Overview

Today – 3:45pm-5:00pm
• Financial Administration: Your Role as Council Member
• Ins and Outs of City Funds: Taxes and Major Revenues
• The Budget and Budget Process
• Financial Reporting and Auditing

Tomorrow – 8:30am-9:45am
• Diagnosing Financial Health
• State-Local Relationship, Milestones
• Pensions and OPEBs
• Financial Policies
• Top Tips
Financial Administration and Your Fiduciary Role

- The Fiduciary Role of Mayors and Councilmembers
- Roles of Key Staff
- The Importance of Long Term Financial Health

Christina Turner

Financial Administration and Your Fiduciary Role

- Setting parameters
- Ensure long and short term financial awareness
- Setting precedents and unintended consequences

The Fiduciary Role of Mayors and Councilmembers

Oversight
- Budget Review/Approval
- Public Contracts
- Labor Relations

Sound financial policies
- Setting parameters
- Ensure long and short term financial awareness

Fiscal & Service Impacts of Decisions
- Setting precedents and unintended consequences
Roles of Key Staff

City Manager
- Budget Preparation
- $ Recommendations
- Year-round Admin.

Finance
- Systems Admin.
- Reporting of Expenses and Revenues
- Auditing

Dept. Heads / Staff
- Budget proposals
- Tracking and reporting

The Ins and Outs of City Funds

- Taxes, Fees
- and the rest
- Local Property Taxes
- Local Sales Taxes

Michael Coleman
Cities Vary
... and so do their finances

- Geography: proximity, climate, terrain, access
- Community Character / Vision: Land use
- Size – urban / rural
- Governance / service responsibilities
  full service city - vs.- not full service

- Statewide generalizations often mask trends among sub-groups

The Mechanics of Government Revenue

Who pays?
visitors, residents, businesses, etc.

What rate / base?
$per gallon, % per price,
depreciated value, etc.

Who decides?
- Statewide voters / Constitution
- State law / Legislature
- Local voters
- Local law / City Council

Who collects?
& enforces payment?

How’s it allocated?
situs; pooled/population, etc.

What is the $ used for?
general, water, roads, parks etc.
Taxes

✓ Charges which pay for public services and facilities that provide general benefits. No need for a direct relationship between a taxpayer’s benefit and the tax paid.
✓ Cities may impose any tax not otherwise prohibited by state law. (Gov Code § 37100.5)
✓ The state has reserved a number of taxes for its own purposes including:
  - cigarette taxes, alcohol taxes, personal income taxes.
✓ General & Special
  - **General Tax** - revenues may be used for any purpose.
    - Majority voter approval required for new or increased local tax
  - **Special Tax** - revenues must be used for a specific purpose.
    - 2/3 voter approval required for new or increased local tax
    - Parcel tax - requires 2/3 vote

Fees and the Rest

Any levy, charge or exaction of any kind imposed by a California government, is a **tax** except:

- **User Fees and Assessments**: for a privilege/benefit, service/product
  - Planning permits, development fees, parking permits, user fees, copying fees, recreation classes, etc.

- **Regulatory Fees**: regulation, permits, inspections
  - Permits for regulated commercial activities (e.g., dance hall, bingo, card room, check cashing, taxicab, peddlers, catering trucks, massage parlor, firearm dealers, etc.); fire, health, environmental, safety permits; police background checks; pet licenses; bicycle licenses.

- **Rents**: charge for entrance, use or rental of government property
  - Facility/room rental fees, room rental fees, equipment rental fees, on and off-street parking, tolls, franchise, park entrance, museum admission, zoo admission, tipping fees, golf green fees, etc.

- **Penalties** for illegal activity, fines and forfeitures, etc.
  - Parking fines, late payment fees, interest charges and other charges for violation of the law.

- **A payment that is not imposed** by government
  - Includes payments made pursuant to a voluntary contract or other agreement that are not otherwise “imposed” by a government’s power to coerce.
### Taxes and Fees/etc. Approval Requirements

**California Constitution**

<table>
<thead>
<tr>
<th>City / County</th>
<th>TAX- General</th>
<th>TAX- Parcel or Special (earmarked)</th>
<th>G.O.BOND (w/tax)</th>
<th>Fee / fine / rent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Majority voter approval</td>
<td>Two-thirds voter approval</td>
<td>Two-thirds voter approval</td>
<td>Majority of the governing board.*</td>
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<tr>
<td>n/a</td>
<td>Two-thirds voter approval</td>
<td>Two-thirds voter approval</td>
<td>Majority of the governing board.*</td>
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<tr>
<td>n/a</td>
<td>Two-thirds voter approval (parcel tax)</td>
<td>55% voter approval*</td>
<td>Majority of the governing board.*</td>
<td></td>
</tr>
<tr>
<td>State</td>
<td>For any law that will increase the taxes of any taxpayer, two-thirds of each house of the Legislature ...or approval of majority of statewide voters.</td>
<td>Statewide majority voter approval</td>
<td>Majority of each house.</td>
<td></td>
</tr>
</tbody>
</table>

### Calif. Gov'ts Rely on a Variety of Taxes

**STATE**

- **Personal Income**: Marginal rates of 1% to 13.3%
- **Sales and Use**:
  - General Purpose State Rate for Local Programs: 3.9375%
  - 2.0625% Rate
- **Corporation**: 8.84% of California net income
- **Fuel**: 96¢ per gallon of gasoline
- **Insurance**: 2.35% of gross premiums
- **Vehicle License Fee**: 0.65% of depreciated value
- **Cigarettes**: 87¢ per pack
- **Alcoholic Beverage**: Varies—$0.05/gallon for beer and wine to $6.60/gallon for spirits

**LOCAL**

- **Property**: 1% of assessed value, plus rate for voter-approved debt
- **Sales and Use**:
  - Leased Statewide: 1.25%
  - Leased Locally: Varies: 0% to 3%
- **Parcel**: Per unit or per parcel $ rate
- **Utility**: Commonly 5% of utility charges
- **Hotel**: Commonly, 10% of hotel charges
- **Business**: A flat amount or based on business gross receipts
- **Documentary or Property Transfer**: Typically 0.11% of transformed property value

*Source: Modified from LAO "Cal Facts"
California City Revenues

Source: CaliforniaCityFinance.com computations from data from California State Controller (revenues). Does not include data from the following cities that failed to report: Beaumont, Hawthorne, Imperial, La Habra, Lindsay, Placerville, Stockton, Taft, and Westmorland.

Discretionary Revenues and Spending

Typical Full Service City

Source: Coleman Advisory Services computations from State Controller reports
Property Tax

✔ An ad valorem tax imposed on real property and tangible personal property
✔ Maximum 1% rate (Article XIII A) of assessed value, plus voter approved rates to fund debt
✔ Assessed value capped at 1975-76 base year plus CPI or 2%/year, whichever is less
✔ Property that declines in value is reassessed to the lower market value.
✔ Reassessed to current full value upon change in ownership (with certain exemptions)
✔ Allocation: shared among cities, counties and school districts according to state law.

Where Your Property Tax Goes

**Shares Vary!**
- Non-Full service cities: portion of city shares go to special districts (e.g. fire)
- Pre-prop13 tax rates

Typical homeowner in a full service city not in a redevelopment area.
Includes Property Tax in-lieu of VLF.

Source: Coleman Advisory Services computations from Board of Equalization and State Controller data.
Sales and Use Tax

✔ Sales Tax: imposed on the total retail price of any tangible personal property

✔ Use Tax: imposed on the purchaser for transactions in which the sales tax is not collected.

Where Your Sales Tax Goes

<table>
<thead>
<tr>
<th>City*</th>
<th>1.00</th>
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<tbody>
<tr>
<td>Co Transp</td>
<td>0.25</td>
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<tr>
<td>Prop 172</td>
<td>0.50</td>
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<tr>
<td>Co Realignment</td>
<td>1.5625</td>
</tr>
<tr>
<td>State GF</td>
<td>3.9375</td>
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<tr>
<td>Total Base</td>
<td>7.25%</td>
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</table>

* For taxable sales in unincorporated areas, the local 1% rate goes to the county.
Sales Tax Collections

Revenues per capita inflation adjusted

Budgets and Budget Processes

- What is a budget?
- What is in a budget?
- What is a “fund?”
- Capital Improvement Program (CIP)
- Budget process
What **is** a Budget?

- **What:** A financial plan projecting revenues and expenditures for a defined period of time (usually 1-2 years)
- **Types:** Operating and Capital

Your budget should:
- Reflect the community’s priorities
- Good estimates of revenues/expenses by fund
- Anchored to Long Term Forecasts (~5 years)
- Provide actual revenue/expense history to gauge accuracy of forecasts!

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What is **in** a Budget?

- A **summary or discussion** of revenues and expenses
- History of **actual** revenues and expenses
- Projected **revenues by type/source**
- Estimates of proposed **expenditures by function** (typically by Department)
- Separate budgets for each and every fund
- Capital Budget – tied to CIP
What is a “Fund”?  

- A **fund** is a self-balancing set of accounts for all financial transactions of specific activities.  

- Most agency budgets include the following types of separate “funds”:  
  - General Fund  
  - Enterprise Fund(s)  
  - Special Revenue Fund(s)  
  - Capital Project Fund(s)  
  - Others: debt service, trust, agency, internal service, special assessment

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**Budget Alternatives**

**Terms:**  
- Typical: One Fiscal Year (July 1 – June 30)  
- Biennial Budget (two fiscal years)

**Types:**  
- Operating  
- Capital

**Budget Formats:**  
- Line Item  
- Performance  
- Program  
- Zero Based
Capital Improvement Program (CIP)

- For infrastructure or capital investment
- Funds come from a variety of sources:
  - Impact fees, restricted taxes, enterprise operations
- Subject to State Law—bidding process and prevailing wages
- Capital Improvement Program should look forward five years, preferably 10

CIP – Policy & Guidelines

**Policy:**
- Statement of plans for capital projects
- Specific goals
  - e.g., PCI for roads
- Use of resources

**Guidelines:**
- preserve an existing asset?
- mitigate health or safety problem?
- mandated by State or Feds?
- contribute to City’s economic health?
- available funding for capital plus ongoing operations & maintenance?
Budget Process

• A budget takes months to prepare
• Performance standards or measures help ensure investment meets desired outcomes
• Your budget calendar and review process should be meaningful
• Your process should allow for needed input at the appropriate times
• Each agency does it differently!

The Budget Process

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<tr>
<td><strong>BUDGET DEVELOPMENT</strong></td>
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<tr>
<td>Staff = Build Baseline &gt; Dept. Proposals &gt; Recommendations =&gt; Proposed Budget.</td>
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<tr>
<td>Goals Budget Priorities</td>
<td>Workshop Long-Range Planning</td>
<td>Workshop Budget Proposals</td>
<td><strong>BUDGET ADOPTION</strong></td>
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< ---------------------- Budget Amendments ------------------- ------->

| **BUDGET MONITORING** | | | | | | | | | | | |
| Prior Year End Audit | Mid-Year Adjust | | | | | | | | | | |
Financial Reporting and Auditing

Christina Turner

- The Comprehensive Annual Financial Report (CAFR)
- Letter of Transmittal
- Independent Auditor’s Report
- Management Discussion and Analysis
- Financial Statements and Notes
- Supplementary and Statistical Information

Comprehensive Annual Financial Report (The CAFR)

Letter of Transmittal

Independent Auditor’s Report

Management Discussion and Analysis

Basic Financial Statements and Note Disclosures

Supplementary Information and Statistical Section
Management’s Discussion and Analysis (MD&A)

• Narrative overview of Basic Financial Statements
  o Explains components
  o Highlights year-over-year changes
  o Analysis of individual funds

• What to look for:
  o Changes in net position
    • Capital assets vs. unrestricted net position
    • Underlying reasons .... One-time occurrences or a trend?
  o Changes in fund balance
    • The change itself is less important than the explanation
  o Analysis of the General Fund

Basic Financial Statements

Government-wide
This is the agency-wide roll-up

Governmental Funds
• General Fund
• Special revenue funds e.g., impact fee funds

Proprietary Funds
• Enterprise funds e.g., utilities, etc.

Fiduciary Funds
• Trust funds e.g., redevelopment dissolution funds, etc.
Introducing:
The League of California Cities’
California Municipal Financial Health Diagnostic

Michael Coleman

Diagnosing Municipal Financial Health

Bad Brew in Troubled Cities

- Over-reliance on land development revenue
- Over-reliance on redevelopment revenues
- Unsustainable / intractable employee compensation esp. public safety pension, retiree health care
- Risky financing schemes
- Unsustainable decline in core revenues
- Fear and Denial
- Toxic Relationships
- Ceding of management and policy choices to others
Four Views of Municipal Financial Health

1. **cash solvency** – ability to meet immediate financial obligations; i.e. over next 30 or 60 days (accts payable, payroll).
2. **budgetary solvency** – ability to meet all financial obligations during a budget year.
3. **long-run solvency** – ability to meet all financial obligations into the future.
4. **service-level solvency** – ability to provide the desired level of services for the general health and welfare of the community.

Difficulties in Assessing Municipal Financial Health

- Published data are not complete or timely.
- Do we know what the numbers mean? Are they enough to draw conclusions?
- Comparisons are often false.
- Requires analysis, forecasting, context, legal
  - *it’s not just an accounting or statistical exercise*
  - *history doesn’t tell you enough about the future*
You Need the Financial Health Diagnostic

- Validate areas in which your city is *fiscally healthy*
- Identify problems, areas to *improve*
- Act to remedy problems *before* they get worse or unmanageable
- Avoid being blind-sided by problems
- Add credibility to your fiscal evaluation
- Help others (labor associations, taxpayers and other interested parties) *understand* your financial position

Our Approach

**California Municipal Financial Health Diagnostic:**

- Get to the primary indicators - useful & essential
  - Leave out extraneous / secondary
  - Add in overlooked & underappreciated factors
- Drill down to the real numbers
- Allow for nuance / clarification / differences
  - Reduce invalid conclusions and comparisons
- Constructive, thoughtful approach
Diagnosing Financial Health

The California Municipal Fiscal Health Diagnostic

Financial Distress Checklist

<table>
<thead>
<tr>
<th>Measures</th>
<th>Fund:</th>
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<tbody>
<tr>
<td>1. The city has recurring general fund operating deficits.</td>
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<tr>
<td>2. General fund reserves are decreasing over multiple consecutive years.</td>
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<tr>
<td>3. General fund current liabilities (including short-term debt and accounts payable within 90 days) are increasing. Cash and short-term investments are decreasing.</td>
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<tr>
<td>4. General fund fixed costs, salaries and benefits are increasing over multiple years at a rate faster than recurring revenue growth.</td>
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<tr>
<td>5. The general fund is subsidizing other enterprises or special funds.</td>
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<tr>
<td>6. The city council’s authority to make changes is constrained by charter, contract, or law. (e.g. binding arbitration, minimum spending, minimum staffing or compensation formulas, etc.)</td>
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<tr>
<td>7. The general fund budget has been balanced repeatedly with reserves, selling assets, deferring asset maintenance.</td>
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<tr>
<td>8. The general fund budget has been balanced repeatedly with short-term borrowing, internal borrowing or transfers from special funds.</td>
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<tr>
<td>9. General fund pension liabilities, post-employment or other non-salary benefits have been repeatedly deferred or costs have not been determined, disclosed or actuarially funded.</td>
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<tr>
<td>10. General fund debt service payments have been “backloaded” into future years.</td>
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<tr>
<td>11. Ongoing general fund operating costs are being funded with temporary development revenues.</td>
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<tr>
<td>12. Financial Reports are not being filed on time. (CAFR, Annual Audit, State Controller’s Financial Transactions Report)</td>
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<tr>
<td>13. Public service levels are far below standards needed in this community.</td>
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</tbody>
</table>

For detailed indicators related to these points see the Financial Health Indicators.

Milestones in Municipal Finance: A Brief History

Michael Coleman

- Plans versus Policies
- Topics for Financial Policies
- Policy versus Practice: Make ‘em Work
- Policies and Financial Ratings
Proposition 13 (1978) nuts & bolts

1. **One percent rate cap.** Property tax rates capped at 1% of full market value
2. **Assessment rollback** of property values for tax purposes to 1975-76 levels
3. **Assessment growth capped** at 2% of property value (or CPI)
   - Reassessment at full market value only upon change of ownership
4. **Special taxes** (local) require 2/3 voter approval
5. **State tax increases require 2/3 vote of Legislature**
6. **Authority for allocating property tax revenues transferred to the state**

Proposition 13 (1978) revenue impacts

- **57% reduction** the proportion of revenue to different entities:
  - City
  - County
  - Special Districts
  - K-14 Schools

Milestones in Municipal Finance History
The AB8 (1979) Bailout
Shifting Local Property Tax to Cushion Impacts of Prop13

Prop13 Impacts After "Bailout" (Billions/year in 1978-79)
- Schools
- Counties
- Cities
- Special Districts

State General Fund

Cities, Counties, Special Districts ➔ Property Tax ➔ Schools

Milestones in Municipal Finance History

The AB8 “Bailout”:
- State legislature
- increased non-school shares,
- reduced school shares,
- paid more state general fund to schools.

Proposition 13 (1978) revenue impacts

K-14 Schools

County

City

Special Districts

**State General Fund**

Cities, Counties, Special Districts

**Property Tax**

Schools

**Reduced general fund support**

Redevelopment Agencies

Special Districts

Counties

Cities

Billions per year

- Net Loss $940 million
- Net Loss $2,780 million
- $590 million
- $350 million

Milestones in Municipal Finance History

Local Revenue Protection: Prop1A (‘04), Prop1A (‘06), Prop22 (‘10)

**Constitutional Protection for:**

1. **Property taxes: cities, counties, special districts**
   - Protection includes Property Tax in lieu of VLF (VLF swap)
   - May reallocate among cities, counties, special districts with a 2/3 vote of both houses

2. **Local sales tax rate, method of allocation**
   - Exception: interstate compact or federal law

3. **VLF 0.65% rate to cities and counties ... unless replaced**
   - VLF may not be diverted to reimburse a state mandate

4. **Transportation Funds to locals - no taking, delay or borrowing**

5. **Prohibitions against unfunded state mandates strengthened**

6. **Redevelopment Tax Increment - may not be diverted for other purposes**
Pensions and Other Post-Employment Benefits (OPEB)

What Happened?
- Pension Funding
- Employer Contribution Rates
- GASB changes
- Other Post Employment Benefits (OPEB)

Retirement Plans

1. Defined Contribution
   - Employees (and/or employers) contribute a fixed amount or a percentage of pay in an account that is intended to fund retirement

2. Defined Benefit
   - Employee benefits are computed using a formula that considers several factors, such as length of employment and salary history
Pension Funding

Defined Benefit Plans are funded from:

1. Contributions from employers
   • Variable based on a variety of factors
2. Contributions from employees
   • Fixed based on pension formula
3. CalPERS investment earnings

Employer Contribution

Two components

- Normal cost
  • Annual cost of future benefit for current employees
  • Expressed as a percentage of pay
- Payment on unfunded liability
  • Required when plan liabilities exceed plan assets
  • Expressed as a dollar amount
Employer Contribution

Many factors cause the employer rate to change, including...

- CalPERS investment earnings
- Benefit changes
  - Formula changes applied retroactively
- Changes in actuarial assumptions
  - Economic, such as the rate of investment return
  - Demographic, such as mortality rates
  - Other experience
    - Pay increases exceeding assumptions

What Happened?

CalPERS Investment Returns

Strong investment returns in the late 1990s created momentum for enhancing benefits. But investment losses combined with more expensive benefits created significant unfunded liabilities.
### CalPERS Payments on the Rise

**Average Employer Contribution Payments**

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</thead>
<tbody>
<tr>
<td>Percentage</td>
<td>0%</td>
<td>5%</td>
<td>10%</td>
<td>15%</td>
<td>20%</td>
<td>25%</td>
<td>30%</td>
</tr>
</tbody>
</table>

#### Contribution Rates

- **Safety (police, fire) plans**
- **Miscellaneous plans**

*Includes employee sharing*
Response

• Some cities implemented new tiers
• Public Employees’ Pension Reform Act (PEPRA)
  o Required new tiers for new employees
• Pension obligation bonds- not recommended
• Section 115 Trusts
  o Can only be used for pension costs
• Employee sharing in employer contribution rate

Other Post-Employment Benefits (OPEB)

• Largely under-the-radar until GASB 45
  o Difference between Actuarial Required Contribution (ARC) and actual contribution on balance sheet
  o No requirement to fund, but creates visibility

• GASB 75 effective last fiscal year (17-18)
  o Similar to GASB 68 for pensions
  o Liability needs to be portrayed in the financial statements (full accrual)
Other Post-Employment Benefits (OPEB) (cont’d)

• Significant liability for many cities
• Cost continuing to increase
  o More retirees
  o Retirees living longer
  o Increasing healthcare costs

Financial Policies: The Foundation of Fiscal Health

Christina Turner

• Plans versus Policies
• Topics for Financial Policies
• Policy versus Practice: Make ’em Work
• Policies and Financial Ratings
Plans versus Policies

• Plans can change over time
  (like ... as soon as the ink is dry)
• Policies, however....
  o Act as your “north star,” guiding your actions
  o Make tough decisions easier by formalizing values and procedures before a crisis hits
  o You could decide to do something else
  o Bottom line... good policies always give you a starting point

Financial Policy Topics

• Balanced Budget
• User Fees & Cost Recovery
• Enterprise Funds: To subsidize or not?
• Fund Balance & Reserves
• Budget Amendments
• Budget Carryover
• Revenue Earmarking
• Capital Financing & Debt Management
• Financial Reporting
• Investments
• Purchasing, bidding, contracting
• Travel guidelines
• Credit Card Use
Formal Policies

**Put financial policies in writing so that they:**
- Can outlive the crisis … or prepare you for one
- Promote stability and continuity
- Create efficiency through standardization
- Save you debt service costs
- Don’t rely on an individual to interpret best practices
- Help with your CAFR process and reduce audit findings

**Crucial Point:**
Policy versus Practice

- Policy should include **specific objective** but not detailed steps in meeting that objective
- Make policy brief and concise.
  - Example: “User fees should be reviewed and adjusted at least annually to avoid sharp changes.”
- Include “how to” steps in **administrative procedure**, if necessary.
- Leave exact steps of review/adjustment to staff.
Long-Term Financial Planning

Combines financial forecasting with financial strategizing to identify future challenges and opportunities, fiscal imbalances, and strategies to secure financial sustainability.

Why?
- Respond to a financial crisis
- Bring financial perspective to planning
- Stimulate long-term thinking
- Stimulate “big picture” thinking
- Address a particular issue or proposal
- Impose discipline
- Demonstrate good fiscal management

Top Tips for Financial Management

1. Obtain key documents:
   - Annual Operating Budget
   - Capital Improvement Program
   - Comprehensive Annual Financial Report (CAFR)

2. Develop and Use Financial Policies.

3. Know the difference between a “one-time” solution versus a “defer” solution versus a “sustainable” solution
   - One-time solutions fix a current problem, but not an on-going one.
   - Deferrals “put-off” a problem by fixing a one time problem but create as much or more added costs in future years.
   - A sustainable solution fixes an on-going budget problem now and into the future.

   - Long Range Financial Plan
   - Interim Financial Reports
   - Investment Reports
Top Tips for Financial Management

4. **Ask hard questions** about programs:
   1) What is the purpose of this program? Why is it needed?
   2) What are the specific intended outcomes of this program?
   3) What are the measurable objectives?
   4) What are the cost components: personnel, contracts, supplies, equipment, etc.?
   5) How will the costs of this program change in the future?
   6) What are the alternative service delivery approaches?
   7) Where will the money come from to pay for this?
   8) What are the consequences of not doing this program?

5. **Avoid unsustainable budget practices including**:
   - Exhaust the reserves
   - Freeze vacant positions
   - Make across the board cuts
   - Defer equipment purchases
   - Defer essential maintenance
   - Long-term formula driven spending
   - Defer pension or capital funding contributions
   - Eliminate training
   - Borrow from other funds
   - Ignore the small cuts

Support Materials

- “Six Things to Know When Issuing Municipal Bonds”
  Municipal Securities Rulemaking Board
  [http://www.msrb.org/msrb1/pdfs/MSRBSixThingstoKnow.pdf](http://www.msrb.org/msrb1/pdfs/MSRBSixThingstoKnow.pdf)

- “Cal Facts” Legislative Analysts Office

  Governing Magazine

- “A Guide to Managing Your Jurisdiction's Financial Health”
  Governing Magazine
Resources

✔ League of California Cities
  ✔ City Advocate Weekly  Regional Managers
  ✔ League Alerts  Conferences/ Seminars

✔ Institute for Local Government (ILC)


✔ Government Finance Officers Association GFOA.com

✔ The California Municipal Finance Almanac
  www.CaliforniaCityFinance.com