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FINANCIAL MANAGEMENT: A BALANCING ACT FOR LOCAL GOVERNMENT CHIEF FINANCIAL OFFICERS

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INTRODUCTION

Citizens expect their governments to do needed activities but within fiscal constraints.[1] Financial management seeks to carry out this fiscal imperative. The private economy generates the wealth that elected representatives of the public extract in part to provide for public goods and services. Public law prescribes the form of this taxation, the method of getting other forms, and the handling of these resources once they are in the custody of the public treasury. Further, the budgeting process offers a structured means for gaining a modicum of political consensus on how to address local goals for the upcoming fiscal period. Civic results, therefore, hinge on the jurisdiction's financial management. Managing local finance requires more than the accounting of funds, however. Chief financial officers (CFOs) have to do a fiscal balancing act within the local body politic, requiring strategic integration of budgeting, accounting, and financial management in pursuit of the public good.

BALANCING PROCESS AND RESULTS

Public budgeting reflects the values of those involved in making the allocation. This means that there is no one best way to conduct budgeting or to judge the outcome. By default, the focus turns to the study of the process of budgetary decision-making and the results of those decisions. Looming on the near horizon, however, is a serious attempt by many to hold governments accountable for their service delivery and the accomplishment of articulated goals.

The process of budgetary decision-making examines the relationship of participants and the sequencing of those decisions. Two

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broad theories capture that thinking: "bottom up" and "top down" approaches to fiscal decision-making (LeLoup, 1988).

Traditional "bottom up" budgeting emanates from fragmented decision-making with significant influence by program managers who build the budget from the bottom-up, one line-item at a time. Although both operating and capital budgets follow a linear sequence, the behavior of each budgetary actor relates to the behavior of others in the process (Kiel and Elliot, 1992; Forrester, 1993). Decision-makers, moreover, adopt simplifying rules to limit the scope of analysis. Stable fiscal environments allow relationships to develop and mature, often with recognizable rules and predictable results governing the budgetary debate. Despite its rejection as a general explanatory theory of budgeting (Berry, 1990), incrementalism retains a theoretical and practical grip on the field of local government budgeting (Hendrick, 1989, 1992a, 1992b; Rubin, 1992).

In "top down" budgeting, top leaders impose macro constraints, by that limiting the role of lower-level managers in setting fiscal goals. A program may receive notice that it will lose its funding or can only propose a budget of a certain level. This preempts a program's desire to define its own budget and offers an opportunity for more comprehensive thinking about broad fiscal policy, forcing micro-level tendencies to yield to macro goals. Besides, macrobudgeting offers a way to respond to resource scarcity since a dynamic environment interrupts routine patterns of decision-making. Macro-decisions, however, can imperil the fiscal health of a local government that otherwise follows fiscally-sound practices. Orange County, California, for example, declared bankruptcy in 1994 because of its aggressive investment practices. In 1996, the city of Miami, Florida, declared a fiscal emergency due to central finance problems.

Traditionally, the results of budgetary decisions appear as dollar allocations. Incremental budget theory posits that history decides budget results, meaning that past funding levels are likely to extend into future allocations. Specifically, in a bottom-up process, the budget of each successive organizational level is an aggregation of lower level decisions (Hendrick, 1992b). In contrast, a centralized, top-down decision-making environment holds that primary decisions are on the total budget size and broad priorities and all other decisions flow from these macro choices. Still, the focus remains on budget change over time as well as in comparison with others. In such cases, it suggests that public agencies are less concerned with

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program accomplishments than with spending totals. Public constraints on taxing, borrowing, and spending naturally spring from citizens expressing their dissatisfaction with such results (O'Sullivan, Sexton, and Sheffrin, 1995).

A contrary focus on what the dollar buys--not just on the formatting of the budget or dollar level--is now taking hold. Tight revenues compel managers to examine all spending patterns and performance and measure success against the stated mission and objectives. As part of this new calculus, governments have to reconsider their roles in the provision and production of each service (Oakerson, 1987). In such an environment, however, CFOs must guard against the temptation of producing a skewed financial analysis to justify a preconceived idea (Hildreth, 1983).

RECONCILING EXPENDITURES TO REVENUES

Balancing revenues against expenditures is the demanding requirement of public budgeting. Insatiable spending demands run up against constrained resources, Nevertheless, public officials have to make tough tradeoffs between spending and taxing options.

Revenues

The power to tax is a key point of distinction between a governmental entity and other organizational forms. Public revenue structures, however, vary from fixed rate tax levels to pricing of private goods publicly produced (*e.g.*, toll roads, utility service). Since many resource flows are dedicated for particular purposes, an accounting system has to record and track each dollar into and out of the appropriate earmarked account. This promotes accountability to the citizens, users, and others and complicates financial reporting practice by requiring lengthy end-of-year financial statements summarizing transactions for each specialized set of accounts.

Aggressive efforts to increase the reach of taxes and fees can run into practical, if not legal, challenges. Taxpayers have to guard their pocketbooks because public officials frequently search for new revenues (Meltsner, 1971). As commerce flows across legal borders, however, it becomes difficult to assess and collect particular taxes. For example, the growth in interstate sales through mail orders and over the Internet renders impotent a growing share of the local sales tax pending a national coordinated solution. Other revenue sources

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must pass constitutional hurdles such as in an interpretation of when a taxing method violates the interstate commerce clause.

Whatever the taxing scheme, it imposes an economic burden on individuals and businesses and these burdens vary by circumstances. A property tax, with differential appraisal and classification methods, affects people differently. Similarly, consumption tax burdens vary by consumption habits and the exemption from taxation of items such as food. An area ripe for political exploitation is the burden on fixed-income individuals caused by utility service fee increases. Relying upon transferred profits from cash-rich government enterprises (such as an electric utility) may help lower property taxes, but it also spreads the burden differently than might occur with a general property tax. As electric utilities, for example, face retail distribution competition, these subsidies may vanish, requiring the general fund to generate substitute funding. As a result, the burden will shift. Compounding the problem is that local governments lag the states in judging the burden of various revenue schemes.

Taxpayers signal dissatisfaction through their unwillingness to pay. Citizens want more services but at a lower cost, quite a conundrum for public officials seeking public support for programs (Glaser and Hildreth, 1996). However, for officials to go around fiscal limits is to risk public retribution upon discovery of this subterfuge (Hildreth, 1994). Revenue flows drive the budget. Overly optimistic revenue projections are the precursors of serious financial problems (Martin, 1982). A community dependent upon a single industry for a major share of the tax base is particularly vulnerable. Caution also extends to communities with a concentrated economy measured by the share of the tax base owned by the top ten taxpayers (Hildreth and Miller, 1994).

Expenditures

Money is a means to a desired end. It takes money to pay for a worker's time, to get equipment and machinery, and to pay for fuel and other essential supplies. The budget has to reach beyond these purchases and return added value to the citizens. Generally, taxpayers tolerate taxation to receive a bundle of services but increasingly make strident calls for results and limits. Performance accountability is one response. To compound matters, however, officials have to adjust public services continually to a changing community. Governments, dependent upon flexible budgets premised on customer

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paying as they use a service, have to adjust spending accordingly. Adding complexity is the high percentage of budget devoted to personnel costs, a fact that limits discretion and influences budget results (Hendrick, 1992b). Moreover, budget systems can influence the incentive of parties to conserve resources (Klay, 1987). Despite protections against incremental budgeting, many government programs get almost what they did in the prior year, although an aggregate view may mask significant changes within the budget (Hendrick, 1989).

Particular types of public spending, especially in physical and social infrastructure, can influence the local economy (Lansing, 1995). This arises because commerce depends upon a well-managed transportation network of streets and bridges, a sufficient water supply and adequate sewage treatment, and effective public safety services (*e.g.*, police, fire, and emergency medical services). Quality of life measures, such as parks, green space, libraries, and cultural attractions, also assume importance in attracting and nurturing the engines of economic growth. Some of these expenditures represent developmental functions of the local budget (Pearson, 1981) which coincidentally rank high as a spending preference of mayors (Longoria, 1994).

Budget Balance

Budgets seek to reconcile expenditures to revenues. Resolving taxing and spending decisions jointly allows taxpayers to understand the tradeoffs and to avoid the illusion of not paying for services. The pressure point is the forecast of expected revenues. Communities using overly optimistic revenue forecasts may do so to avoid tradeoffs only to face cutbacks in midyear (Rubin, 1982). In contrast, when the goal is to have a year-end fund balance, the tendency is to underestimate revenue. Revenues over estimates, therefore, fail to the fund balance. On the other side, unanticipated spending needs may arise from unanticipated service demands to changes in political priorities. Quite frequently, therefore, the original adopted budget does not hold with formal revisions required during the fiscal year (Forrester and Mullins, 1992).

MATCHING ASSETS TO LIABILITIES

An oganization wanting to remain a going concern meeds to have

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and maintain assets sufficient to cover liabilities. The balance sheet reveals the monetary value of assets, liabilities, and equity as of the close of a financial period--a snapshot on a particular date. More than an accounting issue, however, the relationship of assets and liabilities is at the heart of organizational viability.

Things of monetary value held by an organization are assets. Cash held in the treasury is a very liquid asset but the city hall building gotten with past funds is no less an asset although an illiquid one. A dedicated, service-oriented public workforce is an asset, but its value is not posted on the balance sheet since humans are rented, not owned.

Fixed assets, namely property, plant and equipment, require valuation and protection from loss. Few governments, however, completely value the built infrastructure that predates the most recent record-keeping system. To place a replacement value on the extensive network of infrastructure elements exceeds the practical needs of most local governments. Municipal electric utilities, however, must deal with stranded investments in generation capacity as deregulation of retail service takes hold.

Cash, the most liquid of all assets, can become illiquid by its manner of investment. The citizens of Orange County, California, awoke to this fact in late 1994. There, an elected treasurer caused the county to file for federal bankruptcy due to an aggressive investment strategy that failed. While this case was severe, poor investment strategies are not that uncommon in local government finance. For example, Toledo and several other Ohio local governments made investment mistakes in the mid-1980s, followed by another group in the mid-1990s that made the same type of poor investment as did Orange County. As Miller (1987) notes, however, the meaning of loss and its implications vary.

Every asset has a claim against it, either by owners of the organization or by those to whom something is owed. An asset with a corresponding unpaid claim is a liability. Examples include a box of pencils received but not paid for and the first week of a biweekly payroll for employees. Generally accepted accounting principles provide guidance on how to handle such claims. Local governments, both large and small, are prone to overlook the basics of accounting, however (Advisory Commission on Intergovernmental Relations, 1985).

The balance sheet may not reveal all financial liabilities. An extensive textual review of supplemental liabilities is in the "Notes to

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the Financial Statements." Long-term obligations that commit the governmental jurisdiction to payments in the future years but do not rise to the definition of a liability for financial reporting purposes emerge from a review of the Notes. Therefore, for example, a capital-lease purchase contract may give the government a legal way to avoid paying the lease payments by that rendering the lease payment outside the definition of liability. To the market, however, this is a legal artifact to get around the legal definition of long-term debt, not a legal loophole for use by public officials (Hildreth, 1994).

Each asset has an offsetting claim but there is a big difference between a claim by external parties and one by the owners or clients. Insolvency is the condition when total liabilities exceed a fair valuation of assets. More common is technical insolvency or a "maturity matching" problem which occurs when a government in unable to pay debts as they come due in the normal course of business. New York City faced this situation in the mid-1970s and had to restructure its finances quickly to avoid more serious problems. In contrast, Orange County's insolvency led it to file for bankruptcy.

The market expects an organization's fiscal assets to exceed liabilities, not just be equal, and for most governments this is the case. Even in the face of severe fiscal stress, insolvency may not be at risk. For example, Bridgeport, Connecticut, wanted to declare bankruptcy but the federal court dismissed the filing. The court ruled that, although the city had budget deficits, it was not insolvent, by that failing a prerequisite for filing for municipal bankruptcy (Lewis, 1994).

COVERING PAYMENTS WITH CASH

It takes cash to pay a bill. Liquidity is the availability of cash to meet payroll demands. Forecasting cash inflows and outflows for the upcoming fiscal period helps catch potential liquidity problems. One approach for dealing with an interim shortage of cash is to use short-term borrowing. Cash-flow borrowing can cause a problem when the funds are repaid in a different year than when borrowed. Cleveland fell into this trap in 1979, leading to a default on general obligation one-year notes.

Before entering into any obligation, local governments have either to have the cash on hand or forecast its availability within the fiscal year. Most states allow their local governments to spend against budget revenues. There is a risk that these revenues will not appear. Moreover, when revenues fall short of expectations, budgets

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quickly fail the balancing test and require budget revisions to correct the situation. Just because an item has been budgeted, however, does not mean that cash will be there on time to allow that expenditure. Program managers find it quite discouraging to find out that they cannot fill a new position authorized in the budget because the general cash flow situation has changed (Hildreth, 1993a).

RECONCILING SHORT- AND LONG-TERM PLANS

Budgets give a very limited view of a community's civic life. For a specified period (usually 12 months), policy-makers have to define what will be done and at what public price. This fosters a tradeoff of one budget year against all future ones. A fund balance accumulated over several years, for example, is susceptible to use by current spenders. Adding new employees or increasing the pay of the existing workforce may bolster today's public employees but escalate future costs. A similar result flows from deferred maintenance. Saving a few maintenance dollars in one year can lead to higher repair bills later.

Operating and capital budgets provide an opportunity to examine rationally short- and long-term fiscal plans. Practice falls short of theory, however (Forrester, 1991, 1993; Starling, 1986). Large budget decisions linger in a community, such as starting a new landfill, clearing a blighted part of downtown or extending water lines to an outlying development. Furthermore, stable taxes benefit economic development because such strategies allow businesses to make long-term investment decisions. Similarly, a prudent fund balance helps cushion temporary disruptions to the public fisc.

Due to the time lag between making a decision and seeing the results, policy-makers have to make hard decisions early. It takes time to sell public assets or to privatize contracts. To change the frequency, much less the scale, of a service requires planning. Changing the frequency of a service includes, for example, steps to cut the grass only after it reaches a higher height or to sweep the streets less frequently. It does not take long to change the frequency of a service once officials make the decision. Changing the scale of a service, in contrast, represents actions to consolidate services and to eliminate unnecessary levels of supervision, actions that require more complicated and time-consuming approval steps. There is a tendency to avoid taking some of these more controversial actions. An all-too-common local way to deal with fiscal stress is to draw

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down the fund balance and invoke an across-the-board cut. Containing the fiscal shock internally this way only delays the inevitable date for making service changes and the receipt of the fiscal dividend (Donaldson, 1986).

ACHIEVING RESULTS

Budgeting deals with money and gains its mystique from that linkage. A major sense of accomplishment comes from adopting and achieving a balanced budget. Yet, there are other financial and nonfinancial measures of interest to finance officers as sampled below.

Financial Measures

Balance the Budget. Budget laws and tradition define the meaning of a balanced budget rule. Lewis (1994) identifies only 20 states that place municipalities under a constitutional or statutory burden to balance the budget but most large cities face local rules requiring one. A more important point is whether the budget has to be balanced at the end of the year or merely upon submission by the executive and/or at the time of legislative adoption. Furthermore, a budget submission may be in balance but only because it relies upon an unrealistic revenue forecast or a requested, but not yet approved, tax rate increases. Lewis (*Ibid.*) reports that only about one-third of the 100 most populous cities in the United States must balance the budget at year-end!

Obtain a Positive Variance. Officials often strive for a positive variance between what was budgeted and the actual results. In terms of revenues, this means collecting more than the amount forecasted at the beginning of the year. In contrast, a positive expenditure variance translates into spending less than planned. An intended strategy of lowball revenue forecasts and inflated spending plans can yield larger than expected end-of-year fiscal balances. However, while an excess of revenues (and sources of funds) over expenditures (and uses of funds) may give a fleeting sense of accomplishment to top financial officers, ultimately it weakens confidence in the fiscal process by finance managers, elected officials, taxpayers, and service recipients. If fiscal managers manipulate the process to mask intended strategies, the budgetary process can lose its consensus-forming advantages. Besides, the capital market may reward a municipality

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for meeting its balanced budget target not by enlarging (or diminishing) the fund balance (Giroux and Apostolou, 1991).

Maintain a Fund Balance. Governments show their error tolerance but preserve financial flexibility from one fiscal period to the next by maintaining a fund balance (McCollough and Frank, 1992). Credit rating agencies pay attention to this decision although there is no precise guidelines for the desired size (Allan, 1990; Moody's Investors Service, 1993). It is possible to understate the usable fund balance on the Balance Sheet by claiming that the fund balance is unreserved but designated. Usually this is merely an arbitrary label meant only to mask the true size. Instead, it is appropriate to label the fund balance "unreserved, undesignated." After debating the level of a minimum fund balance, that amount would remain safe from all claimants until meeting specified policy conditions. Otherwise, hiding large amounts in arbitrary, technical labels fuels cynicism and undermines full fiscal disclosure.

Invest Non-Recurring Funds. While matching recurring revenues to continuing expenditures is what general budgeting is all about, using a one-time revenue windfall to cover normal expenditures is a recipe for a structural budget imbalance in later years. An alternate course of action is to invest the windfall using only the dividend from the principal each year or dedicating the windfall for capital construction so that the benefits accrue over time (Hildreth, 1988).

Avoid Enterprise Subsidies/Transfers. Municipalities often operate one or more businesslike enterprise operations such as water, sewer, and electrical systems. An enterprise fund's narrow purpose and rate-making discretion contrast starkly with the tight general fund. The pressure, therefore, is to transfer excess utility funds into the general fund. A counterbalance is that lenders of borrowed money typically impose legal covenants requiring rates to cover yearly expenses plus a cushion. Moreover, as competitive rate pressures intensify on each utility, these subsidies will give way to general fund shortfalls. Transfers can go in the opposite direction with the General Fund subsidizing a money-losing public enterprise. Creditors are alert to this fact and factor in this threat to the general fund.

Stabilize Finances Over Time. Fluctuating tax rates complicate business and individual tax planning just as undependable public service interrupt daily routines. Besides, a balanced budget promised on a stable tax rate, if not a lower one, is a powerful political signal.

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Achieve Competitive Advantage. Community leaders and the media frequently draw comparisons between their community and others. Tax rate comparisons are very common but offer only one narrow view of what makes a community unique, distinctive, and attractive to growth and investment. A community must assess its factor endowments--namely location, human capital, and local wealth--and plan accordingly (Schmidt, 1993). Denver, for example, made major investments in downtown event facilities and a new international airport and that strategy is successful.

Maintain Intergenerational Equity. Each yearly set of taxpayers should pay its own way and not push the burden for current services onto a future taxpayer generation. Thus, deferred maintenance of public infrastructure, unfunded pension liabilities, and poorly considered debt repayment schedules illustrate how one spending generation can foist its costs onto another one. In contrast, an accumulated fund balance accrues to the benefit of a future generation.

Obtain a Low Cost of Capital. The goal of capital acquisition is to obtain the needed money at the lowest cost (Hildreth, 1993b). Most issues of debt seek to influence that cost by adopting policies and practices that mirror the recommendations of bond rating agencies. While this is good, it appears that a growing and diversified local economy is the real path to higher bond ratings (Loviscek and Crowley, 1990). If so, there may be little a borrower can do in the short term to improve its rating (Coe, 1994).

Preserve Debt Capacity. A community can afford only so much long-term debt in spite of any legally allowed debt limit. Therefore, it helps to assess local debt capacity and preserve some flexibility within the economic limit (Hildreth, 1996a). Inter-jurisdictional debt coordination recognizes that the same debt base supports various political subdivisions and that it is the aggregate that matters most to taxpayers (Hildreth and Miller, 1994).

NONFINANCIAL MEASURES

A budget is more than a listing of allocated money. It conveys the mix of programs and services authorized for a fiscal period. In essence, the budget publicly defines the boundaries of operational tasks as suggested by the following measures.

Gain Efficiency. Production requires the transformation of some mix of acquired labor, capital, materials, and technology into a

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desired good or service. A typical approach is to count the outputs and compare these results to the costs of production by that gaining a cost per unit. Many governments have developed expertise in applying these measures.

Achieve Effectiveness. Effectiveness addresses whether the organization is doing the right thing, not just doing better what has been done in the past. This imposes a burden on the organization to identify its goals and to measure movement to that target. Applying these types of measures is difficult but there are many governments working toward this goal.

Manage Capacity. An operating system can handle only so much work. Yet, governments have a great tendency to build excess capacity and to design redundancies into operating procedures. Internal audit controls foster a separation of duties in handling cash, for an example. Also, the construction of excess water and sewer treatment capacity imposes cost but no benefits on today's ratepayers. This excess capacity may be a form of risk aversion, a way to avoid another lengthy building cycle with its tough political debate, difficult financial tradeoffs, complicated building procedures, and frequent delays.

Provide Timely Service. Consumers honor a private enterprise when it provides a desired and timely product with the firm tallying its rewards in sales and profits. Governments, however, display a callous disregard for the time of its citizens/customers. Budget allocations seldom depend on achieving service goals measured by time. Other than in public safety response time, few performance indicators consider time a key target.

Maintain Quality. Customers want a fair value for their money. A value-added activity is one that contributes to customer satisfaction with implications for fiscal policy. Foul smelling water, for example, is a clear indicator of a quality problem that can influence a user's willingness to pay for system improvements (Hildreth, 1996b).

Make Investments. A community has to foster its private economy or else it risks economic stagnation, even ruin. Every tax has an economic effect, potentially aiding or harming the economic actors upon whom the community depends. Spending decisions also influence economic investments. It starts with responsible fiscal policy but rests on a viable local (and even regional) economic base defined by many as economic growth. Achieving that goal requires attentive tax and spending decisions (Governor's Tax Equity Task Force, 1995).

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Achieve the Benchmark. Measures of success are not easy to agree upon in the provision of public goods. One way to measure success is to benchmark a community to its peer group or to successful organizations generally. The work on benchmarking is incomplete. Correcting this failing of public management deserves the highest priority of both scholars and practitioners. Otherwise, public attention will shift exclusively to the one area where comparisons are readily available: tax rates.

Make Appropriate Market Disclosures. Local governments with outstanding long-term debt--or plans to issue debt in the future--must consider market demands for information (Hildreth, 1996b). Issuers of debt must formally reveal certain matters upon the issuance of debt, make continuing disclosure each year after that, and reveal particular events when they occur. Failure to make these commitments can render it difficult, if not impossible, to enter the national capital market. Furthermore, it can result in a violation of securities law.

Maintain Adequate Public Communications. Public executives and policy leaders have a responsibility to the citizens and taxpayers to provide continuing information about public policies and plans. The tendency to use technical language in budgets makes this important fiscal document unintelligible for the average reader and even the local media (Swoboda, 1993). A budget serves as an opportunity to present fiscal plans in a way that expresses the tradeoffs made in doing the public's business and the expected results from using the public's funds. Citizens in Maricopa County, Arizona, and Miami, Florida, have learned that an award-winning budget (as in receipt of a distinguished budget presentation award from the Government Finance Officers Association) says little, if anything, about the accuracy of the numbers.

Mobilize Invisible Assets. Not all assets are valued in monetary terms and carried on the balance sheet (Itami, 1987). Termed invisible assets, these items help define the community. For example, the willingness to pay taxes when elected representatives present propositions to the voters is a sign of community consensus. Repeated ballot failures signal an unhappiness with the local public agenda but overuse of the tax base can lead to economic flight. Another invisible asset is the organizational culture with an atmosphere of tight control likely to prevent effective uses of personal incentives and entrepreneurial behavior. Third, a tradition of providing added value for the tax dollar fosters trust in local leaders. Credit-rating firms have a

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difficult time measuring these and other invisible assets but does not prevent them from probing.

WORK TO BE DONE, NOT LOCATION

Local governments, like most organizations, prominently display and budget by the organizational chart. Employees spend most of their careers within one department, fostering loyalty, expertise, and stability (even rigidity). Budgets follow departmental lines, each department a small island, sovereign and separate from the others. This translates into competition among and between departments for scarce dollars, both the new increments of dollars and the existing share of the total budget (Tucker, 1981). Even in a program budget orientation the same aggregation problems reappear with the department remaining the focus of attention.

A contrary approach is to focus on the work process. A work process involves many employee activities that consume time and costs. To control costs, therefore, requires a focus on activities. Each step in the activity chain should add value or else it becomes a candidate for elimination. While organizations rigidly follow departmental structures, work flows across departmental boundaries creating costs in each department. Budgets neatly compartmentalize expenditures and mask any attempt to derive the true cost of a service. Accounting systems must adapt and capture cost at each step in the process, allowing managers to see the total costs, not just a segment. The goal is to track costs as the organization renders the service (Kehoe *et al.*, 1995; Stoner and Werner, 1993; Ostrenga *et al.*, 1992).

CEOs must visualize finance as more than a system of transactions but as a vehicle for enhancing decisions (Hildreth, 1989). What are the budget implications of saving one day in a permit approval process or reducing by a half-minute the average response time for emergency services? Most municipal budgets do not allow readers on their own to make these "what if" analyses. Thus, the budget is not the dynamic, choice-forcing tool it could be.

Balancing Control with Incentives

Budgeting and finance is a staff function and that conveys its most disturbing quality--its distance from the productive services that add value to the life of a community and its citizens. Central

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budget offices can no longer micro manage the budgets of direct service departments, taking the budget review role to the extreme. To steer the future fiscal strategy of a local government requires a shift from a dominant fiscal control orientation to one interested in responsive service delivery.

The chief financial officer has the duty to implement the chief executive's fiscal agenda and enhance the fiscal allegiance of program managers. A control philosophy predominates in most fiscal operations. The budget office structures the budgetary process, using terminology and designs of its choice. It translates fiscal trends and threats into visible budget figures that program managers must overcome. Every action of any monetary term provides valuable information to hold executives and managers accountable for results. Moreover, accounting and auditing controls provide powerful signals on acceptable management behavior. As a result, the finance officer is a central clearinghouse for things that matter in the life of an organization (Gargan, 1987b). With the information flow comes power but it does so at the expense of program managers (Giroux, Mayper, and Daft, 1986). The viability of such a command and control system is under severe challenge in today's dynamic environment.

A contrary approach gives program managers discretion but tied to responsibilities. The first step is to replace the notorious "use or lose" incentive, deriving from the yearly stocking of a department or program with an approved budget amount. After competing and winning against all the other potential claimants for funds, the program must deliver the planned services for the agreed-upon "price" (the budgeted level). To have slack in the budget raises questions about the sincerity of the budget request and the reliability of the the approval process to detect excess funds embedded in the requests (Merchant, 1985). Besides, there is an opportunity cost for not having those funds available to allocate for higher priority purposes. As a result, program directors have little incentive to fain economic savings because it could make the program susceptible to cuts in upcoming budget periods (Wildavsky, 1964). Therefore, there is a rush to spend the funds before the end of the fiscal year perhaps by buying computer equipment or other one-time purchases.

To advance an incentive to save, a local government might allow a budget unit to carry over unspent funds (or at least a share of it) into the next fiscal year. This could allow a program manager to make more judicious use of these hard-earned funds. Complicating

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this move, however, is the prevailing practice of reverting all departmental unspent funds to a general fund balance at year-end. A perverse practice is to hide money in departments up front, knowing that savings will fall to the fund balance at year-end.

After a period of centralized purchasing requirements, the population is swinging back to more discretion by worksite supervisors. Municipalities find that the number of people who have to signoff on small dollar purchases often outweigh the benefits. As a result, some governments now allow purchases below a certain amount (*e.g.*, $500, $1,000 or $5,000, depending upon the size of the budget) without preapproval and with a city's credit card. The credit card has the added benefit of providing a document trail for use in post-auditing.

To encourage more program discretion calls for a change in the role of the central budget. Department heads instigate most spending initiatives by translating service demands into actual program. In turn, the capital budget office serves as a gatekeeper to the money, a powerful counterweight to program heads. This places the budget office in a veto role rather than a partner to the program experts. Finance officers build barriers to avoid getting "blindsided" by program managers. All too frequently, finance officers learn late in the legislative process that the fiscal consequences of an action (perhaps even supported by the chief executive) has escaped attention. Stopping the initiative at this late stage is difficult, even if the chief executive was under the mistaken impression that the proposal had undergone the required fiscal review. To avoid such missteps, municipalities build elaborate fiscal approval sequences, backed up by memorandums and assorted details that make decision-making quite complex and time-consuming.

An improvement to the centralizing tendency is to empower the program head with the fixed expertise to anticipate likely fiscal questions by that preparing a better initial proposal. This places the budget office in a consulting role rather than a gatekeeper. In this arrangement, the program manager engages the fiscal office only when needed. For this scheme to work, however, program managers must become better policy analysts and fiscal managers, and have to set aside their myopic program advocacy role for a shared vision of the organization (Hildreth, 1989).

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LOCAL CUSTOMS, MARKET-BASED GUIDELINES

Over time local financial patterns are ingrained as a way of life. Incrementalism in budgetary decisions "favors old claims over new ones" (Schick, 1986:61). Upon questioning why a particular practice is done a certain way, the refrain is "that is just the way we've always done it." While these cobwebs of the past can retard innovative behavior, they also serve to make people stick to a well-trodden comfortable path even if it is going in the wrong direction. In contrast, unreasonable objectives can push units to improve on the past even if the results fall short of that unreasonable objective (Riordan, 1992).

One challenge to local tradition is the rapid pace of efforts to compare local practice to comparative benchmarks. This ranges from the use of seasoned business executives to analyze government operations (Hildreth and Hildreth, 1989) to more systematic efforts to advance market metaphors in government activity.

The local customs of public finance are yielding to professional morms and standards. Moving from an internal or local focus to one that is more cosmopolitan or external can infuse new thinking into an organization and its strategic planning (Bruton and Hildreth, 1993). Fundamentally, state and local laws compel minimal behavior while professional practice may demand additional steps. For example, state laws require the auditing of local accounts every other year and on a cash basis of accounting. However, governmental units desiring to borrow money in the capital market are expected to have a yearly audit prepared according to generally accepted accounting principles, known as GAAP. In such a situation, GAAP does not replace the cash basis reporting requirement, it just requires an additional set of practices and financial statements. However, if a local governmental unit lacks the capital to do minimal fiscal practice, then it is unlikely to achieve the higher order improvements (Gargan, 1987a).

Finance officers improve their professional standing, if not also their government's, by preparing financial documents that meet peer review criteria. The budget and the Comprehensive Annual Financial Report (the audit) are core financial documents and each is measurable against established guidelines. Budget allocations are political decisions and thus not subject to outsider review, nor is the accuracy of the data tested, as Miami and Maricopa County citizens have learned. Instead, the peer review is of the ducuments as a

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financial plan, an operations guide, a management device, and a communications vehicle (Andrus, 1993). To meet GAAP guidelines requires that a government prepare a Comprehensive Annual Financial Report and issue it within six months of the fiscal year's end.

Another peer review area fosters development and adoption of formal cash management and investment policies as a way to respond to the Orange County situation. Emerging on the horizon is an attempt to develop "best practice" guidelines in all areas of public budgeting so that state and local government officials and finance professionals will have a common set of principles that define performance expectations (Government Finance Officers Association, 1993). Also the effort by GFOA to award the "certified public finance officer" designation upon the demonstrated mastery of five substantive test areas is likely to shape the future of professional development and the education of CFOs in government.

An additional area of market expectation and now federal regulatory review is in disclosure practices regarding the issuance of mumicipal securities. Selling bonds in the national capital market has long required preparation and distribution of an offering circular known as an "official statement," although the comprehensiveness of it has grown in recent decades. These governments now have to aggree to provide continuing disclosure material to investors in those bonds plus certain market events, including defaults and other potential impairments of obligations to pay, demand immediate dissemintation to the broad market.

Moreover, elected officials can no longer delegate to appointed executives or hired experts the responsibility for meeting securities law. In addressing the Orange County debacle, federal securities regulators issued findings against the elected county supervisors for inadequate oversight despite the officials' reliance on a team of legal, financial, and administratie experts (Securities and Exchange Commission, 1996). As a result, elected officials have to know what it is they are agreeing to do when they allow the government unit to issue debt. Elected officials cannot accept the recommendations of professionals without conducting their own review of the facts. This latest development presages a change in the relationship between elected officials and professional finance officers.

CONCLUSION

The fiscal agenda of a public organization permeates all of its

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policies and programs. Success is measured in more than dollars. Without a monetary metric, however, the budget has little meaning. A program advocate or department head can do little without dollars to spend. Furthermore, for any organization to remain a going concern, assets must equal or exceed liabilities and cash has to be available to cover the bills. These are the easy parts of finance.

Finance officers have to examine the long-term implications of contemporary decisions. Innovative and cost-conscious managerial behavior is at a premium as is measuring services against market benchmarks. All of this emphasizes the delicate balancing act facing finance officers as they adjust the competing financial concerns to public policy. To accomplish this goal, finance officers have to change from the controller of transactions (the bean-counter role) to the more demanding job of fiscal strategist.

NOTES

1. An earlier version of this article appears in Jack Gargan (ed.) (1997). HANDBOOK OF LOCAL GOVERNMENT ADMINISTRATION. New York: Marcel Dekker.

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