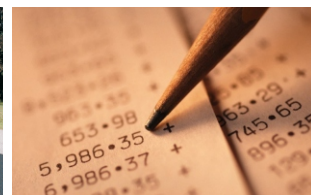


# Fiscal Management Handbook

> ready > set > succeed



# Fiscal Management Handbook

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Ninth Edition  
July 2003

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# I. Introduction

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The *Fiscal Management Handbook* provides guidance and information to elected and appointed municipal officials within Pennsylvania to enable them to better manage their community's fiscal affairs. There are a variety of textbooks and manuals available from state agencies and from professional associations carefully treating the details of technical tasks involved in fiscal management. Most of these publications are directed toward persons who have had the benefit of some formal training in accounting, bookkeeping, budgeting and related topics. Most elected officials do not have, nor do they generally have time to acquire, in-depth training in fiscal techniques. This handbook bridges the gap between the professional language and tasks of finance, and the day-to-day fiscal problems dealt with in a typical Pennsylvania municipality.

This publication will be of most interest to officials of small to medium-sized municipalities of less than 5,000 people. These municipalities generally do not have trained bookkeepers, accountants, payroll administrators or similar professionals. It is usually up to the elected officials themselves, along with their secretary and the auditors, tax collector and solicitor to carry out most fiscal management tasks. Newly-elected officials or those who are acquiring new fiscal responsibilities within their municipality will benefit from this handbook. It includes many definitions of fiscal terms and points out in plain language various provisions of the municipal codes and other laws related to finance.

Municipal fiscal management is becoming a continually more difficult task for elected officials. The difficulties stem in part from the general complexity of government now involving a wide range of revenue sources including various grants from the state and federal governments. Some grant programs require special accounting for the grant funds and strictly limit the uses of the funds. However, the major fiscal problems revolve around the cost/revenue squeeze. Costs for labor and materials are rising almost without exception. Unless the employment, income and real estate tax base within your community rises at least as fast as costs and demands for increased services, higher taxes must be developed or the efficiency of your municipal services must be increased.

This publication is directed mainly toward the major elements of the fiscal management cycle. The input to the cycle, made up largely of taxes, fees and grant funds, is transformed into services you are providing to the taxpayers of your municipality. The services are provided within the framework of the budget, and are subject to the inspection and verification of the audit.

Chapter II describes the fiscal management roles of various elected and appointed officials in the typical municipality, and the interrelationships among their tasks. The chapter explains the difference between the jobs you are responsible for carrying out yourself and those where you have supervisory responsibility to see the job is done properly by others. Summaries of those portions of municipal codes and laws influencing your duties, responsibilities and liabilities are provided.

Chapter III presents the various revenue sources provided in the codes and tax laws and comments on the use of various sources under differing conditions. Characteristics of revenue sources in terms of their fairness, yield and administrative complexity are pointed out to aid in the selection of appropriate taxes, fees or service charges.

The budget process is a requirement of law and many municipalities prepare a budget mainly to satisfy the law. In Chapter IV the legal requirements of the municipal budget are discussed; however, of more importance are the guidelines you can use to make budget preparation a useful planning process. The guidelines include illustrations of revenue forecasting techniques and the development of standard unit costs to be used to project the costs of particular services or projects. Charts outline suggested budget schedules and the responsibilities of the people preparing the budget. An orderly sequence of events is more likely to produce a useful and realistic budget to serve as a basis for the upcoming year's activities.

Chapter V provides a description of municipal accounting, bookkeeping and auditing requirements so the reasons for particular instructions and procedures are easily understood. Various types of funds and alternative accounting methods are described to better prepare you to tailor an accounting system best suited to fulfill your community's needs.



Basic accounting requirements are reviewed in Chapter VI. It also addresses the very difficult subject of payroll administration, with emphasis on simplified methods you can use to account for fringe benefits, social security payments, tax withholdings, and to keep complete and accurate records of payroll payments.

Chapter VII brings together several topics cutting across the earlier ones. The first of these deals with cash flow management techniques to minimize the need for borrowing short term money. This chapter contains recommendations on petty cash control, purchase authorizations, purchase orders and control of revenue and expenditures through the use of such administrative measures as vouchers, receipts and other records. Strategies for investment of municipal funds and legal restrictions are also covered.

Debt management is the subject for Chapter VIII, with discussion of how to calculate debt limits, procedures for borrowing and financing through municipal authorities.

Chapter IX provides local officials with a financial monitoring system to allow them to track the financial performance of their municipality. This will alert them to the need to take steps to correct problem areas.

As with all publications of this type, the contents are for guidance only and do not constitute a legal reference. Where points of law are in question, the appropriate municipal code, tax laws or other legal sources must be consulted. Your solicitor should be called in to answer questions that have unresolved legal implications.

## II. Roles and Responsibilities

Municipal financial management — what does the term really mean in practical terms to you as an elected official? Essentially, fiscal or financial management is the process of obtaining funds to support the necessary services provided by your municipality and using those funds in an effective and efficient manner. Sound fiscal management requires:

- A well-planned budget.
- A bookkeeping and accounting system.
- Procedures and rules for receiving and spending money.
- An annual audit.

Your municipality, in complying with current legal requirements of the municipal code, already has to some extent placed in effect the four major elements of fiscal management listed above. Your present fiscal management system may be operating efficiently and smoothly or you may have occasional doubts about the procedures being used and the accuracy of your accounting records and budget-making process.

As an elected official of your municipality, you have assumed a number of responsibilities. Some of these responsibilities require you, along with your fellow supervisors, commissioners, or council members, to take specific actions — to do things yourself. In other cases, you are responsible for the actions of others — appointed officials or employees of your municipality. In other words, even though employees may make errors, you may be held responsible in some cases. It is necessary to understand your more important responsibilities in financial affairs in order to avoid future difficulties.

Table 1 summarizes some of the major fiscal actions the governing body must take as official acts during properly constituted meetings. The table also points out some of the major tasks appointed officials or employees of your municipality must carry out — and which you must assure are completed properly.

### How to stay out of Financial Trouble!

What happens if these roles are not carried out properly, if the financial operations of the municipality are not adequately monitored? Where there is an ample tax base, nothing may happen for a while. But when circumstances change and resources become less

available, failure to adequately manage municipal finances results in crisis. This combination of declining resources and inadequate management has posed severe challenges for a number of Pennsylvania municipalities over the past decade.

Municipal financial crisis was brought to national consciousness when severe financial difficulties were experienced by large urban centers in the 1980s. Cities such as New York, Cleveland and Detroit teetered on the brink of bankruptcy. Although less well known, smaller municipalities in Pennsylvania also began to experience severe financial difficulties. The Municipalities Financial Recovery Act was passed in 1987 to provide state assistance to help such places avert bankruptcy. Since that time, 17 municipalities have been declared distressed under the Act. Five of them, Ambridge, Shenandoah, Wilkinsburg, East Pittsburgh and North Braddock have since been graduated from the program with restored financial solvency. The distressed communities are concentrated in the Monongahela Valley of southwestern Pennsylvania where the closing down of much of the steel industry has resulted in widespread economic and social distress.

TABLE 1

#### TYPICAL MUNICIPAL OFFICIALS' FISCAL ROLES

<b>You must do these tasks yourself</b>	<b>You must see that these jobs are done properly</b>
set taxes	accounting system
set fee schedules	payroll and deductions
review existing fee schedules	legal notices
select budget items	payment on approved invoices
adopt budget	issuance of receipts
approve expenditures	petty cash fund
make investments	collection of taxes
approve borrowing	financial report
designate fund depositories	file budget and financial report with DCED and county court
secure bonds	filing of liens
	repayment of loans on prescribed schedules

A declaration of distress under the Municipalities Financial Recovery Act is a radical step and one to be averted by local officials if at all possible. The Department of Community and Economic Development (DCED) provides intensive technical assistance to municipalities to help them before they become distressed. The Act requires each municipality to submit an annual Survey of Financial Condition to the Department. Although these are submitted before March 15 of the following year, it is often some time before the Department is able to review the Surveys and determine if positive responses to any of the questions indicate potential financial problems.

DCED also uses data compiled from the Annual Audit and Financial Report as some of the variables for the Early Warning System mandated by the Municipalities Financial Recovery Act. Again, these are filed by March 15 of the following year, then must be edited and compiled by the Department, so it may be almost two years after the data represented in the Report is available for use to track a municipality's financial condition. The usefulness of the data is also dependent on the quality of the local financial reporting system. These limitations on state review mean that local officials cannot rely solely on DCED to identify developing financial difficulties. It is imperative that municipal officials understand some of the symptoms of fiscal problems themselves and learn how to recognize and treat them on the local level.

You can fall into a number of common pitfalls in fulfilling your fiscal roles and responsibilities, and these pitfalls can lead to serious future financial trouble for your municipality. Most of the pitfalls or mistakes don't look serious at the time — but their long term effects can be painful. Most pitfalls occur around two major financial management tasks —

- Preparation and execution of the budget.
- Control of expenditures and borrowing.

The following several pages outline a number of the pitfalls causing serious trouble for Pennsylvania municipalities. The list is not all inclusive — people can always find new ways to make mistakes. However, it does cover a number of common trouble spots. The pitfalls are presented so you and your employees can detect if any of these mistakes are being made in your municipality. If some of the pitfalls look familiar, your municipality should attempt to correct them, perhaps with the assistance of a financial advisor or a consultant.

## Pitfall #1

**Budgeting nonexistent revenue.** Although it seems obvious only real revenue sources should be considered when estimating next year's revenue for your budget, there have been cases when municipalities have budgeted revenues which simply will not exist. For example, some municipalities have neglected to consider the effects local employment problems such as layoffs, or regional disasters such as floods will have on property, personal income and wage taxes. One municipality normally counted heavily on traffic and overweight fines but neglected to consider the opening of a major interstate highway nearby would eliminate this source of revenue.

## Pitfall #2

**Overinflating your revenue estimates.** This pitfall is similar to #1. It is possible to lull yourself into a sense of security by ballooning tax and fee revenue estimates to match your needed expenditures without increasing taxes. A common way revenue estimates become overinflated is calculating revenues for the coming year will increase by the same amount they increased in the current year. This "lazy" method of estimating revenue can result in a false sense of security. Completion of a new subdivision or other housing project may have inflated the current year's revenue, but next year it may remain relatively constant. If you budget to spend nonexistent revenue, your municipality will either have to reduce costs or end up operating at a deficit.

## Pitfall #3

**Failing to follow through on budget cuts.** When the final budget is drawn and adopted, many municipalities will find it necessary to make some cuts from the previous year to balance revenues and expenditures. Perhaps the cuts were a reduction in expenditures for office supplies, or a reduction in the recreation program, or a reduction in the size of the police force. Pitfall #3 occurs when you do not follow through and make the budgeted cuts at the proper time in the new year. Failure to follow through with the cuts will again mean you are spending nonexistent revenue! Proposed budget cuts must be studied carefully to determine whether later citizen demands or the true needs of the municipality will force you to spend funds for items you had planned to delete.

## Pitfall #4

**The “once-a-year” budget.** Many municipalities consider the budgeting process a necessary evil which must be undertaken once a year. As soon as the budget has passed public scrutiny, it is placed in the file and only brought out by request. The total expenditure budgeted for the year is used as the limit, but expenditures in individual accounts are not controlled. The elected officials presume they can always transfer funds from one account to another to match actual expenditures. The budget is the published record of anticipated expenditures. Many accountants maintain approval of the budget is a formal allocation of funds to those accounts, and any expenditure of funds in excess of the limits in each account can be legally accomplished only by formal action of the elected officials to amend or modify the budget.

Both to assure legality of operation, and as good management procedure, each municipality should control its expenditures by individual budget accounts throughout the year

## Pitfall #5

**Fuzzy financial reports.** In many municipalities, the secretary or clerk will prepare a monthly financial report showing the status of revenues, expenditures and the resulting bank balances. Since most municipalities account for revenues when the money is received and account for expenditures when the bills are actually paid, a financial report can be deceptive. For example, a report might show a balance of \$10,000, and this would be reassuring since it corresponds to the budgeted balance at that time. The report would not show the municipality is holding \$19,000 in outstanding bills. So, rather than a solid balance of \$10,000, in reality the municipality is faced with a \$9,000 deficit! Two lessons are to be drawn from this situation. First, all bills should be paid promptly so you can accurately determine the cash position of your municipality. Secondly, if unpaid bills do exist at the end of the month, the financial report should include these bills and their effect on the balance, and the accounting system should include a purchase journal or voucher register to maintain a continuing record of these accrued expenses.

## Pitfall #6

**Tax anticipation loans.** Through good management of your cash position and scheduling expenditures, the need for tax anticipation loans can be minimized as will be explained more fully in Chapter VII.

However, tax anticipation loans are sometimes necessary. For example, if carry-over funds from the previous year are not adequate, a short term loan might be needed to meet the municipal payroll until current year taxes are collected. Tax anticipation loans cannot be carried over from one fiscal year to the next and must be repaid during the year the loan was initiated. This problem ties into Pitfalls #1 and #2. If you obtain a tax anticipation loan for nonexistent revenue, it will be impossible to pay the loan back during the current fiscal year.

## Pitfall #7

**Failure to face up to a tax increase.** Tax rates set at the beginning of a year cannot be changed during that year. Municipal officials who falsely talk themselves into believing a tax increase is unnecessary will find themselves with a totally unrealistic budget and are likely to run short of funds before the end of the year. If the need exists, it is generally better for the municipality and taxpayers if small realistic increases are made on a regular basis rather than holding the line on taxes for several years, and then enacting a substantial increase in one given year. There is less public objection to the incremental approach.

## Pitfall #8

**Failure to budget for repayment of bank loans.** The Local Government Unit Debt Act permits municipalities to obtain temporary bank loans for capital expenditures. Some municipalities have had major difficulties with bank loans. Municipalities sometimes fail to include as a budget expenditure the annual payment of principal and interest. Failure to budget this repayment will result in an unexpected expenditure later in the year, or may require the unlawful carrying forward of the payment to the next fiscal year. Article IX, Section 10 of the Constitution and Section 8104 of the Local Government Unit Debt Act require local governments incurring debt to adopt a covenant to make payments out of its sinking fund or any other revenues or funds in annual amounts sufficient for payment of principal and interest charges. The municipality is no longer required to levy a tax.

## Pitfall #9

**Neglecting to review insurance coverage.** Municipalities having insurance for employees, buildings or vehicles should obtain a full explanation of all coverages from their insurance agent at least once a year. Often when an employee resigns or a building is

sold, the insurance coverage continues in effect and the municipality pays the premium. This obvious waste of money can be avoided by regular review of your policies. The annual review should also be used to assure adequate coverage is being maintained.

## **Pitfall # 10**

**Omitting costs in the budget.** When estimating costs for the coming year, particularly for personnel, carefully include all true costs. A common problem is failure to budget for overtime. Simply using the annual wage and fringe benefit amount for each employee is likely to result in too low an estimate. You should scan through your past experience to determine how much overtime to expect. For example, how much overtime did you pay last year to handle snow removal? A similar problem occurs if you do not take into account changes in fringe benefits for employees. Increased insurance coverage, pension benefits or a more liberal vacation policy can have considerable impact on your costs in the coming years. Other costs sometimes overlooked are increased maintenance and operational expenses when new municipal buildings, new roads, park facilities or similar projects are acquired by the municipality. For example, expenses for heat, paint, repairs and janitorial service for a municipal building can be significant. When you have completed a new capital project, be sure you consider all annual operational costs it will require. Changes such as these should be identified and adjustments in your cost estimates should be made accordingly. Each year prior to enactment of the budget, a written quotation of the next year's actual insurance premiums should be obtained from the agent or agents.

## **Pitfall #11**

**Delayed funding of pension funds.** Various state legislation has provided for the establishment of pension funds for municipal employees to which both the employee and the municipality contribute. Full funding of the municipal share is now required by state law. Failure to make the payment by December 31 incurs interest penalties for the municipality. Interest due compounds for any payment made after the end of the year.

## **Pitfall #12**

**An inefficient tax package.** Many municipalities hesitate to approach their legal millage limit on real estate taxes, and when additional funds are needed they impose a variety of "nuisance" taxes. These taxes are often more difficult (and expensive) to collect than

a real estate tax and present a confusing tax picture in the municipality. The selection of specific taxes and the rates to be used should be based on such factors as fairness and yield. However, the expense and difficulty of collection should also be an important consideration.

## **Pitfall #13**

### **Long-term borrowing for short-lived facilities.**

There have been instances when municipalities have entered into long-term bond issues, and the proceeds of the bond issue were spent for items that will be worn out or replaced long before the bond issue is retired. The term of the borrowing should not exceed the reasonable expected life of the item being purchased.

Ignoring this principle ties up future municipal funds for which no benefit is being received at the time. A good financial advisor should be consulted on all bond issues, and the proceeds should be spent for long-lived improvements.

## **Pitfall #14**

**Overreliance on volunteer groups.** Often occasions arise where a civic group in your municipality offers to provide volunteer services for such activities as recreation, solid waste recycling or school crossing guards. This support is beneficial and should be encouraged. However, you should recognize volunteer groups can fall apart or at any time decide to stop providing the service, and government will always be there. You should be careful your municipality doesn't become unnecessarily or undesirably committed to continue the services if the volunteer group disbands. You might find yourself incurring additional unplanned expenses for a service which cannot be justified as a municipal activity.

## **Pitfall # 15**

**Liquid fuels allocations.** The timely filing of the required annual reports with the Pennsylvania Department of Transportation to comply with the law and their regulations will result in the receipt of the proper allocation on schedule. Otherwise, money will not be made available until the forms are filed, resulting in the loss of accrued interest on this money. When new streets are added to the street system, a mileage update should be done within the year. Contact the Bureau of Municipal Services for the necessary filing procedures. If you are a fast-growing municipality, consider the feasibility of an interim census.



## Pitfall #16

**Investments.** Many municipalities fail to gain added revenue through wise investments of all funds. All monies not necessary for current operations should be invested. However, before funds are invested, the rates of interest from several financial sources should be compared. Investigate pooled municipal investment funds.

## Pitfall #17

**Employe withholdings.** Municipalities should insure they are withholding the proper federal, state and local payroll taxes, including social security employe and employer shares and unemployment compensation taxes. Contact the nearest offices of the Internal Revenue Service and the Pennsylvania Department of Revenue as well as the local tax collectors for earned income and occupational privilege taxes. Failure to adequately account for withholdings and make timely submission of withholdings can artificially inflate a municipality's financial balance. One of the common problem areas discovered in distressed municipalities is accumulation of past due withholdings where the municipality has succumbed to the temptation to divert these funds to other uses, even to the point of incurring penalties for late payment.

## Pitfall #18

**Not requiring accurate disclosure of financial transactions on the accounting records.** Neglecting to require a standard double entry accounting system that accounts for assets, liabilities, revenues and expenditures distorts the true financial position of a municipality. Often the purchase and sale of investments, refunds and amounts due other funds are improperly recorded as revenues and expenditures when they should be recorded under assets and liabilities. Double entry bookkeeping should be required to accurately classify each transaction.

The pitfalls outlined above represent only a few of the most common and potentially serious ways a municipality can get itself into fiscal difficulties. Good budgeting, accounting and fiscal control practices accompanied by common sense and willingness to face up to the true situation can avoid most if not all of the pitfalls. Budgets should be carefully drawn up and then used to control and monitor your expenditures and revenues. Accounting systems must be used to obtain good financial reports to illustrate your municipality's true financial status at any time.

## Budget Balancing Remedies

If one of the pitfalls has led you towards financial trouble, some quick fixes are available. The following list of remedies for putting, or keeping, municipal finances on an even keel has been adapted from a listing produced by the Government Finance Officer Association, 180 N. Michigan Avenue, Suite 800, Chicago, IL 60601. The remedies are not presented in any particular order, nor does it exhaust all the possibilities for improving cash flow. No single remedy is particularly recommended. Each municipality must determine which are going to be most useful for their own particular situation.

- Cut the hours of public facilities, such as libraries, recreation centers or swimming pools.
- Close facilities with the lowest incidence of use or where needed repair is so extensive it is no longer cost effective.
- Reduce frequency of services or scale back existing programs, such as cutting garbage collection from twice to once a week and requiring front curb pickup.
- Determine the full costs of delivery of services before implementing any change to upgrade existing or institute new services, ensuring that user charges pay the complete cost of delivery of the service, including overhead.
- Pursue possibilities of cost savings by joining with neighboring municipalities in a regional program.
- Pare down fund reserves or carry-over surplus. When this is being done, the elected officials should be clearly aware of the trend of final cash balances over the past several years. Continued decline in reserve level is a clear indication that revenues are not meeting expenditures.
- Postpone hiring for selected positions or institute a hiring freeze for all new vacancies for a specified period.
- Refinance debt to obtain lower annual debt service payments. This is particularly beneficial if interest rates have dropped since the debt was incurred. Any extension of the amortization period should be closely scrutinized.
- Examine where part-time and temporary staff are used to decide if the positions are truly needed.
- Use volunteers wherever possible to reduce salary and benefit costs. But, also be conscious of Pitfall #14, above.

- Replace full-time staff with less costly part-time personnel. Be careful to consider training costs and the need for qualified personnel.
- Spread capital equipment costs over a period of several years through lease-purchase agreements.
- Limit or reduce overtime and callback pay.
- Increase user fees and charges for licenses and permits so that costs of programs are covered.
- Create new service charges for user-specific services currently funded by other means. A frequent candidate in Pennsylvania towns has been garbage collection which is still paid for from the General Fund in some places.
- Update asset and equipment inventory list to ensure new purchases are for essential items.
- Institute safety programs for employees to reduce injury claims and absenteeism resulting from injuries.
- Extend the useful life of equipment through preventive maintenance programs.
- Examine organizational structure and job descriptions for possible position consolidation or transfer to areas of greater need.
- Postpone the implementation of new programs or services or provide them on a lower service level.
- Encourage cost-savings ideas from employees through a cash award or public recognition programs.
- Institute early retirement incentives to generate salary and benefit savings by keeping positions vacant or filling them at lower salary levels.
- Delay or cancel capital projects.
- Require employees to pay part of health insurance costs or increase their share.
- Freeze spending in controllable areas of the budget, such as office supplies, travel and subscriptions.
- Sell assets no longer needed or in use.
- Transfer services or program to enterprise funds, if appropriate, where they can be funded through user charges to free up general fund tax revenue.
- Lease or rent property not currently needed for municipal operations.

- Maximize collections through timely billings and aggressive pursuit of delinquent tax and utility payments.
- Participate in a regional joint purchasing agreement or buy items through the state piggyback purchasing program.
- Use employee attrition to incur savings over time by not filling vacant positions.
- Implement across-the-board cuts.

## **Pennsylvania Accounting Forms and Reports**

The Commonwealth of Pennsylvania provides support and establishes requirements on the accounting, bookkeeping and auditing done by Pennsylvania municipalities. The Commonwealth, through the Pennsylvania Department of Community and Economic Development, provides a Budget Form for use by the municipalities, a Chart of Accounts, and a Financial Report Form for use in auditing. PENNDOT also distributes a Treasurer Account Book to all second class townships and boroughs. Finally, PENNDOT also provides a separate set of forms to the municipalities for use solely with the Highway Aid Fund.

A checklist of the specific reports required by PENNDOT and DCED is provided on the next few pages. The following checklists are provided as a first step toward streamlining the procedures for the municipal secretary/treasurer. Suggestions and additions are welcome. They may be sent to the following addresses:

Pennsylvania Department of Transportation  
Bureau of Municipal Services  
Commonwealth Keystone Building  
400 North St. 6th Fl.  
Harrisburg, Pennsylvania 17120-0064

Department of Community  
and Economic Development  
Center for Local Government Services  
Commonwealth Keystone Building  
400 North Street, 4th Floor  
Harrisburg, Pennsylvania 17120-0225

TABLE 2

## DEPARTMENT OF COMMUNITY AND ECONOMIC DEVELOPMENT REPORTS

When Due	Report	Identification	Who Files
January 15	Tax Information	DCED-CLGS-22	Secretary or Clerk
March 1	Annual Financial Report (Cities)	DCED-CLGS-30	Director of Accounts & Finance
March 15	Survey of Financial Condition	DCED-CLGS-69	Presiding Officer of Governing Body
April 1	Annual Financial Report (Boroughs. & Townships.)	DCED-CLGS-30	Auditors
15 days after effective date	Ordinance or Resolution — Act 511 Tax	—	Secretary or Clerk
90 days after close of fiscal year, if fiscal year ends Dec 31, report due July 1, of following year	Annual Report of Municipal Authority	DCED-CLGS-04	Certified Public Accountant

TABLE 3

## PENNDOT REPORTS

When Due	General Forms	Send to:	Special Instructions
January 15	DCED-CLGS-19-5 — Organization of Elected and Appointed Officials	4 copies to PENNDOT Pennsylvania Department of Transportation Bureau of Municipal Services Commonwealth Keystone Building 400 North Street, 6th Floor Harrisburg, PA 17120-0064	
January 31	MS- 965-S — Record of Checks — State Fund Acct.	4 copies to PENNDOT District Office	
January 31	MS- 965 — Actual Use Report of State Funds	4 copies to PENNDOT District Office	
October 1	MS- 990 — Road Mileage & Type	2 copies to PENNDOT District Office	These forms will be prepared by PENNDOT.
Municipality must possess an approved copy prior to expenditure for constr. or reconstruction	MS- 339 — Application for County Aid	4 copies to County Commissioners	These forms will be prepared by PENNDOT.
	MS- 329 — Application for Act 655 Construction or Reconstruction		These forms will be prepared by PENNDOT.
Complete prior to inspection by local authority & PENNDOT Rep	MS- 999 — Completion Report	PENNDOT District Office 3 copies if State Aid — 4 copies if County — 5 copies if both	These forms will be prepared by PENNDOT.



**CONTRACT PURCHASE FORMS WORK PERFORMED BY CONTRACT**

<b>When Due</b>	<b>General Forms</b>	<b>Send to:</b>	<b>Special Instructions</b>
Must be executed prior to performance of work	MS- 944 — Contract	1 copy retained by Municipality carrying out project	Attach Bond (Form 9445)
Same as above	Copy of Advertisement	1 copy retained by Municipality carrying out project	Tabulation of all bids received & copies of plans & specs. should be retained by sec.
Same as above	Copy of Bid Tabulation	1 copy retained by Municipality carrying out project	
Same as above	Proof of Advertisement	1 copy retained by Municipality carrying out project	

**CONTRACT PURCHASE FORMS PURCHASE OF MATERIALS OR EQUIPMENT IN EXCESS OF \$10,000**

(To be retained by local secretary-treasurer.)

Must be approved prior to performance of any work	MS- 963	Attach bond to each copy. Material up to \$5,000, 50% bond; over \$5,000, 100% bond.
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### III. Revenue Sources

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For Pennsylvania's smaller municipalities (third class cities, boroughs and townships), there are three main streams of revenue to generate the needed funds to operate municipal government and provide services to citizens. In 1996, local taxes provided 45 percent of the revenues for these governments. Non-Real Estate taxes provided 34 percent of revenues at the local level. Taxes are "enforced contributions" for municipal services which cannot be rationally allocated to individual users. These include services like police and fire protection, parks and general administration. Such services benefit the entire community and are paid for by all local taxpayers in a tax system somewhat scaled to the ability to pay.

Intergovernmental revenues from the state and federal governments accounted for 10 percent of the revenues of third class cities, boroughs and townships in 1996. More than half of these funds are state liquid fuels monies.

The remaining 45 percent of revenues were generated by the internal operations of municipal government. They are paid by the users of municipal services. The bulk of this revenue is generated by municipal utilities: water, sewer, electric, garbage collection and parking. Also in this category are municipal fees, permits, departmental charges, fines and income from interest and facility rentals.

#### Elements of a Good Revenue System

Since taxes are essentially a form of enforced contribution, your revenue program must be both fair and equitable. Fair treatment of your revenue sources essentially means taxes and fees should not discriminate against any particular group or category of citizens. For example, if a tax were permitted on the membership dues of a religious organization, this might represent a form of discrimination. Act 511 of 1965, the Local Tax Enabling Act, specifically prohibits such a tax. Generally, the taxes local governments in Pennsylvania are empowered to impose do not discriminate and are, therefore, essentially fair.

An equitable tax or charge applies equally to all persons subject to the tax or charge. Real estate taxes are sometimes inequitable because the assessed valuation (and therefore, taxes) for a house built ten years ago is often lower than the assessed valuation for an

equivalent house built today. Although the tax rate may be equal, the base on which the tax rate is applied is not uniform. Unequal enforcement of tax collection also represents a way your revenue program may be inequitable. Following through with all measures allowed by law to collect unpaid taxes is essential to a tax program which treats all citizens of your municipality equally.

Your tax program should be set up to automatically benefit from growth. As your municipality grows, higher levels of municipal services are usually needed. A desirable tax structure results in the new growth paying its own way by bringing in increased revenue. Most taxes Pennsylvania local governments are permitted to levy automatically increase revenues as the value of real estate, incomes and population increase.

#### Tax Levies

Pennsylvania municipalities may enact a tax on real property within their boundaries. This is a general purpose tax and may be used for any of the purposes spelled out in the municipal codes. Further real estate taxing power is provided in the municipal codes for specific purposes and the proceeds maintained in separate funds. (Fund accounting is described in Chapter V). In addition, Act 511 of 1965, the Local Tax Enabling Act, specifies other taxes municipalities (as well as school districts) may enact and the maximum rates of taxation. Complete discussion of tax sources is found in the *Taxation Manual* published by the Department of Community and Economic Development.

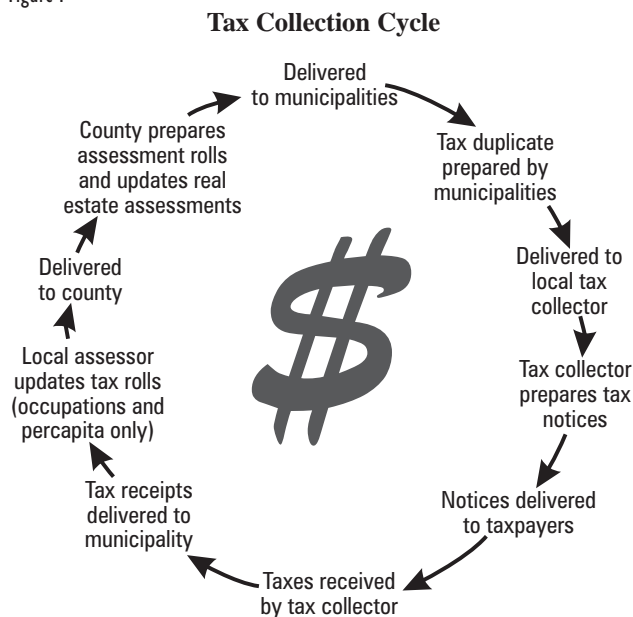
A Special Road Fund for boroughs and a Revolving Fund for townships of the second class may be initially established by levying up to five mills. Costs of street, sidewalk and other permanent capital improvements paid for from these funds can be replenished by the use of special assessments against the owners of the properties benefitting from the improvements. When the funds are replenished by assessments, there is a continuing supply of money available to conduct new capital improvement projects.

## Municipal Tax Collection

In Pennsylvania, the local elected tax collector works independently of the municipal governing body. Tax collector duties, responsibilities and relationships with you as a municipal official are spelled out in the applicable municipal code and the Local Tax Collection Law.

Figure 1 contains a typical tax cycle and illustrates some of the major duties and interrelationships between local and county officials and the tax collector. The assessment roll is prepared by the county after it has been updated by assessments on new taxable properties by the county assessor and on occupations by the municipal assessor. From the assessment roll, the municipality is responsible for the preparation of the tax duplicate, which contains the amount of tax due for each property and person on the basis of their real estate and occupational assessments. In some cases, the county, when preparing the assessment rolls, may calculate the taxes due.

Figure 1



The tax duplicate is delivered to the tax collector by the municipality within 30 days after adoption of the budget or within 30 days after the assessment roll is received from the county. Usually this will result in the tax duplicate being delivered to the collector during the month of January.

Within 30 days after receiving the tax duplicate, the tax collector must prepare and issue the tax notices to each person listed on the duplicate.

As the tax payments are received by the tax collector, each payment is noted on the tax duplicate and funds are paid over to the municipality on or before the tenth day of each month or more often. The tax collector pays the entire amount received and does not deduct any funds for commission or expense. The tax collector's commission or salary can be paid at the time the monthly deposit of taxes is made. However, except for third class cities, the law does not specifically state when or on what schedule the tax collector is to receive compensation.

There are several words, terms and phrases relating to tax collection frequently misunderstood by municipal officials. One of these is exoneration. An exoneration does not excuse a taxpayer from paying the taxes owed. An exoneration only removes the liability of the tax collector to collect certain delinquent taxes. With few exceptions, exonerations cannot be granted for real estate taxes. Usually the tax collector is only exonerated from per capita and occupational taxes, and then only after all reasonable efforts are made to collect the taxes, including the attachment of delinquent taxpayers' wages.

When an exoneration is granted, the taxpayer is still liable to the municipality for the unpaid taxes. The municipality must proceed with all legal means to collect the taxes as if no exoneration has been granted. The municipal clerk or secretary must maintain records of all persons exonerated, as well as the date of exoneration and the amount of tax due. Of course, the tax collector receives no commission on exonerated taxes.

An exemption is a state of immunity or freedom from a tax or other public charge. Taxes are not levied against exempt persons or property. The assessment laws and the Local Tax Enabling Act authorize municipalities to exempt persons whose income from all sources is less than \$5,000 from personal taxes. This action must be taken by an amendment to the ordinance levying the tax. Persons who then qualify for the exemption will be relieved from all liability for these taxes. Because taxing districts frequently request tax collectors to process exemption claims for per capita and occupation taxes, these exemptions have become confused with exoneration.

The tax collector must make an annual settlement of accounts by December 31 of each tax year. The taxing district designates before whom settlement is made, for taxes levied and collected. The tax collector discharges accountability for a given tax levy by being allowed a credit for all taxes collected and paid over.

Credit is allowed for unpaid taxes on real property provided those taxes have been returned to the Tax Claim Bureau; credit is allowed for unpaid per capita and occupation taxes accounted for exoneration. As a final step in discharging annual tax collection duties, the tax collector must, in a sworn statement, affirm a true and just return of all taxes collected has been made.

The Real Estate Tax Sale Law mandates the return of all delinquent taxes to the Tax Claim Bureau, under the control of the county commissioners in each county. The following taxing districts are not included or subject to the provisions of this law: Philadelphia county; city and schools; Allegheny County; Scranton, city and schools.

The Bureau is designated the agent of any taxing district in the prosecution and collection of claims and in the management and disposition of property held by the Bureau as trustee.

Under the law, each tax collector is required to make a return to the Tax Claim Bureau on or before the last day of April of each year, listing all properties on which any taxes levied in the calendar year immediately preceding remain unpaid, plus penalties and interest incurred up to the return date. The Bureau is then required to give notice to each delinquent taxpayer not later than July 31 that taxes have been returned and a claim entered.

Act 511 taxes may or may not be collected by the elected tax collector. The Local Tax Enabling Act gives municipalities complete freedom in making administrative arrangements for collection of Act 511 taxes. Act 511 per capita and occupation taxes are most often collected by the local tax collector since these are billed and collected once a year, usually with the real estate and code per capita and occupation taxes. Earned income taxes are usually collected by specialized bureaus or private collection agencies. Mercantile, business privilege and amusement taxes are often collected by municipal licensing agents.

## **Fees and User Charges**

To cut down on the burden of direct taxation, most municipalities levy one or more fees or user charges on the persons benefitting directly from a municipal service. Most common are water rents and sewage user fees based on the volume of water consumed by residential, commercial and industrial customers. In places where there is municipal garbage collection, a garbage collection fee is usually charged on each serviced property. In some places, solid waste

disposal or recycling fees are added to garbage collection fees. A number of boroughs sell electric power at retail within their boundaries, generating significant revenues. User fees are commonly applied in the recreation area for such things as swimming pools, tennis courts, golf courses, park pavilions and special activities.

In other cases, although municipal services are not “sold” directly, the use of license or permit fees allows municipalities to recapture the cost of providing specified services to individual customers. Zoning permits, junkyard licenses, building permits, transient retailer licenses, and parking lot or meter fees are common examples. The fee limitations are, in some cases, specified in the municipal codes. Where the maximum fee is not specified, you may not set the fee so high that it becomes a money-making operation for your municipality. The fee or permit schedule should be set to cover all of your justifiable administrative expenses. For example, the expenses connected with issuing a permit include filing and storage, cost of forms or other materials, and the time required by municipal personnel making inspections, reviewing or evaluating the application. Generally, where not otherwise constrained by municipal code specifications, you should set fees high enough so that all of your costs associated with a license or permit are recovered from the fee itself. If fees are less than the actual cost, the taxpayers of the municipality are making up the difference and, in effect, subsidizing those persons obtaining permits and licenses.

## **Intergovernmental Revenues**

Intergovernmental revenues are funds transferred from the state and federal government to municipal governments. These form a significant percentage of municipal revenues in some cases. There are two types of intergovernmental revenues. Entitlement funds go out to all eligible local governments with minimal reporting requirements. Discretionary grants are established by state or federal legislation and require application to the administering agency for each grant.

State liquid fuels funds are distributed to all municipalities under a formula based on population and the miles of municipal streets and roads. Use of liquid fuels funds is restricted to highway and bridge maintenance and construction and related equipment and service. Municipalities are required to file copies of their annual audits and other certification forms with the Department of Transportation to qualify for these funds.

Under the Public Utility Realty Tax Act, the state levies a tax on public utilities and distributes funds derived from it to local tax bodies in lieu of local real estate taxes on public utility property under a formula based on total tax receipts, tax rates and the value of public utility realty within its boundaries. Taxing bodies must file an annual report with the Department of Revenue to qualify for the distribution.

The Commonwealth of Pennsylvania has deregulated the elective power generation utility industry to institute competitive pricing and service providers to benefit consumers including municipalities. The cost of the transmission and distribution of electricity by utility companies in Pennsylvania to consumers continue to be regulated by the Public Utility Commission.

Public Utility property owned by electric power generation companies is exempt from the tax the Commonwealth levies on their real estate. This results in less money being paid to the state and in turn, to the taxing bodies. Power generation utilities are, however, now required to pay a local real estate tax to the taxing bodies within their boundaries. Municipalities over time will receive less and less of the annual distribution of the Public Utility Realty Tax Act funds eventually phasing out.

Receipts from the two percent state tax on insurance premiums paid to foreign (out-of-state) fire insurance companies are allocated to municipalities under a formula based 50 percent on population and 50 percent on market value of real estate. Where the municipality is served entirely by volunteer firefighters the allocation is distributed to the municipality to be paid over to the volunteer firemen's relief association or associations representing the fire companies serving the municipality. Where the municipality has both paid and volunteer firefighters, the municipal governing body must annually certify the proportion of service provided by each. The allocation is then divided on the same basis. The portion attributable to volunteers is distributed directly to the municipality for payment to the relief association. The portion attributable to paid firefighters is transferred to

the General Municipal Pension System State Aid program. Receipts from the two percent state tax on foreign (out-of-state) casualty insurance companies plus a portion of the foreign fire insurance premium tax receipts fund the General Municipal Pension System State Aid program. The program provides annual allocations to municipalities for pension costs. The allocation is based on the number of full-time municipal employees covered by a pension plan. Municipalities must make annual certifications of the number of full-time police officers, firefighters and nonuniformed employees participating in pension plans. Distribution of funds is based on the number of employee units with police officers and firefighters counting as two units each and nonuniformed employees as one unit. A transition period through 1995 assures municipalities a minimum amount based on past receipts or the annual municipal costs of its pension plans, whichever is less. The funds received under the program may be allocated to any pension plan maintained by the municipality.

The Commonwealth makes in lieu of tax payments to municipalities for state-owned land used for forest, water, conservation, flood control and game purposes. The federal government makes in lieu of tax payments on certain types of federal lands.

Besides these intergovernmental funds which come more or less automatically to local governments, there are literally hundreds of grant programs operated by both state and federal governments. The *Catalog of Federal Domestic Assistance* provides a comprehensive listing of federal grant programs currently active. It may be purchased from the Superintendent of Documents, U.S. Government Printing Office, Washington, D.C. 20402. Contact them for price information before ordering.

The regional offices of the Department of Community and Economic Development can assist municipal officials in identifying sources of state and federal assistance for financing projects. County planning commissions can often offer technical expertise to assist in the preparation of applications.



## IV. Budget

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Budgeting is a basic tool for managing municipal finances, but it can be more than that. Preparation and adoption of the annual budget should be the occasion for careful planning for municipal activities for the coming year and making reasoned and balanced decisions on how municipal resources will be spent. Some elected officials consider enactment of the annual budget as a formality, or even as a nuisance, but this process has some significant purposes.

- The budgeting process should allow the elected governing body to express its goals for community services for the coming year in a single document that is readily understandable by the citizens.
- The budget allocates revenues among various municipal service needs. Careful decisions on what is most important have to be made in determining where the limited amount of money available will be spent.
- The budget provides citizens information on how their tax dollars will be spent and the process allows citizen input in the making of these decisions.
- The budget document authorizes expenditures for the budgeted items by making appropriations. Expenditures during the year can only be made if sufficiently appropriated funds are available.
- The budget provides a framework for monitoring the performance of revenues and the accumulation of expenditures during the year. If revenues do not match estimates, or if expenditures are significantly higher than planned, quick action must be taken during the year to adjust the budget and bring expenses in line with income.

### Types of Budgets

Pennsylvania has no mandated uniform budget process, or even budget type. The state annual budget form has been eliminated.

There are several basic types of budgets. A “line-item” budget simply categorizes the planned expenditures for things, with little regard for how the things, such as labor, supplies and materials, or contractual services will be used. Although a line-item budget is

easy to prepare, it doesn’t provide much planning information. For example, since all labor costs are lumped, it is difficult to differentiate between labor for police and labor for road maintenance.

At the other extreme of difficulty is a “performance” budget. In a performance budget, all work units are expressed in dollars; for example, the dollars per ton of refuse collected, the dollars per hour of police patrol, or the dollars per square yard of road resurfacing. The performance budget gives very direct planning information relating dollars spent to services received; however, the amounts, accuracy and volume of data needed to make a performance budget work are beyond the practical limits of most small Pennsylvania municipalities.

In addition, there is a “program” budget that allocates money to the functions or activities of a municipality such as public safety, highways and streets, recreation and parks and similar categories. Then, in the municipality’s working budget within each of these functions, expenditures can be broken down into specific object items; for example, salaries and wages, contractual services, supplies and materials. The program budget allows you to judge the reasonableness of the amounts being spent for each function as compared with the other functions, and to determine whether the expenditures for each reflect the needs as seen by the municipal officials and the citizens of the municipality.

As an example, if a municipality is contributing \$15,000 a year toward a regional library system and spending \$27,000 for parks and recreation, does this represent a reasonable balance between these functions? The answer, of course, depends on the particular municipality and the needs as determined by the elected officials. Caution must be used in making these kinds of comparisons assuming the benefits from all functions are equivalent for each dollar spent on the functions. You are really comparing inputs of dollars to the function, rather than the output of municipal service because the output is often difficult to define. A true program budget is developed on the basis of expected output from each municipal function. To develop meaningful output measures is too complex for small municipalities and is not likely to be worth the effort.

## Legal Responsibilities

Each municipal code requires adoption of an annual budget. There is very little detail in any of the codes on how the budget is to be developed. There is more legal detail on the adoption of the budget.

Although the codes contain somewhat different requirements for townships, boroughs and cities, the following are common elements.

1. Projections of revenue estimates and proposed expenditures must be made either by the secretary, department heads or committees of the governing body.
2. The minimum financial obligation of the municipality for the following year must be determined by the chief administrative officer of each municipal pension plan and submitted to the governing body by September 30.
3. A public meeting of the governing body is held at which the budget for all funds of the municipality is discussed and the proposed budget is prepared.
4. After the proposed budget is prepared, it must be advertised. The advertisement should include a statement of where the budget is available for public inspection for a period of at least 20 days, except for boroughs, which is at least 10 days.
5. The governing body must officially adopt a balanced budget before December 31, of the year preceding the budget year.

## Budget Calendar

If the budget process is to be a valuable tool for municipal management, an organized sequence of events should be laid out to permit the participation of all parties at the appropriate time.

The preparation and use of a budget calendar will aid in scheduling participation of the various elected and appointed municipal officials in the budgeting process. The calendar is intended to lead to an orderly process climaxing in enactment of a budget, and to avoid last minute panic efforts to adopt the budget before the deadline.

The budget calendar can be adopted as an ordinance or included as part of the municipality's administrative code. At a minimum, the calendar should indicate the time periods in which the following tasks will be performed, as well as identify the officer responsible for the task.

- Budget forms, instructions and guidelines distributed to the departments.
- Revenue estimates prepared.
- Budget requests submitted by departments and compiled by the appropriate officer.
- Preliminary budget to be reviewed and approved for public inspection.
- Final adoption of the budget and tax ordinance by the governing body. (Resolution in the case of second class townships)

Table 4 is an example of a typical budget calendar for a medium-sized township in Pennsylvania. Specific activities and events are identified and the deadline dates for their completion are indicated. For each activity, the municipal official or employee responsible for obtaining the information and assuring that the deadline is met is noted. Depending on when the county supplies the assessment rolls for your municipality, you may have to adjust several of the dates. In the example, the revenue projections that are indicated for October 1st may have to be rescheduled if your assessment rolls, supplements or updates are not available from the county assessor at that time.

The budget calendar that you design for your municipality may omit some of the steps shown in the example, or you may wish to go into more detail. Excessive detail is likely to lead to confusion. The main point is that the calendar is a plan for developing the budget, and it should point out what must be done, when it must be done and who is responsible.

TABLE 4

### TYPICAL BUDGET CALENDAR FOR A MEDIUM-SIZED MUNICIPALITY

Due Date	Budget Activity	Responsible Person
Sept. 1	Obtain annual budget forms	Secretary
Sept. 15	Post current year expenditures and revenues or estimates to the budget form	Secretary
Sept. 30	Municipal pension obligation submitted to governing body	Chief administrative officer of pension plan
Oct. 1	Project revenue estimates for the next budget year	Secretary consulting other officers
Oct. 30	Submit activity expenditure estimate to secretary	Department heads
Nov. 15	Enter expenditure requests and revenue estimates in annual budget form	Secretary
Nov. 20	Conduct full review of budget	Governing body
Nov. 20-30	Tentative adoption	Governing body
Nov. 30	Submit advertisement to newspaper	Governing body
Dec. 3-23	Make budget available for public inspection	Secretary
Dec. 27	Adopt budget and ordinance setting real estate tax rate	Governing body
Jan. 1	Create budget accounts and enter amount in ledger	Secretary

## Budget Goals and Guidelines

As the elected officials of the municipality, the governing body is responsible for setting policy. A critical policy tool is the annual establishment of goals for municipal services for the coming budget year. This is most appropriately done when the capital program and the municipality's financial status are reviewed in August or September. The goals set by the governing body should guide decision making for both the capital budget and the operating budget. The goals have to be restated as budget guidelines for the municipal departments. The goals may address long-term objectives such as hard surfacing all municipal roads or working towards 24-hour police coverage, or they may respond to more immediate needs such as replacing broken machinery or missing road signs.

The goal setting process should include the following elements:

- Review the current year's fiscal condition and prospects for the budget year to develop a rough estimate of the financial constraints. It is a waste of time to consider new services or facilities if there is no prospect of paying for them.
- Examine what services are really needed. What alternative ways are available for providing them?
- Determine if any programs are no longer needed or can be cut back.
- Are there services that are not being met and can be met within the municipality's ability to pay?
- What community needs require a response in terms of municipal activity, and how important are these in relation to other needs?

Following the establishment of goals for the coming year, the governing body should develop overall guidelines for budget requests from the departments. In smaller municipalities without well-established department structures, this is the next logical step in the governing body's own preparation of the budget. Guidelines provide a common approach to the following issues:

- What is the expected effect of inflation on operating costs for the coming year?
- What are estimated cost adjustments for projected salary increases either as a result of collective bargaining or those granted to nonunion employees?
- What increases can be projected for employee benefits such as health insurance coverage?
- What areas of municipal service are to be strengthened, de-emphasized, reduced or eliminated?
- What general approach will be taken to the need for a tax increase or decrease, or changes in service fees?

## Budget Requests by Departments

The next step in the process is to have the municipal secretary distribute budget forms and instructions to each department. This should be done with sufficient lead time to give the departments full opportunity to prepare thorough budget requests. The budget instructions should at least include the following items:



- The goal statement developed by the governing body for the coming budget year.
- The budget preparation calendar.
- The budget guidelines covering financial factors that apply to all departments, particularly employee costs.
- Copies of whatever budget forms are used, along with the necessary instructions for completing them. Figures 2 and 3 show a sample worksheet for calculating expenditures for part of the General Fund. Separate worksheets on employee costs are often used.

The first step in developing a department's budget request is writing a simple budget narrative. The budget narrative presents the goals of each department and its specific objectives as they relate to the overall goals of the municipality as established by the governing body. Budget narratives commonly include the following elements:

- Explanation of the current program, its accomplishments and areas needing attention.
- Comparison of the current year's budget with the proposed budget, explaining any differences due to changes in departmental spending and services.
- Review of projections for any revenues generated by departmental activities.

Budget requests based on an incremental increase over the past year's costs are a minimum starting point. Department heads should use the budget process to plan and manage the services they provide to the community. Departments need to review operations to determine if things could be done more efficiently and to look closely at the cost effectiveness of new proposals. Any requests for additional funds have to be supported by convincing justification based on the budget goals and guidelines of the governing body. Any new programs or services need to be completely costed out, including all foreseeable expenditures for personnel, materials and equipment. Service options should be presented. If a department head is faced with the necessity to scale back or eliminate an existing service, all potential options should be presented.

Budget documents from departmental worksheets through finalized requests to the municipality's proposed budget should use the coding system adopted with the municipal accounting system. The Department of Community and Economic Development's Chart of Accounts numbering system is also used in the DCED audit report.

Projections for personnel costs may be delegated to department heads or worked out for the entire municipality as a whole. If the municipality has a collective bargaining agreement that covers the budget year, calculating personnel costs will be fairly easy. If one or more contracts are to expire during the year, estimates of wage or benefit increases must be used. For municipalities with no bargaining units, it is up to the governing body to set policy on wage or benefit increases for employees. Wherever possible, retirements should be anticipated so an allowance can be made in the budget for starting the replacement at a lower salary. Personnel costs must include the minimum financial obligation of the municipality to its pension funds for the coming year. This figure must be determined by the chief administrative officer of each fund and submitted to the governing body by September 30.

For help in budget projections, as well as monitoring the costs of services during the year, department heads, or the municipal secretary in small places, will find the development of cost statistics useful. For instance, from prior paving projects, the cost of paving one mile of road can be calculated. Similar statistics should be developed for annual charges for fuel, maintenance and repair of police cars or road equipment. If these figures are maintained during the year, they can be pulled out and used at budget time. Other typical cost statistics that may be calculated include:

- Snow removal costs per mile of road, per inch of snowfall.
- Fire department cost per household.
- Electrical charges per year per street light.
- Library cost per capita.
- Tax collection cost per tax bill.
- Refuse collection cost per ton or per household.
- Building maintenance cost per square foot of floor space.

## Revenue Estimates

During the time frame that the departments are formulating their budget requests, the governing body must settle upon a revenue estimate for the coming budget year. Preliminary revenue estimates need to be developed early in the budget process. This provides the necessary data for the formulation of budget guidelines on tax and user charge policy for the budget year. At this stage, the preliminary estimate is calculated through a review of revenue performance for the current year to date and expectations for the remaining

months of the current year. By this time, almost all real estate and per capita taxes are collected, and additional revenues from earned income taxes and sewer and water charges can be calculated with relative accuracy. However, these early estimates are “soft” because they are done with five months to go in the fiscal year.

Before the proposed budget is formulated, the governing body will have to agree on a more “solid” revenue estimate for the budget year. Hopefully, by this time the total amount of the new real estate tax duplicate is available from the county. This figure, combined with historical trends in the percentage of taxes collected, will provide a fairly accurate estimate of real estate revenues. Earned income tax collections can be projected based on national or regional changes in personal income projected for the future year. However, care must be taken to relate changes in the local economy to what is happening regionally or nationally. If a large local employer will be closing a facility, it is apparent local earned income tax collections will be adversely affected regardless of the trends at the national level. Sewer, water, garbage and electric revenues are easier to project based on past use. However, keep in mind the incentive effect to reduced use caused by any increase in price. Changes in building and zoning permit revenues, as well as receipts from realty transfer taxes, are tied into the local and national economies. If the business cycle is at the beginning of an expansion period, expect an increase in such fees, but if interest rates are increasing sharply, a slowdown in new building is indicated. Projection of intergovernmental income is difficult, but some basic grants such as liquid fuels, Public Utility Realty Tax Act (PURTA) and community development block grants do not vary greatly from year to year. Be aware of any change in legislation or agency regulations that would have a significant impact on revenues you can expect from these sources such as with the Public Utility Realty Tax Act.

The final stage in making a revenue estimate is calculating the year-end balance of the various funds. The governing body must make the decision of whether to spend down any carryover balance to meet revenue needs for the next year, or to raise taxes, utility charges or other user fees. The governing body should calculate and even graph the year-end balances of all significant funds to delineate trends over the past five years. Although tax or fee increases are not politically popular, small increases from year to year to retain adequate fund balances are more acceptable than a “hold-the-line” approach at all cost for several

years, followed by substantial increases in taxes and/or charges which pose hardships to households with tight budgets.

## **Budget Review and Adoption**

Following submission of departmental budget requests and completion of the final revenue estimate, all the pieces must be pulled together in a proposed budget. This can be done by the manager, secretary or finance officer. In municipalities without professional management, it is often done by a budget committee of the governing body, or in smaller places by the governing body itself working as an informal budget committee. In larger places, this process may involve formal meetings with the department heads during which they can present justification for their budget requests.

Completion of a proposed budget requires making difficult decisions on the allocation of limited resources. When it is done by a staff employee, close attention must be paid to the budget goals established at the beginning of the process by the governing body. The nature of proposed budgets varies in complexity, often depending on the size of the municipal operation. Almost all municipalities have a detailed working budget that breaks out costs by department and within departments by cost centers. In more sophisticated municipalities, the proposed budget can include a budget narrative that reviews the programs of the municipality and outlining changes for the coming year. The budget can be used to justify to taxpayers how their tax dollars are spent and why any change in taxes or service charges is necessary.

The proposed budget must be presented at a public meeting at least 30 days before the final adoption of the budget. Only the Third Class City Code specifies that this is to be at the last council meeting in November, but most proposed budgets are presented at November meetings. At this meeting, citizen input is received and any necessary changes can be made in the document by the governing body. The governing body then directs the municipal secretary to advertise the budget for public inspection. All the codes except the Borough Code (10 day inspection period) require a public inspection period of at least 20 days. Readvertising and a new inspection period are required if there are substantial increases in the final budget from that originally available during the first inspection period (except in boroughs). At the same time the budget is advertised for inspection, the secretary should also publish notice of the real estate tax ordinance (resolution in the case of second class townships). Unlike

FIGURE 2

**WORKING BUDGET - GENERAL FUND  
REVENUES**

[illegible]

## WORKING BUDGET - GENERAL FUND EXPENDITURES

[illegible]

Act 511 taxes, real estate taxes must be re-adopted every year, even if the tax rate remains unchanged. If there are new Act 511 taxes adopted or rates are changed, advertising requirements in the Local Tax Enabling Act must be followed.

After the termination of the inspection period, the governing body must adopt the budget at a public meeting. The deadline for adoption of the budget is December 31. If the budget is not adopted on time, the municipality loses all authority to spend money in the new year until a budget is adopted. In practice, municipalities have continued to make expenditures they would have been obliged to pay anyway, such as utility bills and payrolls. However, it is wise to refrain from any discretionary expenditures until the budget is passed. Real estate tax bills cannot be mailed out until the tax ordinance (resolution in the case of second class townships) is adopted. If the budget is delayed, revenues from real estate taxes will be similarly delayed.

## Amending Your Budget

A municipal budget is a financial plan. As with all plans which look into the future and attempt to project what will actually occur, your budget must be flexible enough to take into account unexpected events. Most plans — in this case the budget — are made to be changed and should be changed when necessary.

The various municipal codes under which Pennsylvania municipalities operate contain provisions for making changes to the budget during the year. However, the rules and methods differ somewhat between townships and boroughs.

There are two basic types of budget changes which may be made. First, during the January following any municipal election, the adopted budget may be reopened and the tax rate changed. Any changes made under these conditions must be re-advertised and made available for public inspection. The amended budget must then be adopted on or before February 15th. The main purpose of budget reopening is to permit newly elected officials to adjust the budget to their own set of priorities. However, reopening may be made even though all of the former supervisors or councillors have been reelected.

The codes for townships specify the maximum amounts which the budget may be raised in a reopening under these conditions. Your solicitor or financial advisor should be consulted before reopening the budget to assure that you are following the procedures outlined by your municipal code.

The codes also provide for a second method to change your budget. Essentially, the codes allow you to transfer unencumbered money from one account to another. The term “unencumbered” means money not already committed. For example, if a typewriter has been ordered but not yet delivered, the money in the budget for the typewriter is encumbered, that is, it is committed formally by the purchase order. Any money you may have promised to pay or which must eventually be paid because of prior commitments is encumbered and budget items involving this money may not be changed. Also, any funds committed to debt repayment, to special funds such as the Highway Aid Fund, or revenue which has been collected for a special purpose (such as money resulting from a street light levy) may not be altered in a budget change.

While the boroughs may transfer money between accounts at any time during the year, townships may make such transfers only during the last nine months of the year. In addition to transfers, boroughs and townships may make supplemental appropriations for any item at any time during the year. The items for which supplemental appropriations are made need not have appeared in the original budget document at all. The supplemental appropriations are made from funds on hand or expected to be received that have not otherwise been appropriated. Money may be borrowed to make the supplemental appropriations.

Although the municipal codes make provisions for changing or amending the municipal budget, this authority must not be used as an excuse for making continual unplanned or improperly thought out changes. A carefully prepared budget will have received considerable study and analysis comparing expected revenues with the municipal goods and services needed by your community. This plan — the budget — should be carried out to provide the services within your revenue limitations. Changes are usually only necessary under conditions such as:

1. An “emergency” situation creates new needs not apparent when the budget was originally approved.
2. Unexpected new revenues are received or revenues are much less than expected.
3. An unusual opportunity to obtain matching grant or loan funds at a particular time for a needed project may indicate you should shift a project scheduled for next year into the current year and postpone a currently budgeted project.



Generally, you should attempt to avoid changing or amending your budget except when absolutely necessary. When it does become necessary, the proposed changes should be studied carefully for their impact on your ability to provide essential services to your citizens. Budget changes should be made as carefully, if not more carefully, than your original formulation, and you should consult with your planning commission, solicitor, consultants or other appropriate advisors before making major changes.

## Capital Budget

Part of an overall budget is for items called “capital outlays.” In general terms, capital items include high cost, nonrecurring purchases to provide a permanent improvement; such things as a new municipal building, land for a playground, rebuilding a street or highway and purchasing a fire truck. It is impossible to prepare a capital item list applicable to all municipalities. Most people agree on what constitutes a capital improvement at the upper end of the cost scale, but as you approach the lower end of the scale capital items vary from place to place. In most municipalities a \$10,000 computer system is considered a capital purchase but a \$100 office machine is not. As an initial step in capital budgeting, you should define the term as it will apply in your municipality.

Since you usually need more high cost items than you can afford in any one year, capital budgeting should be based on a capital improvement program. This program is essentially a schedule of planned major improvements extending several years into the future. After you initially formulate a capital improvement program, capital budgeting becomes a process of annually updating the program — dropping the current year and adding a new year to the schedule. This usually entails adding some items, perhaps deleting some, and adjusting priorities.

As compared with the overall municipal budget, the capital budget will ordinarily include a relatively small number of items; however, the costs involved may approach or even exceed the annual expenses for operation and maintenance. Decisions regarding these major expenditures should not be made in haste. Because of special financing arrangements required to pay for a project, you may need time to obtain public support for special a tax levy or a bond issue.

For these reasons, you will find it wise to begin considering the needs for capital improvements somewhat earlier than the more routine matters constituting the greater portion of your municipal budget.

Below is a suggested timetable for unhurried consideration of capital improvements:

June-July	Solicit ideas for new projects.
Aug. -Sept.	Review municipal fiscal position and update capital improvement program.
Oct.	Tentatively approval capital items to be included in municipal budget.
Dec.	Formally approve capital outlays as part of overall municipal budget.

Of course, you can either start earlier or compress the schedule to suit the needs of your own municipality.

## Capital Reserve Funds

Capital reserve funds may be created to accumulate money for anticipated capital expenditures. Capital reserve funds may be created for construction of municipal buildings, purchase of equipment, machinery, motor vehicles or other capital assets. The purpose of the fund is specified at the time of its creation, but may be altered by the governing body.

As many capital reserve funds as are necessary may be established. Similar anticipated capital expenditures may be combined into a single fund to reduce the problems of administering a large number of funds. For example, if a bulldozer and two dump trucks are being planned for purchase within the next several years, it may be advisable to establish a single capital reserve fund for rolling equipment.

Funds are transferred annually from the general fund in sufficient amounts to meet anticipated needs. Annual transfer should be kept as constant as possible to avoid strains on any particular year's budget. Receipts from sale or lease of property or any other general fund revenue not earmarked for another purpose may be placed in capital reserve funds.

Capital reserve funds should be invested in interest bearing accounts or investments to increase the purchasing power of the fund. Since withdrawal time can be anticipated, you may be able to make longer term investments, resulting in improved return.

Capital reserve funds allow municipalities to accumulate money for necessary large capital purchases, keeping municipal finances on a pay-as-you-go basis. However, it does require considerable self control on the part of municipal officials not to skip annual transfer into the fund in tight budget years.

## V. Accounting, Bookkeeping and Auditing

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The accounting and bookkeeping system is the backbone of fiscal management in the municipality. It is this system which records the “facts” upon which responsible fiscal management must be based, that is the actual performance of the municipality.

All municipal officials accept the need for some form of accounting. The question that is frequently raised, though, is “Why does the accounting system have to be so complex?” The answer is... “For your protection.” First, as a taxpayer, you are entitled to know a system of checks and balances exists to protect your money from being misused. Secondly, as an official of the municipality you are entitled to a system to protect your reputation through a series of reviews by independent parties. In this latter case, more than your reputation is protected since you may be liable for a personal surcharge for negligent performance.

Within that basic guideline, every effort is made to assure that the accounting requirements are kept simple and straightforward.

Who specifies the accounting requirements?

Ultimately, of course, it is the people. They have a right to know what you are doing with their money and be assured that public funds are being well handled. There are five considerations impacting on what the accounting system has to look like and what kind of figures it can produce. The first of these is the requirement that public funds can be audited. In actual practice, the elected auditor is the primary representative of the people in Pennsylvania for auditing most municipal funds. The municipal audit, however, can also be performed by an accounting firm, a public accountant or a Certified Public Accountant. In this case, you would proceed according to your respective municipal code.

For specific funds from sources other than local taxes, there are occasionally separate audit agencies. The Pennsylvania Department of Transportation maintains its own group of auditors to verify expenditures of the state Liquid Fuels Fund. Other agencies may require separate accounts to be maintained for their grants and retain the right to audit those expenditures. Again, all of these are representatives of the taxpayers assuring tax monies are being properly handled and utilized.

The first set of requirements your accounting system must meet is to provide a record of financial transactions readily audited by all interested agencies. These are described in detail in the next section on required accounting procedures.

The second set of requirements an accounting and bookkeeping system must meet is equally important. The accounting system must tell the elected and appointed officials of the municipality what the true financial position of the municipality is so they can properly make decisions concerning capital improvements, local services and programs. The accounting system must permit a continuing comparison between the revenue and expenditures estimated in the budget and those actually occurring. This comparison must be presented in a clear and concise fashion, and it must be timely so decisions of the officials are based on up-to-date information. Requirements of the managing officials of the municipality do not much affect the accounting and bookkeeping system as long as the system can provide periodic summaries of the status of accounts. The types of fiscal management and control summaries required are described in Chapter VII, Fiscal Management Techniques.

A third set of requirements affecting your accounting and bookkeeping system is the requirement at the state level to compare performance of municipalities for their mutual benefit. These comparisons are translated into packages of new legislation for the relief of municipalities in financial difficulty and into advisory service programs to assist municipalities in learning from each other. This third set of requirements takes the form of a set of account guidelines and a structured chart of accounts for all municipalities so they all will be using the same accounting language. The details of these guidelines are contained in the *Chart of Accounts* prepared by the Department of Community and Economic Development.

The fourth set of requirements imposed on your accounting and bookkeeping system is that the accounting procedures themselves must be procedures recognized by professional accountants as acceptable accounting practice. This requirement assures the procedures have been used and evaluated in the past as providing an accurate and representative picture of

the financial transactions recorded. The final requirement arises from the need of the accounting and bookkeeping system to be able to identify taxes due to other governmental agencies. These are especially applicable in the handling of payroll information.

The remaining sections of this chapter expand on the essential requirements municipal accounting and bookkeeping systems must meet, and provide details on the variations in accounting systems used by municipalities to meet these requirements.

## Required Accounting Procedures

The most stringent requirements on the municipal accounting system are those of the auditors, whether they be elected auditors, an appointed auditing firm or representatives of the state. To obtain the best possible understanding of the requirements your accounting and bookkeeping system must meet, you must understand what the auditors are going to be looking for.

### *You must leave an "Audit Trail"*

The first and most important requirement on your system is that there be an audit trail. Every number in your accounting system must be traceable ultimately to a receipt, voucher or canceled check. For example, the figure below shows a municipality with total

receipts for the month of May of \$21,000. The auditors must be able to establish a trail from this \$21,000 to each and every receipt made out during the month of May. One of these trails might lead as shown in Figure 4.

Licenses and Permits made up \$950 of that \$21,000.

Building Permits made up \$225 of that \$950.

A Building Permit for J. Smith represented \$75 of that \$225.

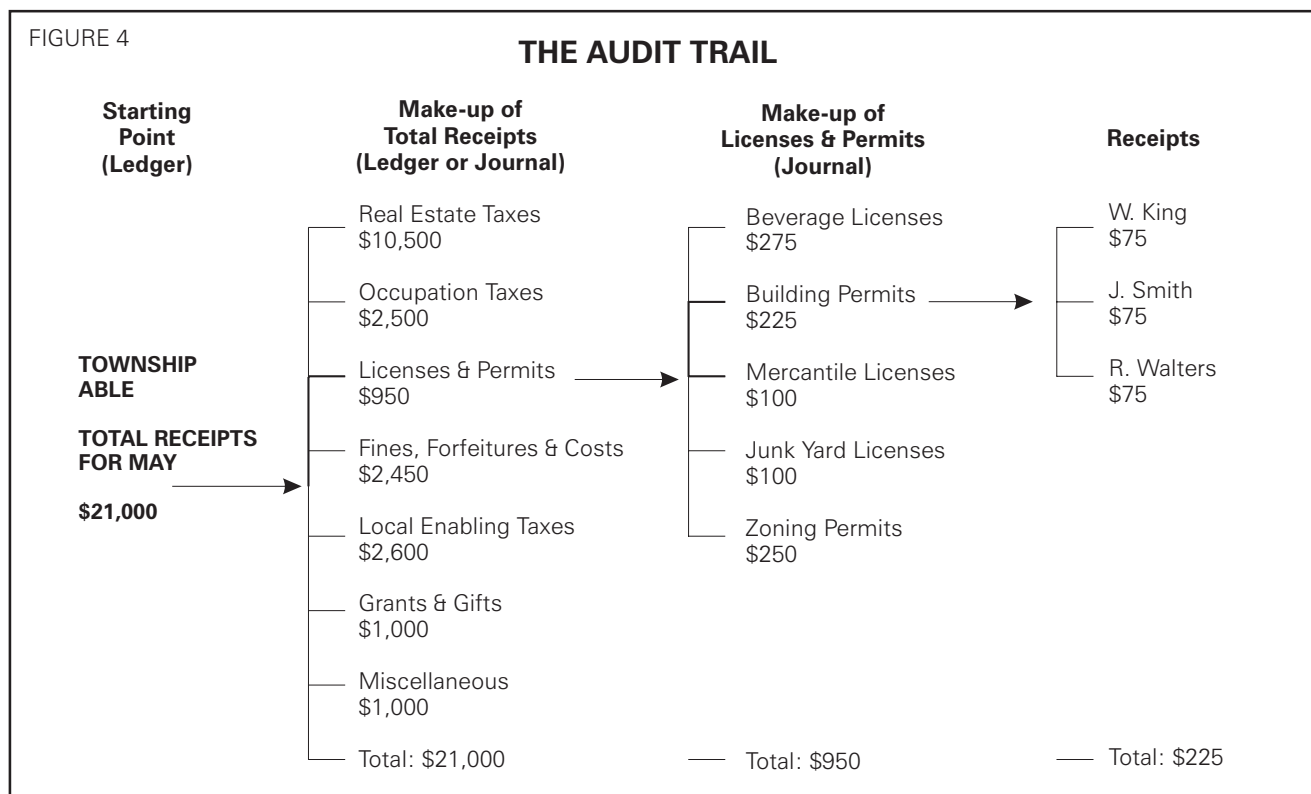
There is a receipt made out to J. Smith on the 22<sup>nd</sup> of May for a Building Permit for \$75.

Thus, the auditors establish a trail all the way from the total receipts for the month down to an individual receipt. They must be able to establish a similar trail for every receipt and expenditure made by the municipality. That is the basic concept of the auditor's role. The specifics the auditors check in their review of the accounts are much more complex, but they are based on this concept. The general guidelines for auditing municipal accounts are listed below.

1. General guidelines for auditing of revenues and receipts:
  - a. Make tests to determine money collected by all departments, boards, commissions, offices or individuals has been turned over to the

FIGURE 4

### THE AUDIT TRAIL





treasurer, promptly and intact, in accordance with laws, ordinances or regulations and has been credited to the proper funds.

- b. Determine all money received by the treasurer has been deposited, promptly and intact, to the credit of the governmental unit.
  - c. Test the accuracy of cash receipts records, noting whether cash or its equivalent in current funds have been received, for receipts issued.
  - d. Test cash transactions between funds, between the governmental unit under audit and other governmental jurisdictions.
  - e. Review the authority for all cancellations, remissions, adjustments or abatements.
  - f. Review general journal entries involving revenues and receipts.
2. General guidelines for auditing of expenditures and disbursement:
- a. Determine whether expenditures were properly authorized and incurred and are charged to the proper fund.
  - b. Determine expenditures are supported by itemized invoices, vouchers, contracts or other supporting documents approved by the proper officials and are marked so they cannot be used again.
  - c. Determine whether disbursements were made by checks, properly signed, for authorized purposes.
  - d. Scrutinize the endorsements and cancellations on checks and warrants.
  - e. Test the mathematical accuracy of disbursement records.
  - f. Test noncash expenditures represented by inter-departmental transactions. Determine all such expenditures are supported by properly authorized vouchers and the proper accounts have been charged.

These general guidelines are applied to all aspects of each of the municipal funds.

A good system of internal controls must be established, especially where there might be any opportunity for fraud. These controls should extend beyond the accounting system to all procedures for handling municipal finances or equipment. For example, in the handling of cash there should always be more than one person aware of the transactions. These tight internal controls are recommended for your protection of the funds of the local taxpayers. Without them, you run

the risk of being falsely accused with no way to prove your innocence.

## Types of Accounting Systems

Many municipal accounting systems in Pennsylvania are still on the “backs of envelopes.” Some record of the receipts and expenditures of the municipality is kept, but the record is often not adequate. In contrast to this, the accountants recommend “fund accounting using the double entry accounting methods on an accrual basis.”

What should you do? First, you should understand the meaning of the terms “fund accounting” and “double entry systems,” and the difference between “cash basis” and “accrual basis” systems. Then, you should reevaluate the needs of your municipality in light of the requirements described in the previous section of this chapter. Finally, you should change your present accounting system... if necessary... to be sure your taxpayers have adequate information to evaluate your handling of their money.

This section defines the terms fund accounting, double entry and accrual so you may see how these relate to your system.

## Fund Accounting

Fund accounting is an accounting method where a complete, self-balancing set of accounts (a fund) is maintained for keeping track of special receipts and expenditures. An easy way to visualize a fund is to think of it as a completely separate “pot” of money that should be kept separate from all other “pots.” Fund accounting is a generally accepted method of accounting for governmental units. Professional accountants agree this method can provide an accurate financial picture of the governmental unit.

Separate funds are needed to avoid intermixing of money received or collected for specific purposes or when required by law or regulation. For example, the laws providing the highway aid money received annually from the state require this money be accounted for separately. Similarly, the municipal codes specify revenue from certain special taxes levied for a specific purpose (for example, for street lighting) be kept separate and distinct from other municipal revenues. The most clear-cut way of doing this is to establish separate funds having no connection with the general funds of the municipality.

*EACH FUND HAS ITS OWN RECEIPTS AND  
EXPENDITURES, AND MAINTAINS ITS OWN  
BALANCE*

Each fund is a completely separate accounting system in itself, with its own unique accounts to record the various revenues and expenditures. The list of account numbers and titles is called the “chart of accounts” of the fund. Finally, each fund will be self-balancing. That is, at any point in time the status of the fund may be determined as shown in the following example.

Month End, 20__	
Cash	\$ 500
Comprised of:	
Cash on hand, beginning of year	\$1,000
Revenues collected in current year	<u>2,500</u>
	\$3,500
Expenditures in current year	<u>3,000</u>
Cash balance, ending	\$ 500

The primary fund in any municipality is called the General Fund. Unless there is a specific reason for not using the General Fund, all revenues and receipts should enter the General Fund, and all operating expenditures and disbursements should be made from this fund. Special funds should be established only as absolutely necessary to meet legal requirements or to isolate certain receipts and/or expenditures. The number of such funds should be kept to a minimum. Numerous funds create complex accounting problems and result in loss of efficiency.

**“TOO MANY FUNDS”**

Borough Static established a fund for paving Little Street in June. In August they established another fund for paving Short Street. Later that fall they established a fund for landscaping and putting benches in the downtown park. Two years later, the borough completed all three projects. However, the accounting was complex, and they had leftover money in each fund which came to a considerable amount when it was all added together.

Borough Modern had three similar projects in mind. In June they created one fund “ear-marked” for all three of the projects. This cut the bookkeeping to one third of Borough Static. Furthermore, since they were pooling their money for all three projects in one fund, they could afford the first project earlier. Borough

Modern completed the paving of Little Street eight months after they started the fund; the paving of Short Street sixteen months after the start of the fund, and the improvements to the park were completed in less than two years by using the excess funds from the other two projects.

The residents of Borough Modern had their paved streets and park improvements sooner, and a minimum of money was sitting idle.

*SEPARATE REVENUE FUNDS  
KEEP REVENUE SEPARATE*

Why have separate funds? The law requires that some funds be established. This is the case with the Highway Aid Fund. The main reason for establishing funds is to record the relationship between certain revenue and expenditures. For example, when a special tax is levied for street lights, a fund should be created to show the money collected is being spent for street lighting. This type of fund is called a special revenue fund because the purpose is to maintain separate records of the revenue being collected.

*UTILITY FUNDS RELATE SERVICES  
TO USER CHARGES*

Another type of fund with the same purpose, called the utility fund, is used to relate the service being provided (water, electricity, sewers) to the user charges being collected for that service. Bond funds are used to relate the proceeds from bond sales to the costs of the projects financed by the bonds.

*SINKING FUNDS ACCUMULATE MONEY  
TO PAY BOND DEBT SERVICE*

Sinking funds, as required by the Local Government Unit Debt Act, are set up to accumulate money for the retirement of bonds and the payment of interest. In Pennsylvania, the role of sinking funds has diminished in importance with the general use of serial bonds. Presently, sinking funds act generally as conduits through which money appropriated from the general or other funds is passed to the paying agent.

*CAPITAL RESERVE FUNDS ACCUMULATE  
MONEY FOR CAPITAL PURCHASES*

The capital reserve fund has been called one of the “most useful devices available to municipalities.” This fund permits the municipality to accumulate money for use at a future time for buying or replacing capital equipment. It is essentially a method of saving for future purchases. The money accumulated for future purchases should be invested in interest-bearing accounts, in certificates of deposit or in treasury bills.

The management of these reserve funds should be carefully studied and reviewed by you and your solicitor or consultant to assure the maximum possible growth in your assets.

## **Double Entry Accounting Method**

Double entry is a term frequently misunderstood by local government officials. They feel it represents considerable change to their present methods and is too complex for the smaller units of government. In reality, just the opposite is true. Double entry accounting represents minimal change and the benefits are numerous. This system provides the opportunity to accurately record financial transactions not possible under single entry systems. In addition, all transactions are formally recorded in the ledgers. The benefits of this are well known to those local officials who have inherited situations where records were incomplete. An accounting system should provide accurate and complete information which double entry does provide. This procedure is also in keeping with generally accepted accounting principles.

The double entry accounting method is an accounting procedure where at least two entries are made for each transaction: one entry shows the effect (increase or decrease) on cash; the other entry shows which revenue or expenditure account caused the increase or decrease in cash.

The explanation is, of course, oversimplified. More accurately, one entry shows the change in assets or liabilities; the other entry shows which revenue or expenditure account caused the change. However, the essential point is included in each definition, that is the use of the double entry method produces a balanced group of accounts. It's like adding or taking away weight from a balanced seesaw. As long as you always do the same thing to each of the two sides, the seesaw stays in balance. Similarly, as long as you make the two entries in the double entry system, your accounts stay in balance. By testing for this balance, you can quickly determine whether you made an error in your recording.

The double entry method is not a guarantee against all errors. If you fail to enter a transaction, the accounts will still balance. But, they will not be correct. If you enter balancing errors, or enter the amounts in the wrong accounts, your books may balance but will not be correct. However, double entry accounting makes it easier to detect the fact an error has been made, and alert the accountant to the need to make corrections.

In formal use of the double entry method, some simple technique to keep track of when to add and when to subtract is needed. The terms "debit" and "credit" are used for this purpose. Although these words are used to record increases and decreases, their meaning changes depending upon the kind of an account they are used with.

## **Cash or Accrual Basis**

The difference between cash and accrual basis accounting is like the difference between paying cash and using a charge account. If your system is on the cash basis, you record expenditures when you pay them. If your system is on the accrual basis, you record expenditures when you "accrue" them... that is, when liability is incurred—usually when an invoice is received.

In a true accrual basis system, you would also record revenue at the time it is due. However, the Governmental Accounting Standards Board (G.A.S.B.) does not require this for municipal accounting. They suggest a modified accrual basis be used. With this method, revenues are not recorded until received, but expenditures are recorded when liability is incurred.

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### **MODIFIED ACCRUAL**

#### **Cash Basis:**

Expenditures are recorded when paid.  
Revenues are recorded when received.

#### **Modified Accrual Basis:**

Expenditures are recorded when the liability is incurred, generally, if measurable.  
Revenues are recorded when they become available and measurable.

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In actuality, the cash basis of accounting can be acceptable if the difference in operating results is nearly the same as it would be on an accrual basis; that is, if very few bills are held past thirty days. This is the case for most small to medium-sized municipalities in Pennsylvania. It is essential, however, to plan carefully at year-end to be certain all collected receipts are recorded and all expenditures due are paid.

## Summary

Given the meaning of the terms “fund accounting,” “double entry accounting method” and “accrual basis,” you should evaluate your municipal system and determine how these accounting procedures can improve your present system.

## Summary of Principles of Accounting

The basis for the accounting principles your system should meet has been presented. This section will briefly summarize the principles. The summary is not intended to be complete but only to highlight especially significant points. Detailed accounting principles and procedures are available in a variety of excellent text-books.

Four minimum requirements should be structured into any municipal accounting system.

1. The system must comply with local and state legal provisions.
2. The system should be an accurate reflection of the fiscal condition of the municipality to provide a basis for money decisions and control.
3. Required financial reports should be easily extractable from the system, such as monthly financial reports, or the Department of Transportation's required report of liquid fuel expenditures.
4. The system must be capable of being audited, preferably in a simple manner.

There is no one ideal system for all municipalities and therefore one single system cannot be recommended. The basic accounting principles apply to all types of financial record keeping. They should be used to help select an adequate accounting system now, or to update your system in the future according to new demands in your jurisdiction.

Each municipality should establish funds as required by their local needs and in accordance with legal provisions.

Depending on legal and financial requirements, the following types of funds are recognized as basic:

### Governmental Funds:

- General Fund
- Special Revenue Funds, including Highway Aid or Fire Protection
- Debt Service Funds, including Sinking Funds
- Capital Projects Funds, including Capital Reserve Funds

### Proprietary Funds:

- Enterprise Funds, such as Water, Sewer or Refuse Collection
- Internal Service Funds, such as Motor Pool or Print Shop

### Trust and Agency Funds:

- Trust Funds, such as Pension Funds
- Agency Funds, such as Fire Relief Fund or Payroll Fund

All funds established should be included in the budget and in all of the municipality's financial reports.

In compliance with simplicity, as few funds as possible should be established while making certain all legal and financial requirements are met. By appropriate use of accounts within the funds, desired control of revenue and expenditure can be maintained without the necessity for establishing a multitude of separate funds for each particular purpose.

If there is a most common deficiency in municipal accounting systems, it is in maintaining too many funds in the books and failing to close funds which have ceased to be applicable.

A complete balancing group of accounts should be established for each fund.

Each fund should have accounts for cash and other assets, liabilities, revenues, expenditures and a fund balance. By providing for internal balancing of each fund, and by interrelating the funds through the use of double entry recording, the total fiscal condition can be analyzed for weak points on an individual fund basis.

The accounting system should provide for budgetary control for both revenues and expenditures.

If the budget is prepared using the accounting system, a quick glance should provide useful information in controlling revenues and expenditures in each fund according to the budget.

Cash basis accounting (revenues recorded when received, expenditures recorded when paid) is the simplest of accounting systems.



The cash basis of accounting is used by most smaller municipalities. However, if this basis is to be most effective, it is necessary to be certain all revenues which should be received are timely received and recorded, and all expenditures promptly paid.

For improved fiscal control of an approved budget, use of the modified accrual basis of accounting is recommended.

The Governmental Accounting Standards Board suggests this modified accrual system as a minimum for municipal accounting. This system requires recording of an expenditure when a liability is incurred, but revenue is not recorded until received.

Revenues should be classified by fund and source; and expenditures by fund and function, department, activity, character and by main classes of objects.

The chart of accounts provided by the Pennsylvania Department of Community and Economic Development satisfies this principle.

A common terminology and classification should be used consistently throughout the budget, the accounts, and the financial reports.

Together these constitute a continuous and repetitive cycle of financial information. It is important they read alike. Again, these requirements are met in the chart of accounts designed by the state for use by Pennsylvania municipalities.

Financial reports should be prepared at least monthly.

These should show the current condition of the budgetary accounts and other information necessary to control operations. At least once each year a general financial report must be prepared and published.

Good financial reports are a primary requirement of an adequate accounting system. They must provide information that is useful at all levels — internal and external. Some of the reasons many financial reports fail to achieve this goal are:

- a. Incompleteness — failure to present fund balance sheets showing financial position of the various funds.

- b. Too much detail — too many statements of detailed breakdown.
- c. Too little summarization of principal facts, in a form useful to elected officials and administrators and for informative purposes to the public.
- d. Too little standardization among governments of similar type.

If your accounting system meets the minimum requirements and generally follows these accounting principles, it should be an adequate system. If you are in doubt, you should study the material in this *Handbook* on municipal accounting systems, or contact an accounting or municipal consulting firm.

## The Meaning of Debit and Credit

One of the most difficult concepts for the layperson to master is the meaning of the terms debit and credit. Common use of the terms in other than accounting applications adds to the confusion. Statements such as “we will credit your account for the returned merchandise,” and “we have completed your credit check so your charge account is approved” seem to convey that the term “credit” is good. Yet, in accounting, a credit to a cash account is a decrease in the amount of cash in the account.

These terms are important in a double entry accounting system. How can you keep them straight? The best suggestion for those who use them often is to memorize their meaning. Or, you might write yourself a note and keep it near the account books. It may be easier for you to remember if you associate the words debit and credit with left and right. They are frequently explained using the following form, called a “T-account.”

debit	credit
-------	--------

In order to determine whether debit means increase or decrease, it is necessary to know to what type of account you are referring.

The first type of accounts we will consider are asset accounts. Assets include such items as cash, savings accounts, investments and other things you own. Assets should have debit balances. Therefore, it is necessary that increases in assets be recorded as debits. Consequently, assets are recorded this way:

## ASSETS

debit	credit
increases	decreases

The second type of accounts to be considered are liability accounts. Liabilities include such items as money due to other governmental units, temporary loans and other debts you may owe. Liabilities are the opposite of assets. Thus, increases in liabilities are recorded as credits.

## LIABILITIES

debit	credit
decreases	increases

As stated earlier, in a double entry accounting system the key is “balance.” The debit and credit concept is used to maintain that balance. When entries are made, each entry consists of a debit to one account and a credit to another. For example, when a \$100 check is received, it increases your assets. Therefore the assets account “Cash” should be debited or increased by \$100. However, since there is a double entry system, there must be an offsetting credit entry somewhere. If the money were borrowed, the \$100 check would be an increase in liabilities because you would owe the money to someone. The appropriate liability account should therefore be credited or increased by \$100.

Transaction: Borrowed \$100 from the bank

### ASSETS — Cash

debit	credit
\$100	

### LIABILITIES — Money Owed to the Bank

debit	credit
	\$100

If you add the debits and credits together, you would have \$100 worth of debits, and \$100 worth of credits. Therefore, your accounts are balanced — the sum of the debits equals the sum of credits.

If another check were received for \$50, this time in payment for a license of some type, again the asset account Cash would be increased or debited. To balance the accounts, there must be an offsetting credit entry somewhere. This time the logical account to credit would be a revenue account established to keep track of the money received from licenses.

Transaction: Received \$50 in payment for a license

### ASSETS — Cash

debit	credit
\$50	

### REVENUE — Licenses

debit	credit
	\$50

Revenue accounts include taxes, grants, fees, permits, licenses, departmental earnings, and all other sources of money except those producing liabilities such as loans. As you can see from the above example, increases in revenue are recorded as credits.

## REVENUE

debit	credit
decreases	increases

Expenditure accounts are the opposite of revenue accounts. Revenue represents money coming in; expenditures represent money going out. Accordingly, increases in expenditures are recorded as debits.

## EXPENDITURE

debit	credit
increases	decreases

As an example of recording an expenditure, assume you pay an invoice of \$25 for road repair. Your check represents a decrease or credit to cash (an asset account). This time the offsetting entry must be a debit. The account to be debited would be the expenditure account for road repair.

Transaction: \$25 paid for road repair

### ASSETS — Cash

debit	credit
	\$25

### EXPENDITURE — Road Repair

debit	credit
\$25	

Again, as they must in a double entry system, debit and credit entries offset each other.

To summarize the meaning of debit and credit for each of the types of accounts:

ASSETS		LIABILITIES	
debit	credit	debit	credit
increases	decreases	decreases	increases
EXPENDITURES		REVENUE	
debit	credit	debit	credit
increases	decreases	decreases	increases

Although, as stated earlier, the meaning of the terms debit and credit is difficult for the layperson to understand, the advantages in use more than offset this difficulty. It is recommended that each municipality use

the double entry method. If your municipality is not using this now but decides to change, it is further recommended that you seek the services of a municipal consulting or accounting firm to help you get started.

For those small municipalities that decide not to change to double entry accounting, a simplified bookkeeping system has been designed under the guidance of the Pennsylvania Department of Transportation, Bureau of Municipal Services. This system achieves some of the effects of the double entry system without requiring the use of the formal terminology. A description of the system can be found in the *Treasurer's Account Book* distributed by the Department of Transportation.

## VI. Accounting Guidelines

This chapter provides selected background data for the municipal treasurer, describes the forms and account books needed in Pennsylvania and presents some examples of the fundamental accounting entries for the forms and books. The chart of accounts used in presenting this material is based on the account numbering system used for the *Treasurer's Account Book* and the Annual Budget Report and Annual Financial Report. Copies are available from the Department of Community and Economic Development or the Bureau of Municipal Services in the Department of Transportation. The forms used in the examples are those designed by the Department of Transportation for use in the *Treasurer's Account Book*.

### The Books of Account

In the simplest terms, the financial transactions of a municipality involve receiving cash (receipts) and spending it (expenditures or disbursements). These transactions must be recorded as soon as possible in the municipal account books. They are recorded in what is formally called "books of original entry." The two most common and most important books of original entry are called:

Receipts Journal  
Expenditures Journal

Sample forms for these journals, showing the types of information required in the journal, might look like this:

MS-903A (5-99)

#### FUND RECEIPTS

PAGE \_\_\_\_\_

RECEIVED FROM	NET AMT. Dr.	REC'T. #	DATE	DISTRIBUTION	
				ACCOUNT #	AMOUNT Cr.
BROUGHT FORWARD					

MS-903C (9-98)

#### FUND DISBURSEMENTS

PAGE \_\_\_\_\_

PAYEE	NET AMT. Cr.	CHK. #	DATE	DISTRIBUTION	
				ACCOUNT #	AMOUNT Dr.
BROUGHT FORWARD					

The abbreviations of "Dr" and "Cr" on these form refer to Debit (Dr) and Credit (Cr). They are included on the form so it can be used for double entry method bookkeeping. However, the forms are equally useful for recording the required information in single entry bookkeeping systems.

The blank space at the top of each form is used to identify the fund for which the form is being used, such as General Fund, Highway Aid Fund or others.

Some transactions which do not involve cash directly also require a book of original entry. For instance, corrections to previous entries must be recorded somewhere. They do not easily fit into one of the above two books because they do not change the cash situation. Therefore, a third book of original entry is used in municipal systems called the General Journal.

There is no particular form for the General Journal. All that is needed is a place for the date and enough room for explanation of the entry. Double entry systems also need two columns for debit and credit entries.

If your municipality uses the modified accrual system, you will have one other book of original entry to record commitments to spend money. This is called the Purchase Journal or Voucher Register. The form for the Purchase Journal is the same as for cash expenditures except the "Net Amt" is recorded as accounts payable instead of as a decrease in cash.

The Payroll Journal may also be considered a book of original entry. However, since payroll is one of the most complex tasks for the municipal bookkeeper, a separate section later in this chapter discusses the handling of payroll in detail.



These are all of the books of original entry. Any transactions of a municipality may be recorded using these books. However, it is necessary to summarize the transactions somewhere so the information can be used in the management of the municipality and the financial status can be compared against the budget. The name of the account book used for this purpose is the General Ledger.

The General Ledger normally consists of an account book with one separate page for each account where you keep track of the total transaction in that account since the beginning of the year and of the amount budgeted for that account. A sample of a typical municipal ledger form follows:

MS-903B (9-98)

LEDGER						PAGE
FUND: GENERAL				Type Acct: Expenditure		
Account Category: Public Works - Sanitation Solid Waste Collection and Disposal						
Account Title: Other Services and Charges - Contracted Services				Acct #: 427.45		
Date		Amount Dr.	Amount Cr.	Balance	Budget	
	BROUGHT FORWARD					
						1
						2
						3
						4

Financial reports should be made directly from this ledger.

In summary, in a cash basis accounting system, you will have the following account books in each fund:

- A Receipts Journal* — to record all the receipts in that fund.
- An Expenditures Journal* — to record all expenditures made from that fund.
- A General Journal* — to record all transactions which do not properly fit into one of the other journals.
- A General Ledger* — to record the budget and keep track of cumulative receipts and expenditures.

If you have a modified accrual system, you will also have a Purchase Journal to record accrued expenses or commitments to spend money.

The flow of information among the account books is shown in Figure 5.

The following sections of this chapter describe how to set up and use each of the above books.

## Double Entry or Not Double Entry

A question that is frequently raised in growing Pennsylvania municipalities is: "Should we change over to double entry method bookkeeping?" In many cases the question is not answered because no one can explain what you can do with double entry that you are not doing already.

Double entry bookkeeping is less subject to mathematical error, it is accepted by professional accountants as a generally accepted method of accounting for governmental units, and it is a flexible technique which can accurately account for the entire financial picture of the municipality. Specifically:

1. Such items as petty cash, investments and other assets can be adequately contained in the books.
2. Joint projects where your municipality is collecting money for other agencies can be handled without giving the impression all of the money collected was revenue for your municipality.
3. Returns of excess taxes can be shown as a decrease in revenue instead of another increase in expenditures.
4. Returns of overpayments from vendors can be shown as a decrease in expenditures instead of as another increase in receipts.
5. The debts and other liabilities of the municipality have a logical place in the double entry system.

For these reasons, double entry method bookkeeping is recommended highly as the best method for use in Pennsylvania municipal accounting. However, many municipalities feel the traditional method they have been using is what they want to continue to use. This consists essentially of a type of combined receipts journal and ledger and a combined expenditures journal and ledger.

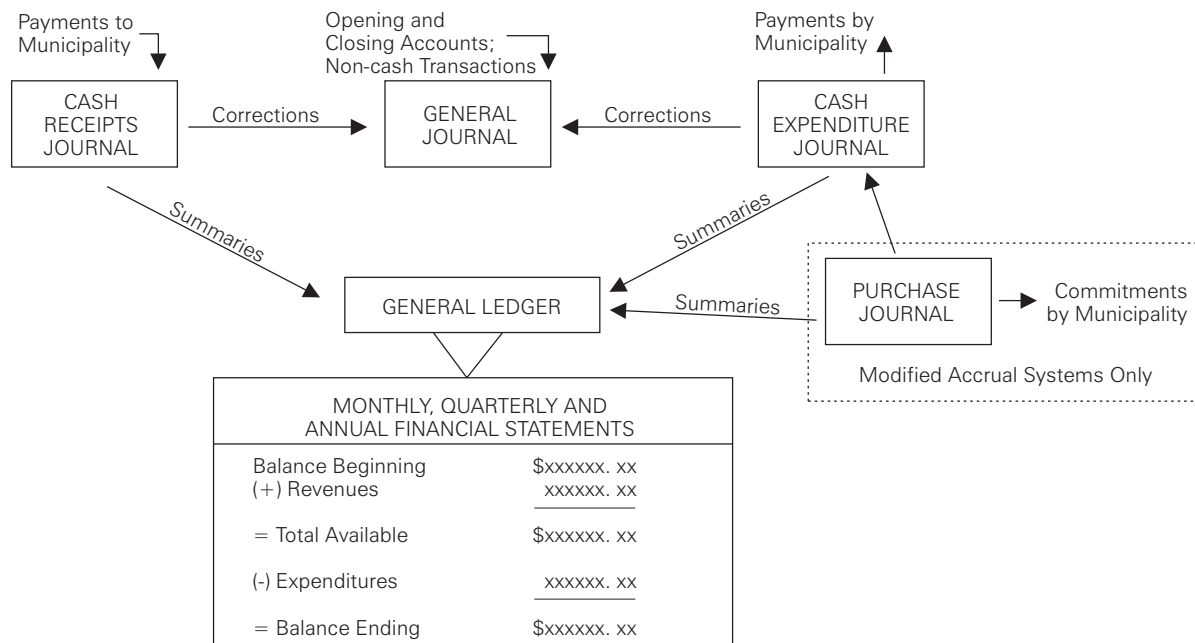
In order to make this chapter useful to all municipalities in reacting to changing guidelines from the state, the discussions of municipal account books will cover both double entry method bookkeeping and the traditional approach still in use in many communities.

## Accounting Procedures and Forms

### Setting up the Books

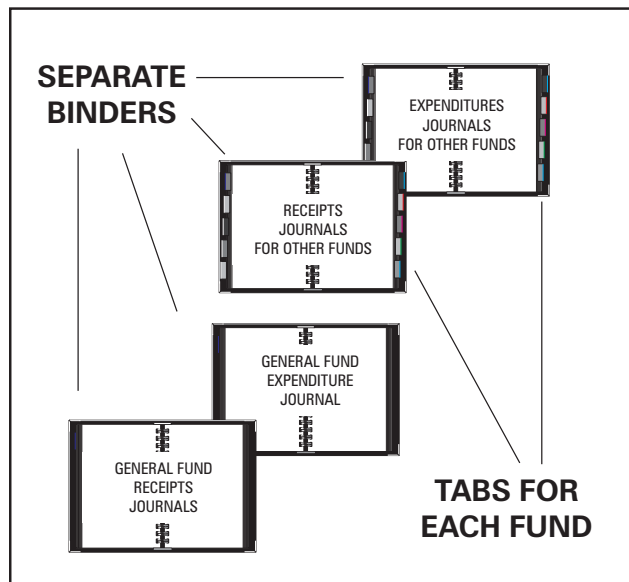
Knowing what books should be maintained is not enough to tell you how to physically organize the books so you can operate efficiently. There are no legal constraints on the number of account books used, or on

FIGURE 5

**FLOW OF ACCOUNTING INFORMATION**

which forms must be kept separate from which. However, some combinations help to minimize errors.

The receipts forms for each fund should be kept together, separated from the receipts forms for other funds. The same holds for expenditures. A separate binder is usually used for receipts forms for the General Fund. This is then called the Receipts Journal of the General Fund. The Expenditures Journal of the General Fund would then be a separate binder used for expenditure forms for this fund.

**Adding a New Fund**

The secretary/treasurer of Township Able used the traditional approach to municipal bookkeeping (they do not use double entry method bookkeeping). The supervisors passed an ordinance establishing a separate fund for street lighting. The secretary set up the accounting for the fund. Here are the steps Township Able followed.

1. Select a chart of accounts for this fund from the DCED Chart of Accounts. This was easy because there is a special account number specifically for "Street Lighting Tax Fund."
2. Set up new sections in the "other funds" binder of the township for the Receipts Journal and Expenditures Journal of the new Street Lighting Tax Fund.
3. Set up Ledger pages for the Receipts/Revenue Ledger and for the Expenditures Ledger... one page for each account.
4. Place a copy of the Charts of Accounts for the Street Lighting Tax Fund in front of each Journal and Ledger.

Since the other funds are normally not used often, it may be convenient to place all of the receipts forms for these funds in one binder and the expenditure forms in another. They should be separated by tabs or index pages so no mistakes are made in recording entries to the individual funds. It is recommended that you choose binders that will lay flat for ease of writing. Standard three-ring binders have proven quite acceptable.

There are two basic ways to set up your General Ledger depending upon whether or not you are using double entry bookkeeping. If you are using double entry, you might establish one binder as a General Ledger for all other funds as shown on the right hand side of the illustration below. Again, the other funds should be separated from each other by tabs.

If you are not using the double entry method, it is recommended that you place the ledger sheets for receipts and revenue accounts in the back of the Receipts Journal, and the ledger sheets for expenditures in the back of the Expenditures Journal for each fund. The resulting binders are shown on the left hand side of the illustration below.

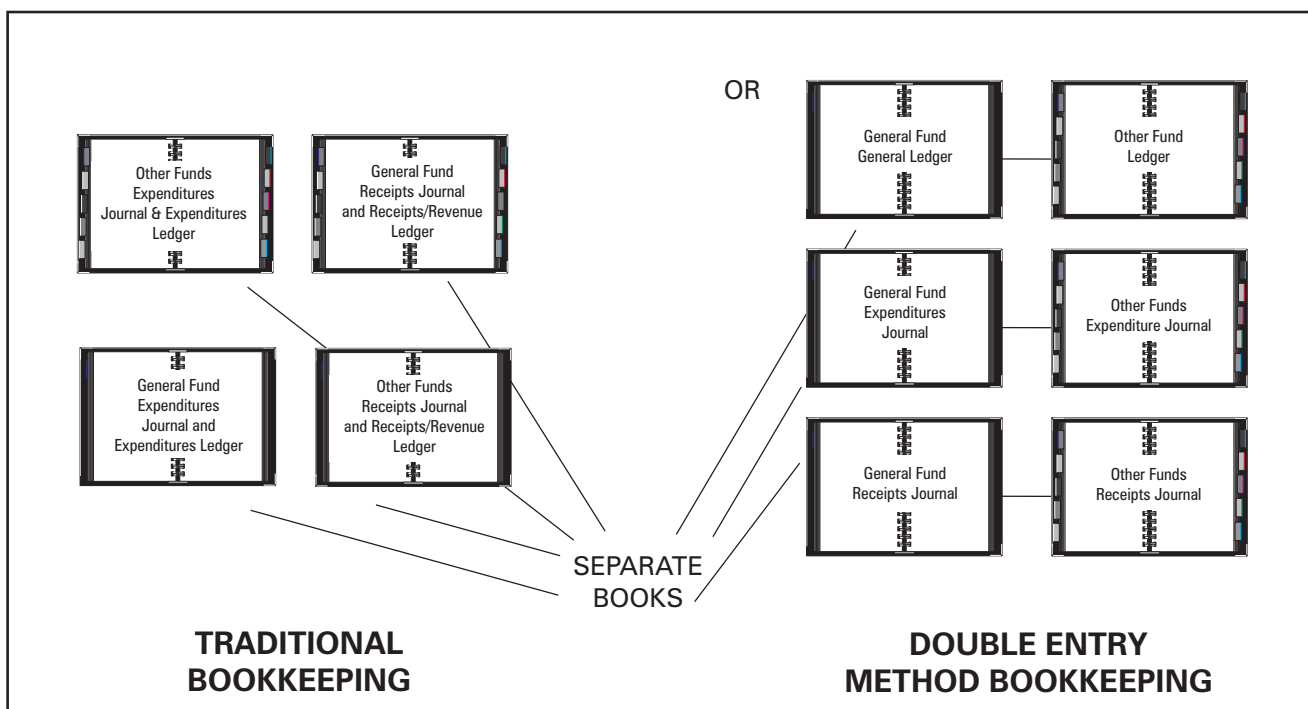
There are no legal constraints on how many binders you use, or on what kind. However, the use of three-ring binders as shown in the illustration has proven effective and efficient.

Some form of General Journal to record corrections and noncash transactions should be added. If a modified accrual system is used, a purchase journal would also have to be added.

## The Chart of Accounts

The account numbering system shown throughout this *Handbook* is based on the Chart of Accounts. The account numbers and descriptions contained in the Annual Audit and Financial Report, Form No. DCED-CLGS-30, correspond directly to the accounts listed in the Chart of Accounts. These account numbers and descriptions are also used in the Department of Transportation forms: Form 903, Treasurer's Account Book; Form 965, Actual Use Report of State Funds.

Prior to 1972, there were different account numbering systems for the respective classes of municipality. While account titles or descriptions were basically the same for each class of municipality, the account numbers were different with no uniformity between classes. The Combined Forms Committee for each class of municipality agreed, in their review and revision of the budget and financial reports, to adopt the chart of accounts referred to in this section as the account numbering system to be used in these reports. As shown in the next figure, the numbers have been divided into three parts: the prefix, the number, and the suffix.



## The Account Number System

For Example: 01.409.20

\*

Prefix	Number	Suffix
Identifies Fund	Identifies the kind	Identifies the
01. General	of account and its	specific expenditure
Fund*	purpose 409	.20 Supplies
	General Government	
	Building Expense	

### Prefix Numbers

The first two digits of the number are the prefix numbers. These identify the fund. In the above example of 01.409.20, the “01” tells you this is the General Fund.\* Prefix numbers for other funds you may establish are listed below.

01. General Fund\*
02. Street Lighting Tax Fund (a special revenue fund)
03. Fire Protection Tax Fund (a special revenue fund)
04. Special Revenue Fund – (as required)
05. Special Revenue Fund – (as required)
06. Water Fund (an enterprise fund)
07. Electric Fund (an enterprise fund)
08. Sewer Fund (an enterprise fund)
09. Enterprise fund – (as required)
10. Special Assessment Bond Fund – Series of \_\_\_\_\_ (a special assessment fund)
11. Special Assessment Bond Fund – Series of \_\_\_\_\_ (a special assessment fund)
12. Special Assessment Bond Fund – Series of \_\_\_\_\_ (a special assessment fund)
13. Special Assessment for Street Lighting Fund
14. Special Assessment for Fire Protection Fund
15. General Obligation Bond Fund – Series of \_\_\_\_\_ (a capital projects fund)
16. General Obligation Bond Fund – Series of \_\_\_\_\_ (a capital projects fund)
17. General Obligation Bond Fund – Series of \_\_\_\_\_ (a capital project fund)
18. Capital Projects Fund – (as required)
19. Capital Projects Fund – (as required)
20. Sinking Fund – Series of \_\_\_\_\_ (a debt service fund)
21. Sinking Fund – Series of \_\_\_\_\_ (a debt service fund)

22. Sinking Fund – Series of \_\_\_\_\_ (a debt service fund)
23. Debt Service Fund – (as required)
24. Debt Service Fund – (as required)
25. Debt Service Fund – (as required)
26. Debt Service Fund – (as required)
27. Debt Service Fund – (as required)
28. Debt Service Fund – (as required)
29. Debt Service Fund – (as required)
30. Capital Reserve Fund (a capital projects fund)
35. Highway Aid Fund (a special revenue fund)
40. Revolving Fund
50. Fire Relief Fund (an agency fund)
55. Fire Pension Fund (a pension trust fund)
60. Police Pension Fund (a pension trust fund)
65. Municipal (Non-uniformed) Pension Fund (a pension trust fund)
70. General Fixed Asset Account
80. General Long-Term Debt Account Group
90. Payroll Fund (an agency fund)

The “01. — General Fund,” and the “35. — Highway Aid Fund” are the minimum funds required of every municipality. Other funds may be established and closed as needed. The funds should be tailored to your specific municipality.

### The Number

The main part of the number, the three digits in the middle, tells you two things: what kind of an account it is (Revenue, Expenditure, etc.) and what the particular account is for. For example, in the number 409.20\* the 409 refers to expenditures for the municipal building. The fact that the number starts with a four (4) means that this is an expenditure.

All 400 accounts are expenditure accounts.

All 300 accounts are revenue accounts.

All 200 accounts indicate liabilities and fund equity.

All 100 accounts indicate assets.

*\*Note: Although 01. refers to the General Fund, usually the number is not actually written because this fund is used so frequently. Thus, the number 409.20 is understood to be in the General Fund.*

### The Suffix

The last two digits of the account number are used to define a specific account. In the example 409.20,\* the

.20 refers to Supplies. When you put the whole number together, it identifies:

01. the General Fund.

409 General Government Building Expense.

.20 for Supplies.

A specific suffix number always means the same thing when it is used with expenditures (400 accounts). For example 403.20\* refers to the tax collector's (403) Supplies (.20); while 456.20\* refers to the library (456), but still identifies Supplies (.20).

When used with the Revenue Accounts (300 accounts), the suffix numbers have different meanings. Refer to the Chart of Accounts in each case to find out what the suffix means.

## Using the Books

### Receipts Journal

All cash received by the municipality from any source should be recorded in this book. Each entry in the book should be supported by a copy of a receipt or a memorandum. The receipts and/or memoranda should be filed in date sequence to provide an audit trail.

The data to be entered in the Receipts Journal is shown by the following form currently used in the Treasurer's Account Book published by the Pennsylvania Department of Transportation.

MS-903A (5-99)

#### FUND RECEIPTS

PAGE \_\_\_\_\_

RECEIVED FROM	NET AMT. Dr.	REC'T. #	DATE	DISTRIBUTION	
				ACCOUNT #	AMOUNT Cr.
BROUGHT FORWARD					
1					
2					
3					

The procedure for using the receipts forms is to record every receipt in the date order it is received, entering whom the money was received from, the account, the receipt number and the date. Write the account number and the amount in the last columns on the page. This completes the original entry in the Receipts Journal.

The Account # used to show what category of receipt was received (taxes, licenses, loans, etc.) should be selected from the Chart of Accounts published by the Pennsylvania Department of Community and Economic Development.

To familiarize you with normal use of the receipts journal, several examples of typical entries are provided.

*Example 1:* Assume that John Smith brings in \$10 for a Zoning Permit. This entry in the Receipts Journal would be:

MS-903A (5-99)

#### GENERAL FUND RECEIPTS

PAGE \_\_\_\_\_

RECEIVED FROM	NET AMT. Dr.	REC'T. #	DATE	DISTRIBUTION	
				ACCOUNT #	AMOUNT Cr.
BROUGHT FORWARD					
1 John Smith	10.00	1	June 1	381.30	10.00
2					
3					

*Example 2:* Suppose Mr. Smith gives you \$20; \$10 is for a Zoning Permit and \$10 is for a Building Permit. To record this receipt, you would use two lines as follows.

MS-903A (5-99)

#### GENERAL FUND RECEIPTS

PAGE \_\_\_\_\_

RECEIVED FROM	NET AMT. Dr.	REC'T. #	DATE	DISTRIBUTION	
				ACCOUNT #	AMOUNT Cr.
BROUGHT FORWARD					
1 John Smith	20.00	2	June 1	381.30	10.00
2				383.41	10.00
3					

*Example 3:* If you have many small receipts of the same kind, such as from selling maps, you may make one entry for the day provided you keep the day's receipts bundled together and properly filed so the auditors can identify the exact receipts included in each entry in the Receipts Journal. For example, the following entry shows the sale of maps as a Miscellaneous Receipt (380). The individual receipts for this entry, which add up to \$24.50, have been stapled together and filed.

*\*Remember the 01. for the General Fund is always understood if no number is written.*



## GENERAL FUND RECEIPTS

PAGE \_\_\_\_\_

	RECEIVED FROM	NET AMT. Dr.	REC'T. #	DATE	DISTRIBUTION	
					ACCOUNT #	AMOUNT Cr.
	BROUGHT FORWARD					
1	<i>Sale of Maps</i>	<i>21.50</i>	<i>3</i>	<i>June 1</i>	<i>3115</i>	<i>21.50</i>
2						
3						

*Example 4:* When depositing receipts in the bank, a practice in many municipalities is to use a line of the receipts journal to show the deposit. This provides an immediate check on the items included in each bank deposit slip.

## GENERAL FUND RECEIPTS

PAGE \_\_\_\_\_

	RECEIVED FROM	NET AMT. Dr.	REC'T. #	DATE	DISTRIBUTION	
					ACCOUNT #	AMOUNT Cr.
	BROUGHT FORWARD					
1				<i>June 2</i>	<i>Deposit</i>	<i>14.25</i>
2						
3						

The entries in the receipts journal should be totaled monthly and balanced. The sum of the totals of the cash column should equal the sum of the totals of the account columns showing what categories the money came from.

You should now be able to set up and maintain the Receipts Journal. You have seen examples of recording simple receipts such as John Smith's \$10 for a zoning permit, and more difficult receipts such as the receipt of \$20 distributed to two separate accounts. An example of combining receipts and of bank deposits has also been presented. In these examples, you used all of the columns in the Journal except the small column headed by a check mark.

The check mark column is used to indicate you have entered or "posted" the information on that line onto the ledger sheets. In the Ledger you keep track of total expenses in each account and of the budget for each account. The section on setting up and using the Ledger provides examples of posting.

## Expenditures Journal

All cash disbursed by the municipality for any purpose should be recorded in this book.

The data that must be entered into the Expenditures Journal for each transaction is shown by the following form, which is also a part of the Treasurer's Account Book.

## FUND DISBURSEMENTS

PAGE \_\_\_\_\_

	PAYEE	NET AMT. Cr.	CHK. #	DATE	DISTRIBUTION	
					ACCOUNT #	AMOUNT Dr.
	BROUGHT FORWARD					
1						
2						
3						

All entries should be supported by a voucher which should, as a minimum, consist of a vendor's invoice and evidence of receipt of the goods or services. The voucher should be verified as to the accuracy of the quantities billed, description of goods or services, unit prices and the totals. Further, an authorized approval for payment should be entered on the invoice. Upon payment, the voucher should be stamped "paid" and the date and/or the disbursing check number recorded. Paid vouchers should be filed alphabetically by vendor.

If a voucher check is used, a copy of the check should be attached to the voucher.

The procedure for recording expenditures is the same as for recording receipts. When you have to distribute the net amount of the check over several accounts, you merely use another line of the page to record each of the accounts that receive portions of the net amount and the portion they should receive.

As with the Receipts Journal, the entries in the cash column and the distribution column should be added and balanced to be certain all entries have been distributed to numbered accounts. Also, as with the Receipts Journal, the check mark column is for use when posting the information onto the ledger sheets. Examples of this are provided in the section on the General Ledger.

## General Journal

This is the book to take care of transactions which cannot be recorded in one of the other books of original entry. Examples of transactions that would be entered in the General Journal are:

1. Changes or corrections to transactions recorded at an earlier time.



2. The opening of the municipal accounts at the beginning of the year.
3. The closing of the accounts at the end of the year.

The data which should be recorded in the General Journal are the date, an explanation of the entry and the pertinent account numbers and amounts. It is important to record a full explanation as a part of every entry in the General Journal so the purpose of the entry can be easily understood by others at a later time. There is no preset form for the General Journal. A variety of locally available accounting forms will serve the purpose. One sample appears below:

Date	Explanation	1 Debt	2 Credit	3

As an example of a General Journal entry, assume that in distributing payroll to the various accounts, \$520 was recorded as salary and wages for "Highways" (account #430) when it really should have been shown as salary and wages for working on "General Recreation Services" (450).

The General Journal entry in a Double Entry Method system would look as follows:

Date	Explanation	1 Debt	2 Credit	3
June 10	In distributing the June 5th payroll an error of \$520.00 was made. This entry is to reallocate that \$520.00 from Highway Services to Recreation Services.			
	Recreation Services, Acct. # 450.00	\$520.00		
	Highway Services, Acct. # 430.00		\$520.00	

The essential characteristics of the General Journal entries include being self-balancing and having a full explanation included as a part of the entry. The above illustration is obviously self-balancing because it contains both a debit and a credit for \$520. The explanation is minimal. It would be proper to include more description of the reason the error was made such as a misread time card or a mathematical error during posting point.

In single entry systems in use across Pennsylvania, the entry might look like this:

June 10 In distributing the June 5th payroll an error of \$520.00 was made. This entry is to reallocate that \$520.00 from Highway Services to Recreation Services.  
 Subtract \$520.00 from  
 Acct. # 430.00 - Recreation Services  
 Add \$520.00 to  
 Acct. # 450.00 - Highway Services

Again, the requirements have been met: a self-balancing entry accompanied by the date and a full explanation of the transaction.

General Journal entries should be entered (posted) immediately to the General Ledger. Since they are not made frequently, it is easy to forget to post the Journal if you wait until the end of the month.

## The Ledger

Here is where the traditional accounting practice and the double entry method part ways. The municipality using the double entry method will create one Ledger for each fund... called the General Ledger. The information from the Receipts Journal, Expenditures Journal and General Journal will come together in this book, but will be integrated correctly through the use of the concept of debit and credit. Ledger sheets will be included in the General Ledger for all municipal assets and liabilities.

Those municipalities using the traditional approach will create two ledgers for each fund; the Receipts/Revenue Ledger for summarizing receipts by account and the Expenditures Ledger for summarizing expenditures by account. General Journal entries will be integrated into one or the other of these Ledgers. However, it will be impossible to have proper ledger sheets for all Assets and Liabilities. Instead, these municipalities should maintain separate lists of assets other than the cash in the checking account and of all liabilities.

Once the ledgers are set up, the instructions for their use are identical until the point of checking whether the ledgers balance. A separate discussion is provided at the end of this ledger section to show the differences.

The Ledgers are not books of original entry. In fact, no entries may be made in the Ledgers unless they have first been recorded in one of the books of original entry.

Typical data which must be entered in the Ledger is provided by the form below, which is part of the *Treasurer's Account Book*.

MS-903B (9-98) **LEDGER** PAGE \_\_\_\_\_

<b>FUND:</b> GENERAL		<b>Type Acct:</b> Expenditure	
<b>Account Category:</b> Public Works - Sanitation Solid Waste Collection and Disposal			
<b>Account Title:</b> Other Services and Charges - Contracted Services		<b>Acct #:</b> 427.45	
Date	Amount Dr.	Amount Cr.	Balance
<b>BROUGHT FORWARD</b>			

The first information a ledger sheet must contain is a detailed identification of the Fund and of the specific account within the Fund. This is provided on the above form by the spaces for:

- Fund
- Type Account
- Account Category
- Account Title
- Account #

To set up the ledger, select the accounts your municipality needs from the Chart of Accounts and fill in the top of a blank ledger form for each account. Remember to include nonrevenue accounts such as Short-Term Liabilities and Tax Anticipation Loans. These may be found in either the 200 or 300 blocks of the Chart of Accounts. For example, receipts from loans are liabilities and would be numbered in the 200s. Transfers from other funds, however, are in the 300s.

Remember to also include the nongovernmental expenditure accounts such as Purchase of Investments and Principal Paid on Bonded Debt. These may be found in the 100 and 400 blocks of the Chart of Accounts. For example, expenditures for Temporary Investments would be Account #120.

In double entry systems, these would be the standard asset and liability accounts selected for the Ledger.

As an example of how to set up the Ledger forms, assume you want to set up an account for your expenditures for contracted services for garbage collection and disposal. In the Chart of Accounts, you would find the following:

**Fund** → **GENERAL FUND**  
**Type Acct.** → **CHART OF EXPENDITURE ACCOUNTS**

Account Number	Classification
<b>426</b>	<b>Public Works - Sanitation</b>
427.00	Solid Waste Collection and Disposal
427.10	Personal Services
427.20	Supplies
<b>427.30</b>	<b>Other Services and Charges</b>
427.50	Contributions, Grants and Subsidies
427.60	Capital Construction
<b>427.70</b>	<b>Capital Purchases</b>
<b>427.80</b>	<b>Depreciation Expense</b>
<b>428.00</b>	<b>Weed Control</b>
420.10	Personal Services
428.20	Supplies
428.30	Other Services and Charges
428.50	Contributions, Grants and Subsidies
428.60	Capital Construction
428.70	Capital Purchases
428.80	Depreciation Expense

The titles to the left are the titles on the same Ledger Form. The proper entry on the sample ledger form for this account is as follows:

MS-903B (9-98) **LEDGER** PAGE \_\_\_\_\_

<b>FUND:</b> GENERAL		<b>Type Acct:</b> Expenditure	
<b>Account Category:</b> Public Works - Sanitation Solid Waste Collection and Disposal			
<b>Account Title:</b> Other Services and Charges - Contracted Services		<b>Acct #:</b> 427.45	
Date	Amount Dr.	Amount Cr.	Balance
<b>BROUGHT FORWARD</b>			

Follow the same instructions for each additional account you wish to add to your ledger.

Note that the account number should really be 01.427.30. The prefix for the General Fund, (01.) was left off. Since the General Fund is used so extensively, the prefix is not used. If no prefix appears it is understood that the account belongs to the General Fund.

## Making Entries or "Posting" from the Receipts Journal to the Ledger

In using the Ledger, there are several ways to enter data onto the forms. One way is to record each amount from the right hand column of the Receipts Journal on the proper page of the ledger. A second approach is to recapitulate the entries at the end of each week or month and post these totals to the Ledger.

Specifically, two items from the Receipts Journal should be written or “posted” in the Ledger: the date and the amount. Which page of the Ledger these are entered on is determined by the “Account #” column on the Receipts Form.

For example, when the \$10 entry for a Zoning Permit was made in the Receipts Journal for John Smith, Account #320.07 was written in the column for Account #.

The second entry where Mr. Smith gave the municipality \$20, \$10 for a Zoning Permit and \$10 for a Building Permit, requires that you post each line. The \$10 for the Zoning Permit would be posted to the Ledger sheet for account #320.07; the \$10 for the Building Permit would be posted to the Ledger sheet for Account #320.02 This is shown by the following illustration:

MS-903A (5-99)

GENERAL FUND RECEIPTS						PAGE
RECEIVED FROM	NET AMT. Dr.	REC'T. #	DATE	DISTRIBUTION		
				ACCOUNT #	AMOUNT Cr.	
BROUGHT FORWARD						
John Smith	100	1	June 1	361.30	100	

Now you should find the ledger page for Account #320.07 (Actually 01.320.07). Enter on that page the date (June 1) and the amount to be distributed to that account (\$10) as follows:

MS-903B (9-98)

MS-903B (9-98)

LEDGER

PAGE \_\_\_\_\_

FUND: GENERAL		Type Acct: Expenditure			
Account Category: Charges for Services - - General Government					
Account Title: Zoning and Subdivision and Land Development Fees			Acct #: 361.30		
Date		Amount Dr.	Amount Cr.	Balance	Budget
June 1	BROUGHT FORWARD		100		

After the entry is made, put a check mark in the Receipts Journal in the small column by the Account # so that you know you have “posted” this entry.

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GENERAL FUND RECEIPTS						PAGE
RECEIVED FROM	NET AMT. Dr.	REC'T. #	DATE	DISTRIBUTION		
				ACCOUNT #	AMOUNT Cr.	
BROUGHT FORWARD						
John Smith	100	1	June 1	361.30	100	

GENERAL FUND RECEIPTS						PAGE
RECEIVED FROM	NET AMT. Dr.	REC'T. #	DATE	DISTRIBUTION		
				ACCOUNT #	AMOUNT Cr.	
BROUGHT FORWARD						
John Smith	200	1	June 1	361.30	100	

MS-903B (9-98)

LEDGER				PAGE _____	
FUND: GENERAL		Type Acct: Revenue			
Account Category: Charges for Services - - General Government					
Account Title: Zoning and Subdivision and Land Development Fees				Acct #: 361.30	
Date		Amount Dr.	Amount Cr.	Balance	Budget
June 1	BROUGHT FORWARD		100		

MS-903B (9-98)

LEDGER				PAGE	
FUND: GENERAL		Type Acct: Revenue			
Account Category: Charges for Services - - Public Safety					
Account Title: Protective Inspection Fees - - Building Permits				Acct #: 362.41	
Date		Amount Dr.	Amount Cr.	Balance	Budget
June 1	BROUGHT FORWARD		100		

Note that there are two amount columns on the Ledger page: Amount Dr. (debit) and Amount Cr. dit). The Receipts Journal forms indicate which column should be used for receipts, because the right hand column is titled Amount Cr. Thus the entry would be “posted” to the column titled Amount Cr. on the ledger sheet.

That completed the entries in all of your books for Smith’s \$20 payment. To review the procedure:

You receive \$20 from John Smith for a Zoning Permit and a Building Permit.

You made a two-line entry in your Receipts Journal.

You entered the date and amount for each line entry on the proper ledger pages.

## Making Entries or “Posting” from the Expenditures Journal to the Ledger

An example of the Journal entry and Ledger posting of an expenditure is shown below. In this example, it is assumed that check number 241 is made out for \$530 to Jones Construction for repair of the Municipal Building — Account #409.37. Accordingly, in the right hand columns of the Expenditure Journal, we enter 409.37 and the total amount of \$530.

MS-903C (9-98)

### FUND DISBURSEMENTS

PAGE

PAYEE	NET AMT. Cr.	CHK. #	DATE	DISTRIBUTION	
				ACCOUNT #	AMOUNT Dr.
BROUGHT FORWARD	<del>4,286.26</del>				
Jones Construction	5300	241	June 1	409.37	5300

To post this entry to the Expenditure Ledger, we find the sheet for account #409.37 (preceded by 01. because this is the General Fund). The date (June 1) and amount (\$530) are entered on this page as shown below. You will note that in this ledger a new balance is computed with every entry, and the remaining budgeted funds are also computed on every line. These computations can also be done once a month if the information is not needed more often.

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### LEDGER

PAGE

FUND: GENERAL		Type Acct: Expenditure			
Account Category: General Government -- General Government Buildings and Plant					
Account Title: Other Services and Charges -- Repairs and Maintenance Services				Acct #: 409.37	
Date		Amount Dr.	Amount Cr.	Balance	Budget
	BROUGHT FORWARD				3500
Feb	2	200		200	3200
Mar	25	400		600	1800
June	1	500		1100	2300

The procedure for completing the ledger forms for Expenditures is the same as for Receipts. The date and amount of each entry in the Expenditures Journal should be posted or written on the page for that account in the General Ledger. The only difference is the Amount column on the Expenditures form is titled “Amount Dr.” for debit. Therefore, when the amount is posted to the Expenditures Ledger, it should be entered in the “Amount Dr.” column.

It is not necessary to post each entry in the Journals to the Ledger. Where the volume of transactions is heavy, the totals for each day or even each week might be posted. The only requirement is that there be an audit trail: that is, it must be possible to trace from each entry in the ledger back through the Journal to the specific journal entry for that transaction.

## The General Ledger — Double Entry Method

In maintaining a General Ledger for double entry bookkeeping, you must formally open the books. This is done at the beginning of the year, before any current transactions are recorded, by entering the remaining balances in the cash and other asset accounts, the liability accounts and the fund balance account. These are the only accounts that will have balances at the beginning of the year.

As an example of Ledger entries in a double entry system, a sample of the Ledger sheet for the Assets account “Cash — Regular Checking Account” is shown below. On this Ledger sheet, the receipt and expenditure entries from the Journals are netted in order to determine the account balance. Since both Debit and Credit entries are made, it is necessary to show the balance on each line.

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### LEDGER

PAGE

FUND:		GENERAL		Type Acct:		Revenue	
Account Category: Taxes -- Real Property Taxes							
Account Title: Real Estate Taxes - Current Year's Levy				Acct #: 301.10			
Date		Amount Dr.		Amount Cr.		Balance	
BROUGHT FORWARD						10,000	
1	Jan 1			5000			
2	Jan 15			1000		12000	
3	Feb 10			3000		92000	
4	Feb 15			6000			
5	Feb 25			3000		24000	
6						5000	

The ledger should be checked at least once a month for errors. This is done by adding together all of the debit balances in the Ledger and comparing that total with the total of all the credit balances. This is called running a trial balance. It gives you a cross check to be sure you have made all of the entries properly. The totals should be equal. If they are not, there is an error in the books that must be tracked down.

The accuracy of the balances in certain of the accounts should be proven by reconciliation or analysis. For example, the balance in the Cash — Regular Checking Account should be reconciled to the bank statement for the same date.



The treasurer of Baker Borough uses the double entry method of municipal bookkeeping. It is the beginning of the year, the General Fund books for last year must be closed and then opened for this year. The steps taken were:

1. Ran a trial balance to be certain that the books being closed were in balance.
2. Made a General Journal entry to do the following:
  - a. Debit all revenue accounts with the amount of their credit balance to bring the balance of the account to zero.
  - b. Credit all expenditure accounts with the amount of their debit balance to bring the balance of the account to zero.
- c. Enter the difference between the sum of the balances of the revenue accounts and the sum of the balances of the expenditures accounts in account 296 - Fund Balance:

As a debit, if the sum of the expenditure accounts exceeds the sum of the revenue accounts.

As a credit, if the sum of the revenue accounts exceeds the sum of the expenditure accounts.

3. Checked to see that the sum of the balances of the asset accounts equaled the sum of the balances of the liability and fund equity accounts.
4. Posted the General Journal entry into the General Ledger.
5. Made and posted a General Journal entry to reduce all of the balances of the asset and liability accounts in last year's books to zero by making debit entries in all accounts with credit balances, and vice versa. For each entry, an offsetting entry was made to place the balance of the account in the new books for this year. The effect these entries represent was that an increase in balances in the asset, liability and fund equity accounts were recopied into the new account books.

## Receipts/Revenue and Expenditure Ledgers — The Traditional Approach

In maintaining separate ledgers for Receipts/Revenue and Expenditures, you have no logical place to record municipal debts or assets other than the cash in the regular checking accounts. At the beginning of the year, you should prepare a separate sheet itemizing both the assets and liabilities.

At least once a month, you should total the receipts on each page of the Receipts/Revenue Ledger, and the Expenditures on each page of the Expenditures Ledger. The totals should be placed in the column headed Balance as shown in the following illustration.

MS-903B (9-98)

LEDGER					PAGE
FUND:	GENERAL			Type Acct:	Revenue
Account Category:	Taxes -- Real Property Taxes				
Account Title:	Real Estate Taxes - Current Year's Levy			Acct #:	301.10
Date		Amount Dr.	Amount Cr.	Balance	Budget
	BROUGHT FORWARD				10,000
1 Jan 1			5000		
2 Jan 15			7000	12000	92000
3 Feb 10			3000		
4 Feb 15			6000		
5 Feb 25			3000	24000	80000
6					

If you need totals more often, you can enter the new total in the Balance column every time you make an entry. In the above illustration, the balance for January is \$1,200; the balance for the two months, January and February is \$2,300.

Each month, check your ledgers to be certain that all entries have been properly made. This is done by adding together the totals or balances on each page of the Receipts/Revenue Ledger and comparing this sum with the total receipts received during the year. The totals should be the same. If they are not, there is an error in the books that must be found.

Each month, you should add together the balances on each page of the Expenditures Ledger and compare it to the total expenditures during the year. Again the totals should be the same. If they are not, you must track down the error.

## All Ledgers

The Budget column of the Ledgers is important and should be used to show the current approved budget for all revenue and expenditure accounts. It can be used in whatever way is most convenient to you. One

of the frequently used techniques is shown in the preceding illustration. The yearly budget amount is recorded on the first line. At the end of the month when you are totaling the receipts in that account, the total received to date is subtracted from the budget and the remainder of the budget is entered on the same line as the total received to date. For example, in the figure above, the budgeted amount for Account #342.02 is \$10,400. Since \$1,200 was received in January, that leaves \$9,200 as the remaining portion of the budgeted amount still outstanding at the end of January.

The comparison of actual revenues or expenditures with budget estimates provides management with the necessary information to control existing programs within the remaining budget limitations.

Monthly financial statements should be prepared directly from the Ledger. For a discussion of these statements, refer to Chapter VII, Fiscal Management Techniques.

### Purchase Journal or Voucher Register

*This book will only be used by those municipalities maintaining their books on a modified accrual basis* (recording expenses when they are incurred instead of when they are paid). Entries should be made when the liability for the expenditure is incurred upon receipt of the vendor's bill.

The data which must be entered in the Purchase Journal is the same as that required for the Expenditures Journal. The only difference is that instead of recording a decrease (or credit) to Cash, as would be done in the Expenditures Journal, the credit is made to Accounts Payable. When actual payment is made, the payment then will be recorded in the Expenditures Journal as a decrease (or credit) to Cash and a debit to Accounts Payable.

For example, suppose that Blank Borough decided to purchase a sign machine for \$900. They obtain bids and send a purchase order to the low bidder for the machine. The following accounting entries would be made upon receipt of the vendor's invoice.

EXPENDITURES		LIABILITIES	
Minor Equipment Purchase		Accounts Payable	
debit	credit	debit	credit
\$900			\$900

These entries represent an increase in expenditures for the purchase of a sign machine. They also represent an increase in liabilities because the borough has committed itself to the expenditure.

Later, Blank Borough will pay the invoices; the entries at that time will be:

ASSETS		LIABILITIES	
Cash		Accounts Payable	
debit	credit	debit	credit
	\$900	\$900	\$900

These underlined entries show the decrease in cash which results from issuing the check, and the decrease in liabilities which results from payment of the bill. As indicated in the Liabilities account, the former entry of \$900 and this entry cancel each other out. This is proper. The objective of Accounts Payable is to record expenses at the earliest possible time to provide the most up-to-date picture of the municipal finances at all times.

The support data for entries in the Purchase Journal is the same as for the Expenditures Journal described earlier. All entries should be supported by a voucher, which should be verified, approved and filed in date order.

The entries in the Purchase Journal should be totaled and balanced monthly. The totals should then be entered or posted in the General Ledger under the appropriate account numbers.

### Payroll Accounting

Accounting for payroll is probably the most difficult and time-consuming portion of the municipal treasurer's job. The requirements to withhold more and different kinds of taxes, unemployment and social security contributions, insurance, pension, and other fringe benefits create accounting problems. The additional requirement to deposit or remit the individual withholdings at different times to different agencies by certain deadlines compounds those problems. The individuals being paid have usually worked on more than one type of activity in the municipality, so the payroll amounts must be distributed over several accounts in the municipal books. Accurate payroll records are extremely important, especially as they relate to the Highway Aid Fund.

Bookkeepers who work without professional advice may unknowingly make the task even more complex. In many cases, for example, bookkeepers will distrib-



ute the net payroll to the various highway, park and recreation, administrative and other accounts. Later, they will distribute the federal income tax withheld. At still another time, they will distribute the state income tax withheld, the local tax withheld, etc. This is unnecessary, and the added complexity which results can create many errors in the books.

There are several alternative approaches to handling payroll. Some of them are listed below with brief descriptions of their advantages and disadvantages. Following that, one method is selected and described in more detail to provide specific guidance to the municipal employee responsible for payroll.

The alternative approaches include:

1. Preparing payroll checks from the General Fund account. Frequently, these checks are signed by more than one official making the system cumbersome. Furthermore, transferring payroll funds from the Highway Aid Fund and other funds tends to make bookkeeping complex and to increase the chance of error.
2. Establishing a separate checking account for payroll within the General Fund and transferring gross payroll into the account. This is simpler, but still requires passing payrolls for other funds through the General Fund.
3. Establishing a separate checking account for payroll within the General Fund and transferring net payroll into the account. In addition to the above problems, under this method a double entry system should be maintained so the various withholdings can be recorded as liabilities at the time of payroll preparation.
4. Establishing a separate checking account and a separate fund for handling payroll. Normally, creating another fund is not recommended, but it is the cleanest and simplest approach to handling the problem.

This handbook recommends the third alternative — the General Fund — as the approach that is least likely to result in accounting errors and most likely to be acceptable to the municipal treasurers. Accordingly, that approach is described in some detail in later portions of this section. First, the specific tasks involved in the handling of payroll will be described.

## Payroll Activities

What is really involved in the task of payroll? Many officials not directly involved have a difficult time understanding the complexity. The best suggestion is to

sit down and learn to make out the payroll yourself. In the absence of the time and opportunity to do that, here is a capsule description of the step-by-step process involved:

1. Obtain time cards from each employee showing regular and overtime hours and distributing the hours to various funds and accounts.
2. Verify the cards are properly made out, properly signed and mathematically correct.
3. Compute gross pay for each employee (including calculation of overtime pay).
4. Compute tax deductions for each employee (F.I.C.A., federal withholding, state income tax, local taxes).
5. Compute other deductions for each employee (insurance, pension, etc.).
6. Determine net (take-home) pay for each employee.
7. Complete an earnings record for each employee.
8. Prepare payroll check and stub record for each employee.
9. Complete a payroll summary to compute total net payroll, total F.I.C.A. withheld, total federal income tax withheld, total state income tax withheld, total local taxes withheld, total insurance payments withheld and others.
10. Calculate the gross payroll amounts to be distributed to each account in each fund where work was performed.
11. Prepare checks to transfer any net payroll from the other appropriate funds to the General Fund.
12. Make accounting entries in each fund distributing the gross payroll to the proper accounts.
13. Distribute net payroll checks to employees.
14. Obtain the matching amount for the municipal contribution to the F.I.C.A. payment from General Fund and other funds. (Also obtain municipal contributions to shared insurance payment if applicable.)
15. Deposit the F.I.C.A. withheld monthly or quarterly as required depending on the size of the payroll.
16. Deposit the federal income tax withheld monthly or quarterly as required.
17. Send the state income tax to the Pennsylvania Department of Revenue monthly or quarterly as required.
18. Send insurance, pension and other withholdings to the proper agencies as required.

19. Reconcile the cash balance in the General Fund and other funds with the checks outstanding, and with the federal, state and other payments not yet made.
20. At the end of the year, prepare:
  - W-2 forms for each employee.
  - W-3 forms for IRS or Income Tax withheld.

Not later than January 31 of each year, the law requires employers to furnish each employee from whom income taxes have been withheld the Wage and Tax Statement, Form W-2. For an employee terminating before the end of the year, the W-2 should be issued within thirty days of termination. Deductions made or F.I.C.A. must also be shown on the W-2 form. Each W-2 and other tax reports must contain the employer's identification number in the upper right corner block.

At least four copies of the W-2 form are prepared. Copy A goes to the Internal Revenue Service Center with the fourth quarterly report. Copy B and C are furnished to the employee. Copy D is kept by the employer for records. Additional copies may be furnished the employee for state and local income taxes.

Those are the steps involved in preparing and accounting for the municipal payroll. With all of the calculations and duplicate entries required, there is much opportunity for error. Accordingly, the simplest system for handling payroll is desirable.

## The Payroll Fund and Payroll Forms

The simplest approach to handling payroll for municipalities without double entry accounting systems appears to be the establishment of a Payroll Fund. Then any other fund which incurs payroll costs. . . the General Fund, the Highway Aid Fund, the Sewer Fund, Water Fund. . . merely transfers the gross amount of the payroll cost to the Payroll Fund. All employee checks and withholding payments are drawn from the Payroll Fund directly.

The sequence of activities involved in taking care of payroll requires a series of forms for payroll accounting. Employees hand in a time card or time sheet indicating which funds they worked for and which accounts within those funds should be charged for their time. These time cards or time sheets are the original invoices for the Payroll Fund. It is these time records the auditor will verify.

Time records can take a variety of forms depending on the desires of the municipality. The essential informa-

tion is simply the dates, the employee's signature, and the number of hours worked on each account. Employees must fill in the different accounts they worked on. The form should be signed by the immediate supervisor to verify that the work was completed. As with any vouchers, the time sheet should be approved by the elected officials. A sample combined time sheet and Payroll Journal is shown in Figure 8 on page 50.

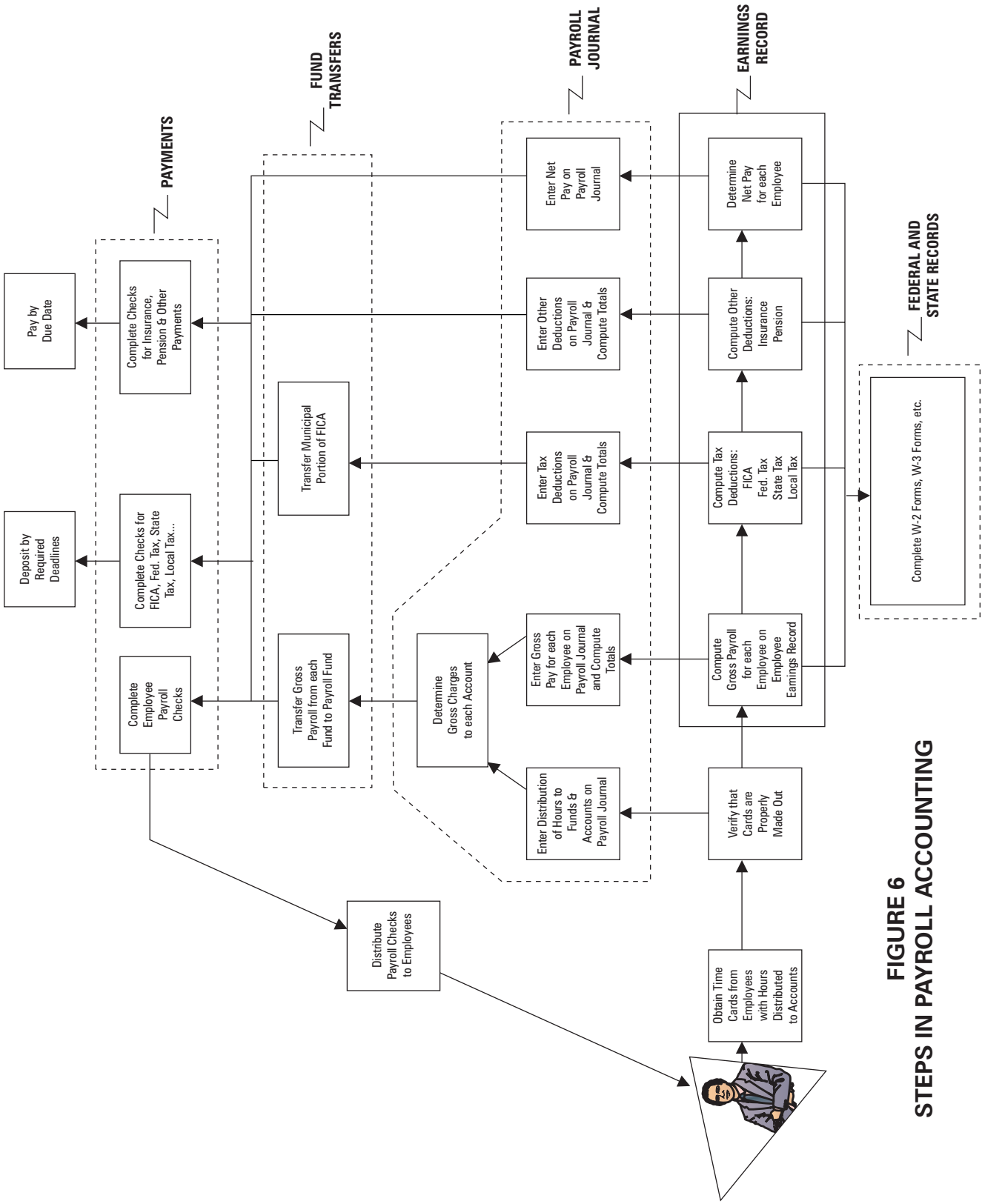
Information from the time cards is recorded in two places. The total hours worked are recorded on the Employee Earnings Record for the computation of gross salary and withholdings; and, the percentage of time worked by the employee on each account and/or each fund is recorded in the Payroll Journal so you can compute the proper amounts to be entered in the municipal books for each account.

A copy of a typical Employee Earnings Record is provided in Figure 7 on page 49. As you can see on this form, for the period ending October 13th, John Smith worked 40 regular hours, and ten overtime hours. Since his rate is \$3 per hour, his regular earnings are shown as 3 x 40 or \$120. His overtime earnings, since his municipality pays time and a half for overtime, are 3 x 1-1/2 x 10 or \$45. Thus his total earnings are shown as \$165. The taxes and other deductions are computed according to the applicable tables and regulations available from the taxing agencies.

The data on the Employee Earnings Record not only provides the base for the payroll activity, but also provides the history of each employee's earnings required for end-of-year reporting such as the W-2 forms.

A copy of a typical Payroll Journal is shown in Figure 8 on page 50. The percentage of time spent by John Smith on each account should be multiplied by his gross pay and the result entered on the right hand side of the form. For example, John Smith is receiving \$165 this pay period. His time sheet showed that he spent 52 percent of his time (26 out of 50 hours) working on general municipal snow and ice removal (432.00), and 48 percent of his time on a Highway Aid project for street markings (35.433.00). Therefore, 52 percent of his pay, or \$85.80, should come from the General Fund where it should be charged against salaries on the snow and ice removal account (432.00), and 48 percent of his pay, \$79.20, should come from the Highway Aid Fund where it should be charged against salaries on the Street Signs and Markings account (35.433.00).

The information on taxes and other withholdings should be transcribed as is from each individual Employee Earnings Record to the Payroll Journal.



**FIGURE 6**  
**STEPS IN PAYROLL ACCOUNTING**

FIGURE 7  
EMPLOYEE EARNINGS RECORD

EMPLOYEE EARNINGS RECORD																
NAME <i>John Smith</i>					SOCIAL SECURITY NUMBER <i>123-45-6789</i>											
ADDRESS <i>123 Main Street</i>					DATE EMPLOYED <i>January 1, 2005</i>											
TOWN <i>Penna.</i>					DATE TERMINATED											
TELEPHONE NUMBER <i>238-3848</i>					NUMBER OF EXEMPTIONS <i>2</i> Single <input type="checkbox"/> Married <input type="checkbox"/>											
DATE OF BIRTH <i>April 7, 1931</i>					OTHER DEDUCTIONS <i>NONE</i>											
Period Ending	Hourly Rate	Reg. Hours	Over-time Hours	Reg. Earn.	Over-time Earn.	Other	Total Earn.	Fed. Tax	Social Sec.	State Tax	Local Tax	Ins.	Other Deduct.	Net Pay	Check No.	Cumulative Earnings
Oct. 6	3.00	BALANCE BROUGHT FORWARD														4873.22
Oct. 13	3.00	40	10	120.00	45.00	-	165.00	19.50	8.58	3.80	1.65	2.50		128.97	2453	5038.22
Oct. 20	3.00	40	-	120.00	-	-	120.00	12.70	6.24	2.76	1.20	2.50		94.60	2472	5158.22
Oct. 27	3.00	40	-	120.00	-	-	120.00	12.70	6.24	2.76	1.20	2.50		94.60	2491	5278.22

Each employee will only require one line on the Journal. The Journal provides the information required to request money from the other funds.

When all of the employees' earnings have been entered on their individual Employee Earnings Records and transcribed to the Payroll Journal, each column of the Payroll Journal should be totaled. The totals to the right tell you how much money to draw out of the General Fund, the Highway Aid Fund and any other funds your municipality may be using. Specific account columns under each fund tell you the proper accounting entries for distributing the payroll when you make the check out for each fund. As you can see on the sample payroll journal, \$211.20 should be drawn from the Highway Aid Fund and \$173.80 from the General Fund. The totals to the left of the Payroll account distribution, (federal tax, social security) tell you how much money should be deposited or paid for each of the withholdings made.

The time cards, the Employee Earnings Records and the Payroll Journal make up an almost complete payroll system. The remaining parts of the system are the payroll check and the check stub. The check stub maintains a record of the receipt of money from each

fund. It also keeps you apprised of your bank balance.

The Payroll Fund should be opened with some minimal amount. Each pay period, a deposit should be made to exactly cover the checks written. After the checks are issued, the bank balance should return to the minimal amount deposited when the account was opened. If it does not, you should immediately check to determine whether an error has been made.

One other feature of payroll withholdings should be noted. The social security payments withheld from the employees must be matched by the municipality. The total social security deposit will be twice the amount withheld from the employees. It is recommended that the municipality contribution for social security also be deposited into the Payroll Fund and one check written for the combined amount when the social security payment is made.

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MUNICIPALITY WEEKLY, BI-WEEKLY OR SEMI-MONTHLY PAYROLL REPORT

Period Beginning \_\_\_\_\_

(YEAR)

Period Ending \_\_\_\_\_

(YEAR)

Payroll Number \_\_\_\_\_

page 1

COUNTY

MUNICIPALITY

NAME S.S.#			1	2	3	4	5	6	7	8	9	10	11	12	13	14	15
			16	17	18	19	20	21	22	23	24	25	26	27	28	29	30
1	Hours																
s.s.#	Code #																
2	Hours																
s.s.#	Code #																
3	Hours																
s.s.#	Code #																
4	Hours																
s.s.#	Code #																
5	Hours																
s.s.#	Code #																
6	Hours																
s.s.#	Code #																
7	Hours																
s.s.#	Code #																
Description Code # :																	
430.99 Agility																	
431 Cleaning Sts. & Gutters																	
432 Winter Maint. Services																	
433 Traffic Control Devices																	
436 Storm Sewer & Drains																	
437 Repairs of Tools & Machinery																	
438 Maint. & Repairs of Roads &																	
Bridges																	
o 1 Structural																	
o 2 Surface																	
o 3 Shoulders																	
o 4 Roadside																	
5 Guardrails																	
439 Highway construction and rebuilding projects																	
Location by Name, Route or Project Number																	
\$ -		\$															
Totals																	
Superintendent -																	
Roadmaster - Foreman																	
Supervisor/Council Person																	
Instructions and distributions on page 2.																	



## Shortcuts, Mechanical Aids and Automated Services

Because of the increasing complexity of municipal accounting, and the frequently changing state and federal regulations on taxes and withholdings, more and more communities are looking for techniques to simplify their accounting and bookkeeping functions. There are two basic approaches to making this function more efficient: one is to purchase mechanical aids; the second is to purchase a service to take care of the accounting/bookkeeping problems for you.

Mechanical aids can range from simple adding machines and calculators to personal computers used for a variety of municipal problems. In the small to medium-sized municipalities toward which this handbook is directed, there is seldom a requirement for large, expensive computers. However, personal computers are now available on the market within the means of even small municipalities. Specialized software programs to handle the payroll function are available from vendors.

There is one form of mechanical aid available to many small to medium-sized municipalities, and it is well within the reach of their finances. This is the “peg board” system for handling payroll. Payroll is one of the most confusing and time-consuming administrative tasks in the small municipality. Payroll information must be recorded on earnings records, monthly payroll journals and check stubs. It must be summarized for F.I.C.A., federal income tax withholding, state income tax, local taxes and others. The “peg board” systems minimize the amount of duplication in this complex process.

With this system, the three records required (Earnings Record, Payroll Journal and Check Stub) are placed on top of one another with carbon paper in between (specially treated paper may also be used). The treasurer writes all of the pertinent information on gross pay, withholdings and net pay through the carbon paper. This minimizes both the time required and the chance for errors in recopying the information. The cost of systems suitable to municipal payrolls is less than \$300.

Automated services are also a distinct possibility for the small to medium-sized community. Although these services appear to cost more than “doing-it-yourself,” frequently that is a misimpression. The overhead costs in these services are compensated for by the greatly increased efficiency with which they can handle your accounts.

Payroll services are offered by many local banks at a small fee per check. The banks minimize the cost because they get the advantage of having your deposit in their bank.

General municipal accounting services are offered by several firms in Pennsylvania at the present time. These services include an entire range of payroll services, automated billing services, municipal bookkeeping, financial control systems and any other special requirements of the municipalities. Your state-wide municipal association can provide guidance in contacting these firms.

Figure 9 on page 53 presents a sample municipal payroll summary form to account for personnel costs on an annual basis.



FIGURE 9

## MUNICIPAL PAYROLL SUMMARY

COUNTY	MUNICIPALITY		YEAR
<b>FIRST QUARTER REPORT</b>			<b>SECOND QUARTER REPORT</b>
Quarterly Gross Payroll	\$	-	Quarterly Gross Payroll \$ -
With-holding Tax	\$	-	With-holding Tax \$ -
Social Security Tax	\$	-	Social Security Tax \$ -
SS/ Med Tax	\$	-	SS/ Med Tax \$ -
State Tax	\$	-	State Tax \$ -
Local Earned Income Tax	\$	-	Local Earned Income Tax \$ -
Other 1	\$	-	Other 1 \$ -
Other 2	\$	-	Other 2 \$ -
Other 3	\$	-	Other 3 \$ -
Quarterly Net Payroll	\$	-	Quarterly Net Payroll \$ -
Highway Aid	\$	-	Highway Aid \$ -
General Fund	\$	-	General Fund \$ -
Other	\$	-	Other \$ -
<b>THIRD QUARTER REPORT</b>			<b>FOURTH QUARTER REPORT</b>
Quarterly Gross Payroll	\$	-	Quarterly Gross Payroll \$ -
With-holding Tax	\$	-	With-holding Tax \$ -
Social Security Tax	\$	-	Social Security Tax \$ -
SS/ Med Tax	\$	-	SS/ Med Tax \$ -
State Tax	\$	-	State Tax \$ -
Local Earned Income Tax	\$	-	Local Earned Income Tax \$ -
Other 1	\$	-	Other 1 \$ -
Other 2	\$	-	Other 2 \$ -
Other 3	\$	-	Other 3 \$ -
Quarterly Net Payroll	\$	-	Quarterly Net Payroll \$ -
Highway Aid	\$	-	Highway Aid \$ -
General Fund	\$	-	General Fund \$ -
Other	\$	-	Other \$ -
<b>ANNUAL REPORT</b>			
Quarterly Gross Payroll	\$	-	
With-holding Tax	\$	-	
Social Security Tax	\$	-	
SS/ Med Tax	\$	-	
State Tax	\$	-	
Local Earned Income Tax	\$	-	
Other 1	\$	-	
Other 2	\$	-	
Other 3	\$	-	
Quarterly Net Payroll	\$	-	
Highway Aid	\$	-	
General Fund	\$	-	
Other	\$	-	

## VII. Fiscal Management Techniques

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The day-to-day management of municipal finances will determine how successful you are in following the annual budget. This management function consists basically of administrative procedures and budget controls.

The main controls you exercise over municipal expenditures should include:

- Quarterly allotments of funds to control the time during the year when expenditures are made.
- A purchasing system assuring responsible officials or employees approve purchases in advance, and assuring sufficient funds are available to pay for the purchases.
- A system of numbered vouchers and receipts to provide organized evidence of payments made by and to the municipality.
- Periodic financial reports to illustrate the revenues and expenditures to date, the unpaid bills and purchase orders outstanding and the unencumbered balance remaining.

The controls and the administrative procedures to implement them are discussed in the sections which follow. There are also discussions of procedures for financing capital improvements; for managing short and long term municipal indebtedness; and for temporarily investing idle funds to provide additional income to pay for the costs of municipal government.

### Cash Flow Management

Municipal expenses occur throughout the year in a fairly predictable pattern, generally similar from year to year. The flow of cash into the municipality from taxes, fees, highway aid and other sources also occurs each year in a consistent pattern. The problem of cash flow management is simply planning and arranging your expenditures throughout the year so revenues available at any given time are adequate to make invoice and payroll payments on schedule. When cash flow is not managed properly your municipality will find it necessary to delay payment of invoices from suppliers or to borrow short-term money to make the payments. Either a delay in payment or unexpected borrowing can result in extra costs to your municipality and should be avoided whenever possible.

Good cash flow management is essentially a planning function. It requires advance planning of your pattern

of budgeted expenditures throughout the year based on the times revenues are expected. You may have developed a balanced budget for an entire year, yet find a serious imbalance between cash on hand and current obligations some time during the year. This is the distinction between budget planning and cash flow planning.

Tables 5 and 6 on page 54 illustrate a simple method you can use to project cash receipts and expenditures throughout the year. Table 5, dealing with cash, contains your estimates of monthly cash receipts in each of several categories. These estimates can be obtained from your past records. It is only necessary to determine the average, over several years, of the cash receipts you experienced in each category, adjust it to the conditions of the present year, and insert it into the form. The beginning balance for the year is shown as a cash inflow in January only. When the form is completed, you total the receipts across the form for each month and then keep a cumulative sum in the right-hand column of total receipts throughout the year.

A similar method is used in the expenditures estimate form of Table 7 on page 54. To assure a solid cash position, the cumulative receipts column must be larger at the end of each month than the cumulative expenditure column. The amount of difference between cash and expenditures, or the "net cash on hand" your municipality should attempt to maintain, will differ from municipality to municipality depending on the size of budget, nature of planned projects and a variety of other factors. In planning for this cushion, you should attempt to maintain adequate cash to take care of possible emergencies such as the need for an expensive truck overhaul, the need for additional part-time employees, and other expenses arising unexpectedly. In many cases, excess cash is being kept in noninterest bearing accounts. This practice results in unnecessary loss of revenue to the municipality. On the other hand, failure to keep adequate cash for emergencies can result in the need for tax anticipation loans.

In larger municipalities which use monthly or quarterly allotments for each department or municipal agency, the use of cash flow planning and management will aid in determining the timing and amounts of the allotments.

TABLE 5 EXAMPLE OF GENERAL FUND CASH RECEIPTS PROJECTION							
	Balance Forward	Real Estate Tax Receipts	Occupation Tax Receipts	Act 511 Receipts	Anticipated Federal and State Aid	Total Cash Receipts	Cumulative Cash Receipts
JANUARY	8500	2000	500	1800		12800	12800
FEBRUARY		2000	500	2700	5000	10300	23100
MARCH		3000	500	2900		6400	29500
APRIL		2000	900	2500		5400	34900
MAY		20000	1100	2200	1000	23300	58200
JUNE							
JULY							

DECEMBER							
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TABLE 6 EXAMPLE OF GENERAL FUND EXPENDITURE PROJECTION						
	Payroll	Supplies & Materials	Services (legal, eng.)	Special Projects	Monthly Expenditures	Cumulative Expenditures
JANUARY	5900	1000	800	0	7700	7700
FEBRUARY	6400	1000	1300	0	8700	16400
MARCH	4800	1000	800	0	6400	20800
APRIL	4000	1000	800	8000	13800	34600
MAY	2000	8000	1300	5000	9300	43900
JUNE						

DECEMBER						
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TABLE 7 EXAMPLE OF CASH POSITION SUMMARY							
	JANUARY	FEBRUARY	MARCH	APRIL	MAY	JUNE	DECEMBER
Receipts	12800	23100	29500	34900	58200		
Expenditures	7700	16400	20800	34600	43900		
Cash Position	5100	6700	6700	300	14300		

## Petty Cash Control

From a practical standpoint, nearly every municipality needs a petty cash fund to handle small disbursements for such items as postage, small quantities of minor office supplies, express charges on shipment of goods and similar items. The items purchased from a petty cash fund still must be accounted for and these expenditures must be reflected in the municipal books of account. This section will outline a relatively simple method of petty cash control to satisfy accounting and auditing requirements, and yet not place an unduly heavy burden on the clerk or secretary.

The first tasks are to designate some employee or official of the municipality to be responsible for petty cash, and to establish the amount of cash needed.

The major steps in establishing and maintaining the petty cash system are as follows:

1. Designate a petty cash custodian—usually the secretary, treasurer or clerk.
2. Determine the amount needed. This will vary depending on the specific municipality, however an amount of \$100 to \$150 is usually appropriate.
3. Prepare a Petty Cash Book to record all petty cash transactions.
4. Write a check from the General Fund to the person responsible for the Petty Cash Book.
5. As petty cash expenditures are made, record the amounts and the account numbers. Keep vouchers and receipts.
6. Periodically write further checks to the responsible person in order to replenish the fund.

Figure 10 is an illustration of a page from a Petty Cash Book which you may adopt for your municipality. As shown, the check from the General Fund made out to the Petty Cash Custodian on January 1, 2003, establishes an initial balance of \$50. During the month of January, as expenditures are made, the date, purpose, amount and the account number are recorded, along with a running balance. In this example, at the end of January, the balance remaining is \$27. On the first of February, a check is written in an amount sufficient to bring the Petty Cash back up to \$50. In this case, the check would be for \$23. All of the expenditures made during January (which total \$23) are then entered in the General Fund Expenditures Journal from which the check was drawn. The Petty Cash Book serves as the voucher for each of the expenditures, and the entries in the Expenditures Journal assure all funds are accounted for. This process, followed each month, maintains the level of the fund at the predetermined amount.

FIGURE 10 PETTY CASH BOOK

Date	Item	Amount of Expenditure	Amount of Deposit	Account Number	Balance
1/1/2003	GF-Check #001		\$50.00		\$50.00
1/7/2003	Postage Due	\$1.90		400.20	\$48.10
1/7/2003	Express Charge	3.20		430.20	\$44.90
1/27/2003	Tax Charge	2.90		430.20	\$42.00
1/31/2003	Postage Due	15.00		430.20	\$27.00
2/1/2003	GF-Check #010		23.00		\$50.00

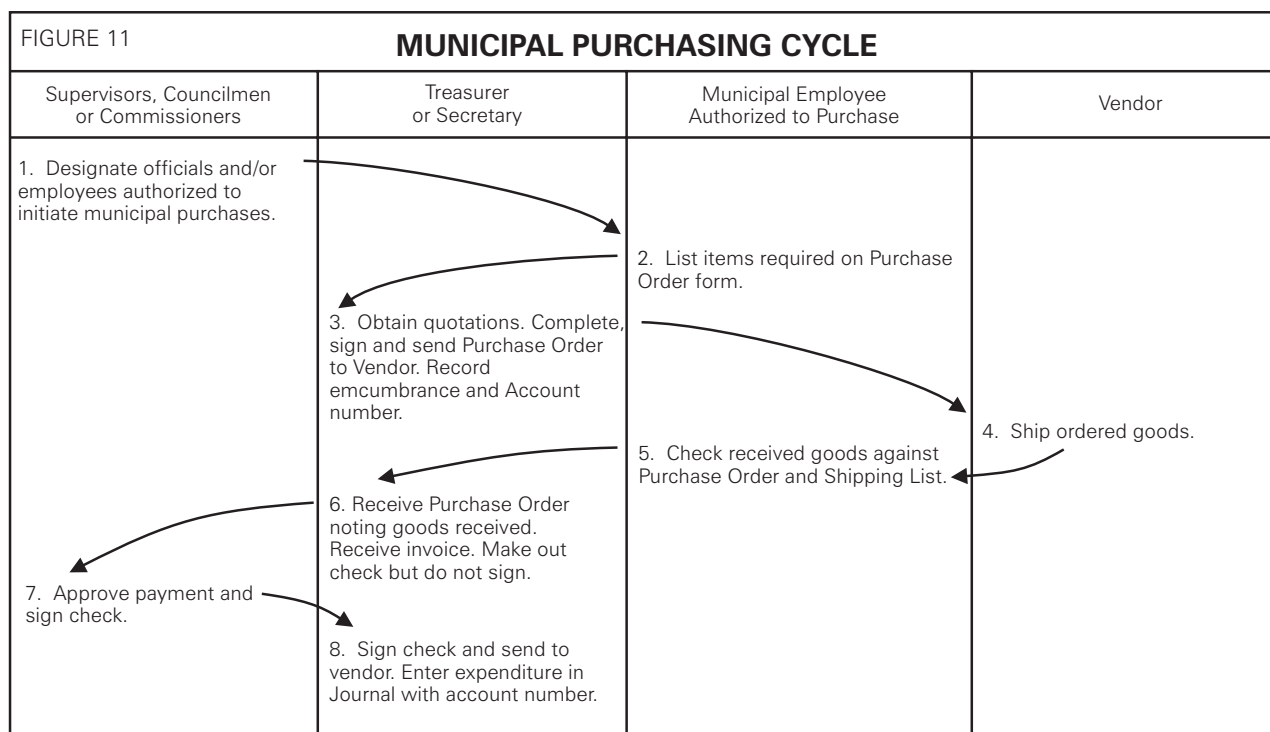
Several cautions should be noted with respect to Petty Cash. First, Petty Cash should be used only for small expenditures of an emergency nature, where payment must be made on the spot. All other expenditures should be brought before the governing body for approval. In addition, you should avoid buying such items as pencils, tape, paper, nuts and bolts and similar items from Petty Cash. You nearly always can obtain a better price by buying such items in quantity using the normal purchase order process. Petty Cash should only be used for emergency needs, and not as a substitute for proper purchasing procedures.

## Purchasing Controls

The purchasing of materials, supplies and services by municipal governments is often handled in a fairly formal way, with little control or uniformity in procedures for recording and accounting. For a small township with no full-time employees except a supervisor/ roadmaster, complicated systems of requisition forms, purchase orders and procedures may not be appropriate. However, as a minimum, all municipalities should have controls over their purchases that accomplish at least the following:

1. Assure materials and services are ordered only by authorized employees and officials.
2. Purchases over \$10,000 are advertised and bids obtained in accordance with the respective municipal codes.
3. Purchases between \$4,000 and \$10,000 are made only after three telephone or written price quotations have been obtained. Records of these price quotations must be retained for three years.
4. Assure ordered goods are actually received prior to authorizing payment.
5. Identify monies encumbered for those purchases ordered, but not yet received.

In this section, a relatively simple purchasing procedure is presented, along with several sample forms used to implement the procedure. This procedure may be modified and adjusted to the particular needs of your municipality, and it is particularly adaptable to



small municipalities without a large staff or a separate purchasing department.

Figure 11 illustrates the major activities and responsibilities of municipal officials and employees in the purchasing cycle. Each of the steps shown in the figure are described below.

1. The governing body designates those municipal officials or employees who are authorized to initiate purchase orders and disseminates that information to all who are involved in the municipal purchasing process.
2. The municipal employee or official authorized to make purchases prepares a listing of all needs on a Purchase Order Form. A sample of a Purchase Order Form is shown in Figure 12. With this form, a separate requisition form is not required. The person authorizing the purchase fills in only the description and number of units required and signs in the lower right above "authorized signature." The form is then forwarded to the municipal secretary or treasurer.
3. If the purchase will amount to more than \$10,000, bids must be obtained as required by the municipal codes. Even for purchases of less than \$10,000, bids are usually desirable, how-

ever, these may be received more informally; perhaps through telephone calls or letters to potential bidders. Figure 13 on page 58 is a sample of a form to be used to request quotations from vendors. On high cost items, a bid bond might be appropriate on the advice of your solicitor.

When firm prices are received, or formal bids tabulated, the balance of the Purchase Order Form is filled out to include the name of the vendor, purchase order number and the expenditure account to be charged. In addition, the treasurer or finance officer signs the form to certify sufficient municipal funds are available to pay for the purchase.

Even though no accounting entry is made when the purchase order is sent out, the money for the amount of the purchase is actually encumbered. It is desirable to have a record of the amount of encumbered money at any time so you can adjust your financial report to reflect the expenditures and the encumbrances as they affect your financial position. For this purpose, you may find the Record of Outstanding Purchases form shown in Figure 14 a useful informal accounting device. As each purchase order is sent out, the amount, date and account number are recorded.



FIGURE 12  
PURCHASE ORDER

FIGURE 13  
REQUEST FOR QUOTATION

Date 3/3/93  
 Requisition No. 14

Bids will be received until 5:00 PM on 3/27 1993 at the office of the borough secretary.

Quotations are requested for furnishing the items described below in accordance with terms set forth herein. All quotations must be F.O.B. destination and include the cost of loading and cartage to delivery point stated below.

Quantity	Unit	Description and Specification	Price per Unit		Total Unit Price
			Trade or Government Discount	Net	
8	each	Tires, 8.15x15 Nylon cord			

(These columns and spaces below are filled in by the vendor and the sheet is returned to the secretary)

TOTAL NET BID

Terms: \_\_\_\_\_ % \_\_\_\_\_ days, or \_\_\_\_\_ % \_\_\_\_\_ days.

To be delivered to \_\_\_\_\_

Delivery to be made \_\_\_\_\_ or \_\_\_\_\_ days from receipt of order

In submitting the above, the vendor agrees that acceptance of any or all quotation by the borough within a reasonable period constitutes a contract.

Terms:

- All quotations must be signed by the vendor.
- Any right is reserved to reject any or all bidder to accept separate items in a bid unless denied by bidder.
- In case of default, the borough may procure its supplies from other sources and hold the original bidder or contractor liable for resulting increased costs.
- The borough reserves the right to cancel any bid at any time.
- The borough reserves the right to increase by 10 per cent the quantities ordered.

Name of firm \_\_\_\_\_  
 Per \_\_\_\_\_ Title \_\_\_\_\_  
 Date \_\_\_\_\_



Purchase Order Date	Item	Amount of Expenditure	Account Number	Date Material Received	Status of Purchase Order
3/10/2003	Gasoline	\$225.00	430.11	7/22/2003	Closed
3/10/2003	Paint	\$55.00	402.40		Open
3/15/2003	Adding Machine	\$160.00	400.20	7/28/2003	Closed
3/29/2003	Tires	\$300.00	411.52		Open

FIGURE 14 RECORD OF OUTSTANDING PURCHASES

When the goods are received (as with the gasoline and adding machine in the example) a line is drawn through the entry and the date of receipt is entered. Whenever a financial report is prepared, the secretary can refer to the Record of Outstanding Purchases and note the encumbrances for each account and adjust the financial report accordingly.

4. On the basis of the Purchase Order Form, the vendor ships the desired materials.
5. The shipping list, the received goods and the Purchase Order are compared by the employee receiving the shipment. If all materials are received as ordered, the recipient should note this information on the purchase order, sign and return the form to the secretary, treasurer or financial officer.

If the accounts of your municipality are maintained on a modified accrual basis, that is—purchases are recorded when the invoice is received rather than when the check is written—then an entry in the Purchase Journal of the municipality should be made at this time. If your accounting system is maintained on a cash basis, no formal entry would be made in the books until the check is actually drawn for the purchase. (For further discussion of the use of the Purchase Journal, see Chapter VI.)

6. The secretary or treasurer then makes out a check (without signature).
7. At the next regular meeting of the governing body, the invoice is presented for approval. Upon approval, the check is signed and the treasurer enters the expenditure in the Expenditure Journal.

8. The check is signed by the treasurer and forwarded to the vendor.

More information on purchasing procedures and requirements is found in the *Purchasing Handbook for Local Governments*, available from the Department of Community and Economic Development.

## Municipal Investments

Municipalities are authorized to invest excess funds to earn interest. Municipalities with aggressive investment policies can earn significant amounts of money through investments, money that does not have to be raised by additional taxes.

Investments of sinking funds are governed by the Local Government Unit Debt Act. Sinking fund moneys can be placed in accounts with banks, savings banks and savings and loan associations and can be used to purchase certificates of deposit. Deposits and certificates above the limit of federal deposit insurance agencies must be secured by collateral. In addition, sinking fund moneys can be invested in any security the Commonwealth is using for investment at the time of the investment. Management of sinking funds is governed by Sections 1001 through 1006 of the Local Government Unit Debt Act.

Municipalities are authorized to invest all other funds of the municipality. They are required to invest funds consistent with sound business practice. The governing body can adopt rules and regulations to govern the investment of municipal funds.

Five types of investments are authorized by the municipal codes:

1. United States Treasury bills.
2. Short-term obligations of the United States Government or its agencies or instrumentalities.
3. Savings accounts, time deposits and certificate of deposit in banks, savings and loan associations and credit unions insured by federal deposit insurance agencies. Any deposits above the limit insured by federal agencies must be secured by collateral.
4. General obligation bonds of the United States, the Commonwealth of Pennsylvania or Pennsylvania political subdivisions or any of their agencies or instrumentalities backed by the full faith and credit of the issuing government.
5. Shares of registered investment companies, such as mutual funds or money market funds, investing solely in the types of securities listed above. Investment objectives and practices of any investment company should be closely scrutinized by the municipality to ensure its investments are limited to the classifications permitted to it.

Monies from more than one fund can be combined to purchase a single investment, provided moneys of each of the funds are accounted for separately and earnings are separately computed, recorded and credited to each of the funds. Municipalities may also join with other political subdivisions and municipal authorities for joint investment, provided separate accounting, recording and crediting is maintained for each unit's funds. Cooperative investment programs are available through the Pennsylvania Local Government Investment Trust and the State Treasury.

Treasury bills are short-term United States Government securities, issued with maturities as short as thirty days, traded daily in the open market, and may be purchased by arrangement made through your local banking institution. These securities are sold at discounts which fluctuate, and they bear interest at variable rates. Because of these fluctuations, you should discuss with your banker the relative merits of treasury bills and the other authorized forms of investments at the time you are preparing to make an investment. Many municipalities neglect to take advantage of the extra earnings which can result from careful planning of investment procedures.

Municipalities commonly receive large amounts of money early in the year—around April and May—from such sources as tax collections and the state Highway Aid Fund. However, particularly in those municipalities where snow removal costs are high, the heaviest expenditures often occur in the fourth quarter.

As an example, suppose your quarterly expenditure estimates are as follows:

	<b>1st Quarter</b>	<b>2nd Quarter</b>	<b>3rd Quarter</b>	<b>4th Quarter</b>
Estimated Expenditures	\$42,000	\$28,000	\$43,000	\$73,000

Now, in this example, assume your municipality has \$50,000 of revenues to invest during the second quarter. If this money were placed in ordinary savings accounts at 2-1/4 percent interest, it would be available any time, but the interest for a six-month period would only amount to about \$630. However, since the funds will not be required until the fourth quarter, it is also possible to invest in five and six month time deposits which may yield five percent. The dollar yield would be approximately \$1,250 on the \$50,000 an improvement over the savings account.

The use of time deposits rather than savings accounts requires a more careful determination of when funds will be needed since these deposits cannot be converted to cash until expiration of the term. Deposits should be timed to mature before large expenditures are likely to occur. Of course, these investments should be distributed among several saving institutions so that the F.D.I.C. insurance limits are not exceeded in any one institution. If F.D.I.C. limits are exceeded, the municipality must verify that the financial institution has collateralized the excess deposit amount by pledge of assets. This can be done on a pooled basis.

To gain maximum earnings on your municipal funds, you should discuss investment opportunities with local financial institutions and select those investment methods best suited to your particular circumstances. If there is any doubt about the legality of an investment, consult with your municipal solicitor.

## Pensions

Municipalities are authorized by the General Assembly to provide pensions or retirement benefits for their employees. Pension systems are mandated for police and paid firefighters in third class cities and for boroughs and townships which employ three or more full-time police officers. Pension benefits for other classes of employees are discretionary with the local governing body, but pensions are a valid subject for collective bargaining with employee organizations.

Municipalities can use insurance or financial institutions as the funding agencies for their pension plans, or they may manage them internally. Municipalities may

also become members of the Pennsylvania Municipal Retirement System.

Since July 1, 1991, virtually all municipal employees not covered by a retirement system must be covered by social security. This includes elected officials, temporary and part-time workers. The cost of coverage is split between the employee and the local government.

The Municipal Pension Plan Funding Standard and Recovery Act, Act 205 of 1984, requires full municipal funding of all pension plans. The Act requires actuarial valuation reports be made every two years and filed with the Public Employee Retirement Study Commission. The actuarial valuations must be made on common standards included in the Act. Based on the results of the actuarial work, the chief administrative officer of each pension plan must determine the annual financial requirements of the pension plan for the upcoming year. This officer must annually certify the minimum financial obligation of the municipality for the pension plan to the governing body of the municipality in September. The minimum financial obligation of the municipality is the full actuarial cost of the pension plan reduced by the expected amount of any member contributions. The municipal governing body must include the certified minimum financial obligation of the municipality for all its pension plans in its budget for the following year. The full amount of the municipal obligation must be paid into the pension fund by the end of December. Any amounts not paid by the end of December accrue interest from the first of the year.

In cases where the municipal pension plans have been underfunded in past years, the Act requires all unfunded actuarial accrued liability to be paid off over a period of thirty years. The Act establishes recovery programs for distressed pension systems, based on objective actuarial and municipal finance distress indicators. Municipalities participating in the programs are subject to more stringent controls, but are eligible for supplemental state pension aid.

Each municipality must make an annual certification to the Auditor General of the number of police officers, firefighters and other municipal employees employed full-time and participating in a pension plan. These figures are used in calculating the distribution of funds under the General Municipal System State Aid Program. The proceeds from the state tax on foreign casualty insurance premiums fund the program. Allocations are based on the number of employee units. Police officers and paid firefighters count for two units and other employees count for one unit. No municipality can

receive an amount more than the municipality's pension cost. Because of past overfunding of certain pension plans, some municipalities may receive less than the per unit allocation because this figure would exceed their actual pension costs. A transition period through 1995 guarantees each municipality at least the amount it received in 1982, but in no case more than the cost of police and paid firefighter pension plans for the current year.

State aid must be deposited in the pension plan within thirty days of receipt. If the municipality has more than one pension plan, the governing body must determine how to split the allocation. Of course, municipal officials must be aware they are responsible for full actuarial funding of all pension plans. The annual actuarial cost of all plans must be met by a combination of employee contributions, state aid and municipal contributions. Further discussion of municipal pension funding requirements is found in the *Municipal Pension Plan Handbook for Boroughs, Towns and Townships*, published by the Department of the Auditor General.

## **Risk and Insurance Management**

Cost and availability of insurance periodically cause serious problems for municipal governments in Pennsylvania. Enactment of the Political Subdivision Tort Claims Act in 1978 has eased the situation somewhat. The Act now defines those situations where municipal governments may be sued and sets forth procedures governing suits against local governments, their officials and employees. The Act also gives local governments the authority to hire professional risk managers to administer risk and insurance management programs, to join together in a joint program to pool risks and coinsure and to self-insure.

The purpose of a risk and insurance management program is to protect the financial integrity of the municipality from potential perils. It becomes a way of deciding the most effective means for handling a given risk. All municipalities now manage risk in some way, even if it means ignoring many risks and going unprotected. There are five major elements to a planned risk and insurance program: (1) a search for loss exposure, (2) evaluation of these exposures in terms of dollar loss, (3) control of risk through precautionary measures, (4) selection of risk funding tools, including insurance and (5) implementing a risk-handling program.

Loss exposures include damage to property from fire, wind and flooding, loss by theft, loss of income or ad-

ditional expenses to maintain services. The most serious loss exposures are in liability to others resulting from accidental injury to persons or property. Potential losses should be evaluated in terms of probable frequency and severity. This is made easier through creation of a loss history over the past five years.

Risk control means implementing programs to avoid losses before they occur. These include measures such as security devices, workplace safety programs, defensive driving training, fire inspections, emergency plans and careful review of contractual liability.

Insurance is only one of a number of risk funding tools available to municipalities. The objective is to ensure sufficient funds are made available to meet loss situations as they occur. Tools available are payment of losses from current operating funds, creation of reserves, borrowing, tax increases, pooling with other municipalities, federal or state reimbursement of disaster losses and purchase of insurance.

Many municipalities rely too heavily on insurance when they could retain part or all of some risks. A guideline generally considered prudent is that the municipality should be willing to accept up to one tenth of one percent of its operating budget in uninsured loss from a single occurrence, or up to one percent of the operating budget as the aggregate of uninsured losses in a single fiscal year. Many municipalities practice partial self-insurance through use of deductibles or purchase of excess loss insurance coverage.

Forms of insurance available to municipalities fall in several general areas. Property insurance coverage includes both fire and all-risk insurance on buildings, contents and property in transit. All-risk coverage generally includes fire, collapse, water damage, earthquake, flood, vandalism and malicious mischief. Other property coverages include boiler and machinery, business interruption, extra expense and coverage on electronic data processing equipment.

Crime coverage includes employee dishonesty and faithful performance bonds, some being required by the municipal codes. Insurance also offers protection against

burglary, robbery or theft. Consideration should be given to property of others held by the municipality, such as impounded valuables.

Liability coverages include all forms of public liability insurance, automobile insurance and workers' compensation. Umbrella or excess liability coverage is advisable; generally it is available with a minimum limit of \$1 million. Liability coverage should be extended to cover all officials and employees, boards and agencies and volunteers acting on behalf of the municipality. Both the Workmen's Compensation Act and the Political Subdivision Tort Claims Act make the municipality liable for volunteer firefighters operating in official capacity. Special liability coverage is available for certain professional fields.

Employee benefits are often provided through insurance policies, including health, major medical, hospitalization, accident and group life insurance coverage. These benefits are authorized by the municipal codes and are often the subject of collective bargaining agreements. Participation in the unemployment compensation program is now mandated for municipal employers. Municipal pension and disability plans are often funded through insurance policies.

The wide variety of insurance programs and their increasing cost compel prudent officials to take a close look at the insurance needs of the municipality. Existing policies should be reviewed on an annual basis for adequacy of coverage, possibilities of self-insurance, pooling and other means of financing risk. Risk and insurance management should be approached as a conscious policy even in the smallest municipality. A single individual should be appointed as risk manager with the responsibility to carry out a written policy set by governing body on risk and insurance management. At the very least, responsibilities should include risk exposure identification and evaluation, management of insurance coverage or other types of risk financing, processing claims and keeping loss records.



## VIII. Municipal Borrowing

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Borrowing is one of the principal options open to local governments in considering how to pay for large capital projects. A municipality borrows money by issuing bonds or notes and redeeming them over a period of time, paying interest for the privilege of using the money.

Borrowing is a common form of financing capital projects in Pennsylvania. A survey by the Department of Community and Economic Development showed 52 of the 66 county governments and 732 of the 2,573 municipal governments in the Commonwealth reported outstanding debt at the end of 1991.

The question of entering into a long-term debt to obtain needed municipal capital improvements (such as roads, swimming pool or municipal building) is often one of your most difficult decisions. There is no convenient rule of thumb or other guideline which will make the decision for you.

There are two basic approaches to financing capital improvements—"pay-as-you-go" and "pay-as-you-use." The pay-as-you-go approach essentially means that before undertaking a project or making a capital expenditure, you acquire the necessary funds and pay the costs without debt. Pay-as-you-use financing involves borrowing money to pay for the capital improvement and repaying the debt while the project is being used.

In a book by the Municipal Finance Officers Association,\* a series of arguments arriving at financing decisions, the major points of these arguments are as follows.

### Factors Favoring Pay-as-you-go

1. It requires facing up to the situation. Borrowing often looks too easy. Municipalities utilizing pay-as-you-go must plan and discipline themselves to accumulate the needed funds, and may take a harder look at the true needs for capital projects before approving them.

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\* "Administration of Local Government Debt," Lennox L. Moak, *Municipal Finance Officers Association*, Chicago, 1970.

2. In the event of an unexpected drop in revenue, or the need for emergency expenditures, capital projects may be postponed until a more favorable period to avoid the necessity for a tax increase.
3. The interest on each \$1,000 bond issued at 6 percent is approximately \$1,200 over 20 years. Pay-as-you-go financing saves this interest cost.
4. Use of pay-as-you-go financing preserves your borrowing capacity for times when it might be greatly needed.
5. When projects are paid for as they are obtained, large debt repayments are not passed on to future generations.

### Factors Favoring Pay-as-you-use (Borrowing)

1. As per capita income increases over time, debt re-payments in the future will represent a smaller share of income. In addition, with continuing inflation, future debt repayment dollars may be worth less than current dollars in terms of purchasing powers.
2. Postponement of projects because funds are not yet accumulated may severely hinder the full and proper development of the community and retard growth of the tax base and the local economy.
3. Since capital projects will be used over a long time period, it is proper for future generations to contribute their share of the cost through debt payments under pay-as-you-use financing.
4. Families which now more frequently move from municipality to municipality pay, as part of their taxes, a share of the cost of the capital improvements which benefit them during the time they are living in your municipality.

### Debt Limits

Municipal borrowing is subject to limits set by the General Assembly under the authority of Article IX, Section 10 of the Pennsylvania Constitution. This part of the Constitution was amended by the voters in 1968, making a basic change in the method of computing municipal debt limits. Prior debt limits were based on assessed valuation of real estate within the taxing unit. The new provision changes the base to a percentage of



the municipality's total revenues. This allows more flexible and realistic debt limits, based on the municipality's total ability to pay.

Debt limits are set for all local government units, except the city of Philadelphia, by the Local Government Unit Debt Act, 1972 P.L. 781, No. 185, as amended. Home rule municipalities are subject to the substantive provisions of the Act and may adopt the procedural provisions by reference in their home rule charters.

## Major Provisions of the Act

The Local Government Unit Debt Act establishes the nonelectoral debt limit for third class cities, boroughs and townships as 250 percent of their average total revenue over the past three years. The total of nonelectoral debt and lease rental debt cannot exceed 350 percent of the borrowing base.

Later in this section an example explains this limit in more detail. Other major provisions of the Act include:

1. No limit on electoral debt—that is, on debt approved by the electors of your municipality.
2. Bond anticipation notes can be issued in order to obtain funds, pending the sale of long-term bonds or notes.
3. The maturity date on bonds may not be more than 40 years, or not more than the life of the project being financed, whichever occurs first.
4. Bonds or notes may be sold at public or private sale.
5. “Self-liquidating debt”—that is, debt which is repaid solely from rents, special liens and assessment or other user charges—may be excluded when calculating outstanding debt.
6. Under certain conditions, municipalities in a financial crisis may fund “unfunded debt” in order to meet their obligations.
7. Temporary indebtedness (tax and revenue anticipation loans) is now governed by the Local Government Unit Debt Act rather than by the municipal codes. These tax and revenue anticipation notes may not exceed 85 percent of the outstanding revenues anticipated in the period when the note is outstanding and must be repaid during the fiscal year in which it is incurred.

Of course, before entering into any borrowing action, you should work out the legal and financial details with your solicitor, bond counsel, financial advisor and other consultants. Except for temporary indebted-

ness, or certain borrowings of under \$125,000 all debt actions must be approved by the Office of Legal Services, Department of Community and Economic Development. The Governor's Center for Local Government Services, is also available to provide guidance and information which you may need in preparing to incur municipal debt.

Although the new procedures for determining the remaining debt limit for your municipality are quite complicated and involved, a simple example has been prepared to illustrate some of the procedures and items used in evaluating your debt situation.

Figure 16 on page illustrates some of the factors to be taken into consideration. In this example, your debt limit is first established, then your net nonelectoral debt is calculated. The debt limit minus the net nonelectoral debt is the remaining debt capacity of your municipality. Nonelectoral debt is that debt your governing body can incur without an election by your citizens.

The Local Government Unit Debt Act states that your nonelectoral debt limit is, in most cases, 250 percent of your average total revenue over the past three years. As illustrated in the example, total revenue is obtained by subtracting from total municipal income such one-time receipts as interest, grants, user charges, assessments and similar receipts specified in the Act. Total revenue is calculated for each of the past three years and is then averaged to obtain the average total revenue. This represents your borrowing base. Your nonelectoral debt limit is then calculated by taking 2.5 times the borrowing base (or 250 percent). In the example, a borrowing base of \$50,000 establishes a debt limit of \$125,000.

Once the nonelectoral debt limit is established, it is necessary to calculate your current outstanding non-electoral debt as shown in the lower half of the illustration. To do this, you begin with the total gross outstanding principal of all debt, both electoral and nonelectoral. From this gross total you deduct electoral debt (that authorized by an election of your constituents) and lease rental debt. Further deductions are made from this figure to represent money you have in funds due from assessments or liens which can be applied toward the gross nonelectoral debt. Here you deduct such amounts as are represented by sinking funds established to repay existing debt, debts due the municipality, and any cash on hand which is not otherwise appropriated and which will be used to reduce your existing debt. The remainder is your net nonelectoral debt which is deducted from your debt

FIGURE 15

**DETERMINING NET NONELECTORAL DEBT**

	1989	1990	1991
Revenues Received from All Sources .....	\$70,000	\$55,000	\$65,000
Less Interest on Sinking Funds .....	200	0	300
Less Grant Funds .....	3,800	5,000	7,700
Less Revenue from Sale of Assets .....	<u>20,000</u>	<u>3,000</u>	<u>0</u>
<b>Total Revenues .....</b>	<b>\$46,000</b>	<b>\$47,000</b>	<b>\$57,000</b>

$$\text{Borrowing Base} = \frac{46,000 + 47,000 + 57,000}{3} = \frac{150,000}{3} = \$50,000$$

$$\text{Debt Limit} = \$50,000 \times 250\% = \$125,000$$

Gross Outstanding of Bonds or Notes (electoral and nonelectoral) .....	\$92,000
Less electoral debt outstanding .....	<u>\$60,000</u>
<b>Gross Nonelectoral Debt .....</b>	<b>\$32,000</b>
Less amount in Sinking Fund .....	0
Less debts due municipality .....	4,000
Less assessments and liens expected .....	5,000
Less surplus unappropriated cash .....	<u>1,000</u>
<b>Net Nonelectoral Debt .....</b>	<b>\$22,000</b>

*Limit on new nonelectoral debt is "debt limit" less existing "net nonelectoral debt;"  
e.g., \$125,000 - 22,000 = \$103,000 remaining nonelectoral debt limit.*

limit to establish your remaining borrowing capacity. In the example, the remaining nonelectoral debt capacity is \$125,000 less \$22,000, or \$103,000.

In actual cases, specific funds and monies to be counted or deducted are stated more precisely and in greater detail in the Act than in this example. Careful study and legal advice are required to make the necessary calculations.

## Lease Rental Debt

In addition to the terms identified above, the Act defines lease rental debt. In basic terms, lease rental debt is debt incurred by an authority or another local government unit you are obligated to repay through leases, subsidy contracts or other forms of guarantee. For example, you might have formed a municipal authority to construct a municipal building. You may then have entered into a lease agreement with the authority requiring you to pay a fixed sum per month or year for the use of the building. In this case, the authority debt you are obligated to repay through your lease agreement for the building is considered a lease rental debt of your municipality.

Your lease rental debt limit is defined as 350 percent of your borrowing base, but nonelectoral debt and lease rental debt together cannot exceed 350 percent of the borrowing base. When borrowing, therefore, all outstanding nonelectoral debt and lease rental debt

must be considered to determine the aggregate does not exceed the limit on the combined debt. This is a departure from the previous law where the amount of the outstanding lease rental debt could not affect the nonelectoral capacity.

When you have incurred, or plan to incur, either ordinary nonelectoral debt or lease rental debt to be repaid solely from service charges, rents or fees collected from the users of the resulting project, this form of debt is self-liquidating debt and is not charged to outstanding debt provided it has been properly excluded in accordance with the Act. For example, if your municipality borrows funds to make capital improvements to a municipal water company and the funds are to be repaid totally by the revenues from the sale of water, and tax funds are not pledged, then this is self-liquidating debt. If you use self-liquidating debt for such projects as sewer, solid waste or water systems, you may finance the project without regard to debt limit and without the necessity of forming a municipal authority. However, any such decision should be arrived at only after careful consideration of all factors and consultation with your engineer, solicitor and other advisors.

Another form of debt not included under your debt limit is subsidized debt. Subsidized debt is debt which is self-liquidating to the local government unit, because the annual debt service will be covered, under certain circumstances, by subsidies or reimbursements

to be paid by either the state or federal government, or both; or, if payments will be covered under a subsidy contract with another local government unit or authority.

All in all, the Local Government Unit Debt Act is intended to provide greater flexibility to local governments in their financial capabilities, and the Act should be carefully studied before incurring municipal debt. With the increasing importance of revenue sources such as the earned income tax, municipal utilities, user fees and departmental earnings, debt limitations based on revenue rather than assessed valuation provide a more realistic basis for regulating local government borrowing.

## **Borrowing Procedures**

Before you enter into any borrowing action, you should work out the legal and financial details with your solicitor, bond counsel, financial advisor and other consultants. Except for temporary indebtedness or certain borrowings of under \$125,000 all debt actions must be approved by the Office of Legal Services, Department of Community and Economic Development. All borrowing actions must be filed with that office.

The state's concern about local government finances, and in particular about the way debt is incurred, goes back more than half a century. Since 1927, state approval has been required for several kinds of local debt financing. This function has been carried out by the Department of Community and Economic Development since its creation.

Basically, DCED's role is to make sure a community or a school district seeking to incur debt is within its legal debt limits and is meeting other technical legal requirements. This review extends to all bonds and notes. However, the legislature has amended the Local Government Unit Debt Act to permit local governments to issue bonds or notes of \$125,000 or 30 percent of their borrowing base, whichever is less, without DCED approval.

DCED has 20 days from the time a proposed local debt proceeding is received to approve or reject it. Most are approved. When a proceeding cannot be approved, DCED is required to state the reasons and advise the municipality of correctable errors. As long as the debt issue meets all legal and technical requirements, it must be approved. DCED has no power to reject a note or bond issue on the grounds a municipality is engaging in poor fiscal policy; for example, going into debt unnecessarily. There is nothing, of course, to

stop DCED officials from advising a municipality not to issue debt, and they have sometimes done so, but the municipality is free to follow or ignore this advice.

Obligations sold and delivered without the approval of the department are invalid. Once approved, though, the validity of the bonds or notes cannot be questioned in court, unless a constitutional matter is involved. DCED has the power to audit the sinking funds established under the Act.

## **Application for Approval**

Before delivering any bonds or notes in excess of \$125,000 or 30 percent of the borrowing base, whichever is less, the local government unit must apply for the approval of DCED. The application in the required form must be accompanied by a transcript of the proceedings consisting of certified copies of all the following.

1. The ordinance calling the election in the case of electoral debt with proofs of all proper advertisements.
2. The return of the election.
3. The ordinance or resolution authorizing the bonds or notes and prescribing the manner of sale with proof of proper publication.
4. The accepted proposal for the purchase of the bonds or notes.
5. The ordinance awarding the bonds or notes with the proof of proper publications.
6. The debt statement prepared as described in Section 8110 of the Local Government Unit Debt Act.
7. The certificates and proofs which may be necessary for the exclusion of any portion of the series proposed to be delivered or any prior series as self-liquidating debt or subsidized debt if the exclusion is desired by the local government unit.

Before becoming bound to an amount in excess of \$125,000 or 30 percent of the borrowing base, whichever is less, on any lease evidencing the acquisition of a capital asset, a local government unit must apply for and receive the approval of the Department of Community and Economic Development. The application, in the form required by DCED, must be accompanied by certified copies of the following:

1. The ordinance authorizing the execution of the lease.
2. The debt statement as required in Section 8110 of the Local Government Unit Debt Act.

No lease executed and delivered after the effective date of the Act and prior to the approval or the presumed approval will be valid or obligatory. Except as reference is made to lease rental debt, the Local Government Unit Debt Act has no application to the authorization, issue or sale of obligations by any municipal authority.

Information and assistance on procedures and requirements for filing proposed municipal borrowings can be obtained from the Office of Legal Services. This office can answer technical questions on the Local Government Unit Debt Act for your solicitor and bond counsel. Copies of the Act are also available from this office. Direct inquiries to:

Office of Legal Services  
Department of Community  
and Economic Development  
Commonwealth Keystone Building  
400 North St., 4th Fl.  
Harrisburg, Pennsylvania 17120-0225  
(717) 720-7309

## Temporary Indebtedness

The Local Government Unit Debt Act has repealed portions of the various municipal codes and replaced the repealed portions with the authorization for local governments to issue tax anticipation notes. Tax and revenue anticipation loans must be repaid within the fiscal year in which the debt was incurred. The major procedural points in obtaining tax and revenue anticipation notes under the provisions of the Act include the following:

1. The loan is authorized by enacting a municipal resolution.
2. Debt limitations do not apply to tax anticipation notes.
3. The amount of the note may not exceed 85 per-cent of the taxes levied for the year and the current revenues remaining to be received until the time the note matures.
4. Tax anticipation notes may be sold by public or private sale.

The Act also lists the documentation to be assembled and submitted to Department of Community and Economic Development in order to make the notes valid. The list includes certified copies of:

1. The authorizing resolution.
2. A certificate of the remaining taxes and revenues to be collected as prepared by the municipal governing body.

3. A copy of the proposal by the lending institution selected as the purchaser of the tax anticipation notes.

Approval by the Department of Community and Economic Development is not required for tax anticipation notes.

As discussed earlier in this Chapter, in order to re-reduce the need for temporary indebtedness you should time your expenditures to match receipt of revenues. In addition to the cost of interest paid on tax anticipation loans, there is the danger borrowed money on hand may create a false impression of fiscal well-being; and, of course, temporary debt complicates the bookkeeping system by necessitating additional checks to be drawn, funds maintained, and similar administrative tasks.

## Municipal Authorities

An option to consider in municipal borrowing is the use of the municipal authority. The municipal authority in Pennsylvania is a vehicle for accomplishing public purposes, not possible or practical through direct action of municipal governments. A municipal authority is created to acquire, construct or operate projects and to borrow money and issue bonds to finance them.

Authorities can be created by a single municipality or by joint action of two or more municipal governments. Authorities serving more than one municipality are common in water and sewer projects to take advantage of the economies of scale and larger service areas.

The debt obligations of authorities must be repaid solely from the revenues of the projects it operates. It cannot pledge the credit of the municipality or of the state. Authorities were first formed in Pennsylvania to circumvent restrictive debt limits to allow financing of public works projects during the Depression.

Authorities are under the complete control of their appointed boards and are not restricted by state laws governing municipal operations. Terms of board members are for five years with one vacancy per year, so authority operations are not directly affected by elections.

There are a number of significant differences between the operations of an authority and a municipality.

1. A municipal government exercises powers of governmental and entrepreneurial nature, subject to the expressed wishes of the electorate. By contrast, an authority exercises entrepreneurial

power only and is some distance removed from the voters.

2. An authority sells bonds to secure its initial capital and must rely on user charges to cover expenses and debt retirement. A municipal government may draw upon tax revenues in addition to service charges and the proceeds of loans.
3. An authority can raise and spend money without reference to the immediate wishes of the electorate. A municipal government is subject to approval of its policies at the polls.
4. Municipal authorities are free from the restraints imposed by the state on the budgetary and personnel practices of municipalities, but are bound by the terms of their trust indentures.

5. Authorities usually concentrate on a single service while municipalities have multiple responsibilities.

These differences may be summarized by stating an authority is restricted as to the functions it may perform and is relatively free as to the methods it may use. On the other hand, a municipality is relatively free with regard to services rendered, but is restricted as to the methods employed.

More information on the use of municipal authorities can be found in the booklet, *Municipal Authorities in Pennsylvania*, available from the Department of Community and Economic Development.



## IX. Fiscal Monitoring System

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Since the early 1980s, many Pennsylvania municipalities have been faced with fiscal crisis, either as the result of a sudden loss of tax base caused by the closing of a major industrial employer or the cumulative effects of a long-term decline in the local economy. Reduced resources have challenged local officials to make drastic changes in the accepted way of doing things in their communities. All too often, the local government's overall financial position is considered only at budget time, and in far too many places, not even then. Local officials need a way of tracking the financial condition of their community over time, so potential problem areas can be spotted before they worsen into a crisis.

Local officials can set up a monitoring system that uses financial statistics to compare performance or status with previous results or projections. Periodic computation of these factors or indicators and tracking them on a time scale will give the local officials a picture of how the community is performing and reveal the direction it is headed.

This chapter summarizes the fiscal monitoring system developed by the Intergovernmental Cooperation Program of the Allegheny League of Municipalities. Relevant factors were incorporated from national fiscal monitoring models into a simplified system suitable for smaller Pennsylvania municipalities. Training on the use of this system is periodically offered by the Department of Community and Economic Development. Local officials are encouraged to select those factors most applicable to their communities in developing their own monitoring systems.

### Using the System

The system developed by the League includes 24 factors related to municipal financial performance. Not all are suitable for every municipality, and the importance of any particular factor may vary from place to place. Many are annual factors, to be recalculated and examined each year. After calculation of the factors selected by your municipality, you need to chart or graph the year to year change in order to evaluate trends. Where applicable, an action agenda should be prepared and specific steps taken to try to deal with unfavorable trends.

Some municipalities may want to go back several years and calculate factors for the recent past in order to start trend analysis immediately. Others may wish to use the present as a starting point and move forward. The best way to effectively use the monitoring system is to agree that it will be presented to and reviewed by the governing body at a specific time each year. Useful times may be after the audit report is completed in the spring, or in late summer before budget preparation for the next year is begun.

Some may want to employ constant dollar comparisons to eliminate the effect of inflation. This allows the comparison of factors over time based on constant dollars. A base year is selected and all financial figures are adjusted to account for the change in the CPI since that base year, then entered on the graph for trend analysis. Adjusting for inflation may show that even though revenues are going up in current dollars, they are decreasing in constant dollars. The adjustment factor is calculated by dividing the CPI index for the year being calculated into the CPI index for the base year, then multiplying all financial figures by this adjustment factor.

For further assistance on using the fiscal monitoring system, please contact the Allegheny League of Municipalities or the nearest regional office of the Department of Community and Economic Development.

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**FACTOR 1:**      *Revenue Per Capita*

**Description:** Shows how a municipality's revenues are affected by changes in population and whether revenues are keeping pace with growth in the community. If revenues per capita are decreasing, a municipality might be unable to maintain service levels unless new sources of revenues are found. Also look at expenditures per capita.

**Formula:**      
$$\frac{\text{Total operating revenues}}{\text{Population}}$$

**Data Source:** Total operating revenues are from the Annual Audit and Financial Report, General Fund, Liquid Fuels Fund and other funds with operating revenues such as utility funds.

**Warning Signal:** Decreasing operating revenues per capita over time.

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**FACTOR 2:**      *Intergovernmental Revenue*

**Description:** Shows if a municipality is becoming heavily dependent on revenues from other levels of government. Overdependence can be dangerous since the funding source may withdraw the funding or reduce the level of support. The factor calculates the percentage of intergovernmental operating revenue as a percent of total operating revenue.

**Formula:**      
$$\frac{\text{Intergovernmental operating revenues}}{\text{Total operating revenues}}$$

**Data Source:** Account 350 of Annual Audit and Financial Report (operating only) for intergovernmental revenues. Use total operating revenues from Factor 1.

**Warning Signal:** Intergovernmental revenues increasing as a percentage of your total operating revenues.

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**FACTOR 3:**      *Real Estate Tax Resources*

**Description:** Shows how much additional revenue is potentially available from the real estate tax. The ability to raise additional property tax revenues is an important part of fiscal health.

**Formula:**      
$$(\text{Maximum general purpose real estate millage rate}) - (\text{Current general purpose real estate millage}) \times (\text{Net value of one mill of real estate tax})$$

**Data Source:** Millage rate limit from municipal code; current general purpose millage from budget; net value of one mill by dividing last year's collections by millage rate.

**Warning Signal:** Decreasing amount of unused real estate tax resources over time.

---

**FACTOR 4:**      *Expenditures Per Capita*

**Description:** Shows the cost per person of running the municipal government and indicates the impact of adding or deleting services or changing service levels. Increasing expenditures per capita are troublesome if revenues per capita are not keeping pace. If the trend of this factor is bad, every expenditure area should be examined.

**Formula:**      
$$\frac{\text{Total operating expenditures}}{\text{Population}}$$

**Data Source:** Total operating expenditures are from the Annual Audit and Financial Report, General Fund, Liquid Fuels Fund and other funds with operating expenditures such as utility funds.

**Warning Signal:** Significantly increasing operating expenditures per capita.

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<b>FACTOR 5:</b>	<b><i>Fringe Benefits</i></b>
<b>Description:</b>	Shows the impact that fringe benefits are having on the municipality's finances. Rapidly escalating health costs and premiums for worker compensation are a major financial drain for employers, including municipalities.
<b>Formula:</b>	$\frac{\text{Total fringe benefits costs}}{\text{Total salaries and wages costs}}$
<b>Data Source:</b>	Municipal payroll records.
<b>Warning Signal:</b>	An increase in fringe benefit costs compared to total salary and wage costs.

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<b>FACTOR 6:</b>	<b><i>Cash Position</i></b>
<b>Description:</b>	Any business operation, including a municipality, needs enough cash on hand to pay its current bills. This factor shows how the municipality stands at a specific point in time by comparing cash (bank accounts and short-term investments) with current liabilities. Depending on the type of accounting system, this may be difficult to properly calculate. Tracking the cash position on a quarterly or more frequent interval is recommended.
<b>Formula:</b>	$\frac{\text{Cash and short-term investments}}{\text{Current liabilities}}$
<b>Data Source:</b>	The Annual Audit and Financial Report can be used if December 31 is the time point selected, otherwise use monthly or quarterly financial statements. Current liabilities may not be completely listed and may have to be calculated from bills payable and pending payrolls.
<b>Warning Signal:</b>	Decreasing cash and short-term investments as a percentage of current liabilities.

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<b>FACTOR 7:</b>	<b><i>Debt Service</i></b>
<b>Description:</b>	Shows the proportion of general operating revenues devoted to paying off outstanding debt each year. Excessive debt loads can cripple the ability to provide services. Principal payments on tax anticipation notes are excluded but interest on them is included.
<b>Formula:</b>	$\frac{\text{Debt service payments}}{\text{Total operating revenues}}$
<b>Data Source:</b>	Sum of principal and interest paid on long-term debt plus interest payments on short-term debt during year is debt service. For total operating revenues, see Factor 1.
<b>Warning Signal:</b>	Increasing amount of debt service as a percentage of total operating revenues.

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<b>FACTOR 8:</b>	<b><i>Long-Term Debt</i></b>
<b>Description:</b>	Illustrates the debt burden by comparing debt to assessed valuation of real estate, comparing the amount promised to pay back with the ability to pay.
<b>Formula:</b>	$\frac{\text{Long-term debt}}{\text{Assessed valuation}}$
<b>Data Source:</b>	Schedules B-7 and B-3 of the Annual Audit and Financial Report.
<b>Warning Signal:</b>	Increasing amount of long-term debt as a percentage of assessed valuation.

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<b>FACTOR 9:</b>	<b><i>Debt Per Capita</i></b>
<b>Description:</b>	Measures the impact of long-term debt per individual municipal resident, reflecting the ability of the citizens to repay loans through the taxes on their earnings.
<b>Formula:</b>	$\frac{\text{Net long-term debt}}{\text{Population}}$
<b>Data Source:</b>	Schedule B-7 of the Annual Audit and Financial Report
<b>Warning Signal:</b>	Increasing long-term debt per capita.

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<b>FACTOR 10:</b>	<b><i>Operating Position</i></b>
<b>Description:</b>	Shows whether a municipality is at least breaking even or whether it is relying on spending down fund balances for current operations. In this calculation, a number greater than one means you operated during the year at a deficit; one means you broke even; a number less than one means you took in more than you spent.
<b>Formula:</b>	$\frac{\text{Total operating expenditures}}{\text{Total operating revenues}}$
<b>Data Source:</b>	See Factors 1 and 4.
<b>Warning Signal:</b>	Increasing amount of total operating deficits as a percentage of your total operating revenues.

---

<b>FACTOR 11:</b>	<b><i>Unfunded Pensions</i></b>
<b>Description:</b>	Shows unfunded pension liability against assessed valuation as a measure of the community's ability to meet its pension commitments. One of the critical problems in many Pennsylvania municipalities is unfunded pension liabilities. These are really long-term debt owed to employees and will eventually have to be paid.
<b>Formula:</b>	$\frac{\text{Unfunded pension liability}}{\text{Assessed valuation}}$
<b>Data Source:</b>	Unfunded pension liabilities are found in the municipal pension plan(s)'s latest actuarial report. Assessed valuation can be taken from the current real estate tax duplicate.
<b>Warning Signal:</b>	Increasing amount of unfunded pension liability as a percentage of assessed valuation.

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<b>FACTOR 12:</b>	<b><i>Revenue Shortfalls</i></b>
<b>Description:</b>	Compares estimated revenues with actual revenues for the year. This examines both the fiscal condition and the success of municipal officials in controlling budgets. Persistent overestimation of revenues to balance a budget will lead to financial problems and difficulty in keeping expenditures in line with the budget.
<b>Formula:</b>	$\frac{\text{Actual year-end revenues}}{\text{Budgeted revenues}}$
<b>Data Source:</b>	The Budget Report and the Annual Audit and Financial Report.
<b>Warning Signal:</b>	Increasing and/or consecutive revenue shortfalls.

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<b>FACTOR 13:</b>	<b><i>Budget Overruns</i></b>
<b>Description:</b>	Shows whether there is a continuing pattern of exceeding appropriations to weigh the performance of management. If this occurs along with revenue shortfalls, it indicates the budgeting process is not realistic.
<b>Formula</b>	$\frac{\text{Year-end actual expenditures}}{\text{Budgeted expenditures}}$
<b>Data Source:</b>	The Budget Report and the Annual Audit and Financial Report.
<b>Warning Signal:</b>	Consecutive budget overruns.

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<b>FACTOR 14:</b>	<b><i>Uncollected Real Estate Tax</i></b>
<b>Description:</b>	Shows fiscal health and management productivity by comparing the percentage of uncollected real estate tax to the total levy. The higher the percentage, the more the uncollected taxes.
<b>Formula:</b>	$\frac{\text{Uncollected real estate tax}}{\text{Net real estate tax levy}}$
<b>Data Source:</b>	Schedule B-3 of the Annual Audit and Financial Report.
<b>Warning Signal:</b>	Increasing amount of uncollected real estate taxes as a percent of net real estate tax levy.

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<b>FACTOR 15:</b>	<b><i>Tax Subsidy for User Fee Programs</i></b>
<b>Description:</b>	Shows whether user fees are high enough to cover all the costs associated with the service provided. Where they are not, a subsidy from the general revenues supports the program. The extent of this subsidy is a policy decision, but municipal officials need to be aware of the extent of the subsidy.
<b>Formula:</b>	$\frac{\text{Fees and user charge revenues}}{\text{Expense of providing service}}$
<b>Data Source:</b>	For user charges, see accounts 361-379 in the Annual Audit and Financial Report; for expenses, see accounts 400-468.
<b>Warning Signal:</b>	Decreasing percentage of fee revenue to cover costs of user services.

---

<b>FACTOR 16:</b>	<b><i>Employees Per Capita</i></b>
<b>Description:</b>	Productivity is difficult to measure in a simple formula, but the community must have some standard against which to measure the growth of the workforce. Employees per capita is a simplified measure. In order to have the result in whole numbers, multiply the measure by 1,000.
<b>Formula</b>	$\frac{\text{Full-time municipal employees}}{\text{Population}} \times 1,000 = \text{Municipal employees per 1,000 population}$
<b>Data Source:</b>	Payroll records; use the same date each year, or average employment for the year.
<b>Warning Signal:</b>	Increasing number of municipal employees per 1,000 population over time.

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**FACTOR 17:     *Property Values***

**Description:** Measures the growth in property values from year to year, a key sign of economic health.

**Formula:**       
$$\frac{(\text{Current year property value}) - (\text{Prior year's property value})}{\text{Prior year's property value}}$$

**Data Source:** Used assessed value figures from the Annual Audit and Financial Report or market value figures from the County Assessment Office.

**Warning Signal:** Decreasing growth of property values or actual decline.

---

**FACTOR 18:     *Fiscal Capacity***

**Description:** Measures the community's health by showing the ability to meet its obligations as reflected in its major asset, property values.

**Formula:**       
$$\frac{\text{Assessed value}}{\text{Population}}$$

**Data Source:** Schedule B-3 of the Annual Audit and Financial Report.

**Warning Signal:** Decreasing amount of assessed valuation per capita.

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**FACTORS 19, 20:     *Employment Base***

**Description:** An important indicator of the community's fiscal health, employment base may be measured either by the number of jobs in the community or the number of residents who are employed. For balanced communities, both factors may be worthwhile looking at. The formulas produce a percentage of growth/decline.

**Formula:**       
$$\frac{(\text{Number of occupation privilege accounts for current year}) - (\text{number of accounts for prior year})}{\text{Number of accounts for prior year}}$$
  
$$\text{AND/OR}$$
  
$$\frac{(\text{Number of earned income tax accounts for current year}) - (\text{number of accounts for prior year})}{\text{Number of accounts for prior year}}$$

**Data Source:** Tax collector/treasurer records.

**Warning Signal:** Decreasing growth or actual decline in number of community jobs and/or working residents.

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**FACTOR 21:     *Construction Activity***

**Description:** Measures economic activity and fiscal health from year to year.

**Formula:**       Total number of permits issued and/or total value of permits.

**Data Source:** Building permit records.

**Warning Signal:** Decline in number/value of building permits.

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**FACTORS 22-24: *Municipal Demographics***

- Description:** Three critical population statistics are suggested for tracking: population growth, personal income and percent of population over 65. Adverse trends may be the result of unique community characteristics, but an effort should be made to keep a balanced community population through long-range planning.
- Formula:** Change from year to year in total population, personal income per capita and percent of population over 65.
- Data Source:** Census figures and intercensal estimates available from the county planning commission or the State Data Center.
- Warning Signal:** Decline in population, decline in personal income per capita or increase in the percentage of population over 65.

# Publications

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For further information on various financial matters consult the publications listed below. They are available free upon request from The Governor's Center for Local Government Services, Department of Community and Economic Development, 400 North Street, 4<sup>th</sup> Floor, Commonwealth Keystone Building, Harrisburg, Pennsylvania 17120-0224, 1-888-223-6837 or [www.inventpa.com](http://www.inventpa.com).

*Auditors Guide.* Guide to auditing procedures for elected auditors of boroughs and townships, including suggested audit programs for various types of funds.

*Computers for Municipal Government.* Explains choices for municipal computerization and the process for selecting, buying and implementing a computer system. Focuses on the computer as a tool for financial management.

*Debt Management Handbook.* Introduces the process of incurring new debt and managing existing debt. Reviews factors for judging the appropriateness of borrowing, the legal framework governing debt, the options for borrowing and the procedures used for issuing debt.

*Insurance Primer for Municipal Secretaries.* Provides introduction to insurance concepts, explains various types of insurance policies and methods of obtaining insurance.

*Manual for Municipal Secretaries.* Comprehensive survey of office of borough and township secretary and city clerk, describing duties and special areas of interest.

*Municipal Authorities in Pennsylvania.* Describes creation and operation of municipal authorities and contains complete text of the Municipality Authorities Act.

*Purchasing Handbook for Local Governments.* Outlines basic procedures in the purchasing process with legal requirements.

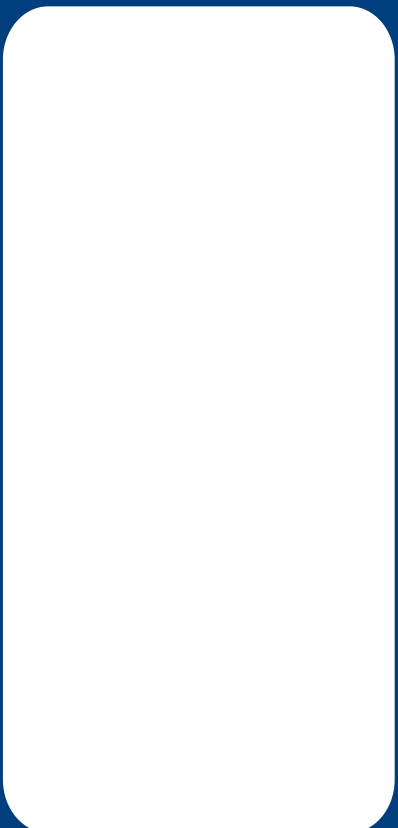
*Taxation Manual.* Describes taxes available to local governments under the municipal codes and Act 511 with a analysis of each. Contains complete text of the Local Tax Enabling Act.

*Tax Collectors Manual.* Describes office of tax collector in third class cities and townships and outlines their powers and duties. Contains complete text of Local Tax Collection Law.

**Pennsylvania Department of Community & Economic Development  
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