING

- 1. Assess community needs, priorities, challenges and opportunities*
- 2. Identify opportunities and challenges for government services, capital assets, and management*
- 3. Develop and disseminate broad goals*

DEVELOP APPROACHES TO ACHIEVE GOALS

- 4. Develop financial policies*
- 5. Develop programmatic, operating, and capital policies and plans*
- 6. Develop programs and services that are consistent with policies and plans*
- 7. Develop management strategies*

DEVELOP A BUDGET CONSISTENT WITH APPROACHES TO ACHIEVE GOALS

- 8. Develop a process for preparing and adopting a budget*
- 9. Develop and evaluate financial options*
- 10. Make choices necessary to adopt a budget*

ASSESS PERFORMANCE AND MAKE ADJUSTMENTS

- 11. Monitor, measure, and assess performance*
- 12. Make adjustments as needed*

BUDGET PRACTICES

Definition of a Budget Practice

A budget practice is a procedure that assists in accomplishing a principle and element of the budget process. It is appropriate for all governments and in all circumstances and situations. Budget practices can be hierarchal—that is, one practice can help accomplish another practice. The Council has avoided a practice hierarchy of more than one level. A budget element typically has multiple practices associated with it.

Budget practices must be clearly related to activities identified in the budget process definition. A practice is not a budget practice unless it specifically contributes to the development, description, understanding, implementation and evaluation of a plan for provision of services and capital assets. For example, a policy statement on debt capacity is included in a set of budget practices since debt is a component of the budget and the budget decision making. However, a practice encouraging competitive sales of debt is not a budget practice. More specific methods of accomplishing a budget practice are usually categorized as tools and techniques. There also may be alternative ways to accomplish a practice. Different governments may find one tool or technique works better for them than another. Budget practices do not identify a specific time frame, but tools and techniques may do so. See the section on Budget Tools and Techniques for a more detailed description of these items.

Format of a Budgetary Practice

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The budgetary practice format used by the NACSLB is concise and normally fits on one page. Practice examples are in addition to the one page description. The format includes the following:

Name - A short phrase naming the practice that can be used to succinctly describe the practice.

Principle and Element - Name of the principle and element with which the practice is associated.

Component Practice - Name of the practice to which this practice is hierarchically related, if any.

Description - A brief description of the practice. It should be no more than two or three sentences.

Rationale - A short one to three sentence explanation of the need for the practice and why it is important. It describes the generally applicable benefits.

Output - A brief description of communications and outputs. It identifies what is to be produced and who is the audience.

Notes - Additional information with regard to practice implementation, roles, and optional features. Award program requirements and sources may also be provided.

Examples - The NACSLB generally has tried to provide one or more examples with each practice to make the practices compendium more useful. The Council may experiment with the format of practices. It is hoped that practices and corresponding examples will eventually be available on CD-ROM or the Internet.

Comprehensiveness and Categorization of Budget Practices

The NACSLB considers that the recommended budgetary practices are representative of the range of issues raised by each budgetary element. However, the NACSLB also recognizes that there may be additional practices that can be associated with each element and that practices may be added or changed in the future. As a result, this classification is intended to be dynamic and periodically reviewed and updated.

The budgetary practices are categorized using the principle/element/practice/example hierarchy described in this budgetary framework document. Practices help to accomplish a budgetary element which in turn is a component of a budgetary principle. In the future, the Council may consider additional categorization of examples. The Council may also provide examples that identify developing initiatives.

Budget Tools and Techniques

Budget tools and techniques are specific methods of accomplishing a practice. Budget tools and techniques assist in some situations or governments, but may not in all. The NACSLB has not developed tools and techniques. Tools and techniques supporting each practice may be better left to the NACSLB member associations and others to develop.

Issues Affecting Budget Practices

There are numerous issues affecting the successful implementation of budget practices. Failure to address these issues will, at a minimum, be an impediment to improving the budget process, but could have a more severe, adverse impact on the budget process and the quality of the budget results. The NACSLB feels the practices it has developed respect the problems a government may have in implementing a good budget process. The following issues need to be taken into account in the tools and techniques that support budgetary practices:

- Managing the budget process and changes to budget practices.
- Dealing with differences between governments, including size and legislative processes.
- Adjusting for organizational structure and issues.
- Addressing the organizational culture with regard to the budget process.
- Election campaign issues. Desire to have change or to prevent change.
- Level of resources available for programs.
- Available level of technical system and support.
- Dealing with high (or low) expectations.
- Legal requirements.
- Ensuring citizen processes work.
- The level of stakeholder understanding.
- Accuracy of projections and assumptions.
- Level of disclosure.

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Practices Are Recommendations, Not Requirements

The budget practices have been developed to provide guidance to governments that want to make improvements to their budget processes. The NACSLB endorses the practices and considers them a component of good government. These practices should not be regarded as standards or requirements, however. The complex, evolving, and political nature of the budget process make it certain that some governments will find alternative approaches to good budgeting. These approaches may well become additions to or provide the basis for modifying practices identified by the NACSLB.

Success in implementing the principles, elements, and practices should not be measured by how rapidly they are incorporated into the budget process. Successful implementation is likely to take a number of years in order to build the necessary level of understanding among all participants, institute support systems, and make modifications to accommodate the unique nature of each government.

Conformance of Recommended Practices with Statute

The recommended practices are intended to supplement existing statutes controlling a government's budget process. The recommended practices should rarely, if ever, be directly in conflict with statute. A conflict can usually be resolved by simply having official materials meet statutory requirements and preparing additional materials conforming to the recommended practices. If there ever is unresolvable conflict, then statutory requirements should take precedence.

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APPENDIX

An Outline of Recommended Budget Practices of the National Advisory Council on State and Local Budgeting

This appendix sets forth a set of recommended budget practices formulated by the National Advisory Council on State and Local Budgeting (NACSLB). These budget practices address all aspects of the budget process as defined by the principles and elements described herein. Practices identified in this outline are essential components of the element with which they are associated. However, there may be practices within each element that have not been currently identified and practices may be added or changed in the future. This list of recommended budget practices is intended to be dynamic and periodically reviewed and updated.

As a result of the evolving nature of good budgeting practice, these practices are not intended as mandatory prescriptions for governments. Rather, practices are set forth as recommendations only, and can serve as a blueprint for governments that want to make improvements to their budget processes. Implementation of these practices is expected to be an incremental process that will take place over a number of years.

PRINCIPLE 1- ESTABLISH BROAD GOALS TO GUIDE GOVERNMENT DECISION MAKING

This principle provides for the development of a set of broad goals that establish a general direction for the government. These goals serve as the basis for development of policies and programs, including the service types and levels that will be provided and capital asset acquisition and maintenance. Goals are developed after undertaking an assessment of community conditions and other external factors, and a review of the internal operations of the government, including its services, capital assets, and management practices. Based on the assessment of current and expected future conditions, and opportunities and challenges facing the community and the government, broad goals are established that define the preferred future state of the community. Other principles address the development of strategies and allocation of resources to achieve these goals.

1 Element 1 - Assess Community Needs, Priorities, Challenges and Opportunities

A government should develop an understanding of the condition of the community, and trends and issues that may affect it in the future. This process requires an examination and assessment of stakeholder issues, concerns, needs, and desires. Also, factors that affect the community, stakeholders, and the government should be identified. These include the state of the economy, the composition of the population, technology, legal or regulatory issues, intergovernmental issues, and physical or environmental issues.

PRACTICES

1.1 Identify stakeholder concerns, needs, and priorities

- 1.1.1 Practice: A government should develop mechanisms to identify stakeholder concerns, needs, and priorities.
- 1.1.2 Rationale: The limited resources of a government should be directed in a manner consistent with the concerns, needs, and priorities of stakeholders; hence, a government must be aware of those concerns, needs, and priorities.
- 1.1.3 Outputs: This practice provides for a series of mechanisms to promote stakeholder participation in discussing and communicating values and issues that are of concern to them. Among the mechanisms that might be considered are public hearings, surveys, meetings of leading citizens and citizen interest groups, government strategic planning processes,

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meetings with government employees, and workshops involving government administrative staff and/or the legislative body.

- 1.1.4 Notes: This practice is integral to practices addressing the development and dissemination of broad goals. This practice is also related to practices that assess stakeholder satisfaction with programs and services and progress toward achieving goals. (See practice entitled Monitor, Measure, and Assess Stakeholder Satisfaction.)

1.2 Evaluate community condition, external factors, opportunities and challenges

- 1.2.1 Practice: A government should regularly collect and evaluate information about trends in community condition, the external factors affecting it, opportunities that may be available, and problems and issues that need to be addressed.
- 1.2.2 Rationale: A government must have an understanding of the issues and trends affecting a community in order to establish the most appropriate goals.
- 1.2.3 Outputs: A variety of mechanisms should be considered to gather information about the community and to report on the results. Some mechanisms will involve data gathering from preexisting sources or through opinion surveys. Other mechanisms will be subjective, such as observing physical characteristics of geographic areas within the community or talking to residents, experts, business and community leaders, and legislative bodies. Formal studies of particular issues or trends may also be undertaken.
- 1.2.4 Notes: The intent of this practice is for a government to have up-to-date information with which to evaluate community conditions and major issues that are integral to the development and achievement of goals. In evaluating community condition, a government may want to consider local, regional, national, and global factors affecting the community, including:
- Economic and financial factors,
 - Demographic trends,
 - Legal or regulatory issues,
 - Social and cultural trends,
 - Physical (e.g., community development) or environmental factors,
 - Intergovernmental issues, and
 - Technological change.

2 *Element 2 - Identify Opportunities and Challenges for Government Services, Capital Assets, and Management*

A government should undertake an assessment of its own operations, including the services it currently provides, the assets it owns, its management structure, and the opportunities and challenges that may affect them. A government should review existing services and assess how well services address community needs and changes that may be necessary to respond to opportunities and challenges. There should also be a corresponding review of existing capital assets. Note that this element provides only for an evaluation of services and capital assets and does not address decisions as to whether to provide or maintain them. Since internal management practices can affect achievement of goals, issues such as organizational structure, information flow, and employee motivation should be reviewed to determine whether changes will be needed to achieve goals.

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PRACTICES

2.1 Assess services and programs, and identify issues, opportunities, and challenges

- 2.1.1 Practice: A government should identify and assess the programs and services that it provides, their intended purpose, and factors that could affect their provision in the future.
- 2.1.2 Rationale: Changes in community conditions or other factors may result in a program or service no longer addressing the needs it was intended to serve. Also, changes in the operating environment may affect the cost or effectiveness of service delivery in the future. These changes must be understood before an assessment can be made of whether existing programs should be continued or whether adjustments should be made.
- 2.1.3 Outputs: A government should have a process for inventorying and evaluating programs and services to determine the relationship of these programs to the needs and priorities of the community. The review should include an assessment of the programs' purposes, beneficiaries and needs served, and issues, challenges, and opportunities affecting their provision in the future. The inventory of programs and services should identify the organization responsible for service delivery if it is not the government itself. An evaluation of factors affecting service delivery also should be undertaken, such as funding issues; changes in technology; economic, demographic or other factors that may affect demand; and legal or regulatory changes. These reviews will typically utilize a variety of information sources. Stakeholder involvement in these reviews should be encouraged.
- 2.1.4 Notes: The intent of this practice is to ensure that a government understands the programs and services that it provides.

2.2 Assess capital assets, and identify issues, opportunities, and challenges

- 2.2.1 Practice: A government should identify and conduct an assessment of its capital assets, including the condition of the assets and factors that could affect the need for or ability to maintain the assets in the future.
- 2.2.2 Rationale: The capital assets of a government and their condition are critical to the quality of services provided, and hence are important in determining whether the needs and priorities of stakeholders can be met.
- 2.2.3 Outputs: A government should have a process for inventorying its capital assets and assessing the need for and the condition of these assets. The assessment should include an evaluation of issues, challenges, and opportunities affecting the provision of capital assets in the future, such as community needs and priorities; funding issues; changes in technology; economic, demographic, or other factors that may affect demand; and legal or regulatory changes. This review may be undertaken in conjunction with an evaluation of the program or service utilizing the particular assets. The assessment of capital asset condition should consider the impact of any deferred maintenance and needed improvements.
- 2.2.4 Notes: Reviews of the condition of a capital asset and how well it is meeting its intended purpose may not be undertaken very often, particularly if there is little change occurring. However, the information obtained from these assessments can be an important component of an overall evaluation of community needs and issues. Capital assets that have shorter lives or require more maintenance should be examined

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more frequently than longer-lived assets or assets requiring little maintenance. Governments should stay abreast of developments that may affect their major capital assets, such as regulatory changes, population movements, or technological advances, and consider the impact of such issues in the goal-setting process.

2.3 Assess governmental management systems, and identify issues, opportunities, and challenges

- 2.3.1 Practice: A government should identify and analyze its organization and management systems, including system strengths and weaknesses and factors that could affect these systems in the future.
- 2.3.2 Rationale: The support systems established to manage a government are integral to the achievement of goals.
- 2.3.3 Outputs: A process should be instituted to routinely identify, analyze, and address issues related to a government's organization and management systems and the environment in which these systems operate. This process includes an examination of strengths and weaknesses of the organizational structure, interdepartmental communication and cooperation, communication of goals and directives, motivation of staff, conflict management, and provision of other internal needs and support systems. The review also should include an assessment of management policies, procedures, and systems that support achievement of goals. These reviews should involve stakeholders, as appropriate, including legislative bodies; government managers, employees and/or their representatives; and business and community leaders.
- 2.3.4 Notes: The intent is that a government have a workable process for reviewing its internal management systems. The process identifies the changes necessary to respond to perceived opportunities and challenges and to achieve particular goals.

3 Element 3 - Develop and Disseminate Broad Goals

A government should identify and disseminate broad goals. Broad goals should be related to the needs, challenges, and opportunities confronting the government and take into account the services operated by the government, its capital infrastructure, and its organization and management systems. A government should also provide for dissemination and review of goals to ensure stakeholder understanding of the direction in which the government is moving.

PRACTICES

3.1 Identify broad goals

- 3.1.1 Practice: A government should identify broad goals based on its assessment of the community it serves and its operating environment.
- 3.1.2 Rationale: Broad goals define the priorities and preferred future state of the community or area served. They provide a basis for making resource allocation decisions during the budget process and serve as a focal point for assessing and coordinating various long-range or strategic plans.
- 3.1.3 Outputs: Goals should be expressed in written form and should reflect stakeholder concerns, needs, and priorities as well as factors affecting the community and the government. They must be sufficiently specific to help define the services to be emphasized and make difficult resource allocation decisions in the budget process.

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- 3.1.4 Notes: This practice builds on work accomplished through elements addressing the identification of community needs and priorities, and evaluation of community condition and the government's operating environment. Goals should be developed proactively rather than reactively and with the involvement of all levels and units of government. Broad goals may be prioritized. Care must be taken to minimize conflict when goals are prioritized so that the government has a clear understanding and general consensus on the direction in which it is heading. Once goals are established, more detailed action plans can be developed and integrated with management and budget processes.

3.2 Disseminate goals and review with stakeholders

- 3.2.1 Practice: A government should disseminate broad goals and review them with stakeholders.
- 3.2.2 Rationale: Disseminating and reviewing goals helps foster participation, awareness, consensus, pride, and a sense of direction.
- 3.2.3 Outputs: Dissemination may occur by conducting public forums and by publishing goals in key public documents, such as strategic and other planning documents and budget documents. Electronic media may also be used. Opportunities should be provided to review goals periodically. If necessary, they should be updated to reflect the general desires of stakeholders.
- 3.2.4 Notes: To be effective, broad goals need to be actively discussed on an ongoing basis. Stakeholders also need to understand how these goals relate to policies, action plans, and resource allocation decisions. In disseminating goals, a government should encourage feedback from stakeholders, both on the goals themselves and on related policies and practices.

PRINCIPLE 2 - DEVELOP APPROACHES TO ACHIEVE GOALS

This principle provides for the establishment of specific policies, plans, programs, and management strategies necessary for the government to achieve its long-term goals. While broad goals set the general direction of a government, it is the policies, plans, and programs that define how the government will go about accomplishing these goals. As such, the development of policies and programs must explicitly consider how they contribute to the achievement of the government's broad goals. Policy and program goals should relate, where appropriate, to broad goals. Measures should be developed to determine the progress being made by the government in achieving goals.

4 Element 4 - Adopt Financial Policies

A government should develop a comprehensive set of financial policies. Financial policies should be consistent with broad government goals and should be the outcome of sound analysis. Policies also should be consistent with each other and relationships between policies should be identified. Financial policies should be an integral part of the development of service, capital, and financial plans and the budget. All other adopted budgetary practices of a government should be consistent with these policies.

PRACTICES

4.1 Develop policy on Reserve funds

- 4.1.1 Practice: A government should develop policies to guide the creation, maintenance, and use of resources for financial stabilization purposes.

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- 4.1.2 Rationale: Governments should maintain a prudent level of financial resources to protect against reducing service levels or raising taxes and fees because of temporary revenue shortfalls or unpredicted one-time expenditures.
- 4.1.3 Outputs: The policies should establish how and when a government builds up reserve funds and should identify the purposes for which they may be used. Development of a policy on minimum and maximum reserve levels may be advisable. Policies on reserve funds should be publicly available and summarized in materials used in budget preparation. They also should be identified in other government documents, including planning and management reports.
- 4.1.4 Notes: Reserve funds are called by many names including rainy day funds, unreserved, undesignated fund balances, and contingency funds. These funds may be used at a government's discretion to address temporary cash flow shortages, emergencies, unanticipated economic downturns, and one-time opportunities. They provide flexibility to respond to unexpected opportunities that may help a government achieve its goals. Policies on the use of these funds may also be tied to an adverse change in economic indicators (such as declining employment or personal income) to ensure that the funds are not depleted before an emergency arises. The minimum and maximum amounts to be accumulated may be based on the types of revenue, the level of uncertainty associated with revenues, the condition of capital assets, or the government's level of security with its financial position. Reserve funds may be constrained by state or local laws. Legally required reserves should be distinguished from discretionary reserves.

4.2 Develop policy on fees and charges

- 4.2.1 Practice: A government should adopt policies that identify the manner in which fees and charges are set and the extent to which they cover the cost of the service provided.
- 4.2.2 Rationale: Policies that require identification of both the cost of the program and the portion of the cost that will be recovered through fees and charges allow governments and stakeholders to develop a better understanding of the cost of services and to consider the appropriateness of established fees and charges.
- 4.2.3 Outputs: Policies may address a requirement to review all fees and charges, the level of cost recovery for services and the reason for any subsidy, and the frequency with which cost-of-services studies will be undertaken. Stakeholders should be given an opportunity to provide input into formulation of these policies. Policies on fees and charges should be publicly available and summarized in materials used in budget preparation. They should also be identified in other government documents, including planning and management reports.
- 4.2.4 Notes: Costs of service include direct and indirect costs such as operating and maintenance costs, overhead, and charges for use of capital (depreciation and debt service). A government may choose not to recover all costs, but it should identify such costs. Reasons for not recovering full costs should be identified and explained. State and local law may govern the establishment of fees and charges.

4.3 Develop policy on debt issuance and management

- 4.3.1 Practice: A government should adopt policies to guide the issuance and management of debt.

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- 4.3.2 Rationale: Issuing debt commits a government's revenues several years into the future, and may limit the government's flexibility to respond to changing service priorities, revenue inflows, or cost structures. Adherence to a debt policy helps ensure that debt is issued and managed prudently in order to maintain a sound fiscal position and protect credit quality.
- 4.3.3 Outputs: Elements of policies on debt issuance and management include: purposes for which debt may be issued; matching of the useful life of an asset with the maturity of the debt; limitations on the amount of outstanding debt; types of permissible debt; structural features, including payment of debt service and any limitations resulting from legal provisions or financial constraints; refunding of debt; and investment of bond proceeds. Legal or statutory limitations on debt issuance should be incorporated into debt policies. Debt policies should be made available to the public and other stakeholders. Because these policies are essential to budget decision making, particularly capital budgets, they should be reviewed by decision makers during the annual budget process and summarized in the budget document. The legislative body should formally adopt debt policies and compile them with other financial policies.
- 4.3.4 Notes: Debt policies should be integrated with other financial policies, particularly operating and capital budget policies. The policies should reflect statutory and legal requirements as well as the government's financial condition and philosophy. The GFOA has adopted a recommended practice on the development of a debt policy.

4.4 Develop policy on debt level and capacity if not defined in statutes

- 4.4.1 Practice: A government should adopt a policy on the maximum amount of debt and debt service that should be outstanding at any one time.
- 4.4.2 Rationale: Policies guiding the amount of debt that may be issued by a government help ensure that outstanding and planned debt levels do not exceed an amount that can be supported by the existing and projected tax and revenue base.
- 4.4.3 Outputs: A government should develop distinct policies for general obligation debt, debt supported by revenues of government enterprises, and other types of debt such as special assessment bonds, tax increment financing bonds, short-term debt, variable-rate debt, and leases. Limitations on outstanding debt and maximum debt service may be expressed in dollar amounts or as ratios, such as debt per capita. Policies on debt level and capacity should be incorporated into other debt policies and adopted by the legislative body.
- 4.4.4 Notes: Policies on debt level and capacity should be developed in accordance with an analysis of debt capacity. Factors that are recommended in evaluating debt capacity include current financial capacity, projected future capacity, statutory and constitutional limitations, and bond covenants. The GFOA has adopted a recommended practice on analysis of debt capacity. Also, the International City/County Management Association publication Evaluating Financial Condition provides a set of indicators that can be used to evaluate debt capacity.

4.5 Develop policy on use of one-time revenues

- 4.5.1 Practice: A government should adopt a policy limiting the use of one-time revenues for ongoing expenditures.

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- 4.5.2 Rationale: By definition, one-time revenues cannot be relied on in future budget periods. A policy on the use of one-time revenues provides guidance to minimize disruptive effects on services due to non-recurrence of these sources.
- 4.5.3 Outputs: One-time revenues and allowable uses for those revenues should be explicitly defined. The policy should be publicly discussed before adoption and should be readily available to stakeholders during the budget process. The policy, and compliance with it, should be reviewed periodically.
- 4.5.4 Notes: Examples of one-time revenues include: infrequent sales of government assets, bond refunding savings, infrequent revenues from development, and grants. These revenues may be available for more than one year (e.g., a three-year grant), but are expected to be non-recurring. Examples of expenditures for which a government may wish to use one-time revenues include startup costs, stabilization (e.g., to cover expenditures that temporarily exceed revenues), early debt retirement, and capital purchases. Uses that add to the ongoing expenditure base should be carefully reviewed and minimized, e.g., capital expenditures that significantly increase ongoing operating expenses without a sustainable and offsetting long-term revenue plan. Certain variable components of major revenue sources are similar to one-time revenue sources. While they may be addressed in a one-time revenue policy, they also may be considered separately. (See practice entitled Evaluate the Use of Unpredictable Revenues.)

4.6 Evaluate the use of unpredictable revenues

- 4.6.1 Practice: A government should identify major revenue sources it considers unpredictable and define how these revenues may be used.
- 4.6.2 Rationale: Unpredictable revenue sources cannot be relied on as to the level of revenue they will generate. Particularly with major revenue sources, it is important to consider how significant variation in revenue receipts will affect the government's financial outlook and ability to operate programs in the current and future budget periods.
- 4.6.3 Outputs: For each major unpredictable revenue source, a government should identify those aspects of the revenue source that make the revenue unpredictable. Most importantly, a government should identify the expected or normal degree of volatility of the revenue source. For example, revenues from a particular source may fluctuate, but rarely, if ever, fall below some predictable minimum base. A government should decide, in advance, on a set of tentative actions to be taken if one or more of these sources generates revenues substantially higher or lower than projected. The plans should be publicly discussed and used in budget decision making.
- 4.6.4 Notes: Many of the most important revenue sources relied on by state and local governments are unpredictable to some degree. Examples may include intergovernmental revenues, inheritance taxes, taxes on mineral production, interest income, sales and use tax, lottery revenues, and revenues subject to future judicial rulings. These revenues are often used to fund ongoing programs. A financial plan for governments should take into account the unpredictable nature of key revenues. This ensures that a government understands the potential impact on its ability to cover service costs and develops contingency plans in advance to address unpredictable revenue fluctuations. Specific allocation and contingency plans do not have to be developed for all unpredictable revenues, but become increasingly necessary as the size or unpredictability of the

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revenue source increases. This practice may address or refer to a separate policy on the use of stabilization funds. (See practices entitled Develop Policy on Stabilization Funds and Develop Policy on Contingency Planning.)

4.7 Develop policy on balancing the operating budget

- 4.7.1 Practice: A government should develop a policy that defines a balanced operating budget, encourages commitment to a balanced budget under normal circumstances, and provides for disclosure when a deviation from a balanced operating budget is planned or when it occurs.
- 4.7.2 Rationale: A balanced budget is a basic budgetary constraint intended to ensure that a government does not spend beyond its means. At a minimum, balance should be defined to ensure that a government's use of resources for operating purposes does not exceed available resources over a defined budget period. A more stringent definition requires that a government maintain a balance between operating expenditures and operating revenues over the long term, not just during the current operating period. This latter definition of balance is referred to as structural balance, and is the goal of this practice.
- 4.7.3 Outputs: The policy should provide clear definition as to how budgetary balance is to be achieved. Definitions of items to be counted as operating resources (e.g., revenues) and operating resource uses (e.g., expenditures) should be explicitly identified. All funds should be included. Statutory and other legal "balanced" budget requirements should be met, but this practice recommends additional policies and practices, if necessary, to achieve and report on structural balance. The policy should explicitly note and, if necessary, explain the relevant constitutional, statutory, or case law provisions that impose a balanced budget requirement upon the government. The policy also should identify the circumstances when deviation from a balanced budget may occur. The policy should be written in nontechnical language or have a nontechnical summary. Because of its importance in budget decisions, it should be readily available to stakeholders and publicly discussed at key points in the budget process. Compliance with the policy should be reviewed and disclosed during each budget period.
- 4.7.4 Notes: Some states and local governments define resources and resource uses to include fund balance or changes to fund balances. There may be statutory or other requirements that a budget must be balanced based on this definition. These types of statutory balanced budget requirements are a component of and not in conflict with the goal of achieving structural balance. Additional or even separate reporting may be required to demonstrate that both statutory balance and structural balance have been achieved. This practice does not directly apply to capital budgets. Capital budgets are often funded at least partially from one-time resources. However, the ongoing maintenance or replacement of capital equipment or facilities is an important part of the budget process. Such items, particularly maintenance or equipment replacements, are often defined as operating items to ensure their inclusion in operating budget decisions.

A balanced budget policy may include the following:

- Identification of and rationale for what operating resources and resource uses are included or excluded from the definition of a balanced budget calculation. For example, does the calculation include operating revenues and expenditures only; does it include capital maintenance or replacement; does it include interfund transfers; and does it include

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highly variable components of ongoing revenues (such as the volatile component of sales tax revenues or development-related revenue).

- The circumstances when fund balances may be used as a resource.
- The point(s) at which the budget must be balanced, e.g., upon adoption, throughout the year, or at year-end.
- The accounting basis (cash, accrual, other) that is used to define revenues and expenditures.
- The circumstances in which noncompliance with the balanced budget policy is permitted (e.g., during the early stages of an economic downturn so that services can be reduced in an orderly fashion).
- The official, agency, or legislative body (or combination of authorities) responsible for making any necessary decisions on whether or not a budget is in balance.
- The authority that must take action to bring the budget into balance if adjustments are needed in the course of a fiscal period.

4.8 Develop policy on revenue diversification

- 4.8.1 Practice: A government should adopt a policy that encourages a diversity of revenue sources.
- 4.8.2 Rationale: All revenue sources have particular characteristics in terms of stability, growth, sensitivity to inflation or business cycle effects, and impact on tax and rate payers. A diversity of revenue sources can improve a government's ability to handle fluctuations in revenues and potentially help to better distribute the cost of providing services.
- 4.8.3 Outputs: The policy should identify approaches that will be used to improve revenue diversification. An analysis of particular revenue sources is often undertaken in implementing the policy. This analysis should address the sensitivity of revenues to changes in rates, the fairness of the tax or fee, administrative aspects of the revenue source, and other relevant issues. The policy and the approach to implementation should be periodically reviewed.
- 4.8.4 Notes: Over time a government should strive to improve its revenue diversity to the extent feasible. When a government is statutorily or otherwise limited as to the types of revenues it may raise, it should consider options to enhance flexibility within the constraints of available revenue sources. For example, governments that must rely heavily on property taxes may seek to diversify the tax base on which the property tax is levied. A government should recognize that changes in the diversity of revenue sources can affect the relative tax burden on different stakeholders.

4.9 Develop policy on contingency planning

- 4.9.1 Practice: A government should have a policy to guide the financial actions it will take in the event of emergencies, natural disasters, or other unexpected events.
- 4.9.2 Rationale: When emergencies or unexpected events occur, having a policy that can be applied, or at least serve as a starting point, for financial decisions and actions improves the ability of a government to take timely action and aids in the overall management of such situations.
- 4.9.3 Outputs: This policy should identify types of emergencies or unexpected events and the way in which these situations will be handled from a financial management perspective. It should consider operational and

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management impacts. The policy should be publicly discussed and reviewed periodically.

- 4.9.4 Notes: Policies on contingency planning are used as a general guide when an emergency or unexpected event occurs. A set of actions and strategies will be identified for each type of situation. Examples of financial emergencies that require contingency plans are sudden and severe decreases in locally collected revenues or intergovernmental aid, and unexpected major capital maintenance requirements. Development of a contingency plan in advance of such situations may be viewed positively by the rating agencies when evaluating a government's credit quality. It can also help expedite relief efforts when an emergency does occur and allow the government to recover funds more quickly or more effectively in the event of a natural disaster. (See practice entitled Develop Policy on Stabilization Funds.)

5 **Element 5 - Develop Programmatic, Operating and Capital Policies and Plans**

A government should develop policies and plans to guide service provision and capital asset acquisition, maintenance, replacement, and retirement. These policies and plans give direction to the government regarding the level of services and types of capital assets to be provided, and the manner in which the services and capital assets will be provided. They should be integrated with the government's broad goals and its service and capital needs. They may include the development of standards for service provision and capital asset condition and maintenance. Policies and plans also should be consistent with each other. The practices associated with this element and those of Element 6 are closely related and will involve an iterative process.

PRACTICES

5.1 **Prepare policies and plans to guide the design of programs and services**

- 5.1.1 Practice: A government should develop and adopt policies and plans to guide the design of specific programs and services.
- 5.1.2 Rationale: Service and program policies and plans translate broad goals into strategies for achieving goals. These policies and plans provide the basis for designing specific programs and services.
- 5.1.3 Outputs: Program and service policies and plans may address items such as: groups or populations to be served, service delivery issues, examples of possible programs, standards of performance (including level of service standards or other measures to gauge success), expected costs, time frames for achievement of goals, issues pertaining to organizational structure, and priorities for service provision. Policies and plans should be adopted by the governing body and made publicly available.
- 5.1.4 Notes: A clear, well-documented statement of policies and plans in broad program and service areas becomes particularly important when goals cross organizational and program lines. For example, a goal to revitalize the downtown or to promote rural development could result in multi-departmental programs addressing job creation, transportation, housing, and health care.

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5.2 Prepare policies and plans for capital asset acquisition, maintenance, replacement, and retirement

- 5.2.1 Practice: A government should adopt policies and plans for capital asset acquisition, maintenance, replacement, and retirement.
- 5.2.2 Rationale: Policies and plans for acquisition, maintenance, replacement, and retirement of capital assets help ensure that needed capital assets or improvements receive appropriate consideration in the budget process and that older capital assets are considered for retirement or replacement. These policies and plans are necessary to plan for large expenditures and to minimize deferred maintenance.
- 5.2.3 Outputs: Policies may address inventorying capital assets and evaluating their condition, criteria for acceptable condition, criteria for continued maintenance versus replacement or retirement of an existing asset, and identification of funding for adequate maintenance and scheduled replacement of capital assets. Plans should be developed to establish ongoing, multi-year replacement and renewal schedules, and should recognize the linkage of capital expenditures with the annual operating budget. Stakeholders should have an opportunity to provide input as capital asset policies and plans are formulated. Once adopted, the policies and plans should be made publicly available, particularly as set forth in budget, management, and planning documents. Policies and plans should be incorporated into decision making in the budget process.
- 5.2.4 Notes: Capital asset acquisition, maintenance, replacement, and retirement policies provide a basis for formulating long-range plans to address capital needs. These policies should be realistic if they are to be used in decision making. Information gathered through processes described in the practice entitled Assess Capital Assets, and Identify Issues, Opportunities, and Challenges can be helpful in formulating the policies and plans.

6 *Element 6 - Develop Programs and Services That Are Consistent with Policies and Plans*

A government should develop and evaluate programs, services, and capital assets. Because there may be times when a government's policies and plans are best achieved by having other entities besides the government provide services or capital infrastructure, an analysis of service delivery and capital acquisition alternatives is an integral part of the program evaluation process. Performance measures should be developed to determine whether program and service goals are being met.

PRACTICES

6.1 Develop programs and evaluate delivery mechanisms

- 6.1.1 Practice: A government should develop programs and services that are consistent with policies and plans and should evaluate alternative delivery mechanisms.
- 6.1.2 Rationale: Programs and services are the means by which a government addresses priorities established through its policies and plans. An evaluation of delivery alternatives for services and programs helps ensure that the best approach is selected for delivering a service.
- 6.1.3 Outputs: A government should institute a process to develop new programs and services and review existing ones in the context of how well they meet programmatic and operating policies and plans. All programs should have measurable goals that relate to goals established for the more general policies and plans. The process should include an

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examination of how a government traditionally provides the service. It also should consider whether the service could be delivered more effectively or more efficiently if provided in a different way, either by the government itself or by entities outside of the government.

- 6.1.4 **Notes:** Ideally, programs and services will be developed after the adoption of program policies and plans. Once a program has been developed, however, periodic review is necessary to ensure that it remains consistent with a government's general policies and plans. Considerations in evaluating service delivery mechanisms, whether provided directly by a government or contracted out, include:
- Cost of service, including short- and long-term direct costs, costs to administer and oversee the service, impact on rates and charges, and impact on costs of other government services.
 - Service quality and control, including safety and reliability, ability to control service levels and who receives the service, ability of the government to make internal changes to improve its own performance, ability to change the delivery mechanism in the future, and risk of contractual nonperformance and default.
 - Management issues, including the quality of monitoring, reporting, and performance evaluation systems, public access to information, and ability to generate or sustain competition in service delivery.
 - Financial issues, including impact on outstanding debt and grant eligibility. Impact on stakeholders, including government employees, customers, and taxpayers.
 - Statutory and regulatory issues, including impact on federal and state legal and regulatory requirements, and liability.

6.2 Develop options for meeting capital needs and evaluate acquisition alternatives

- 6.2.1 **Practice:** A government should develop specific capital project options for addressing capital needs that are consistent with financial, programmatic, and capital policies and should evaluate alternatives for acquiring the use of capital assets.
- 6.2.2 **Rationale:** Capital project planning is necessary to give adequate consideration to longer-range needs and goals, evaluate funding requirements and options, and achieve consensus on the physical development of the community. An evaluation of alternative mechanisms helps ensure that the best approach for providing use of a capital asset or facility is chosen based on the policies and goals of the government.
- 6.2.3 **Outputs:** A government should have a process that identifies capital projects that are needed to achieve goals and a general time frame in which these assets will be needed. This assessment should consider need, life cycle costs (including operating costs), impact on services, beneficiaries of the project, financing issues, and other impacts. Plans for acquiring capital assets should be part of or consistent with land use, transportation, or other long-range plans of the community or area. Options for acquiring the use of capital assets and facilities should be examined. In some cases, the process for evaluating capital acquisition alternatives is linked with a corresponding process for evaluating service delivery alternatives.
- 6.2.4 **Notes:** This practice is intended to encourage a government to consider whether capital project proposals (including retirement of assets) meet policies and plans. Periodic reviews of existing projects and facilities in relation to goal attainment also should be undertaken when deciding

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whether to maintain, renovate, replace, or abandon those facilities. Considerations in evaluating acquisition mechanisms include:

- Costs, including both capital and operating costs, impact on rates and charges, and impact on costs of other government services.
- Effects on service, including technical and financial capabilities of the entity that owns the asset, ability to control the use of the asset (including expanding or contracting the facility), ability to maintain the asset, and risk of contractual nonperformance and default.
- Management issues, including maintaining oversight of the asset and related services and operations, impact on economic growth and development, impact on service coordination, and public access to information.
- Financial issues, including availability of cash, budgetary impacts, impact on outstanding debt, and grant eligibility.
- Impact on stakeholders such as government employees, customers, and taxpayers.
- Statutory and regulatory issues, including impact on federal and state legal and regulatory requirements, and liability.

6.3 Identify functions, programs, and/or activities of organizational units

- 6.3.1 Practice: The functions, programs, and/or activities of the government's organizational units should be identified.
- 6.3.2 Rationale: Clear identification of the functions, programs, and/or activities of organizational units assists those reviewing or evaluating the government develop a better understanding of the role of each organizational unit, and it aids in evaluating the services it provides. Explicit descriptions of these items also help employees of the government better understand the tasks for which they are responsible.
- 6.3.3 Outputs: Descriptions of the purpose and roles of organizational units should be published using appropriate technology and made available to policy makers, management, employees, citizens, and other stakeholders. This documentation should be prepared with stakeholder involvement and review in order to ensure that employees as well as other stakeholders understand the responsibilities of each organizational unit and its relationship to other units. Any organizational unit for which resources are allocated through the budget process should also have its basic purpose and roles described in the budget document. Descriptions of organizational units should include the major functional relationships to other organizational units.
- 6.3.4 Notes: Identification of what organizational units do is an important task of a government. Preparation of these descriptions can be undertaken at any time and updated when necessary and appropriate.

6.4 Develop performance measures

- 6.4.1 Practice: A government should develop and utilize performance measures for functions, programs, and/or activities.
- 6.4.2 Rationale: Performance measures are used for assessing how efficiently and effectively functions, programs, and activities are provided and for determining whether program goals are being met.
- 6.4.3 Outputs: Performance measures should be linked to specific program goals and objectives. The measures should be valid, reliable, and verifiable. Whenever feasible, they should be expressed in quantifiable

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terms. Measures should be reported in periodic reviews of functions and programs and should be integral to resource allocation decisions. They also should be reported in the budget document and may be reported in separate management reports or reports to citizens. Different aggregations of performance measures may be appropriate for different audiences.

- 6.4.4 Notes: There are several types of performance measures: inputs (resources), outputs, efficiency, and effectiveness (outcomes). Each of these types of measures serves a purpose, although only the measures of efficiency and effectiveness truly report on performance. Sources of data for performance measures include existing records, trained observer readings, and surveys.
- Performance measures can help managers direct and manage an organization. They also provide tools for managers to determine the most appropriate tasks to perform. It is often easier to focus on achieving goals and objectives if they can be expressed as the achievement of quantifiable measures. Care should be taken to minimize potential problems such as misinterpretation, misdirection of a program and its staff as a result of poor or incomplete measures, costly data collection, and measures that are affected by uncontrollable environmental factors. A good performance measurement system will avoid the inclusion of so many measures that they become overwhelming and difficult to interpret. A government should periodically review its performance measurement system and make improvements in terms of the measures used, data collection, analysis, and reporting.

6.5 Develop performance benchmarks

- 6.5.1 Practice: Performance benchmarks should be developed to aid in assessing how well a function, program, and/or activity is provided and how well it meets needs.
- 6.5.2 Rationale: Performance benchmarks are comparative standards of performance and provide a frame of reference for evaluating program and service quality and cost-effectiveness. They are used as a basis against which to compare performance measures of functions, programs, and activities.
- 6.5.3 Outputs: Benchmarks can be developed to allow performance comparisons with other service providers, whether within the government, with other governments, or with private providers. External benchmarks (those providing comparison with outside service providers) can be beneficial to overall evaluation, especially if valid comparisons can be made with the best service providers. Internal benchmarks (comparisons to alternatives within the government) will provide somewhat less information, but there may be fewer problems with consistency of data. When selecting any type of benchmark, it is important to consider how closely it relates to stated program and service goals. Benchmarks should be consistently defined and measurable. Performance benchmarks and the measures being compared should be included in management reports and reports to stakeholders.
- 6.5.4 Notes: Performance benchmarks, along with an accompanying review of each chosen provider's service approach, can be helpful in making improvements. These comparisons may provide valuable information and insight to policy makers, managers, and other stakeholders that can be used to guide the direction of a function, program, or activity. Performance benchmarks also help stakeholders better assess whether government performance in a particular area is acceptable or could be

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improved. Benchmark comparisons should be undertaken carefully to avoid misinterpretation resulting from differences in the scope of the function, program, or activity used for comparison; the environment in which the service operates; and measurement techniques. The use of accompanying explanatory information helps avoid invalid comparisons.

7 Element 7-Develop Management Strategies

A government should develop appropriate management strategies to enhance its ability to successfully execute the budget and to achieve long-range goals. Management strategies are necessary to facilitate achievement of both programmatic and financial goals, and to promote budgetary compliance. The choice of budget type and manner of presentation affects the information available to management and other decision makers, issues that will be raised, and level of control.

PRACTICES

7.1 Develop strategies to encourage attainment of program and financial goals

- 7.1.1 Practice: A government should develop an organizational structure and management strategies to encourage attainment of program and financial goals.
- 7.1.2 Rationale: Goals are more likely to be achieved if organizational and management strategies are developed to support and encourage organizational and individual performance directed toward goal attainment.
- 7.1.3 Outputs: A government should develop, review, improve, and implement strategies that encourage the organization and its employees to work toward achievement of goals. These strategies include both positive incentives and penalties. They also include support systems such as technology support, education, and training. When developing these strategies, opportunities should be provided for input from those who will be affected.
- 7.1.4 Notes: While this practice is intended to address strategies that focus on both rewards and penalties, it is expected that emphasizing rewards will produce more beneficial results for the organization. Each government may have unique approaches and strategies for goal attainment.

7.2 Develop mechanisms for budgetary compliance

- 7.2.1 Practice: A government should have mechanisms in place to ensure compliance with the adopted budget.
- 7.2.2 Rationale: Appropriate management processes and systems allow a government to detect and correct significant deviation if it occurs.
- 7.2.3 Outputs: Mechanisms should be in place to detect and correct deviations from the budget. These measures may be as simple as a requirement (supported by appropriate rewards and penalties) that managers not go over budget. Budgetary compliance is encouraged through use of data collection and reporting systems that control disbursements of funds and that facilitate the evaluation of revenue and expenditure trends and financial projections. Development of a monthly or quarterly revenue and spending plan against which to compare actual results and contingency plans to address significant deviation if it occurs should also be considered. Mechanisms usually also include the assignment of budget or finance personnel to conduct monthly or quarterly reviews of trends in

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actual expenditures and revenues and actual-to-budget comparisons so that timely corrective action can be taken. A government should institute procedures to review the budget periodically (e.g., quarterly) and decide on actions to bring the budget into balance, if necessary. (See practice entitled Develop Policy on Contingency Planning.)

- 7.2.4 Notes: Deviations caused by external factors or "big picture" issues are not as susceptible to management control and are not the focus of this practice. However, effective mechanisms to control the financial aspect of the budget may help detect these external issues so that adjustments can be made to comply with the adopted budget. This practice is intended to apply to all components of the organization.

7.3 Develop the type, presentation, and time period of the budget

- 7.3.1 Practice: A government should choose the type of budget, the manner in which it will be presented, and time period covered by the budget that best fit its needs.
- 7.3.2 Rationale: The type of budget, the time period covered, and the manner of presenting materials in the budget documents can have a significant practical impact on a government's approach to planning, control, and overall management of its programs, services, and finances, and on the quality of information provided to stakeholders.
- 7.3.3 Outputs: The outputs of this practice are the type of budget selected (line-item, program, modified zero-base, other, or some combination), the time period covered (annual, biennial, multi-year), and the physical form of the budget and related documents. A formal review should be undertaken periodically to ensure that the budget type, time period, and approach to presenting the budget continue to meet the needs and priorities of the government. Such a review should be broadly focused, and not directed simply at the format of individual pages.
- 7.3.4 Notes: The main types of budgets are line-item and program budgets. Line-item budgets focus primarily on the inputs to be purchased, while program budgets focus on the outputs and outcomes to be achieved with a given level of resources. Some governments also present parts of the proposed budget in a decision package format, displaying varying amounts or quality of service that can be provided with different amounts of resources. The choice of budget type and presentation style will influence the nature of the questions asked during budget review. Legal and other constraints may partially dictate the approach to presenting the budget.

PRINCIPLE 3 - DEVELOP A BUDGET CONSISTENT WITH APPROACHES TO ACHIEVE GOALS

This principle provides for the preparation of a financial plan, a capital improvement plan, and budget options. Development of a long-range financial plan is essential to ensure that the programs, services, and capital assets are affordable over the long run. Through the financial planning process, decision makers are able to better understand the long-term financial implications of current and proposed policies, programs, and assumptions and decide on a course of action to achieve its goals. These strategies are reflected in the development of a capital improvement plan and options for the budget.

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8 *Element 8 - Develop a Process for Preparing and Adopting a Budget*

A government should establish an administrative structure that facilitates the preparation and approval of a budget in a timely manner. Procedures should be established for ensuring coordination of the budget process. A process is also needed to develop and communicate the policies and guidelines that will guide budget preparation. In order for the budget to be adopted in a timely manner, processes should be developed to assist stakeholders in understanding tradeoffs and to help decision-makers make choices among available options. The processes should include reporting to, communicating with, involving, and obtaining the support of stakeholders.

PRACTICES

8.1 Develop a budget calendar

- 8.1.1 Practice: A government should publish a comprehensive budget calendar that specifies when budget tasks are to be completed and that identifies timelines for those tasks.
- 8.1.2 Rationale: Stakeholders need to be aware of when key budget tasks, events, and decisions will occur so they have an opportunity to plan and to participate in the process. The preparation of a calendar helps ensure that all aspects of the budget process have been considered and that adequate time has been provided.
- 8.1.3 Outputs: Multiple calendars will usually need to be produced, each with different levels of detail and emphasis to meet the needs of the different types of stakeholders. Calendars should list the dates of key events and deadlines. At least one calendar should describe the overall budget and planning process and identify roles, responsibilities, and assignments. To ensure the greatest impact, calendars should identify when and how stakeholders can participate in the process.
- 8.1.4 Notes: Budget calendars are a tool to keep participants in the process on track. Statutory deadlines should be highlighted. The calendar should make clear the relationships between various processes and should be developed to coordinate these processes. For example, a calendar may illustrate the relationship of the operating and capital budget processes, or the processes of revenue forecast revision and budget reconciliation. The development of a budget calendar is typically guided by statutory deadlines. Calendar development should also take into account other key organizational dates that affect participants in the budgetary process. The practice entitled Develop Mechanisms for Coordinating Budget Preparation and Review addresses the role of the calendar in providing overall coordination.

8.2 Develop budget guidelines and instructions

- 8.2.1 Practice: A government should prepare general policy guidelines and budget preparation instructions for each budget cycle.
- 8.2.2 Rationale: Budget guidelines and instructions help ensure that the budget is prepared in a manner consistent with government policies and the desires of management and the legislative body. Instructions are necessary so that all participants know what is expected, thereby minimizing misunderstanding and extra work.
- 8.2.3 Outputs: Budget guidelines are specific to the particular budget under development and should incorporate relevant aspects of the government's financial policies. They may set forth financial constraints and key assumptions that will be used to guide development of the budget, as well as policy direction. Instructions often include sample forms to be completed by operating departments or program heads. Guidelines and instructions should be prepared in a written format but may also be presented in an electronic format or through training and/or

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an oral presentation. Involving stakeholders in guideline development, where possible, helps promote buy-in.

- 8.2.4 **Notes:** In developing budget guidelines and instructions, a government should consider the role played by the various stakeholders such as departments within the government or other agencies that are involved in budget preparation. Involving stakeholders may be accomplished by holding meetings in which administrative staff and selected internal and external stakeholders help develop the processes and general directions provided to budget preparers. Given time and resource constraints, full stakeholder input may not be practical.

8.3 Develop mechanisms for coordinating budget preparation and review

- 8.3.1 **Practice:** A government should develop mechanisms and assign responsibilities to provide for overall coordination of the preparation and review of the budget.
- 8.3.2 **Rationale:** The complete budget process involves many levels, departments, and individuals in a government, as well as a number of distinct processes and disparate groups of stakeholders. Coordination is needed to ensure that processes move forward as planned, to prevent confusion and misinformation, and to ensure appropriate stakeholders are involved.
- 8.3.3 **Outputs:** A single point of coordination is often appropriate in local governments, although individual components of the process may be coordinated by different individuals or departments. For state governments, coordination of the executive and legislative processes may be provided separately. The coordination process involves a number of tasks: developing a calendar, identifying responsibilities for completing various tasks, ensuring that various parts of the budget process are properly integrated, keeping the process on schedule, producing reports, identifying issues and problems, and ensuring that other requirements are met and quality standards are maintained. The person(s) assigned responsibility for coordinating the budget process should respond to stakeholder issues and concerns that arise in the context of the budget process.
- 8.3.4 **Notes:** The assignment of coordination responsibility does not necessarily imply overall decision-making authority. However, at a minimum, the coordinating person(s) should have immediate access to decision makers, as many issues typically come before the coordinator for resolution. Coordination mechanisms may be established for inter-governmental interaction and legislative/executive branch interaction.

8.4 Develop procedures to facilitate budget review, discussion, modification, and adoption

- 8.4.1 **Practice:** A government should develop and implement a set of procedures that facilitate the review, discussion, modification, and adoption of a proposed budget.
- 8.4.2 **Rationale:** Appropriate procedures are needed to resolve conflicts, to promote acceptance of the proposed budget by stakeholders, and to assist in timely adoption of the budget.
- 8.4.3 **Outputs:** A series of processes should be developed that permit stakeholders to satisfy themselves as to the appropriateness of the budget proposal and to allow the legislative body to achieve consensus and adopt a budget. These processes should be summarized in budget materials. Some examples include: small group meetings, hearings,

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workshops, independent analysis, specific decision-making techniques and procedures, conflict resolution processes, and methods for presenting portions of the budget.

- 8.4.4 **Notes:** Discussion will inevitably be needed regarding the tradeoffs and choices that need to be made. Issues can be more satisfactorily addressed to the extent that there are clear and accepted processes for considering options and reaching the compromise position that most budgets inevitably represent. Consistency over time in the budget review and adoption process is important, but it is also essential to recognize that as the makeup of the administration and legislative body changes, the process may need to be adjusted.

8.5 Identify opportunities for stakeholder input

- 8.5.1 **Practice:** A government should provide opportunities in the budget process for obtaining stakeholder input.
- 8.5.2 **Rationale:** By definition, stakeholders are affected by a government's resource allocation plans and service and program decisions. Stakeholders should have clearly defined opportunities to provide input. This helps ensure that stakeholder priorities are identified and enhances stakeholder support for the approved budget.
- 8.5.3 **Outputs:** Stakeholder input can be obtained in a number of ways, including public hearings, advisory commissions, informal conversations, round-table briefings, TV and video presentations, opinion surveys, neighborhood meetings, office hours, letter writing, telephone calls, and e-mail. The approaches are likely to differ with the size of the government. The budget calendar should identify specific opportunities for citizen input where government officials are available to explain issues and choices and to receive comments.
- 8.5.4 **Notes:** The budget process should include opportunities for all stakeholders to participate. A general-purpose public hearing shortly before final decisions are made on the budget is not adequate as the sole means of soliciting stakeholder input, especially on major issues. The process developed for obtaining stakeholder input should ensure that information is gathered in a timely and complete manner to be useful in budget decision making.

9 Element 9 - Develop and Evaluate Financial Options

A government should develop, review, and update long-range financial plans and projections. The information obtained from these plans and projections is used in determining the resource and expenditure options available for the budget period and the implications of those options. This element does not address decisions on a specific set of programs and services to be funded through the budget.

PRACTICES

9.1 Conduct long-range financial planning

- 9.1.1 **Practice:** A government should provide opportunities in the budget process for obtaining stakeholder input.
- 9.1.2 **Rationale:** Financial planning expands a government's awareness of options, potential problems, and opportunities. The long-term revenue, expenditure, and service implications of continuing or ending existing programs or adding new programs, services, and debt can be identified. The financial planning process helps shape decisions and permits

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necessary and corrective action to be taken before problems become more severe.

- 9.1.3 **Outputs:** The planning process results in the preparation of a financial plan consisting of various components such as an analysis of financial trends; an assessment of problems or opportunities facing the jurisdiction and actions needed to address these issues; and a long-term forecast of revenues and expenditures that uses alternative economic, planning, and policy assumptions. The financial plan identifies key assumptions and choices related to achievement of goals. The plan may be summarized in the budget document or in a separate report. It should be available to decision makers for their review in making choices and decisions related to the budget process. It should also be shared with stakeholders for their input.
- 9.1.4 **Notes:** A financial plan illustrates the likely financial outcomes of particular courses of action or factors affecting the environment in which the government operates. A financial plan is not a forecast of what is certain to happen but rather a device to highlight significant issues or problems that must be addressed if goals are to be achieved.

9.2 Prepare revenue projections

- 9.2.1 **Practice:** A government should prepare multi-year projections of revenues and other resources.
- 9.2.2 **Rationale:** Projection of revenues and other resources is critical in order to understand the level of funding available for services and capital acquisition. Projections for future budget periods help determine the likelihood that services can be sustained and highlight future financial issues to be addressed. Preparing revenue projections also enhances a government's understanding of revenue sensitivity to changes in assumptions and to controllable factors such as changes to tax rates or fees.
- 9.2.3 **Outputs:** Revenue projections developed for financial planning purposes should extend over a period of at least three years into the future or longer if necessary to evaluate how revenues may change over time, to isolate non-recurring revenues, or to understand the impact of revenues when fully phased in. A government may produce a single revenue projection or projections under alternative scenarios; alternatively, the forecast may be stated in terms of a range of values. Major assumptions should be prominently identified. Projections should be available to participants in the budget process before budgetary decisions are made. One or more updated projections should be available during the budget period to avoid unintended deviation from balanced-budget requirements.
- 9.2.4 **Notes:** Particular attention should be paid to major revenue sources. Trend analysis, econometric modeling, and other methods should be used, as appropriate, depending on the type of revenue being projected, the availability of data, and the time frame covered by the projections. Other factors to evaluate are the variance between the previous period's actual and forecasted revenues and any changes to revenue sources such as would occur with a rate or base change. Forecasting variances should be analyzed to improve forecasting in future periods. Preparing projections under different assumptions (e.g., economic assumptions, demand), particularly in the development of a financial plan, permits decision makers to consider the level and mix of taxes, user fees, and other revenues that would need to be raised to provide various levels of service.

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Revenue projections should generally strive for accuracy by coming as close as possible to the actual outcome. However, the forecasting of sharp turns in national, state, or local economies is problematic. As a result, actual outcomes may be different from projections, particularly for revenue streams dependent upon consumption and income.

9.3 Analyze major revenues

- 9.3.1 Practice: A government should maintain an in-depth understanding of its major revenues.
- 9.3.2 Rationale: A large unexpected variance in a major revenue source is usually a major problem, but even a relatively small variance in a major revenue source can have a significant impact. The better the ability of a government to predict these changes, or at least their direction, the less disruptive these changes will be. In addition, improved estimation of these revenues will enhance the confidence of stakeholders in the overall revenue projection.
- 9.3.3 Outputs: An analysis of major revenue sources should identify factors that have influenced historical collections, forecasting assumptions, and any problems or concerns. Any trends should also be identified, along with an analysis of whether or not the trend is likely to continue. The analysis can be summarized in a separate document or used as an input into an overall revenue projection. Significant changes to major revenue sources (projected and actual) should be highlighted in the budget document.
- 9.3.4 Notes: Changes in revenue sources may be due to economic, legal, environmental, demographic, or other reasons. In-depth revenue analysis for revenue sources that provide a substantial portion of total resources is often useful for more than budgetary projections. Issues may be uncovered in advance, permitting the government to develop options and take action in a timely manner to avoid a crisis. See also practice entitled Evaluate the Effect of Changes to Revenue Source Rates and Bases.

9.4 Evaluate the effect of changes to revenue source rates and bases

- 9.4.1 Practice: A government should evaluate and understand the effect of potential changes to revenue source rates and bases.
- 9.4.2 Rationale: Changes in rates and fees of revenue sources and revenue bases may be made by a government for a variety of reasons (e.g., to increase or decrease revenue) or may happen outside of the control of a government. Understanding the effects of such changes, in terms of expected revenue collections or other impacts, in advance of the changes will increase understanding about the outcome, enhance decision making, and provide a better opportunity to plan for the changes.
- 9.4.3 Outputs: Analyses of the effect of pending or potential changes to revenue sources may be undertaken as part of the budget process or may be undertaken as warranted. The results of these analyses should be available to stakeholders. In any event, they should be presented as part of any proposed decision on changes to revenue source rates and bases.
- 9.4.4 Notes: Factors to consider in analyzing changes to revenue sources are: legal and statutory issues; affordability to taxpayers or rate-payers; political implications; expected revenue impact; and impact on competitive position, including the effect of the changes on stakeholder decisions (e.g., location of a business or use of a service). Policies on

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fees and charges, including the percentage of service costs to be covered by user fees, should be reviewed in adjusting user fees and charges.

9.5 Analyze tax and fee exemptions

- 9.5.1 Practice: A government should periodically estimate the impacts and potential foregone revenue as a result of policies that exempt from payment, provide discounts and credits, or otherwise favor particular categories of taxpayers or service users.
- 9.5.2 Rationale: Periodic review of current or proposed exemptions and fees is necessary to verify their desirability, their potential benefits and costs, and the extent to which they benefit certain stakeholders more than others.
- 9.5.3 Outputs: Outputs include routine analyses and reports that define each exemption and estimate foregone revenues. It is important to make the results of analysis publicly available. Tax and fee exemptions tend to be politically sensitive issues and often involve highly vocal, well-established interests. An appropriate context and venue for the release should be determined that provides an opportunity for review, discussion, and decision making, while minimizing unproductive discord between competing views.
- 9.5.4 Notes: The most efficient tax (one that raises the greatest amount of revenue with the lowest cost of compliance) is one with the broadest base and lowest rate. However, exemptions and discounts from taxes and fees are common for a variety of reasons. Tax and fee exemptions may be broadly defined, such as a graduated tax (versus a flat tax), or narrowly defined, such as a homeowner tax exemption. Tax and fee exemptions that are narrowly defined may be more practical to report on and analyze, but more broadly defined exemptions are also appropriate to review occasionally. Analyses and discussions related to tax and fee exemptions may occur at a different time from resource allocation decisions to help ensure that issues pertaining to each are given adequate consideration without competing pressures.

9.6 Achieve consensus on a revenue forecast

- 9.6.1 Practice: A government should develop a process for achieving consensus on the forecast of revenues used to estimate available resources for a budget.
- 9.6.2 Rationale: A process that provides for developing consensus on the revenue forecast is more likely to remove the forecast from ongoing dispute and keep the budget process on track. The process of achieving consensus helps ensure a critical review of assumptions underlying the forecast.
- 9.6.3 Outputs: To achieve consensus, the process for producing the forecast must be trusted by all parties and be clear, open, and consistent. Governments may need to reach consensus within one branch of government, across branches of government (e.g., legislative and executive/administrative), or across different governments (e.g., in cases involving intergovernmental coordination on budgetary decisions). The process developed to achieve consensus should recognize where problems are likely to emerge and be structured accordingly.
- 9.6.4 Notes: The process for achieving a revenue forecast consensus will vary by government. In some cases, representatives of the executive and legislative branches will collaborate to produce the forecast. Another approach relies on sources outside the government to produce a

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forecast. The outside sources may be perceived as more objective or more expert, such as academic and/or private sector economists. A consensus forecasting process is increasingly being used by state governments. Despite the benefits of achieving consensus on a forecast, political realities may not always make it possible to do so for every aspect of the forecast. Moreover, not all revenues necessarily need to be included in the consensus forecast. For example, for enterprise types of operations with revenues driven by service levels, it may not make sense to achieve consensus on a forecast prior to consideration of expenditure issues.

9.7 Document revenue sources in a revenue manual

- 9.7.1 Practice: A government should prepare and maintain a revenue manual that documents revenue sources and factors relevant to present and projected future levels of those revenues.
- 9.7.2 Rationale: The documentation of revenue sources promotes a better understanding of a government's resources. Revenue documentation is also important as an administrative function, since budget operations often experience fairly frequent staff turnover.
- 9.7.3 Outputs: Documentation of revenue sources in the form of a revenue manual that uses a consistent format for each revenue source is suggested. Major revenue sources are the most important to document. The budget document may also include documentation of major revenue sources, either as summary material or in lieu of a revenue manual. The revenue manual or other documentation should be made available to all interested parties. It should be reviewed and updated at least every budget period.
- 9.7.4 Notes: The format for documentation in a revenue manual could include the following:
- Title and brief description of the revenue source;
 - Statute section providing authorization and any limitations;
 - Identification of any dedication or "earmarking" of the revenue, whether legislated or by other means;
 - Collection methodology and any collection issues;
 - Definition of the revenue base and tax or rate structure;
 - Accounting information, such as account and fund numbers;
 - Historical information such as legislative history, impact of other laws, rate changes, exemptions, etc.;
 - Historical revenue levels (trends) and projected future levels and the basis for the future projections, along with graphic presentation of trends;
 - Equity impacts on taxpayers or rate-payers; and
 - Effect of changes in economic circumstances or other external factors.

9.8 Prepare expenditure projections

- 9.8.1 Practice: Governments should prepare multi-year projections of expenditures for each fund and for existing and proposed new programs.
- 9.8.2 Rationale: Expenditure projections provide critical information to decision-makers and other stakeholders about whether projected expenditure levels can be sustained, whether new programs are affordable, and whether a program's current and future costs are acceptable compared to program benefits and projected revenue availability.

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- 9.8.3 Outputs: Expenditure projections should extend several years into the future. A period of at least three years (or longer if necessary) is recommended to evaluate how costs may change over time, to isolate non-recurring costs or savings, and to understand the implications of costs once fully phased in. Fund level and government-wide expenditure projections should be prepared and documented so that they may be linked with the accounting system and integrated into overall financial projections. All expenditure projections should identify service level assumptions and key issues that may affect actual expenditures. Expenditure assumptions should also be described in relation to revenue assumptions. A single expenditure projection may be prepared based on one set of assumptions (covering multiple periods); or, multiple projections using alternative sets of assumptions may be prepared in order to more clearly identify the impact of different scenarios. Projections should be available to stakeholders prior to making budget decisions. Inclusion of multi-year projections in a formal budget document, at least in summary form, is recommended.
- 9.8.4 Notes: Assumptions for expenditure projections should be consistent with related revenue and program performance assumptions. A review of expenditure projections for individual programs, particularly those with significant unexpected increases or decreases, is critical. Projections may identify only direct costs or both direct and indirect costs. However, if only direct costs are identified, a discussion accompanying the projections should address indirect impacts. Projections of maintenance and operating costs for any capital expenditures, as well as debt service expenditures, also should be prepared. Documentation should clarify key issues related to expenditures, highlight critical assumptions, and discuss recurring and non-recurring items. Forecasting variances should be analyzed to improve projection methodologies.

9.9 Compare revenue and expenditure options

- 9.9.1 Practice: A government should evaluate revenue and expenditure options together, and consider the implications for other financial indicators prior to making specific choices with regard to the proposed budget.
- 9.9.2 Rationale: Decision makers and other stakeholders should have an understanding of the financial implications of revenue and spending options being considered, including the ability of the government to sustain programs and services in the long run.
- 9.9.3 Outputs: A process should be established for undertaking a comprehensive review of options for program and service levels and projected funding amounts. The review should also include beginning and ending fund balances; changes in fund balances at a fund level, for the government as a whole, and for major programs; and outstanding debt levels. Financial information, both actual and projected, and assumptions used for preparing projections should be documented using appropriate technology to aid this process. At least a summary of the key materials should be incorporated into formal budget documents. Such a summary is often included in sections of the budget document highlighting key issues.
- 9.9.4 Notes: A key component of this process is determining whether a package of revenue and expenditure options being considered for the budget will maintain, erode, or improve a government's financial position in the budget period and longer term. This process also provides an opportunity to consider the degree of revenue diversification, to review

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revenues identified as one-time or unpredictable and their uses, and to evaluate the extent to which program fees cover program costs. This process does not necessarily involve dedicating revenues to support specific programs (other than enterprise operations). Before dedicating revenues, governments should consider any impact such action might have on financial flexibility and whether it would reduce the level of scrutiny given to program expenditures and operating efficiency.

9.10 Develop a capital improvement plan

- 9.10.1 Practice: A government should develop a capital improvement plan that identifies its priorities and time frame for undertaking capital projects and provides a financing plan for those projects.
- 9.10.2 Rationale: The cost of desired capital projects will usually substantially exceed available funds in most governments. Development of a capital improvement plan provides a framework for prioritizing projects and identifying funding needs and sources.
- 9.10.3 Outputs: A process should exist for evaluating proposed capital projects and financing options, and developing a long-range capital improvement plan that integrates projects, time frames, and financing mechanisms. The plan, including both capital and operating costs, should project at least five years into the future and should be fully integrated into the government's overall financial plan. The process for developing the plan should allow ample opportunity for stakeholder involvement in prioritizing projects and review. The capital improvement plan should be included in a budget document, either in a single document describing both the operating and capital budgets or in a separate document describing the capital improvement plan and capital budget. The plan should be approved by the governing body.
- 9.10.4 Notes: The emphasis of this practice is on ensuring that proposed capital projects, their timing, and their financing best meet the government's policies and plans. The capital improvement plan should take into account overall affordability in terms of both capital and operating costs, community concerns, available alternatives, coordination with other projects (including projects being considered by other governmental entities), impacts on services, beneficiaries of the project, and important community goals such as those related to economic development or the environment. The GFOA Distinguished Budget Presentation Award Program recommends documentation of the impact of proposed capital improvements on the operating budget. An evaluation of capital financing alternatives should address equity considerations, or who will pay for the project in relation to who benefits from it. It should also consider whether the money will be available when needed, how costly the financing method is, whether a financing method is legally permissible, and the administrative requirements associated with the financing option. In evaluating each funding option, the philosophy of the government regarding use of debt relative to pay-as-you-go and the acceptability of the financing method may also be considered. A government should consult its debt and other relevant policies when deciding how projects will be funded (see practices entitled Develop Policy on Debt Issuance and Management and Develop Policy on Debt Level and Capacity).

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10 Element 10 - Make Choices Necessary to Adopt a Budget

A government should prepare and adopt a budget. The proposed and adopted budget should be a comprehensive operating and financial plan. The budget document should communicate key fiscal and policy decisions, issues, and tradeoffs. In order to facilitate stakeholder understanding of the choices that have been made, it is essential that materials be prepared in format that is clear and comprehensible.

PRACTICES

10.1 Prepare and present a recommended budget

- 10.1.1 Practice: A government should prepare and present a recommended comprehensive program and financial plan (the "budget") for review by stakeholders and consideration for adoption by the governing body.
- 10.1.2 Rationale: A complete plan is necessary to allow stakeholders to judge how well all of the different aspects of the plan fit together and whether there is an appropriate balance of resources and assigned uses.
- 10.1.3 Outputs: The proposed budget will consist of a set of recommended actions regarding programs and services to be funded, including service level, quality, and goals to be achieved. It will also identify funding requirements and sources of funds, and provide the supplemental information necessary to review the plans. The budget should be consistent with policies and goals set by the government. The recommended budget must also comply with any statutory requirements; in some cases, it may be appropriate to produce a separate document to comply with these requirements.
- 10.1.4 Notes: The recommended budget should be the government's considered approach to addressing stakeholder issues previously raised. As a comprehensive program and financial plan, the budget should include all programs and funds. Consideration also should be given to including closely related entities that may not otherwise have their own budget or whose budget is important to a government, e.g., an urban renewal authority or a captive capital leasing organization. A proposed budget consists of one or more separately bound documents. Ideally, the proposed budget should be a complete and comprehensive document that includes everything that will be in the adopted budget, except for any subsequent changes made by the legislative body and a copy of the appropriations resolution or bills authorizing the budget.

10.2 Describe key policies, plans and goals

- 10.2.1 Practice: A government should include a description of key programmatic and financial policies, plans, and goals in its budget documents.
- 10.2.2 Rationale: Identification of key programmatic and financial policies, plans, and goals assists stakeholders in determining the appropriateness of a government's direction and allows stakeholders to develop their own opinions as to whether the government's programs and decisions conform to or are likely to achieve those policies, plans, and goals.
- 10.2.3 Outputs: Budget documents should describe key financial and programmatic plans and goals. Goals and objectives for individual programs and/or organizational units included in the budget documents should also be provided. Organization-wide policies and goals are often presented in an introductory section of the budget. The goals and objectives for individual programs and organizational units also should be described. They usually appear as a part of the narrative for each

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individual unit or program. Key interrelationships of programs and units in terms of goals to be achieved should be identified.

- 10.2.4 Notes: This practice is oriented toward identifying those policies, plans, and goals that most influence the recommended budget. A description of policies, plans, and goals can help build support among stakeholders for actions that might not otherwise be understood. It is particularly important to describe policies pertaining to achieving budgetary balance, use of fund reserves, and creation and use of stabilization funds. (See practice entitled Develop Policy on Reserve Funds.)

10.3 Identify key issues

- 10.3.1 Practice: The budget and the budget deliberation process should highlight key issues and decisions.
- 10.3.2 Rationale: Identification of key issues and decisions focuses attention on the most critical areas, improves the likelihood that an appropriate level of deliberation will occur regarding decisions in these areas, supports the notion of government accountability to stakeholders, and promotes trust.
- 10.3.3 Outputs: Identification and analysis of key issues and major programmatic and financial changes should be provided as early as possible in the budget process and also should be identified in the proposed budget. Summary information should always be provided, with more detailed information available where appropriate or upon request.
- 10.3.4 Notes: Key issues and decision areas may be programmatic, financial, or process-oriented. The goal is to provide for disclosure, appropriate analysis, and discussion of these issues so that well-considered budgetary decisions may be made. At times, key decisions and issues may arise that a government administration or legislative body considers inappropriate to highlight. In these cases, a government should take into account practical considerations along with the intent and purpose of this practice. Good practice requires identification of key issues, even if the information may cast the government in an unfavorable light.

10.4 Provide a financial overview

- 10.4.1 Practice: Budget documents should contain a description of the short-term and long-term financial plan of the government.
- 10.4.2 Rationale: Stakeholders need to have the financial plan of the government clearly identified in order to make the best budgetary decisions.
- 10.4.3 Outputs: A financial overview typically consists of financial statements and accompanying narrative, charts, and graphics. The overview should clearly describe the current and projected financial position and fund balances, the financial activities and expectations for the budget period, and the expected implications for future periods. The overview should provide clear information about capital plans and funding, along with the impact of capital plans on operating costs and activities. Debt and debt service issues should also be discussed. Financial data presented in the budget documents should include comparisons of prior period actual results, current period budget and/or estimated actual results, and budget period projected figures. Key assumptions for revenues and expenditures should be highlighted.
- 10.4.4 Notes: A financial overview should normally consist of all funds of a government, whether or not there are statutory requirements for budgeting those funds. The manner of presenting materials on fund balances, including available amounts and reserve funds, should be carefully considered. A clear distinction should be made between total

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fund balance (or reserves), the amount restricted by legislative policy (as opposed to statutory requirements), and the amount considered available for expenditures.

10.5 Provide a guide to operations

- 10.5.1 Practice: Budget documents should include information that provides the reader with a guide to the programs the government operates and the organizational structure in place to provide those programs and services.
- 10.5.2 Rationale: Information concerning programs and the organizational structure supporting those programs provides context for the proposed allocation of resources in the budget. This information is necessary in order to make reasoned decisions about the use of resources and to make clear the direction of the government's programs.
- 10.5.3 Outputs: Information provided to the reader in the budget documents and through other means should include: program descriptions, goals and objectives, organization charts, means of providing major services (e.g., in-house or contracted out), information relating programs to organizational units, management approaches, multi-period comparative staffing information by unit, unit sources and uses of funds, and performance measures. Key functional relationships between organizations also should be identified.
- 10.5.4 Notes: The intent of this practice is that a government make available sufficient information about its operations so that the interested stakeholder has an understanding of the programs and services provided, can identify goals and priorities of each program, and can place resource needs for those programs and services into an appropriate context.

10.6 Explain the budgetary basis of accounting

- 10.6.1 Practice: The budget should include a description of the relationship between the form of accounting used to describe revenues and expenditures in the budget, and the form of accounting used to prepare the annual financial report.
- 10.6.2 Rationale: Explaining the differences between the budgetary basis of accounting and the basis used in preparing the annual financial report helps stakeholders understand and interpret the numbers presented in each document. Documented reconciliations between different bases can also help prevent errors during preparation or interpretation of the budget.
- 10.6.3 Outputs: The relationship between budgetary revenues, expenditures, and funds available and those presented in financial reports should be explained by both numerical reconciliations and a written explanation, in both the budget and the annual financial report. In some cases, the bases used may be identical.
- 10.6.4 Notes: There are four basic categories of difference between the budgetary basis of accounting and the basis of accounting that follows generally accepted accounting principles (GAAP) for state and local governments:
- Basis of accounting--"Cash plus encumbrances" and "modified accrual" are two of the different ways to define revenues and expenditures;
 - Timing--The budget period may differ from the accounting reporting period, e.g., lapse periods for encumbrances;
 - Perspective--The budget and accounting reports may have different fund reporting structures, e.g., a budget may account for debt service

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in the general fund, while GAAP principles require that debt service be recorded in a separate fund.

- Entity--The government's financial report may not include all of the same entities and funds as the budget document.

10.7 Prepare a budget summary

- 10.7.1 Practice: A government should prepare a summary of both the proposed and final budget.
- 10.7.2 Rationale: Most stakeholders do not want to take the time to read and understand the details of a budget. A concise summary of key issues, choices, and financial trends is therefore needed to inform and direct the reader to the appropriate location for additional information.
- 10.7.3 Outputs: The summary should focus on issues likely to be important to the public. Contents may include priorities, key issues, and choices/decisions for the budget period; major changes in tax rates, tax policy, or projected service levels and priorities and reasons for those changes; important financial issues, including changes in the economy and the long-range outlook; and significant use of or increase in fund balance or retained earnings. The summary should also refer the reader to additional information available elsewhere about particular issues or financial details. The summary can take many forms, including a transmittal letter, budget message, executive summary, or budget-in-brief. The summary should be available and disseminated in an easily accessible manner that is likely to be communicated to the public and generate interest. Preparation of separate documents tailored to different audiences, including citizens, the media, and elected officials, is encouraged. Electronic formats should be considered as a means to disseminate the budget.
- 10.7.4 Notes: The summary should be as nontechnical as possible and easy to read. The GFOA Distinguished Budget Presentation Award Program recommends, at a minimum, the inclusion of summary information in the budget document and, if feasible, in a separate document as well.

10.8 Present the budget in a clear, easy-to-use format

- 10.8.1 Practice: Budget documents and related materials made available to stakeholders should be presented in a clear and readily comprehensible format.
- 10.8.2 Rationale: The budget is the guide that determines the direction of government. It is arguably the single most important document routinely prepared by governments. To be usable, it not only must contain the appropriate information, but must also be prepared in a manner that is clear and comprehensible.
- 10.8.3 Outputs: Some items in a budget document that will assist the reader include: a table of contents, summaries, a consistent format, high-level summary information that describes overall funding sources and the organization as a whole, a description of the overall planning and budgeting process and the interrelationships of those various processes, supplementary information about the government and the area for which it has responsibility, charts and graphs to better illustrate important points, succinct and clearly-written summaries, uncluttered pages, and detailed information placed in appropriate locations so that it does not overwhelm the reader. Similar requirements apply to the non-written means (e.g., audio, video) of presenting budget material to stakeholders

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at various times during the budget process. Some governments prepare summary information in a document separate from the more detailed budget document in order to avoid overwhelming the reader and to control overall costs of document preparation.

- 10.8.4 **Notes:** To achieve the goal of this practice, multiple formats may be used that are tailored to the needs of various stakeholders. These may include brief summaries of important information to be used by different audiences to enhance their understanding of important budget issues and tradeoffs.

10.9 Adopt the budget

- 10.9.1 **Practice:** A government should adopt a budget that meets all statutory requirements prior to the beginning of the fiscal year.
- 10.9.2 **Rationale:** The timely adoption of a budget permits the government to proceed with implementing programs and services that further the achievement of goals.
- 10.9.3 **Outputs:** The adopted budget should clearly present the financial, operating, and capital plan. It should include all operations and funds, although not necessarily at the same level of detail. Non-appropriated funds, revolving funds, and any other planned revenues and expenditures also should be included. Whenever feasible, the adopted budget should include (though not necessarily in a single document) all statutorily required materials such as the appropriation ordinance or bills, tax levies, and rate adjustments. Legally required documents that otherwise do not contribute to an understanding of the budget may be included as an appendix.
- 10.9.4 **Notes:** If there are delays in adopting the budget, actions should be taken to minimize uncertainty when the new budget period starts, as appropriate. A continuing appropriation may be legally required.

PRINCIPLE 4 - ASSESS PERFORMANCE AND MAKE ADJUSTMENTS

This principle identifies practices that are needed to monitor and assess the government's progress in meeting financial and programmatic goals identified in the budget and through its policies and plans. Based on this review, the government may need to make adjustments to the budget and to plans and policies if goals are to be achieved. The review undertaken through this principle feeds back into goal development and review processes to ensure that goals remain relevant.

11 Element 11 - Monitor, Measure, and Assess Performance

A government should monitor and analyze the performance of its service programs, its capital programs, and its financial performance. Performance should be based on stated goals and budget expectations. The analysis should also include customer and other stakeholder satisfaction and should include the impact of external factors affecting the government such as the economy, demographic and social factors, intergovernmental changes, weather, and other relevant factors.

PRACTICES

11.1 Monitor, measure, and assess program performance

- 11.1.1 **Practice:** A government should periodically evaluate the performance of the programs and services it provides.
- 11.1.2 **Rationale:** Government functions, programs, and activities should be periodically reviewed to determine whether they are accomplishing intended program goals and making efficient use of resources. Unlike private enterprise, there are often no simple measures such as profit to

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- evaluate "bottom line" performance. A performance evaluation provides both accountability and information on which to base improvements.
- 11.1.3 Outputs: Performance measures, including efficiency and effectiveness measures, should be presented in basic budget materials, including the operating budget document, and should be available to stakeholders. Performance measures should be reported using actual data, where possible. At least some of these measures should document progress toward achievement of previously developed goals and objectives. More formal reviews and documentation of those reviews should be carried out as part of the overall planning, decision-making, and budget process.
- 11.1.4 Notes: Evaluating and reporting on program performance on a routine, publicized basis keeps stakeholders apprised of actual results compared to expectations. One option is to prepare regular reports of key performance measures, with in-depth evaluations or reviews conducted once every several years. Program performance information should be available during the budget process. Regardless of whether the program is provided by government employees or contracted out, the reporting and evaluation process should be similar.

11.2 Monitor, measure, and assess stakeholder satisfaction

- 11.2.1 Practice: Governments should monitor and assess stakeholder satisfaction with programs and services.
- 11.2.2 Rationale: The main contact with a government for many stakeholders is through the programs and services it provides. It is important for a government to be aware of and respond to stakeholders' perceptions of these programs and services. Stakeholders' perceptions of the quality of public services is an important factor in their overall perception of the government and their level of confidence in governmental decision making.
- 11.2.3 Outputs: There are many ways to assess stakeholder satisfaction, including various forms of contact with the legislative body and administrative leaders, citizen surveys, public forums or hearings, and focus groups of clients/customers. A government should determine the methods it wishes to use and should then formally assess satisfaction with programs and services. These assessments should be conducted regularly. Stakeholder satisfaction should be reported using appropriate technology and should be available to all stakeholders.
- 11.2.4 Notes: Governments define areas where goals need to be adjusted by identifying and understanding stakeholders' concerns. Governments should consider developing performance measures and benchmarks to evaluate stakeholder satisfaction.

11.3 Monitor, measure, and assess budgetary performance

- 11.3.1 Practice: A government should evaluate its financial performance relative to the adopted budget.
- 11.3.2 Rationale: Regular monitoring of budgetary performance provides an early warning of potential problems and gives decision makers time to consider actions that may be needed if major deviations in budget-to-actual results become evident. It is also an essential input in demonstrating accountability.
- 11.3.3 Outputs: Budget-to-actual or budget-to-projected actual comparisons of revenues, expenditures, and fund balance should be included in periodic reviews undertaken during the budget period. Staffing levels should also be monitored. Comparisons for at least the current year should be included in the budget document and be generally available to

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stakeholders during discussions related to budget preparation and adoption.

- 11.3.4 **Notes:** Consistency and timeliness are particularly important when implementing this practice: it is essential that reports are prepared on a routine, widely-publicized basis. In addition to monitoring budget-to-actual results, reasons for deviations should be evaluated. These factors are important in assessing the significance of variations, including whether they are expected to be temporary or longer-term in duration. (See practices entitled Monitor, Measure, and Assess Program Performance and Monitor, Measure, and Assess External Factors.)

11.4 Monitor, measure, and assess financial condition

- 11.4.1 **Practice:** A government should monitor and evaluate its financial condition.
- 11.4.2 **Rationale:** The financial health of a government is critical to its ability to meet the needs of stakeholders. Financial condition should be evaluated to identify potential problems and any changes that may be needed to improve performance over both the short and long terms.
- 11.4.3 **Outputs:** Financial indicator measures often are developed to monitor financial condition and achievement of explicitly set financial goals. Indicators to monitor factors that affect financial performance are also reported. A report on financial condition should be periodically prepared and updated. The report may be a separate document or incorporated into other relevant documents, including the budget document. When reporting on financial condition, the government should highlight the significance of relevant indicators.
- 11.4.4 **Notes:** Financial condition is distinguished from budget performance. Budget performance identifies explicit short-term indicators, primarily revenue and expenditure status for the budget period. An evaluation of financial condition considers a broader array of factors that may have long-term implications for the financial health of the government. These factors may include specific measures of the government's financial performance (e.g., trends in operating position or liquidity) as well as measures of the community's general social, demographic, and economic conditions.

11.5 Monitor, measure, and assess external factors

- 11.5.1 **Practice:** Governments should monitor and assess external factors that may affect budget and financial performance and achievement of goals.
- 11.5.2 **Rationale:** Factors outside the government's control, such as the national or regional economy, demographic changes, statutory changes, legislation, mandates, and weather, may affect achievement of stated goals. Monitoring these factors helps governments to evaluate and respond to the effect of these external influences on goals, programs, and financial plans.
- 11.5.3 **Outputs:** External factors that are likely to be important in achieving goals should be identified and monitored regularly. The results of this analysis should be factored into the assessment of program and financial performance and considered in making adjustments to these programs. Trends and significant issues may be described in reports to stakeholders discussing program, budget, and financial performance. The assessment of external factors should be reported, at least in summary form, and available to stakeholders.
- 11.5.4 **Notes:** Many external factors cannot be controlled or sometimes even predicted by a government. Contingency planning can help address

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negative impacts or take better advantage of positive factors that might arise from external events. To the extent that external events have long-range impacts, programs, plans, and goals may need to be adjusted to reflect these changes. (See practice entitled Develop Policy on Contingency Planning.)

11.6 Monitor, measure, and assess capital program implementation

- 11.6.1 Practice: Governments should monitor, measure, and assess capital program implementation.
- 11.6.2 Rationale: Monitoring the status of capital projects helps to ensure that projects progress as planned, problems (such as delays in key milestones and cost overruns) are identified early enough to take corrective action, funds are available when needed, and legal requirements are met.
- 11.6.3 Outputs: Reports on capital project implementation should be prepared for decision makers and other stakeholders. Summary information should be considered for projects that are progressing as planned. More detailed information will probably be needed for projects where there are issues. Project milestones, such as dates for completion of such tasks as planning, land acquisition, engineering and design, and construction, should be identified and progress in meeting these milestones should be reported. Governments should monitor quality compliance and financial performance.
- 11.6.4 Notes: A government may have a large number of significant projects. This practice is intended to promote the development of mechanisms to ensure that decision makers are not overwhelmed with information on which no decision is needed and that they receive timely information where decisions or actions are required.

12 Element 12 - Make Adjustments as Needed

From time to time, a government may need to adjust programs, strategies, performance measures, the budget, and goals based on the review and assessment of program, budget, financial condition measures, stakeholder satisfaction and external factors. Processes are needed to ensure that these adjustments are formally presented to decision makers and other stakeholders and receive adequate consideration.

PRACTICES

12.1 Adjust the budget

- 12.1.1 Practice: The budget should be adjusted during the budget period should unforeseen events require changes to the original budget plan.
- 12.1.2 Rationale: The budget is a plan based on a set of assumptions that may not always match actual experiences during the execution phase. A government should watch for significant deviations from expectations and make adjustments so that the plan is consistent with revised expectations.
- 12.1.3 Outputs: Governments should have procedures in place to determine when deviations from the budget plan merit adjustments to the budget. Budget adjustments, whether to programs or to revenues and expenditures, should be made as appropriate. Final changes to the budget should be reported. The timing and manner in which this is done depends on the stakeholder group and the level of materiality of the changes.

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- 12.1.4 **Notes:** Budget adjustments may be administrative or legislative depending on the government's procedures and on statutory requirements such as the legal level of control of the budget appropriations.

12.2 Adjust policies, plans, programs and management strategies

- 12.2.1 **Practice:** A government should adjust its policies, plans, programs, and management strategies during the budget period, as appropriate.
- 12.2.2 **Rationale:** Changing conditions or programs and services that are not producing the desired results or efficiently utilizing resources may require adjustments in order for the government to continue to meet the needs of stakeholders and to meet its own goals.
- 12.2.3 **Outputs:** Governments should have procedures in place to provide for review, decision making, and implementation of changes to policies, plans, programs, and management strategies during the budget period. Adjustments should be based on findings obtained from monitoring and assessing program and financial results, stakeholder input, and external circumstances. Regular briefings to senior program officers, management, and elected officials on the contents of the reports permit timely adjustments as needed to the plan or program activities.
- 12.2.4 **Notes:** The adjustments made by a government should be based on its assessment of performance. This practice helps complete the budget planning cycle and will feed into the review of services, goals, plans, and programs which occurs near the beginning of the cycle. This practice is distinguished from the earlier review processes in that it is intended to focus more on mid-period adjustments, rather than on more fundamental changes that may be needed to achieve broad goals. (See practices under elements entitled Identify Opportunities and Challenges for Government Services, Capital Assets, and Management; Develop Programmatic, Operating, and Capital Policies and Plans; Develop Programs and Services That Are Consistent with Policies and Plans; and Develop Management Strategies.)

12.3 Adjust broad goals, if appropriate

- 12.3.1 **Practice:** A government should modify or change its broad goals if conditions change sufficiently that these goals are no longer appropriate.
- 12.3.2 **Rationale:** Goals may need to be adjusted in response to new information about program results, stakeholder needs, and external circumstances in order to be more relevant for the community or more practically attainable.
- 12.3.3 **Outputs:** Governments should have procedures in place to ensure that goals are reviewed during the budget period and adjusted when appropriate. Adjustments should be based, in part, on findings obtained from monitoring and assessing program and financial results, stakeholder input, and external circumstances. Opportunities and challenges facing the government also should be considered.
- 12.3.4 **Notes:** This practice helps complete the budget planning cycle and will feed into the goal development phase which begins the cycle. It is desirable to minimize the number of adjustments to longer-term goals in order to maintain credibility. Adjustment of performance measures associated with goals is another way to adjust or clarify goals without changing basic intent of a goal. (See elements and practices under principle entitled Establish Broad Goals to Guide Government Decision Making.)

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