

COUNTY OF MILWAUKEE
Inter-Office Communication

Date: December 17, 2002

To: Supervisor Lee Holloway, Chairman
Milwaukee County Board of Supervisors

From: Terry Kocourek, Fiscal and Budget Administrator, Department of Administration
Jerome J. Heer, Director of Audits
Rob Henken, County Board Director of Research

Subject: Analysis of a Prospective Conversion to a Biennial Budget Process and Analysis of the Fund Transfer Process (File No. 02-324)

Background

On July 25, 2002, the County Board adopted File Number 02-324, which authorized and directed the Department of Administration, Department of Audit and County Board staff to jointly prepare a report regarding:

1. The pros and cons of transforming Milwaukee County's annual budget process to a biennial process, including a recommendation on such a transformation.
2. A recommendation regarding possible legislation to be pursued by the Division of Intergovernmental Relations to allow the County to reform its fund transfer process in order to improve governmental efficiency and reduce time spent by administrators and Supervisors on unnecessary paperwork.

Biennial Budget

We obtained information on the budget cycles of 54 local governments, primarily from querying professional contacts and through researching individual government web sites. Of the 54 jurisdictions, 43 use annual budget cycles, while the remaining 11 use biennial cycles. We conducted interviews with the principal budget administrators in five of the 11 jurisdictions that use biennial budget cycles.

Local Government Experiences

Of the five jurisdictions using biennial budget cycles, one (the city of Los Alamos, New Mexico) is in the process of converting from an annual budget, and is in the midst of its initial biennial cycle. The other four jurisdictions all indicated that the biennial process saves time and promotes a longer-term view of operations. In general, these jurisdictions follow a process under which the budget for the first year is adopted and the second year budget is conditionally approved at the beginning of the two-year cycle. At mid-term, the second year budget is revised to adjust revenue estimates and reflect any major changes in programs. Then the revised second year budget is formally adopted.

The administrators we interviewed cited two primary advantages of a biennial budget process: time saved by staff and elected officials that was formerly devoted to processing essentially repetitive base budget amounts on an annual basis; and the ability to focus on long range planning. This latter benefit flows from the former, as time saved in the 'off' year can be used for long term planning projects.

There was agreement among the administrators that while forecasting is less accurate, a mid-term revision can compensate for any lack of initial precision, and departments can absorb and adapt to some fluctuations over the longer time period. One budget manager said that the longer time period allows department heads to manage their budgets and not have the budget manage the department. With a one-year cycle, planning for the next year has to start soon after the current budget is adopted. It places too much emphasis on preparing the budget and not enough on planning and managing.

State Government Experiences

A November 2000 report by the National Conference of State Legislatures (NCSL) provides an excellent summary of annual and biennial budgeting experiences of state governments. According to the NCSL report, 23 states have changed from biennial budgeting to annual budgeting since 1940, resulting in a current mix of 21 states with biennial cycles and 29 states with annual cycles. Of the 21 states with biennial budgets, 15 actually adopt two annual budgets at once, but have annual sessions in which they can and do modify the adopted budgets. Thus, only six states adopt a two-year budget without an intervening regularly scheduled session in which adjustments can be made.

There are several reasons for the shift to annual budgeting that have little connection to the budget period. For instance, many of the state legislatures changed their legislative sessions from biennial to annual and adjusted their budget cycles accordingly. In addition, budgets have become more complex and state finances have become more dependent on personal income and sales taxes, making revenue streams less stable and thus more difficult to project.

The report shows that there is not a clear case for the superiority of either biennial or annual budgeting. In fact, two states have reversed their decision to use annual budgets and have returned to biennial budgets.

Pros and Cons of a Biennial Budget Cycle

We have compiled a list of potential advantages and disadvantages of a biennial budget cycle as identified by various researchers and users.

Pros

- **Conducive to long-term planning. Fosters a more long-range view of budgets.** A conceptual argument is made that biennial budget cycles provide a longer frame of reference for budgetary decisions and thus lead to greater focus on longer-term goals.
- **Allows for emphasis on planning, review and evaluation in the 'off' year.** A strong argument can also be made that biennial budgets provide more time for performance evaluation and thus can encourage administrators and legislators to move in the direction of outcome-focused budgeting rather than continued focus on budget controls.
- **Reduces the time, cost and effort involved in budget adoption.** Biennial budgeting may reduce executive branch costs of preparing budgets, since the process is consolidated in comparison with annual budgeting.

Cons

- **Unstable revenue sources are not conducive to multiyear budgets.** Volatility in revenue streams makes the establishment of two-year budgets more precarious than annual spending plans. Instability in significant program and service areas also complicates extension of the budget cycle beyond one year.
- **Supplemental appropriations cycles can become as demanding as annual budgets.** Greater managerial flexibility within budget parameters is one way to combat the consequences of volatile funding streams noted above. However, major program adjustments or policy decisions may demand mid-course adjustments to biennial budgets. The need for frequent budget adjustment sessions can defeat the purpose of the biennial approach.
- **Conversion from an annual budget process is demanding and requires state legislation.** Further, some realignment of staff resources and skill sets would be necessary to achieve the desired benefits of greater long-term focus, improved program evaluation and stronger focus on outcome-based budgeting.

The advantages and disadvantages identified above are primarily theoretical arguments offered by proponents of annual and biennial budget cycles. However, the 2000 NCSL report cites two extensive studies on the topic and noted, "There is little evidence of clear advantages of either annual or biennial state budgeting practices." The first study cited in the NCSL report, by the Council of State Governments (CSG) in 1972, concluded:

In reality, a State can develop a good system of executive and legislative fiscal and program planning and controls under either an annual or biennial budget. The system would work differently with the alternative timespans, but could be effective under either approach.

A separate study in 1984 by analysts at Texas A&M University included an examination of the CSG data as well as an independent analysis of subsequent data. The Texas A&M study concluded:

The arguments used to justify and refute both annual and biennial budgets remain essentially unchanged [since 1972] and unproven. The success of a budget cycle seems to depend on the commitment of state officials to good implementation rather than on the method itself.

Milwaukee County Circumstances

The 2003 budget adoption process highlighted several areas of uncertainty that are of continuing concern to both the County Executive and County Board of Supervisors as they struggle to balance community needs with limited resources. These included:

- Pension Fund contribution.
- Jail, Court and Juvenile Detention costs.
- Employee Health Insurance costs.
- Impact of interest rates and other economic factors on sales tax revenue, investment income and other revenue streams.

Each of the areas identified above have experienced rapidly escalating costs or widely fluctuating circumstances that do not lend themselves to long-term prediction.

Further, there are several major administrative reforms and other factors with major budgetary implications for Milwaukee County during the next budget cycle that make this a particularly difficult time to consider sweeping changes in the budgetary process. These include:

- Implementation of the Department of Administrative Services model, which provides for greater centralization of certain administrative functions while retaining decentralized deployment of staff.
- Additional reorganization of the Department of Health and Human Services along functional lines.
- Anticipated glut of retirements in 2004 with significant budgetary consequences from sick leave payouts.
- Pension system funding contribution requirements, which the Pension Fund actuary has projected could grow to more than \$37 million in 2004 (a potential increase of \$22 million over the 2003 budgeted amount).
- Continued escalation of Employee Health Benefits costs. A new Employee Health framework reduced anticipated employee health care increases significantly in the 2003 Budget, but double-digit percentage increases for both the County's self-funded plan and its HMO arrangement again are anticipated in 2004. In addition, there is considerable concern regarding the County's ability to achieve its projected 2003 savings.

- Continued contention regarding the appropriate level of funding for the Courts and Sheriff's Department and the extent to which those entities can and should share in the County's budget-cutting efforts.
- The State's monumental fiscal crisis, which puts the County at risk to receive severe funding cuts in several major State aid programs.

While the above Milwaukee County circumstances represent potential arguments against a conversion to a biennial budget process at this time, a circumstance that would support such a conversion is the limited time currently available to the Board of Supervisors to review, amend and adopt the annual budget. The existing five- to six-week period that is provided to the County Board limits the Board's ability to obtain detailed independent analysis and comprehensive public input. Conversion to a two-year cycle potentially could address this problem by allowing the Executive Branch to begin its budget process earlier in the year in which the budget must be adopted given the added time between budget cycles. This, in turn, could enable the Board to receive the Recommended Budget several weeks earlier.

Conclusions

At the outset of this project, the authors agreed upon the following precept: A persuasive body of evidence would be necessary to merit a recommendation that Milwaukee County convert to a biennial budget cycle. Given the level of administrative effort and legislative action required to enact such a conversion, conceptual arguments alone would not be sufficient to justify a change. While some anecdotal information from administrators who have converted from an annual to a biennial budget cycle suggests that a biennial budget process can, in their view, be beneficial, careful study of the issue has failed to present a compelling case for the superiority of either method. *Given this factor and Milwaukee County's current circumstances, including substantial organizational reform, several highly volatile revenue streams and a full plate of extremely difficult budget issues, conversion to a biennial budget cycle is not recommended at this time.*

It should be noted that one of the benefits of biennial budgeting—a longer-term focus on budgeting and policy issues—could be achieved in other ways. For instance, the County's commitment to the strategic planning process and outcomes-based budgeting, as described in ***Charting the Course, Milwaukee County's Goals, Strategies, Action 2000–2004*** (File No. 99-494), provides a mechanism for achieving this longer-term focus by policy makers and administrators.

Another means of achieving longer-term budgetary vision would be the adoption of a five-year plan for future County operating budgets. Two years ago, the DOA-Fiscal Affairs Division began preparing a Five-Year Capital Improvements Plan for inclusion in the annual budget. As noted in the 2002 Adopted Capital Improvements Budget, the Five-Year Capital Improvements Plan is viewed as a “general blueprint for planned future capital expenditures. The plan is constructed based on a consensus among departments on their capital needs over the next few years in order to develop a comprehensive capital budget forecast. Although details of the plan are subject to change, it is a useful capital planning guideline for the County.”

A similar document could be developed to provide guidance, subject to revision and approval, on annual operating budgets. This document could provide growth estimates for major County revenue streams and balance those with estimates of major anticipated fixed costs, such as employee wages and health benefits, Pension Fund requirements and other long-term obligations. The preparation of such a document—and its consideration by policymakers—could assist the County in moving toward an approach that would emphasize long-term structural balance.

Finally, it should be noted that the provision of additional time for the County Board to review and approve the budget could occur under the existing annual budget framework. The County Executive has indicated an interest in condensing his budget preparation process in order to submit his Recommended Budget by early September, and this effort should be pursued for 2004 Budget deliberations.

Fund Transfers

Wisconsin State Statutes govern Milwaukee County budget and fund transfer procedures. Section 59.60 provides for an annual proposed budget prepared by the County Executive based on submissions by department heads. The County Executive is required to conduct public hearings on initial budget estimates and may revise those estimates at his or her discretion and submit a resulting proposed budget to the County Board on or before October 1 of each year. After an additional public hearing, the Finance [and Audit] Committee must submit its revisions, if any, to the proposed budget to the County Board for its approval. Upon approval, these sums become legal appropriations and anticipated revenues for the upcoming year.

Since departments are authorized to spend only those funds that are legally appropriated, it is sometimes necessary to transfer unexpended funds appropriated in one area to another, or to seek additional appropriations. State Statutes include the following general requirements for fund transfers.

- The department head, with the recommendation of the County Executive, may request that the Finance and Audit Committee transfer funds between principle objects within the department's budget.
- The County Board, upon recommendation of the Finance and Audit Committee and by a majority vote, may transfer any unencumbered appropriation from one department to another.
- In the case of supplemental or emergency appropriations, the County Board, with a two-thirds majority vote, may transfer from the contingency fund or create a new appropriation for any legal County purpose if unforeseen conditions require an appropriation of funds during the budget year.
- If sufficient funds are not available, the County Board, with a three-fourths majority vote, may issue tax anticipation notes.

Chapter 56.03 of the Milwaukee County Ordinances and the Administrative Manual specify the manner in which department heads request fund transfers. A chart summarizing the various approval levels is presented as **Exhibit 1**.

Fund Transfer Approvals

Finance and Audit Committee minutes provide convincing evidence that fund transfer requests are routinely approved. As shown in **Table 1**, of the 100 fund transfer items for which votes were taken during the nine-month period of January through September 2002, all 100 were approved. In fact, all but one vote in the eight meetings during that period reflected a unanimous vote approving all fund transfer requests in collective fashion. In the one instance during the period in which separate action was requested, the individual fund transfer separated from the collective vote also was approved, but on a 5-2 vote.

Table 1

**COMMITTEE ON FINANCE AND AUDIT
2002 FUND TRANSFERS**

Types of Fund Transfers	2002 Monthly Fund Transfers												
	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Total
Departmental-Receipt.of Rev. 2001	3	3						N	7				13
Departmental-Receipt of Rev. 2002	2	2	5	4	6	3	2	O					24
Unallocated Contingency Fund 2001	2												2
Unallocated Contingency Fund 2002			1				1	S	1				3
Capital Improvement 2001		4						E					4
Capital Improvement 2002	1	2		9	3	2	4	S	11				32
Departmental-Capital Outlay 2001	1							S					1
Departmental-Capital Outlay 2002							2	I					2
Departmental 2001	1		1					O					2
Departmental 2002		2	1	1			1	N	3				8
Inter-Departmental		1		1			1	S					3
Departmental -Other Charges 2002		1	1	2			2						6
TOTAL PER MONTH	10	15	9	17	9	5	13		22				100
TOTAL YEAR-TO-DATE FUND TRANSFERS = 100	Board Action Taken (Ayes - Noes)												
VOTE ON FUND TRANS. REQUESTS	6-0	6-0	7-0	6-0	*7-0	7-0	7-0		6-0				
*VOTE ON SEPARATE ACTION ITEM					5-2								

Source: Finance and Audit Committee Meeting Minutes, January—September 2002.

Discussions with long-time County Board staff members indicate the pattern of overwhelming approval rates for fund transfer requests in 2002, as depicted in Table 1, is consistent with prior years.

In an audit report of Milwaukee County operations issued in September of this year, the Wisconsin Legislative Audit Bureau (LAB) noted that Milwaukee County is unique in the manner in which State Statutes govern its intra-departmental fund transfers. According to the report, Milwaukee County is the only county required by statute to have its County Board approve all departmental requests to transfer funds between budget lines during a fiscal year. The report further states:

Eliminating the requirement that the board review all intradepartmental budget line transfers would provide departments flexibility to address unforeseen expenditures before requesting assistance from the county's contingency fund. In addition, it is likely to reduce the amount of time spent by administrators and the county board on small intradepartmental transfers that have no policy implications.

LAB goes on to recommend that the Milwaukee County Board seek authority from the State Legislature to implement a passive review process for certain intradepartmental budget transfer requests. We concur with LAB's conclusion that eliminating a formal approval process for routine intradepartmental fund transfers would provide greater administrative flexibility and efficiency. Care must be taken, however, to realize these benefits without sacrificing legislative oversight responsibility.

Conclusions

As suggested by LAB, one way to achieve increased administrative flexibility and efficiency without sacrificing legislative oversight responsibility would be to create a passive review process. This would afford any County Board Supervisor the ability to delay approval of an individual fund transfer request, but provide for automatic approval in the absence of any requested delays. This could be accomplished by:

- Placing responsibility on the Department of Administrative Services to regularly package and route all fund transfers approved by the County Executive to the County Board at least nine working days in advance of scheduled Finance and Audit Committee meetings.
- Providing for automatic placement of any fund transfer request on the next Finance and Audit Committee agenda at the request of any Supervisor who makes such request to the Chairman of the Committee at least 48 hours in advance of the meeting. This would permit Supervisors a window of seven working days to obtain information regarding any proposed fund transfer, or to formally request that an item be placed on the next Finance and Audit Committee agenda. It would also provide the Chairman of the Committee at least 24 hours to meet the statutorily required 24-hour public notice for agenda items. Placement of a fund transfer request on a Finance and Audit Committee agenda would prevent automatic approval of the item and require active approval of the full County Board.

The above procedures could be adopted for all intradepartmental fund transfer requests, including departmental receipt of revenue requests, capital improvement requests, departmental/capital outlay and departmental/other charges requests. Specifically excluded from this passive review procedure would be any fund transfer requests involving allocated or unallocated contingency funds, as well as any fund transfer requests involving transferring funds between separate departments.

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It is the recommendation of the authors of this report that the County Board authorize and direct Intergovernmental Relations staff to seek appropriate statutory revisions to accomplish a passive review process for all intradepartmental fund transfer requests. Such passive review process would not include any requested transactions involving allocated or unallocated contingency funds, nor would it include any request involving transfers between separate departments.

Please refer this report to the Committee on Finance and Audit.

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cc: County Board of Supervisors
Supervisor Richard D. Nyklewicz, Jr., Chairman, Finance and Audit Committee
Scott Walker, Milwaukee County Executive
Linda Seemeyer, Director, Department of Administration
Roy de la Rosa, Director, Intergovernmental Relations
Lauri Henning, Chief Committee Clerk, County Board Staff

Current Approval Levels for Fund Transfers

Type of Transfer	Description	Approval Needed
Allocated Contingency	County Board has specified that dollars within the contingency are dedicated to the fund transfer item.	F & A Committee approval and 2/3 vote of County Board
Departmental/Receipt of Revenue	A department receives revenue that was not included in adopted budget.	F & A Committee approval and 2/3 vote of County Board
Unallocated Contingency	Used on an emergency basis when a department needs funding for an item not budgeted and there is no revenue anticipated to offset the expenditure.	F & A Committee approval and 2/3 vote of County Board
Capital Improvement/ Allocated Contingency	County Board has specified that dollars within the contingency are dedicated to the fund transfer item - capital projects only.	F & A Committee approval and 2/3 vote of County Board
Capital Improvement	Used for modifications to a capital project.	F & A Committee approval and majority vote of County Board
Departmental/Capital Outlay	Used for modifications to the 8500 series - capital outlay accounts.	F & A Committee approval and majority vote of County Board
Departmental/Other Charges	Used to move funding from a trust fund or balance sheet account including establishing an imprest fund and transfers within 8000-8499 account series.	F & A Committee approval and majority vote of County Board
Interdepartmental	Funds are being transferred to another department.	F & A Committee approval and majority vote of County Board
Departmental	Used to move an appropriation within a department into a different account series.	F & A Committee approval only
Substitution of Equipment Class III	Used to request additional equipment not authorized in the budget, and for which appropriations are available from a surplus in the department's equipment appropriation.	F & A Committee approval only
DOA only	Department requests a transfer of funds within the 6000 or 7000 account series. May also be used within the 8000 series on certain conditions.	Fiscal and Budget Administrator signature only

Source: Milwaukee County Administrative Manual