



BEST PRACTICE

Adoption of Financial Policies (2001) (BUDGET)

Background. The National Advisory Council on State and Local Budgeting (NACSLB) has developed a comprehensive set of recommended budget practices. The recommendations have been endorsed by a number of key governmental associations, by academia and by labor groups associated with state and local governments. These practices and the associated framework outline a budget process that encompasses the broad scope of governmental planning and decision-making with regard to the use of resources. This work is recognized as one of the most important advances in governmental finance in decades. The Government Finance Officers Association (GFOA) has adopted a recommended practice endorsing the NACSLB practices and the associated framework. However, the policies included in this Recommended Practice are those considered fundamental to the budget process and relevant to the broadest number of jurisdictions.

The work of the NACSLB provides a framework for describing the overall budget process. The framework is organized around the four principles of the budget process:

- Establish Broad Goals to Guide Government Decision Making
- Develop Approaches to Achieve Goals
- Develop a Budget Consistent with Approaches to Achieve Goals
- Evaluate Performance and Make Adjustments

Each of these principles has additional elements that provide guidance for an effective budget process. Element #4, of Principle 2, Adopt Financial Policies, addresses the need for jurisdictions to establish policies to help frame resource allocation decisions.

Recommendation. The Government Finance Officers Association (GFOA) recommends that, at a minimum, financial policies in the following areas be developed by professional staff and formally adopted by the jurisdiction's governing board *as well as the governing boards of those component units; state, provincial and municipal corporations and organizations; and other bodies under their jurisdiction.*

- Financial Planning Policies
- Revenue Policies
- Expenditure Policies

The jurisdiction's adopted financial policies should be used to frame major policy initiatives and be summarized in the budget document.

It is further recommended that these policies, along with any others that may be adopted, be reviewed during the budget process. Professional staff should review the policies to ensure continued relevance and to identify any gaps that should be addressed with new policies. The results of the review should be shared with the governing board during the review of the proposed budget.

Policy categories that should be considered for development, adoption and regular review are as follows:

Financial Planning Policies

These policies address both the need for a long-term view and the fundamental principle of a balanced budget. At a minimum, jurisdictions should have policies that support:

1. **Balanced Budget** - A jurisdiction should adopt a policy(s) 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. (NACSLB Practice 4.5)
2. **Long-Range Planning** - A jurisdiction should adopt a policy(s) that supports a financial planning process that assesses the long-term financial implications of current and proposed operating and capital budgets, budget policies, cash management and investment policies, programs and assumptions. (NACSLB Element 9, GFOA Recommended Practice)¹
3. **Asset Inventory** - A jurisdiction should adopt a policy(s) to inventory and assess the condition of all major capital assets. This information should be used to plan for the ongoing financial commitments required to maximize the public's benefit. (NACSLB Practice 2.2)²

Revenue Policies

Understanding the revenue stream is essential to prudent planning. Most of these policies seek stability to avoid potential service disruptions caused by revenue shortfalls. At a minimum jurisdictions should have policies that address:

1. **Revenue Diversification** - A jurisdiction should adopt a policy(s) that encourages a diversity of revenue sources in order to improve the ability to handle fluctuations in individual sources. (NACSLB Practice 4.6)
2. **Fees and Charges** - A jurisdiction should adopt policy(s) that identify the manner in which fees and charges are set and the extent to which they cover the cost of the service provided. (NACSLB Practice 4.2)
3. **Use of One-time Revenues** - A jurisdiction should adopt a policy(s) discouraging the use of one-time revenues for ongoing expenditures. (NACSLB Practice 4.4)
4. **Use of Unpredictable Revenues** - A jurisdiction should adopt a policy(s) on the collection and use of major revenue sources it considers unpredictable. (NACSLB Practice 4.4a)

Expenditure Policies

The expenditures of jurisdictions define the ongoing public service commitment. Prudent expenditure planning and accountability will ensure fiscal stability. At a minimum, jurisdictions should have policies that address:

1. **Debt Capacity, Issuance, and Management** - A jurisdiction should adopt a policy(s) that specifies appropriate uses for debt and identifies the maximum amount of debt and debt service that should be outstanding at any time. (NACSLB Practice 4.3, 4.3a, GFOA Recommend Practices pp.90-92)
2. **Reserve or Stabilization Accounts** - A jurisdiction should adopt a policy(s) to maintain a prudent level of financial resources to protect against the need to reduce service levels or raise taxes and fees due to temporary revenue shortfalls or unpredicted one-time expenditures. (NACSLB Practice 4.1)³⁴

¹ See also GFOA's best practice on *Establishment of Strategic Plans*, 2005.

² See also GFOA's best practice on *Sustainability*, 2002.

³ See also GFOA's best practice on *Business Preparedness and Continuity Guidelines*, 2005.

⁴ See also GFOA's best practice on *Appropriate Level of Unreserved Fund Balance in the General Fund*, 2002.

3. **Operating/Capital Expenditure Accountability** - A jurisdiction should adopt a policy(s) to compare actual expenditures to budget periodically (e.g., quarterly) and decide on actions to bring the budget into balance, if necessary. (NACSLB Practice 7.2)

References

- "Developing Formal Debt Policies," *Government Finance Review*, August 1991.
- "Elements of a Comprehensive Local Debt Policy," *Government Finance Review*, October 1994.
- GFOA Best Practice, "Setting of Government Charges and Fees," 1996.
- *Recommended Budget Practices: A Framework for Improved State and Local Government Budgeting* National Advisory Council on State and Local Budgeting, 1998.
- *A Guide for Preparing a Debt Policy*, Patricia Tighe, GFOA, 1998.