



• *NAVIGATING TURBULENT TIMES*  
Approaches and Strategies

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Over the past several years, cities, counties, and school districts have experienced financial challenges due to declining populations and property tax bases, rising unemployment rates, and decreasing state funding limits on revenue-raising potential. In fact, for the sixth straight year, U.S. cities are facing financial pressures that have created a sense of urgency for many local governments. To navigate these turbulent times, local governments need proactive approaches and strategies that address critical fiscal management issues — and a number of best practices are available for finance officers to use in guiding their organizations to fiscal stability and long-term sustainability.

### TRENDS THAT DRIVE CITIES' HEALTH

The National League of Cities' April 2013 Local Economic Conditions Report recently attributed a number of trends to the underlying economic conditions that drive much of cities' fiscal health and affect their ability to provide critical community services. The common issues that lead to fiscal distress include poor budgeting, accounting, and financial reporting; fluctuations in property values, collections, and retail sales tax base; excess spending (not living within the government's means); difficulty in differentiating the "nice-to-haves" from the "must-haves"; internal borrowing practices; unfunded pension funds and other postemployment benefits; inaccurate forecasting; declines in population; weak management and political leadership; changes in fund balances and governmental revenues and expenses; lack of plans or resources to address increased pension costs; lack of financial policies; major disclosure and internal control issues; unawareness of community needs and expectations for service solvency; use of one-time funds to pay for ongoing expenses; maintenance efforts related to federal funds; borrowing to cover cash flow needs; and unsustainable expenditure commitments during periods of budget surplus.

The NCL research study also indicates that the performance of local, regional, and state economies has improved somewhat over the past year. Despite improvements, however, cities continue to struggle, signaling that growth is not at a level necessary for a sustained recovery (see Exhibit 1). The study

found tepid improvement in housing starts, commercial and residential property values, business activity, and health of the retail sector; a persistent lack of growth in incomes and employment rates; and workforce skills that have not kept pace with employer demand. In addition, the number and scope of investment projects are likely to decline if a federal limitation is placed on the tax-exemption of municipal bonds.

### STEPS FINANCE OFFICERS CAN TAKE

While the actions of finance officers do not directly affect the local housing market, property values, or crime rates, they can still provide fiscal relief for their organizations by taking immediate steps toward sound financial management policies and practices. Following are six action steps for creating a plan.

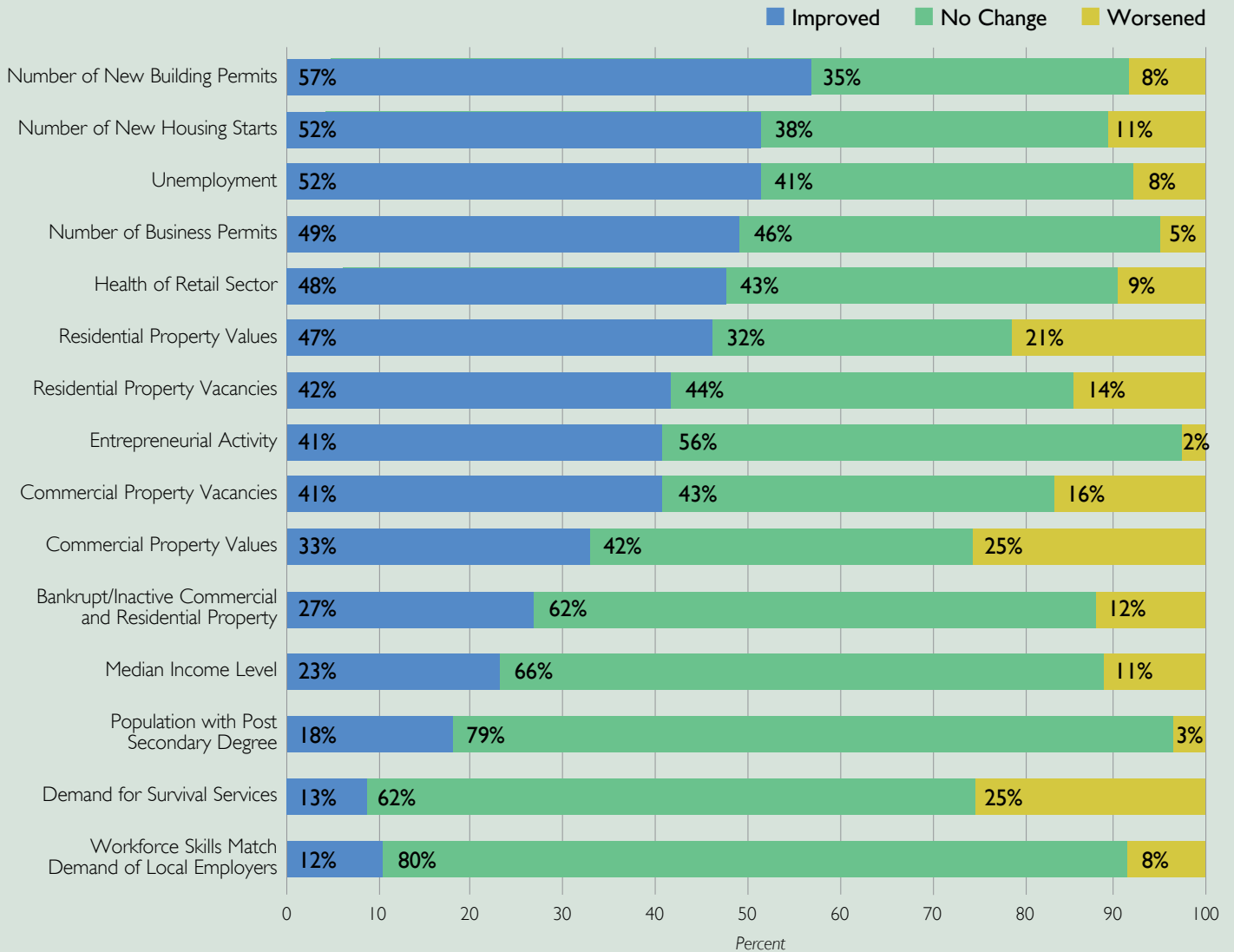
#### Action 1: Develop Monitoring Systems to Track Financial Health.

Financial officers are responsible for budgeting conservatively and maintaining a balance within their jurisdictions. The first step in addressing potential deficits is committing to a proactive approach. Analyzing the government's financial condition to predict potential issues can help prevent recurring operating deficits and financial insolvency. This method has been adopted by multiple states, as well as the International City/County Management Association. Financial condition analysis looks at environmental, financial, and organizational indicators of distress, helping a jurisdiction gauge its budget solvency, or its ability to generate sufficient revenue within the current fiscal period to cover expenditures. Assessment models also help define historical, current, and projected financial and economic conditions, which helps determine the status of the government's cash flow and long-term financial sustainability.

Environmental trends are not immediately quantifiable, which makes analysis difficult; but they provide an early indication of future economic trends. See Exhibit 2 for examples of major environmental and demographic statistics that are readily available (e.g., crime rate and property value) or quantified over periods of time (e.g., population and pov-

To navigate these turbulent times, local governments need proactive approaches and strategies that address critical fiscal management issues.

## Exhibit I: Local Economic Condition Change in 2012



Source: National League of Cities April 2013 Local Economic Conditions Report

erty). Government officials need to constantly monitor their local environment, ask questions about why certain changes occur, assess the significance of these changes, and develop plans to avoid future problems.

Governments also need to regularly review key financial indicators for negative variances, which are more immediate signs of distress than environmental trends. Since financial reports represent changes on a yearly basis, any signs of inconsistencies require urgent action. Municipalities should “red flag” consecutive years of the economic indicators found

in Exhibit 3 and develop plans for addressing these issues as they present themselves.

Certain management actions can also indicate municipal distress. When local government leaders attempt to balance the budget by repeatedly using reserves, short-term debt, internal transfers, asset sales, and deferred pension liabilities, they may compound existing problems, resulting in a spiraling deficit that could lead to financial insolvency.

**Action 2: Provide Timely Reporting of Financial Results.** A challenge that local governments frequently face

## Exhibit 2: Indicators and Trends

Key Indicator	Trend Over Time	Environmental Trends
		Reversing the Trend
Population	▼	<ul style="list-style-type: none"> <li>• Reduce building code restrictions, development fees, or other land-use restrictions</li> <li>• Use zoning to encourage residential development</li> <li>• Develop a program for marketing available land for development</li> </ul>
Crime Rate	▲	<ul style="list-style-type: none"> <li>• Determine if it is a statewide, regional, or local trend</li> <li>• Assess public safety expenditures and its constraint on the budget</li> <li>• Determine if it is driving away existing business or discouraging new business</li> </ul>
Property Full Value	▼ or ◀▶	<ul style="list-style-type: none"> <li>• Redevelopment programs</li> <li>• Housing grants</li> <li>• Rehabilitation loans</li> <li>• Mortgage subsidies</li> <li>• Upgrade telecommunication networks</li> <li>• Use of impact fees for improvement of roads, parks, water or sewerage facilities</li> </ul>
Poverty	▲	<ul style="list-style-type: none"> <li>• Set a strategic plan in place for economic development</li> <li>• If possible, take advantage of state, federal, or other programs to increase local residents' job skills and employment opportunities</li> </ul>

Source: *Evaluating Financial Condition: A Handbook for Local Government*, IMCA

is a lack of current financial and operational results, actual cash position, and budgetary performance. Many distressed cities find themselves 12 to 24 months delinquent in completing their annual comprehensive financial reports. How can city officials make informed public policy decisions without timely financial reports?

In its 2008 best practice, *Improving the Timeliness of Financial Reports*, the Government Finance Officers Association recommends the way governments should deal with unforeseen circumstances: "...the inherent uncertainty should not unduly delay the financial report preparation process and the independent audit. Accordingly, it often is better to proceed with the issuance of the financial statements based upon estimates, rather than to delay their issuance."

Cities don't always produce formal monthly or quarterly budget-to-actual statements or other financial statements for leadership review, either. A county commission, school board, or city council cannot be expected to understand the jurisdiction's financial

position without monthly budget-to-actual, cash flow, and similar statements. A look at fiscally stable cities shows that many have established operating procedures for preparing the quarterly and monthly financial reports that keep decision makers informed about the city's financial condition. These financial reports often include a year-to-date discussion on the city's financial performance; a comparison of budget-to-actual revenue collections by major fund appropriation; an

inventory of employee positions and status; the status of capital projects; and any changes in local economic factors. The report should also include a current copy of the government's annual internal controls memorandum and an accountability plan for the jurisdiction's major internal control issues, along with an update on the recommended action plan items. Failing to address any material weaknesses quickly can impede current-year financial reporting results and affect cash flows.

**Action 3: Understand Cash and Financial Position.** One of the great-

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### Exhibit 3: Red Flag Indicators

Key Indicator	Trend Over Time	Financial Trends
		Reversing the Trend
Revenues per Capita	▼	<ul style="list-style-type: none"> <li>• Revise revenue collection procedures</li> <li>• Reduce tax delinquencies</li> <li>• Institute or increase service charges, fines and penalties, license and permit fees</li> <li>• Update property assessments</li> <li>• Sell surplus property or equipment</li> <li>• Secure special-purpose or grant funding from public or private agencies</li> </ul>
Restricted Revenues	▲	<ul style="list-style-type: none"> <li>• List each of the restricted revenues and identify the service or expense area to which it contributes</li> <li>• Assess how essential this service is to the local government or its citizens</li> <li>• Rate the likelihood that the revenue source will continue</li> </ul>
Intergovernmental Revenues	▲	<ul style="list-style-type: none"> <li>• Carefully examine all potential grants for matching requirements</li> <li>• Set a limit where intergovernmental revenues will not exceed a certain percentage of net operating revenues</li> <li>• Use intergovernmental assistance to finance those capital improvements that are consistent with local government priorities</li> </ul>
Expenditures per Capita	▲	<ul style="list-style-type: none"> <li>• Consolidate support services</li> <li>• Cross-train personnel to avoid duplicating functions</li> <li>• Eliminate programs that are no longer important</li> <li>• Use more advanced management controls, information systems, and technologies</li> </ul>
Municipal Employees per Capita	▲	<ul style="list-style-type: none"> <li>• Evaluate employee productivity</li> <li>• Determine if lost grant funding is requiring local governments to pay workers previously hired under grants</li> <li>• Research community population characteristics and adapt service levels</li> </ul>
Fringe Benefits	▲	<ul style="list-style-type: none"> <li>• Cost out all nonsalary benefits and assess their impact on future budgets</li> <li>• Focus all compensation negotiations on total compensation salary plus benefits</li> <li>• All cost analyses of salary increases should include the effects from fringe benefit increases</li> </ul>

Source: *Evaluating Financial Condition: A Handbook for Local Government*, IMCA

est challenges is determining the organization’s cash position. While local governments approve annual budgets, regular, ongoing review and analysis of the organization’s financial cash position is frequently overlooked. As a first step to avoiding a cash crisis, processes must be established that inform officials when revenues and expenses occur — a lesson several distressed organizations have learned the hard way. In normal government operation, revenues and expenses are not evenly distributed over a 12-month period. Cash flow projections help identify variances in revenues and expenses and the overall cash position, which is a leading indicator of fiscal health.

Predicting potential issues through an analysis of financial condition can help prevent recurring operating deficits and financial insolvency.

Without current financial information, actual cash position, and budgetary performance information, managing operations effectively will prove difficult.

In another best practice, *Use of Cash Flow Forecasts in Treasury Operations*, the GFOA recommends integrating operational cash flow forecasts into a government’s financial policies. Specific elements should be incorporated in the development of cash flow forecasts, according to *Use of Cash Flow Forecasts in Treasury Operations*. This GFOA best practice suggests that cash flow forecasts include inflows and outflows for a defined period (typically weekly

## CASE STUDIES

### City of San Jose, California

The City of San Jose faced a budget deficit of nearly \$115 million for fiscal 2011-12, largely due to the skyrocketing costs of retirement benefits and pension contributions, which accounted for nearly 50 percent of the deficit. In May 2011, the city council approved a fiscal reform plan that included a strategy for achieving long-term financial stability; restoring key services for police, fire, libraries, and community services; and opening facilities that had recently been completed or were under construction. This plan also identified retirement cost reduction strategies.

In implementing the fiscal reform plan, San Jose's city manager proposed an operating budget for fiscal 2011 that resulted in cuts to both essential and non-essential services, despite outside pressure from community activists and union advocates. In addition, since personnel expenses accounted for nearly 70 percent of spending in the previous budget cycle, a net 440 positions were eliminated to close the gap. In tandem with these budget-slashing efforts, the city sought a 10 percent wage decrease for public-sector employees in order to preserve jobs and reduce the proposed cuts in the fiscal 2011-12 operating budget.

The city manager likewise called on city departments to discover new efficiencies in their respective programs, including the use of outsourcing. Many cuts were identified as being "tough" on city residents but necessary nonetheless. They included instituting rolling brownouts at fire stations, reducing police and fire department staffing levels, limiting community center hours, and reducing park maintenance schedules. In addition, San Jose, which had significantly increased its library facilities in recent years, limited the number of hours and days for new neighborhood branch libraries and created open hour "shifts" throughout the system.

One of the greatest lessons to take away from the experience in San Jose, which has a highly unionized workforce, is the way the city handled its labor negotiations. While under open contracts, the city persuaded bargaining groups to build consortiums to allow the city to manage benefit structures. The city was thus able to lower its personnel costs through negotiations with its labor groups and stakeholder input. This proactive leadership allowed the city to enter fiscal 2012-13 with a \$9 million surplus.

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**JENNIFER MAGUIRE**, budget director for the city of San Jose, contributed to this article.

### City of Kalamazoo, Michigan

Another example of a local government that deployed a consolidated services plan is the City of Kalamazoo, Michigan. The city faced significant budget challenges in the late 1970s, when the then-city manager led an initiative to review the funding levels for all city programs and services. The city implemented a resource allocation budgeting model that replaced the traditional line-item budgeting process, which did not prioritize the delivery of city services. It used a hybrid zero-based priority budgeting process with budgets built from the ground up, rather than simply adopting all historical expenditures. At the same time, essential services were funded before non-essential services. Employing this budget program allowed the city to quickly detect inflated budgets, eliminate obsolete programs, and identify opportunities for reducing long-term costs.

The core cause of Kalamazoo's deficits was the disproportionate funding allocated to the police and fire departments. Kalamazoo was reluctant to merge these two vital departments, but the traditional steps of cutting costs by reducing employees and unnecessary services had been unsuccessful, so the city eventually consolidated the police and fire departments into a fully integrated public safety agency. With assistance from the leadership of both the police and fire unions, the consolidation initiative reduced the total personnel employed by police and fire from 383 in 1982 to 287 today, and the city estimates that the consolidation saves the city \$9 million a year. Additionally, consolidating the police and fire dispatches into a single agency has decreased costs by \$300,000 a year.

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**ROBERT BOBB**, president, Robert Bobb Group, and former city manager for the city of Kalamazoo (1972-1984), contributed to this article.

## Exhibit 4: Three Essential Questions of Planning and Building

Prerequisite	Planning	Budgeting
What is affordable?	What are the community's priorities and how can government action add value?	What programs should we fund in order to best achieve the priorities?
	How much and what quality of service does the community need from a given program?	What level of service should we fund within a program?
	Is the service provided efficiently?	For a given service level, are the requested inputs reasonable for the output we expect to receive?

or monthly) by each major fund group, with input from city department heads about the timing of planned expenditures. Doing so ensures that the jurisdiction will have adequate cash on hand to address departmental needs, while at the same time maximizing the return on available cash.

**Action 4: Prioritize Government Services and Operational Reviews.** Jurisdictions need to look for creative ways of addressing their financial problems. A GFOA whitepaper, “Zero-Based Budgeting: Modern Experiences and Current Perspectives,” outlines approaches governments can use to develop budgets, especially during times of fiscal distress. (See Exhibit 4.) The cities of San Jose, California, and Kalamazoo, Michigan, provide examples of governments that were able to develop expenditure reduction plans by evaluating essential and non-essential services; see the “Case Studies” sidebar for details about what they did.

**Action 5: Provide for Accountability in Financial Management.** Revenue and expenditure policies provide a complete understanding of revenue sources and, thus, a basis for prudent planning, but they are not always included in the critical checklist. The GFOA recommends that local governments have detailed financial management policies in place to support sustainable and accountable organizations.<sup>1</sup> Without city council safeguards, including these approved policies, there is no basis for sustainable financial stewardship. The GFOA’s *Adoption of Financial Policies and Long-Term Financial Planning* best practices recommend that jurisdictions should have city council-approved policies that address:

- Financial planning policies, which speak to both the need for a long-term view and the fundamental principle of a balanced budget.
- Revenue policies, which seek stability to avoid potential service disruptions caused by revenue shortfalls. Understanding the revenue stream is essential to prudent planning.

- Expenditure policies, which promote fiscal stability by ensuring that a jurisdiction is prudent in planning for its expenditures.

Along with deploying financial policies, governments must use transparency and accountability in monitoring and reporting financial results. In many instances, local governments have approved policies but fail to follow them. Finance officers therefore need to monitor and report the outcomes of approved policies and make adjustments as needed.

**Action 6: Be Willing to Spend Money to Save Money.** Local governments sometimes need to identify initiatives that will cut costs and improve efficiency in the long run; the techniques and practices on the GFOA’s Fiscal First Aid Strategies website (at [www.gfoa.org](http://www.gfoa.org)) support the notion that governments need to make use of external resources that create value. The services of external industry professionals can also help validate the organization’s financial position and condition.

## CONCLUSIONS

In difficult economic times, finance officers need resources to help them manage their jurisdictions through fiscal distress. Best practices from organizations such as the GFOA provide governments with strategies they can use to become sustainable for the long run. ■

### Note

1. National Advisory Council on State and Local Budgeting, *Recommended Budget Practices: A Framework for Improved State and Local Government Budgeting* (Chicago: Government Finance Officers Association), 1998.

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