

Citizens Tax Committee Guide to Prescott's 2010 Budget

Prepared by

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As part of its ongoing mission to serve as guardians of the taxpayer's money, the Citizens Tax Committee is issuing this report to facilitate public review of and comment on local government finance in our community. The following pages and accompanying tables provide background information on the context in which the City of Prescott budget process takes place, describe a few important concepts that arise in municipal finance and budgeting, and present an overview of Prescott's revenues and spending for the current and upcoming fiscal years.

As this article is being written, the City of Prescott is in the process of completing its budget for fiscal year 2010, which commences on July 1, 2009. The budget process is the mechanism whereby the City's available resources are allocated to achieve the City's short and long term objectives. Under Arizona law, no expenditure may be made for a purpose not included in the budget adopted by the City Council. And in cities like Prescott, whose citizens have chosen to operate under the so-called "Home Rule Option", the budget process has even greater significance.

In 1980, the Arizona Constitution was amended to limit spending growth in the State's cities and counties to the sum of population growth and inflation. However, this change came with an important exemption. Specifically, the voters of any Arizona city or town can vote to adopt an alternative expenditure limit, a so-called "home rule". If a city's voters approve a home rule, the basic State mandated expenditure growth limitation is overridden and replaced by that city's alternative limit. If a city's voters approve such a home rule, that rule remains in effect for four years, at which time a new home rule must be approved by the voters or State expenditure limitations take effect.

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As noted above, because the City of Prescott has adopted a home rule, its spending limit is established in the context of its annual budget process rather than being subject to State's spending limit formula. Under Prescott's current home rule (set to expire after the current budget process is complete unless renewed by the voters in this November's City elections) formal adoption of the budget establishes the next fiscal year's expenditure limit for the City.

Importantly, the public has an opportunity to comment on the City's proposed budget and expenditure limit before it is formally adopted by the City Council, although the complexity of the budget and time constraints discourage extensive public involvement in the budget process.

Consider this year's budget timeline. The public's (and Council's) first exposure to the outlines of the 2010 budget was at the City Council's May 21 budget workshop. At that workshop, the City's Finance Director walked the Council through a 124 page PowerPoint presentation of the preliminary 2010 budget proposal. At that workshop and over the ensuing three weeks, Council input is provided and a "Tentative Budget" is adopted on June 9. The Tentative Budget is further reviewed and possibly tweaked during the next two weeks. Then, on June 23, a public hearing on the budget is held and concludes with final adoption of the budget (and the next year's expenditure limit) by the City Council.

While 33 days may seem like more than enough time to review carefully and finalize the budget for a city with a population of less than 45 thousand, it really isn't. The City of Prescott's 2009 budget document (available online at http://www.cityofprescott.net/d/2009_budget.pdf) consists of over 460 pages of narrative discussion, charts, graphs, tables and financial schedules. Furthermore, city budgets utilize an arcane method of accounting referred to as "fund accounting" that can be extremely difficult to follow for someone who is unfamiliar with this basis of presentation.

Fund accounting may be likened to the use of envelopes to manage a family's budget. Just as a homemaker may divide each week's pay among envelopes for food, clothing, housing, entertainment, transportation, utilities, medical, college savings, retirement savings, etc., the City's income is allocated among various funds. The City of Prescott has literally dozens of separate funds, ranging from the "General Fund" to the "Wastewater Fund" to the "Golf Course Fund" to the "Capital Improvements Fund" to the "Streets and Open Space Fund". Financial statements, containing both historical data and detailed projections for income by source and expenses by category as well as for the assets and liabilities, are prepared for each of these funds.

Each of the City's myriad of funds falls is classified either as a Governmental Fund or an Enterprise Fund. Governmental Funds encompass basic government activities of the City that are financed primarily by taxes and other revenues that are not collected in conjunction with the use of the services being undertaken. Included in this category are the General Fund (which includes most basic City services like Police, Fire, Parks, Recreation and Library services²), a variety of Special Revenue Funds (which track collection and use of specific categories of revenue like Highway User Revenue, the 1% Streets and Open Space Sales Tax, and the Transient Occupancy Tax that are legally restricted as to their use), various Capital Projects Funds and Debt Service Funds.

Enterprise Funds account for operations that (1) are financed and operated like private businesses where user charges are intended to cover costs or (2) where the Council has determined it would be useful to track revenues and expenses as though the activity were a separate business. The City of Prescott maintains six Enterprise Funds, including: the Water Fund; the Wastewater Fund; the Golf Course Fund; the Airport Fund; the Solid Waste/Transfer Station Fund, and; the Parking Garage Fund.

In addition to segregating funds into Governmental and Enterprise Funds, all budgeted expenditures are classified either as Operating expenditures or Capital Outlays/Projects. Operating expenditures encompass general ongoing expenses such as employee salaries and benefits, utility charges and costs of supplies. Capital Outlays/Projects include (1) items costing more than \$5,000 with a useful life of more than one year, and (2) major construction, acquisition or renovation activities.

Importantly, accounting standards for city governments treat capital expenditures differently than they are treated under generally accepted accounting principles (GAAP) applicable to private businesses. Specifically, City budgets treat capital outlays as expenses in the year they are undertaken, while in GAAP accounting capital outlays are treated as acquisitions of depreciating assets. Consequently, when the City purchases a truck, the entire cost is treated as an expense in the year of the purchase. In contrast, when a private company purchases a truck, the cost is spread over the vehicle's useful

² The cost of operating those areas of the General Fund that provide support to other City activities are recovered through internal charges to those other areas. For example, the costs of the City's human resources department are paid for through internal charges levied on each area of City government that utilizes human resources department services. The levels of those internal charges are based on indicators of service usage.

life, with a fraction of the initial cost taken as a depreciation expense in each year until the initial cost is fully accounted for.³

For fiscal year 2009, the total budget for the City of Prescott was just over \$256 million. Of this total, about \$81 million was Operating expenditures and about \$175 million was Capital Outlay/Projects expenditures. Of the \$81 million budgeted for Operating expenditures, 60% was for Governmental Fund Operating expenditures and 39.2% was for Enterprise Fund Operating expenditures. And of the \$175 million of budgeted Capital Outlay/Projects expenditures, about 58.3% was for Governmental Fund Capital expenditures and 41.7% was for Enterprise Fund Capital expenditures.

As every reader of this report doubtless understands, the City of Prescott has been grappling with the same sort of revenue shortfalls (relative to historical levels) as virtually every other municipality in the State of Arizona, if not the nation. For example, sales taxes⁴ represented about 48% of Governmental Fund revenues for fiscal 2009.⁵ Consequently, it is particularly significant that sales tax collections have been trending downward for the past couple of years, with current collections about 17% below two-year-ago levels. Other revenue categories, such as State-shared income taxes, State-shared vehicle license taxes, City license and permit fees and service charges as well as Highway Users Revenue funds (HURF) are expected to be well below the levels they had been just two years ago. Enterprise Fund revenues for fiscal 2009 were substantially below budget as well.⁶

The extent of these revenue declines was not (and could not have been) fully anticipated when the 2009 budget was adopted, and consequently the City was faced with revenue shortfalls during the past year. In response, actual expenditures have been well below budget. Compared to the budgeted \$81 million for Operating

³ Cities and other government entities are required to produce Comprehensive Annual Financial Reports ("CAFRs") each year, which present detailed financial schedules for the last full fiscal year. The most recent available CAFR for the City of Prescott is for fiscal year 2008. See http://www.cityofprescott.net/d/2008_cafrr.pdf The CAFR presents entity-wide statements on a "modified business basis" that accounts for capital expenditures as they would be under GAAP accounting, that is, treating capital expenditures as acquisitions of assets rather than expenses and including annual depreciation charges as expenses.

⁴ Sales taxes are more formally referred to as Privilege and Use Taxes.

⁵ Table I present a breakdown of Governmental Fund revenues by category of revenue, and a breakdown of Enterprise Fund revenues by Fund. **Tables are included at the end of this report.**

⁶ Table II presents a breakdown of Enterprise Fund revenues by Fund.

expenditures, actual Operating expenditures for the year ending June 30, 2009 should be about \$74 million. And compared to the \$175 million budgeted for FY 2009 Capital Outlay/Projects, actual expenditures for the year will total approximately \$45 million.

Next year's tentative budget reflects the expectation that total City revenue will rebound from the depressed level experienced in fiscal year 2009. In particular, despite the fact that sales and use tax and state shared revenues are expected to be somewhat below actual receipts for 2009, these declines are more than offset by substantial increases in expected Grant revenues and Local Intergovernmental transfers. Overall, while budgeted revenues for fiscal 2010 are well below the levels budgeted for 2009, the City's total 2010 revenues are expected to be 16% higher than estimated actual 2009 City revenues.

Comparing fiscal 2009 and fiscal 2010 budgets, spending levels have been slashed. Budgeted Governmental Fund expenditures dropped by about 36% between 2009 and 2010, and budgeted Enterprise Fund Expenditures fell by about 20%.⁷ However, actual 2009 expenditures were so far below budget, projected expenditures for fiscal 2010 exceed estimated actual expenditures for 2009 by wide margins. Budgeted fiscal 2010 Governmental Fund expenditures exceed actual Governmental Fund expenditures by about 30% and budgeted 2010 Enterprise Fund expenditures exceed actual 2009 Enterprise Fund expenditures by over 80%.

Variations in budgeted and actual capital outlays and projects account for the substantial bulk of these budget swings. For instance, reductions in budgeted expenditures for Capital Outlays/Projects account for the entire \$77 million decline in budgeted spending for the City as a whole. Thus, while FY 2009 Capital expenditures were budgeted at \$175.4 million, FY 2010 Capital expenditures are budgeted at just \$97.9 million, a 44% reduction. Meanwhile, Citywide Operating expenditures for FY 2010 are projected to increase marginally from the level specified in the FY 2009 budget – from \$80.8 million in FY 2009 to \$81.4 million in FY 2010.

Finally, it is noteworthy that the impact of the current recession on City of Prescott day-to-day operations has been minimal. For example, after increasing steadily for many years, the City's Operating budget declined by about 6% between FY 2008 and FY 2009, but, as noted above, it is slated to increase slightly in the proposed FY 2010 budget.

⁷ Table III compares budgeted and actual expenditures for FY 2009 and budgeted expenditures for FY 2010 for all Governmental Funds. Table IV makes the corresponding comparisons for all Enterprise Funds.

As mentioned earlier, the public is supposed to be involved in the City's budget process. Admittedly, understanding the details of the City's finances can be a challenge. But the City's budget documents are easily accessible and provide tons of information on Prescott's activities, budget priorities and financial condition even for those with the most rudimentary understanding of finance. The City's Finance Department puts an enormous amount of effort into providing a readable exposition of where the City is getting its revenue, where it is spending its money and why, and every taxpayer should have enough interest in those topics to spend a few minutes perusing the City's most recent Budget and Comprehensive Annual Financial Report, both of which are available in the Documents section of the City of Prescott website (<http://www.cityofprescott.net/documents/>) under "Financial/Budget Reports". Who knows, you just might learn something.

Table I
Governmental Revenues⁸

FY 2009 Budgeted and Estimated Actual versus 2010 Budgeted⁹

Revenue Category	FY 2009 Budgeted	FY 2009 Estimated Actual	FY 2010 Budgeted	% Change FY 2009 Actual to FY 2010 Budget
Sales and Use Taxes	\$29,805,000	\$26,160,020	\$24,872,500	-4.9%
% of Total	45.9%	48.2%	37.1%	
Property Taxes ¹⁰	\$3,129,101	\$3,129,101	\$2,882,381	-7.9%
% of Total	4.8%	5.8%	4.3%	
Franchise Tax	\$1,564,191	\$1,577,355	\$1,608,902	2.0%
% of Total	2.4%	2.9%	2.4%	
Licenses and Permits	\$895,915	\$406,827	\$397,750	-2.2%
% of Total	1.4%	0.7%	0.6%	
Impact Fees	\$596,995	\$322,700	\$322,700	0.0%
% of Total	0.9%	0.6%	0.5%	
Other Fees, Service Charges and Fines	\$1,239,529	\$1,038,651	\$1,021,220	-1.7%
% of Total	1.9%	1.9%	1.5%	
Intergovernmental - State Shared	\$16,178,245	\$14,806,003	\$14,931,095	0.8%
% of Total	24.9%	27.3%	22.3%	
Intergovernmental – Local	\$3,398,077	\$3,046,552	\$4,796,672	57.4%
% of Total	5.2%	5.6%	7.1%	
Miscellaneous Grants	\$5,169,923	\$1,394,392	\$13,512,539	869.1%
% of Total	8.0%	2.6%	20.1%	
Interest Earned	\$856,366	\$468,395	\$441,464	-5.7%
% of Total	1.3%	0.9%	0.7%	
Other	\$2,032,647	\$1,947,065	\$2,308,374	18.6%
% of Total	3.1%	3.6%	3.4%	
Total Governmental Revenue	\$64,865,990	\$54,297,062	\$67,095,598	23.6%

⁸ Internal service fund revenues and proceeds of a \$20,500,000 Streets bond issue slated for FY 2010 are excluded from this schedule.

⁹ Note that a significant portion of Governmental Fund revenues (in particular, revenues of Special Revenue Funds such as the 1% Streets and Open Space Fund and the Highway User Revenue Fund) may be used only for specified purposes.

¹⁰ Property Taxes include Primary Property Tax and Secondary Property Tax. The Secondary Property Tax levy is tied directly to repayment requirements for voter approved bonds. The \$280,000 decline in this levy between 2009 and 2010 is only partially offset by a \$20,000 increase in Primary Property Tax.

Table II
Enterprise Fund Revenues¹¹

FY 2009 Budgeted and Estimated Actual versus 2010 Budgeted

	FY 2009 Budgeted	FY 2009 Estimated Actual	FY 2010 Budgeted	% Change FY 2009 Actual to FY 2010 Budget
Enterprise Funds				
Water Fund	\$22,030,453	\$15,454,609	\$16,040,675	3.8%
% of Total	37.9%	42.9%	41.3%	
Wastewater Fund	\$7,949,402	\$6,554,892	\$6,958,609	6.2%
% of Total	13.7%	18.2%	17.9%	
Solid Waste/Transfer Station Fund	\$9,798,603	\$9,068,208	\$9,400,449	3.7%
% of Total	16.9%	25.2%	24.2%	
Golf Course Fund	\$4,166,660	\$3,135,529	\$3,377,007	7.7%
% of Total	7.2%	8.7%	8.7%	
Airport Fund ¹²	\$14,122,642	\$1,727,634	\$2,960,681	71.4%
% of Total	24.3%	4.8%	7.6%	
Parking Garage Fund	\$75,800	\$60,282	\$64,500	7.0%
% of Total	0.1%	0.2%	0.2%	
Total Enterprise Funds Revenue	\$58,143,560	\$36,001,154	\$38,801,921	7.8%

¹¹ Bond proceeds are excluded from this schedule. A \$21 million bond issue for Wastewater system improvements and a \$19 million bond issue for water system improvements were included in the FY 2009 budget, although a substantial portion of these planned financings were postponed. A substantial portion of these planned borrowings have been rolled over to the FY 2010 budget, which includes a \$11.5 million bond issue for wastewater system improvements and a \$27.5 million bond issue for water system improvements.

¹² The 2009 Airport Fund budget includes more than \$12.5 million of capital grants.

Table III

Governmental Fund Expenditures

FY 2009 Budgeted and Estimated Actual versus 2010 Budgeted¹³

	FY 2009 Budgeted	FY 2009 Estimated Actual	FY 2010 Budgeted	% Change FY 2009 Actual to FY 2010 Budget
Governmental Fund				
General Fund	\$33,857,409	\$32,015,617	\$31,112,233	-2.8%
% of Total	24.8%	48.1%	35.8%	
Special Revenue Funds				
Highway User Fund	\$4,165,866	\$4,016,336	\$3,882,857	-3.3%
% of Total	3.1%	6.0%	4.5%	
1% Streets and Open Space Fund	\$23,225,513	\$21,895,353	\$29,388,936	34.2%
% of Total	17.0%	32.9%	33.8%	
Transient Occupancy Tax Fund	\$839,122	\$672,691	\$594,393	-11.6%
% of Total	0.6%	1.0%	0.7%	
Capital Improvement Fund	\$11,160,211	\$3,836,654	\$4,614,042	20.3%
% of Total	8.2%	5.8%	5.3%	
Impact Fee Fund	\$223,200	\$750	\$191,700	25460.0%
% of Total	0.2%	0.0%	0.2%	
Grant Funds	\$5,911,082	\$1,627,780	\$14,956,310	818.8%
% of Total	4.3%	2.4%	17.2%	
Debt Service Fund	\$2,369,675	\$2,369,675	\$1,986,840	-16.2%
% of Total	1.7%	3.6%	2.3%	
Capital Projects Funds	\$54,590,021	\$0	\$0	0.0%
% of Total	40.0%	0.0%	0.0%	
Trust Funds	\$100,000	\$100,000	\$100,000	0.0%
% of Total	0.1%	0.2%	0.1%	
Total Governmental Funds	\$136,442,099	\$66,534,856	\$86,827,311	30.5%

¹³ Includes capital outlays and excludes internal service fund expenses.

Table IV
 Enterprise Fund Expenditures
 FY 2009 Budgeted and Estimated Actual versus 2010 Budgeted¹⁴

		FY 2009	FY 2009	FY 2010	% Change
		Budgeted	Estimated Actual	Budgeted	FY 2009 Actual to FY 2010 Budget
Enterprise Fund					
Water Fund		\$48,740,756	\$18,144,334	\$55,707,840	207.0%
	% of Total	46.6%	39.4%	66.2%	
Wastewater Fund		\$28,002,728	\$13,038,218	\$12,880,361	-1.2%
	% of Total	26.7%	28.3%	15.3%	
Solid Waste/Transfer Station		\$10,061,302	\$8,509,154	\$9,082,788	6.7%
	% of Total	9.6%	18.5%	10.8%	
Golf Course Fund		\$4,470,926	\$4,219,596	\$3,372,782	-20.1%
	% of Total	4.3%	9.2%	4.0%	
Airport Fund ¹⁵		\$13,309,432	\$2,070,415	\$3,069,265	48.2%
	% of Total	12.7%	4.5%	3.6%	
Parking Garage Fund		\$117,858	\$96,323	\$77,160	-19.9%
	% of Total	0.1%	0.2%	0.1%	
Total All Funds		\$104,703,002	\$46,078,040	\$84,190,196	82.7%

¹⁴ Includes capital outlays and excludes internal service fund expenses.

¹⁵ More than \$10.2 million of budgeted FY 2009 Airport Fund expenditures were associated with anticipated grants for Airport improvements. In fact, these grant funds did not materialize during 2009. Anticipated grants for airport improvements for FY 2010 have been scaled back substantially to about \$1.5 million, and these anticipated grants account for the entire increase in FY 2010 budgeted Airport Fund expenditures over estimated actual FY 2009 Airport Fund expenditures.