HANDBOOK FOR MINNESOTA CITIES

Chapter 20
Municipal Budgeting

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HANDBOOK FOR MINNESOTA CITIES

Chapter 20
Municipal Budgeting

Learn the characteristics of city budgets as a work plan and communication tool. Understand the budget cycle and structures, sources of city revenue, typical expenditure categories, and planning for multiple-year expenditures, like infrastructure, with a separate capital budget. Become aware of how GASB and Truth in Taxation impact budgeting.

RELEVANT LINKS:

Minn. Stat. § 412.221.

I. Public versus private budgeting

Cities are under great pressure to streamline operations and meet strict financial standards at the same time. Sustainability is an overarching concern for cities. Simply adopting last year's budget is not acting in the city's best interest.

Done thoroughly, city budgets reflect city plans, policies and goals regarding services and sound resource management. Consider city goals, what programs and services citizens want in the city and then look to sustaining or allocating funding for those goals, using the budget document as an important communication tool revealing a city's plan for the coming year

A city is a municipal corporation but budgeting in the public sector is different than it is in the private sector. The table below illustrates some of the major differences in terms of scope, law, and process.

CITIES	PRIVATE OR NON-GOVERNMENTAL ORGANIZATIONS (NGOS)
Provide services and programs for the entire community.	Provide services to a discrete set of customers.
Budgets focus on public safety and well-being of the community as a whole.	Allocate money to meet shareholder or owner expectations for profit.
Must fund a wide variety of activities from safe roads and clean water to economic development.	Focus spending on narrowly defined programs or services.
Subject to a significant number of state and federal mandates or laws that legally require cities to provide certain services but do not provide funding for them.	Not subject to such extensive and numerous legally binding mandates that require both provision and levels of service.

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RELEVANT LINKS:

CITIES	PRIVATE OR NON-GOVERNMENTAL ORGANIZATIONS (NGOS)
Must not borrow money from a bank but issue debt in the form of bonds to build public infrastructure such as roads and bridges.	Obtain funds by borrowing money to build or improve business or buildings.
Use taxing authority to raise funds to provide services and programs often at or below cost.	Charge for services or programs at a cost that includes a profit.
Prepare budgets in public and include the public in the process and in the final product.	Prepare budgets in private with no public participation.
Must make budgeting decisions by consensus.	Often vest decision-making authority in one person.
Competing interests are a given when cities prepare budgets.	Fewer competing interests - making a profit and/or being competitive is typically the focus.
Must budget for services in good and bad markets based on community needs, goals and objectives.	Make budget decisions based on competition with other businesses and on market conditions.
Subject to stringent and comprehensive financial controls and public reporting to prevent mismanagement and misuse of public funds.	Not subject to public accounting and financial controls or public scrutiny of funds and spending activities.

II. Budgeting basics and funds

Minn. Stat. § 6.745.
Minn. Stat. § 471.6965.
See Sections X-XII, *Plan B cities, Standard plan cities, Charter cities*.
Minn. Stat. § 471.696.

Budgeting is basically planning and prioritizing goals for the coming year based on experiences in the past year or years. All cities are required to prepare and adopt an annual budget. By law in Minnesota, the fiscal year of a city and all its funds must be the calendar year. Thus, for cities, a budget is one year of estimated money coming in (revenue) and money going out (expenditures). The council adopts the budget by a resolution which sets forth the total for each budgeted fund and each department.

Minn. Stat. § 412.711.

Note: Cities organized under Plan B form of government, and cities with home rule charters, special laws, local ordinances or unique circumstances may have additional or special budgeting requirements and considerations.

RELEVANT LINKS:

A city budget is a comprehensive financial plan for one year. It is a snapshot in time of city activities and services supported by discrete city funds for the coming year.

In governmental accounting terms, a "fund" is a sum of money set aside for a specific purpose—not necessarily a separate bank account—but tracked on paper separately. The three basic city fund types are:

Handbook, *Financial Reports, Accounting and Auditing*.

- Governmental funds—used to finance most governmental services and based on tax revenues, special assessments, or issuing debt. The city's general fund, debt service funds (to pay off bonds), and capital project funds are examples of governmental funds.
- Proprietary funds—financing for governmental activities operating like a private business, for example, water and sewer utilities, electrical utilities, or municipal liquor stores. Service charges usually provide most of these funds.
- Fiduciary funds—trust and agency funds used to account for assets a city holds in a trustee capacity or as an agent, for example, pension funds. Fiduciary funds cannot be used to support the city's own programs.

See Sections VI and VII, *Revenues and Expenditures*.

Uniform Chart of Accounts, Office of the State Auditor.

The Office of the State Auditor (OSA) provides the Uniform Chart of Accounts to facilitate the preparation of uniform annual financial statements. The outline of accounts may also serve as a useful checklist when preparing city budgets. Every city should consult this chart when preparing the annual budget and maintaining financial records. The OSA recommends the adoption of the uniform account numbering system for all cities, including cities under 2,500 in population, whenever practical.

Preparing city budgets involves policy decisions about the use of money, and it helps cities make important decisions, tying funding to specific goals set by the council. During the budgeting process, city council members and staff look back to what programs and services worked the previous year and they look forward to what city activities may be changed, dropped, or increased in the coming year.

III. Municipal budget is a plan

To make a useful municipal budget, examine all city services and programs, for example, firefighting services, police protection services, water and sewer services, elections, park and recreation programs and maintenance, snowplowing, and any other city-funded activity.

Include personnel costs, office supplies, computers, software, building and maintenance supplies, fuel costs, and any other equipment. These are the current expenditures. Next look at money coming in, or revenue, from all sources.

RELEVANT LINKS:

As explained in more detail below, property taxes are the largest source of revenue for cities. In order to balance the budget, total estimated revenues must be equal to or exceed total estimated expenditures. The budget sets out a council's yearly plan to maintain, change, add or drop services and activities.

Fund Balances for Local Governments, Statement of Position, Office of the State Auditor, Feb. 2014.
LMC website: "*City Fund Balances 101*".

Planning a city budget includes a fund balance, or unrestricted money available to cover unexpected costs. The state auditor recommends but does not require that cities keep a minimum of five months' operating costs on hand and accessible to cover such unanticipated costs. Some city councils believe that higher fund balances provide more protection against unforeseen emergencies.

Section VIII, *Capital Improvements*.

Cities often budget and plan separately for capital improvements because the process covers more than one year. Capital improvements include planning for replacing, repairing and maintaining infrastructure such as streets, sidewalks, water and sewer systems, transportation, buildings and parks. Planning for future infrastructure costs is essential. Without it, cities run the risk of costly emergency repairs to local infrastructure.

A. Local Performance Measures

Minn. Stat. § 6.91.

Performance Measurement Program, Office of the State Auditor

Cities that elect to participate in the standard measures program must report its results to its citizens annually through publication, direct mailing, and posting on the jurisdiction's website, or through a public hearing at which the budget and levy will be discussed and public input allowed. Participating cities must report their results to the state auditor. The state auditor must compile the results, make them available to all interested parties, publish them on the auditor's website, and report them to the legislative tax committees.

Minn. Stat. § 6.91.

A city that elects to participate in the standard measures program may benefit in these ways:

- Eligible for reimbursement of 14 cents per capita, but not to exceed $25,000 for any government entity.
- Exempt from levy limits for taxes payable in the following year, if levy limits are in effect.

B. Budget cycle

Budget Process, City of Hopkins.

The process of annual budget preparation occurs within the framework of the state property tax system. Property taxes are generally the primary revenue source for Minnesota cities. Each fall, cities submit their property tax levies for the upcoming year to the county auditor.

RELEVANT LINKS:

Counties are responsible for property tax administration; the Department of Revenue provides assistance and oversight.

Section VI, *Revenues*.

Minnesota cities also participate in a revenue-sharing program known as local government aid (LGA). LGA supplements property tax revenue.

Section IX.C, *Truth-in-Taxation*.

Cities must prepare and adopt proposed budgets and proposed property tax levies each year. Cities over 500 in population that propose a property tax increase are required to provide notice of the proposed budget adoption and to allow public input on the proposed budget and property tax levy. The "truth-in-taxation" (TNT) process is described later in this chapter.

Cities generally prepare budgets in the summer with the following due dates, although particular dates may vary by year if a due date falls on a holiday or a weekend:

Minn. Stat. § 477A.014.
Minn. Stat. § 275.74, subd. 1.
Minn. Stat. § 275.065, subd. 1.
Minn. Stat. § 275.065, subd. 6.

- **On or before Aug. 1**: The Department of Revenue notifies cities of state aid amounts.
- **On or before Sept. 1**: The Department of Revenue notifies cities of the applicable levy limit, if any.
- **On or before Sept. 30**: Cities must adopt their proposed budget and certify their proposed levy to the county auditor.
  Note: Once cities certify a proposed levy in September, they may decrease the amount when they certify a final levy in December—but may not increase it.

Minn. Stat. § 275.065, subd. 1.

Minn. Stat. § 275.066.

Minn. Stat. § 275.07, subd. 1.

LMC information memo, *Budget Guide for Cities.*

- **Between Nov. 25 and Dec. 20**: The TNT public comment hearings, if required, must occur. Remember to check current calendars for each year's due dates.
- **On or before five working days after December 20 in each year**: Cities must adopt a final tax levy and certify that final property tax levy to the county auditor. If this deadline is missed, the final levy for 2019 will stay the same as it was in the previous year.

Minn. Stat. § 477A.015.
Minn. Stat. § 273.1384, subd. 4.
LMC website: *Dates for City Budgets 101.*

Cities generally receive property tax revenues and state aid at various times. The county treasurer distributes property tax revenues to cities in two payments. The Department of Revenue distributes LGA payments to cities in two equal installments, on or around July 20 and Dec. 26 each year.

City budgeting never stops. While city councils and staff are preparing new annual city budgets, they are also tracking and reviewing the current year's revenues and expenditures. As cities implement a new year's budget, they are also auditing and reporting on the past year's expenditures. Preparation, approval, implementation, and audit review comprise the ongoing budget cycle.

RELEVANT LINKS:

1. Budget preparation

Cities begin budget preparations in May or June, examining current economic trends, as well as all revenue sources and expenditures and proposing increases or decreases accordingly. City staff collects budget information and presents it to the council at meetings where interested citizens may participate. The goal of budget preparation is to balance all revenues and expenditures, prioritize capital improvements, and appropriately manage outstanding debt.

2. Budget approval

Minn. Stat. § 275.07, subd. 1.
Section VI, A 2. *Setting the property tax levy within limits*.

By law in Minnesota, the fiscal year of a city and all of its funds is the calendar year. By December of each year cities determine their financial condition. Cities adopt a new budget late in December to begin in January of the coming year.

3. Budget implementation

City councils must monitor the current budget, directing how staff accounts for expenditures and revenues.

The Importance of Internal Controls, Statement of Position, Office of the State Auditor
Credit Card Use and Policies, Statement of Position, Office of the State Auditor.

One important step is for council to adopt a policy on internal controls, meaning that the council sets the rules to prevent misuse of public money. For example, if possible, the same person should not be taking in money and paying it out. This 'segregation of duties' is part of a policy on internal control and budget implementation crucial to appropriate use of public funds.

Petty Cash (Imprest) Funds, Statement of Position, Office of the State Auditor.

Policies on the use of petty cash (known as imprest funds in financial jargon) and credit cards also help protect cities from loss or misuse of public funds.

4. Budget audits

Minn. Stat. § 471.697, subd. 1.
Minn. Stat. § 471.49, subd. 10.

City councils must audit budgets, depending on the size, structure, and annual revenues of the city. The state auditor publishes the audit threshold in early February of each year.

Minn. Stat. § 412.591, subd. 2.
Minn. Stat. § 412.02, subd. 3.
Handbook, *Financial Reports, Accounting and Auditing*.

Audit Requirements for Cities, Frequently Asked Questions, Office of the State Auditor.

At a minimum, a city with a population of 2,500 or less and a combined clerk/treasurer must have an annual audit done by a certified public accountant if its annual revenue is *greater than* $272,000—for the year ending Dec. 31, 2022. A city with a combined clerk/treasurer and annual revenue of *less than* $272,000 (for the year ending on Dec. 31, 2022) must have an audit done by a certified public accountant once every five years, and the person doing the auditing will select the year to be audited.

RELEVANT LINKS:

A city with a population over 2,500 must have an annual audit performed. Remember to check with the state auditor for current audit thresholds in February of each calendar year.

5. Budget amendments

City budgets are not set in stone. Many cities must revise their original budgets over the course of the year for a variety of reasons. Amending the budget is not illegal nor is it necessarily undesirable. Typically, city councils simply note the reason for amending the city budget and adopt the amendment in a resolution.

Minn. Stat. § 412.731. Section X: *Plan B cities*.

However, in Minnesota's 19 Plan B cities, resolutions reducing amounts in the budget or authorizing transfers from unencumbered balances must pass by a four-fifths vote of all the members of the council.

City of Eden Prairie, 2023 Comprehensive Financial Report Recipient of Comprehensive Annual Financial Report award from GFOA. Governmental Accounting Standards Board. (GASB 34).

For cities over 2,500 in population, the Governmental Accounting Standards Board (GASB) requires that cities include the original budget and budget amendments in budget reports, such as the comprehensive annual financial report.

IV. Budget as a communication tool

2023 Corporate Report to the Community: City of Bloomington.

City councilmembers, as policymakers, must understand budget documents. Making a city budget understandable to citizens is not easy.

Comprehensive Annual Financial Report City of Arden Hills.

Using the budget process and product to communicate with the public, by showing what services resident tax dollars fund, is one way to make budgeting meaningful for council members and residents.

Government Finance Officers Association (GFOA): Sort by state to see all Minnesota recipients of the Distinguished Budget Award.

Certificate of Achievement for Excellence in Financial Reporting Program.

An award was created by the Government Finance Officers Association to recognize government entities that extract information from their comprehensive annual financial report to produce high quality annual financial reports specifically designed to be readily accessible and easily understandable to the general public and other interested parties without a background in public finance.

A. Explain city financial conditions in budget documents

Comprehensive Annual Financial Report 2023, City of Richfield.

Citizens have a sense of the current economy but may not understand how the state economy impacts city budgets. City councilmembers also need to look at the city budget in light of overall economic conditions. In the budget documents, explain which of these state and local challenges affects your city:

- Interest rates on city investments have been on the rise resulting in an increase in interest income.
- The interest rate on bonds reflects the increasing interest rates in the market, making projects more expensive with a higher interest component.
- State aid has increased with one-time allocations from the surplus
- Unpaid utility charges/challenges with utility charge collections
- Abandoned or vacant properties.
- Employee recruitment and retention challenges

City budget documents build on the past year and project into the coming year. Communicating an accurate picture of the city's financial condition helps citizens and council develop strategies to sustain the city.

B. Tie budgeting to goals in budget documents

Citizens support goals, not just expenditures. For example, all cities share the critical responsibility to hold elections. One city sets a goal in the annual budget to "continue providing efficient and friendly non-partisan voter registration, absentee, and election day services" and tracks everything related to that goal in the annual budget document.

Citizens are therefore able to understand and support the city's expenditures related to elections.

C. Foster citizen involvement in budget process

City of Hopkins, City Budget Process.

City of Minnetonka: Budget Feedback.

City of Worthington, Budget Information.

Many cities use citizen surveys to determine city priorities and guide budget decisions about the level of city services provided. Given the stress on city budgets and the expenses of a city-wide survey, a number of cities seek citizen input on the city budget simply by providing a way to submit ideas, questions or comments about the budget through the city website. Cities may also seek citizen input from targeted discussion groups, advisory boards and public meetings during the development of the budget.

Even though allowing citizen participation is required in cities with population over 500, the required participation does not occur until late in the budget cycle. Cities may wish to publicize the budget process or calendar to encourage citizen participation earlier in the year.

D. Link citizen input to budget decisions

Once a city engages citizens in the budgeting process, include that participation and comments in the budget documents.

RELEVANT LINKS:

For example, if many citizens comment on the need to revitalize certain commercial or residential areas of the city, include the comments and actions that the city council takes on that issue in the budget document, even if it is a preliminary plan to investigate revenue related to revitalization. Then, citizens see how their involvement impacts the city's budget process and plan.

E. Use the budget to communicate the value of government

City of Shakopee, Property Tax Receipt

Easy to understand information on what programs and services a city tax dollar supports helps citizen understand the value of government and city budgets. City budgets necessarily focus on the overall cost of a service, for example, police protection. But, looking at city budgets from the opposite end—how much tax revenue comes into the city from each home and all the services those dollars support—shows a more accurate picture of the value of city services to residents.

V. Budget structures

Most cities approach budgeting using a particular format. The most common budget techniques cities use include the following formats:

- Line item budgets: the simplest budgeting structure showing each expenditure on a separate line.
- Program budgets: presents budgeting information around particular programs instead of simple line item expenditures.
- Performance budgets: rather than just expenditures, includes service goals and objectives, and measures outcomes related to expenditures.
- Zero-based budgets: starts with funding city services at a minimum level and working up from there to a level of funding that councils agree is appropriate for each city service.

Many city budgets contain a mix of these formats. The format is simply a way to present information on expenditures so that city councils may decide which services the city will fund, and at what level, for the coming year.

VI. Revenues

Minn. Stat. § 410.32.
Minn. Stat. § 412.301.
Minn. Stat. § 297A.99, subd. 1 (d).

City budgets start with a picture of revenue (money coming in). Minnesota law greatly restricts the available types of local revenue sources. Unlike some other states, local governments in Minnesota may not impose an income tax. In addition, without specific legislative authority, cities may not impose a local sales tax, and the local sales taxes that have been granted are usually for specially designated purposes.

RELEVANT LINKS:

Minn. Stat. § 297A.99, subd. 1 (d).

A political subdivision may not advertise or expend funds for the *promotion* of a referendum to support imposing a local option sales tax, but a city may expend funds to:

- Conduct the referendum.
- Disseminate information included in the resolution but only if the disseminated information includes a list of specific projects and the cost of each individual project.
- Provide notice of and conduct public forums at which proponents and opponents of the referendum are given equal time to express their opinions on the merits of the referendum.
- Provide facts and data on the impact of the proposed local sales tax on consumer purchases.
- Provide facts and data related to the individual programs and projects to be funded with the local sales tax.

Understanding where city funds come from is the first step in developing a budget plan. Based on the state auditor's uniform chart of accounts, revenue for most cities includes money from the following 13 categories.

A. Tax revenue

Minn. Stat. Ch. 275.
Minn. Stat. § 282.08.
Minn. Stat. § 216B.025.
Minn. Stat. § 276.131.
Minn. Stat. § 349.213.
Minn. Stat. § 469.190.

Tax revenue includes current property taxes; delinquent property taxes; apportionments from tax forfeit sales; franchise and public utility taxes; and city sales, gambling, and local lodging taxes, if any. Cities in Minnesota receive a variety of shared tax revenue, or general state aid, from the state. Amounts for each city are typically available from the Minnesota Department of Revenue on or before Aug. 1 of each year.

1. Property tax revenue

LMC website: Property Taxation 101.

The property tax is the primary revenue source for cities, and it applies to all taxable property within city boundaries.

Accounting Manual for Small Cities and Towns in Minnesota.
Uniform Chart of Accounts, Office of the State Auditor.

The Minnesota property tax system is complicated, including classifications of property based on the use of the property. Over time, the system has become more complex. Local officials, however, can only control local levy decisions and must focus on that for budgeting purposes.

2. Setting the property tax levy

Each year, cities certify a property tax levy for the following year in dollars, not at a specific rate. The council should set a tax levy high enough to provide money for the following purposes during the upcoming budget year:

RELEVANT LINKS:

Minn. Stat. § 477A.011.
Minn. Stat. Ch. 275.
Minn. Stat. § 275.70, subd. 5.
Handbook, *Property Tax Levy*.

- Payment of all estimated expenditures, including an allowance for a reserve and the amount necessary to make all city contributions to the Public Employees' Retirement Association (PERA).
- Current expenditure liabilities the city cannot pay in the present year for lack of current funds or that the city will pay through short-term borrowing.
- Repayment of all tax anticipation certificates the city issued during present and past years.
- An amount in anticipation of any reduction or loss of state aid, federal revenue, or other undependable sources of revenue.
- For the payment of interest and repayment of principal on bond issues before the bonds are delivered. (Bonds issued previously are already funded by a portion of the city levy).

3. Gambling taxes and funds

Minn. Stat. § 349.213, subd. 3.

Cities may impose up to a 3 percent local gambling tax on licensed gambling organizations in order to cover the cost of regulating lawful gambling. A city may not use these tax revenues for any other purpose.

Minn. Stat. § 349.213, subd. 1(a).

Cities may also require organizations conducting lawful gambling to contribute 10 percent of their net profits derived from lawful gambling to a city-administered fund to be disbursed for lawful purposes. State law defines lawful purpose. Such funds cannot be used for the benefit of a pension or retirement fund.

See LMC information memo, *Lawful Gambling*.

For further discussion of lawful gambling expenditures and regulation, see LMC information memo, Lawful Gambling.

B. Franchise fees

Minn. Stat. § 216B.36.
47 U.S.C.A. § 542.
Accounting Manual for Small Cities and Towns in Minnesota.

Cities are authorized to impose a franchise fee on utility services, such as gas, electric, and cable television. Franchise fees for gas and electric utilities are subject to negotiation. Cable franchise fees are limited to no more than 5 percent of the cable operator's gross revenues over a 12-month period.

Uniform Chart of Accounts, Office of the State Auditor.

The revenues from franchise fees can be useful in offsetting a city's costs to regulate these businesses and maintain and protect the public right-of-way. The state auditor classifies franchise fees as "other taxes."

C. License and permit revenue

Handbook, *City Licensing*.

Another source of revenue for cities come from license and permit fees. Cities should be conservative when estimating these amounts as they can vary considerably from year to year. Municipal licensing should not be viewed as a significant source of revenue.

RELEVANT LINKS:

In Minnesota, license fees must approximate the direct and indirect costs in issuing the license and policing the licensed activities.

D. Intergovernmental revenue

1. Local government aid

LMC website, LGA 101,

LMC website, History of Local Government Aid to Cities,

For some cities, local government aid (LGA) from the state is a significant source of income. The goal of LGA is to equalize cities' ability to provide an average level of services at reasonable property tax rates.

LMC website, LGA Formula Key Points.

LMC website, Dates for City Budgets 101.

Minn. Stat. § 477A.014.

Minnesota Department of Revenue: Local Government Aid (LGA) and Annexations, Boundary Changes, or Changes in Form of Government.

A complex formula determines how much LGA each city receives. The Minnesota Department of Revenue certifies how much LGA each city receives by Aug. 1 of each year. Cities receive two annual LGA payments—one in mid-July and the other at the end of December.

The commissioner of the Department of Revenue notifies each city of its LGA distribution during the first week of August. Cities have 60 days to appeal the calculation or factors used in the computation. Special considerations apply for cities dealing with annexation or a change in the form of city government.

2. Market value homestead credit ended in 2011

The Legislature eliminated the market value homestead credit (MVHC) program effective for tax year 2012. The main problem with the program for cities had been that the state did not always reimburse the entire amount of the credit.

Thus, cities did not receive the full amount they levied in a given year. The program was replaced by the homestead market value exclusion.

3. Homestead market value exclusion

Minn. Stat. § 273.13, subd. 35.

Minnesota Department of Revenue: Homestead Classification.

House Research: The Homestead Market Value Exclusion.

The homestead market value exclusion (HMVE) program replaced the MVHC program for taxes payable in 2012 and beyond. This means that what the city levies is what the city receives directly from property owners (less any amount that property owners fail to pay). This law is effective for taxes payable in 2012 and thereafter.

In place of the MVHC program, homeowners will receive an exclusion of a portion of the estimated market value of their house from property taxes. The exclusion is computed in a manner similar to the market value homestead credit.

4. General state aid

Cities in Minnesota receive a variety of shared revenues from the state. Amounts for each city are typically available from the Minnesota Department of Revenue on or before Aug. 1 of each year. Each of these programs has a separate policy goal, and, taken in combination, the programs and their impact on city finances can be confusing. The following sections describe these programs and their interaction with the city budget-setting process.

a. Fire and police state aid—filing forms required

Minn. Stat. § 477B.
Minn. Stat. § 477C.
Minn. Stat. § 424A.08.
Minn. Stat. § 471.699.

Handbook, *Financial Reports, Accounting and Auditing*.

The state determines which cities and independent nonprofit firefighting corporations qualify for fire state aid directly—or qualify to receive fire state aid paid to the voluntary statewide lump-sum volunteer firefighter retirement plan. The state also determines which cities are qualified to receive police state aid. The state must pay the police and fire aid by Oct. 1, so the money usually goes out just before that deadline. **However, cities must file the appropriate forms by March 15 each year to receive this money**. In addition, the state auditor can delay the Oct. 1 payment date if a city fails to submit legally required financial reports.

For forms, instructions and letters about both forms see Minnesota Revenue:

Police State Aid (Use Form PA-1).

Fire State Aid (Use Form FA-1).

The city clerk in the city served by the volunteer relief association must also countersign the fire relief association's financial report – or it may be countersigned by the city clerk in the largest city served by the fire relief association. According to the Minnesota Department of Revenue, if the forms are not received by March 1 the Department of Revenue will send a final reminder stating that the forms have not been received and that the fire or police department could forfeit part or all its aid for the year if the forms are not received by March 15.

The amount of aid forfeited is equal to the amount of yearly aid multiplied by 10 percent for each week or fraction of a week that the form is late. **Please note:** the police state aid form must be signed and dated by the city clerk. If the form is not signed and dated, the form will be returned. Please also note that the fire state aid form must be signed and dated by either the municipal clerk (or secretary of an independent nonprofit firefighting corporation) and the fire chief. If the form does not contain both signatures, the form will be returned.

Funding for these programs comes from the state general fund, based on taxes paid to the state by most insurers writing homeowners, fire, and commercial non-liability policies.

RELEVANT LINKS:

The state apportions the money to qualifying cities for fire and police pensions. If all the police officers in the city police department are members of the PERA Police and Fire Fund, the state peace officer aid must be applied toward the city's employer contribution to the Police and Fire Fund of PERA. If there is no firefighters' relief association and the city is not a member of the statewide volunteer firefighter retirement plan (SVFRP), then the fire aid must be used to maintain the fire department.

Minn. Stat. § 424A.02, subd. 3a.
Minn. Stat. § 424A.02, subd. 10.

Office of the State Auditor
525 Park Street - Suite 500,
St. Paul, MN 55103
(651) 296-2551.

City councils preparing budgets should know that there is a penalty if a defined benefit relief association pays out service pension benefits in excess of the statutory limits. This penalty includes the possible loss of fire state aid for the city. In addition, city councils should note that volunteer firefighter relief associations associated with the city fire department must file a copy of revised bylaws with the state auditor whenever they are amended or when the city council approves any amendment to the relief association's governing bylaws. Failure to file revised bylaws may also result in a loss of state aid until such documents have been filed.

b. Highway user tax distribution fund

Minn. Const. Art. 14.
Minn. Stat. § 162.09.

The Minnesota Constitution requires that state gasoline taxes and motor vehicle registration fees provide funding for certain city, county, and state roads. These revenues go into the highway user tax distribution fund (HUTDF), and the Minnesota Department of Transportation (MnDOT) distributes them. Twenty-nine percent of the fund is dedicated for certain county roads and highways. Nine percent goes to cities with populations over 5,000. The remaining 62 percent is dedicated to the state trunk highway system.

Minn. Stat. § 162.05.
Minn. Stat. § 162.11.

Minn. Stat. § 161.081, subd. 1.

Pursuant to article 14, section five of the state constitution, 5 percent of the net HUTDF is set aside for use on municipal and state roads. The 5 percent breaks down as follows:

Minn. Stat. § 162.081.

- 30.5 percent is devoted to the town road account.
- 16 percent is devoted to the town bridge account, allowing townships to use funds in the town bridge account to pay 100 percent of bridge rehabilitation and replacement costs.
- 53.5 percent is devoted to the flexible highway fund, to be used primarily to fund trunk highway turnbacks. Turnbacks are former trunk highways that the state relinquishes control of to another level of government, for example from state control to county responsibility. The flexible highway fund includes turnbacks of county highways in the computation of municipal state aid miles.

RELEVANT LINKS:

Minn. Stat. § 161.081.

The law also requires the Department of Transportation to consult with the League of Minnesota Cities and the Association of Minnesota Counties (AMC) regarding the distribution of the HUTDF flexible fund's turnback money. City and county officials make recommendations on how to divide the fund between cities, counties, and the state regarding turnbacks. The commissioner of Transportation incorporates those recommendations in the department's biennial budget requests to the governor's office and the Legislature.

E. Charges for services

Cities may also receive revenues from election filing fees, sales of maps and ordinances, assessment searches, court fees, police patrol and fire service fees, street and sidewalk repair fees, parking fees, refuse collection, water and sewer charges, inspection fees, and service charges such as those made by libraries, museums, and recreation facilities.

F. Public safety revenue

Contact the POST Board for further information at (651) 643-3060 or postboard.agency.docs@state.mn.us.

The state reimburses cities for some police officer training costs. The reimbursement amount available for training and per officer depends on the number of eligible officers and is not determined until all the applications have been received. The state determines the final amounts and transfers funds to cities in mid-September.

G. Culture and recreation

Cities may generate income from cultural or recreational activities. This may include money from park rentals or revenue from city sponsored programs such as swimming classes, city festivals and city parades.

H. Enterprise funds

Accounting Manual for Small Cities and Towns in Minnesota.

Uniform Chart of Accounts, Office of the State Auditor.

Enterprise funds come from city operations run in a manner similar to private businesses.

Examples include water and sewer operations, municipal liquor stores and electric utilities. These services are typically funded by charging those who use the service. According to the state auditor, cities are required to report sewer operations as enterprise funds.

I. Penalty charges

City revenue also comes from penalties and fines such as court fines, confiscated deposits, and collections on bonds or surety held for enforcement or security purposes.

RELEVANT LINKS:

Though such revenue occurs, accounting for it in the city budget does not mean that cities plan on issuing a set number of penalties or fines.

J. Special assessment revenue

"Special Assessments" House Information Brief, Sept. 2008.

Special assessments are a charge imposed on properties for a particular improvement that benefits the owners of those selected properties. The payments may continue coming in to the city for years and may be tied to bond payments for local infrastructure improvements such as improved water and sewer structures.

K. Miscellaneous revenues

According to the state auditor, miscellaneous revenues do not come from taxes, licenses and permits, intergovernmental revenues, charges for services, or fines and forfeits.

Examples of miscellaneous revenues includes money from interest on investments, including such investments as savings accounts, certificates of deposit, money market funds and treasury bonds and bills, net increases in the fair market value of investments, rents and royalties such as revenues from rental of city properties (excluding city hall and community hall rent, parking lot fees, and auditorium use fees which are classified elsewhere) and contributions and donations from private agencies or persons.

L. Other revenue

An example of "other revenue" in this fund is cash received from insurance companies or individuals to compensate the city for the loss of general fixed assets due to theft, accident or natural disaster. Also included in this "other revenue" fund is interfund transfers (legally authorized transfers between revenue funds to expenditure funds).

Examples include transfers from the general fund to a capital projects fund for authorized construction and transfers from an enterprise fund to the general fund to finance general fund expenditures.

This fund also tracks money from the sale of general obligation bonds issued by the city.

VII. Expenditures

Excerpt from the Accounting Manual for Small Cities and Towns in Minnesota, Office of the State Auditor, June 2001.

Cities must estimate their expected costs for the upcoming fiscal year and budget accordingly. Common expenses across all categories of expenditures include salaries and other employment costs, equipment, supplies, materials, maintenance, repairs, training, and fuel costs.

RELEVANT LINKS:

Many cities will have some activity in most of these seven categories and the first two categories (general government and public safety) make up the majority of city expenditures.

A. General government

Accounting Manual for Small Cities and Towns in Minnesota.
Uniform Chart of Accounts, Office of the State Auditor.

Expenditures under this category include general costs for the administration and finance of city government. Costs include those associated with council activities, such as publishing ordinances, and meetings. This category includes all costs for holding general and special elections.

Legal costs fit into this category as do salaries, wages, and related employee benefits such as employer contributions to retirement systems, insurance, sick leave and similar benefits for general fund employees.

Minn. Stat. § 415.11.

City councils may temporarily reduce their own salaries for one year. The law allows a city council to enact an ordinance to take effect immediately and provides an automatic readjustment back up to the previous salary unless a city's ordinance specifies a different time.

B. Public safety

Minn. Stat. § 626.8458.

The basic costs of public safety, at service levels determined by the council, include police protection, fire protection, ambulance service, emergency preparedness, and some protective inspections. Cities should be sure to budget for public safety training costs. Training costs include statutorily required training, such as police-pursuit training and training requirements for part-time police officer licensure.

Minn. Stat. § 424A.091.
"Municipal Contributions to Volunteer Fire Relief Associations," Office of the State Auditor, Feb. 2009.

The city must provide for at least the minimum obligation to the fire relief association in the annual municipal budget. The main sources of revenue for relief associations are municipal contributions, fire state aid, and investment earnings.

Municipal contributions can be made voluntarily by a local community or may be required, based on the relief association's financial situation.

Specifically, state law requires that a city pay a minimum annual contribution to the special fund of its affiliated fire relief association, unless the special fund is fully funded, or fire state aid is sufficient to cover the municipal obligation. Decreased earnings on investments generally mean higher required municipal contributions, which can create challenges for a municipality's budget.

RELEVANT LINKS:

C. Culture-recreation

Document all expenditures for city organized cultural and recreational activities. Examples include city expenditures for libraries, lifeguards, community centers, senior citizen centers, park supervision, park lighting and trails.

D. Conservation of natural resources

This category covers all expenditures for the conservation and development of natural resources, for example shade tree programs and the staff time taken to provide such programs.

E. Debt service

Minn. Stat. § 471.70.
Office of the State Auditor: Report of Outstanding Indebtedness (Excel spreadsheet format).
Minn. Stat. § 475.755.
Minn. Stat. § 475.754.
Minn. Stat. § 412.301.
Minn. Stat. § 410.32.

Cities have no authority to borrow money from banks or financial institutions. Instead, cities issue debt, or bonds, to finance public infrastructure improvements. Each year, councils and staff must keep track of the amount of debt issued, and payments of bond principal, interest and all associated costs. Cities must also document costs of issuing bonds and payments to fiscal agents working with a city on bonds in this category.

Minn. Stat. § 475.755.

Minn. Stat. § 475.61.
Handbook, *Debt and Borrowing*.

Cities may budget for the use of certificates of indebtedness in a variety of circumstances. If the income of a city is reasonably expected to be reduced below the amount anticipated in its budget when the final property tax levy was certified, and those receipts are insufficient to meet the expenses incurred or to be incurred during the fiscal year, a city can issue certificates of indebtedness to mature within two years or less from the end of that fiscal year. The certificates must be repaid by a levy that, according to the Department of Revenue, is not subject to or included in a city's levy limit (if any levy limits are in place). The maximum amount the certificates may be issued for in a fiscal year is the expected reduction and the costs of issuance.

Minn. Stat. § 475.58, subd. 1(11).
Minn. Stat. § 275.70, subd. 5 (2).
Minn. Stat. § 475.61.

Cities may issue short-term certificates of indebtedness to make up for an expected reduction in revenue from the amount the city was scheduled to receive when it certified and budgeted for its levy.

Minn. Stat. § 412.301.
Minn. Stat. § 410.32.
Handbook, *Debt and Borrowing*.

Cities may issue certificates of indebtedness for capital equipment. These certificates are general obligations requiring the 105 percent over-levy and are subject to the debt limit, but none of the other provisions of bonding law applies. A reverse referendum procedure is contained in the statute if the amount of the certificates exceeds 0.25 percent of the estimated market value of taxable property in the city.

RELEVANT LINKS:

F. Miscellaneous expenditures

Miscellaneous expenditures are those that do not fit in the other categories. Examples of miscellaneous expenditures may include costs to maintain a cemetery, airport, costs to settle legal claims against the city and costs related to enterprises like water and sewer that do not fit anywhere else.

VIII. Capital improvements

Minn. Stat. § 412.221.

Budgeting for city infrastructure (roads, bridges, buildings etc.) covers more than one year so many cities separate these costs from yearly budgeting. Planning for future infrastructure costs is essential.

A capital budgeting plan, sometimes referred to as a *capital improvement plan* or CIP, typically lists five or six years of major capital improvements, the order of priority, and a way to pay for them. A plan allows a city to save money for these projects. Priorities in the capital budget program remain tentative, and the council reviews them annually. Although capital improvement budgeting may appear cumbersome and unwieldy to small cities, this is not the case. A capital improvement plan provides protection to small cities, avoiding unforeseen infrastructure failures and expensive emergency repairs.

IX. Other regulations impacting municipal budgets

A number of state and federal regulations require certain types of reports and technical accounting strategies related to city budgets and city budgeting practices.

A. GASB

Governmental Accounting Standards Board. Summaries of GASB Statements.

The Governmental Accounting Standards Board (GASB) issues statements that establish standards for accounting and financial reporting—or generally accepted accounting principles (GAAP)—for state and local governments throughout the United States.

Reporting and Publishing Requirements For Cities Reporting in Accordance with Generally Accepted Accounting Principles, Office of the State Auditor.

In Minnesota, pursuant to state law, the state auditor enforces the accounting standards for cities. Specifically, the state auditor requires and enforces compliance with GAAP for cities with populations of 2,500 and higher.

RELEVANT LINKS:

Minn. Stat. § 477A.017, subd. 2.
Reporting and Publishing Requirements For Cities Reporting in Accordance with Generally Accepted Accounting Principles, Office of the State Auditor.

However, state law does not require that cities with populations under 2500 report GAAP financial statements. These cities may prepare GAAP statements as a good business practice or because of some contractual requirement but are not required to do so by state statute. The state auditor provides a discussion on compliance with GASB 34 in small cities in the document, "Reporting and Publishing Requirements For Cities Reporting in Accordance with Generally Accepted Accounting Principle."

This guidance should be used with the help of financial service providers to be best prepared to meet financial reporting requirements.

See OSA; GASB; and GFOA.

GASB 34 is lengthy and is not discussed in detail in this chapter. For further information on GASB 34, contact GASB, the Minnesota Office of the State Auditor, or the Government Finance Officers Association (GFOA).

B. State auditor reports

Handbook, *Financial Reports, Accounting and Auditing*.

State law requires that cities file budget information with the state auditor's office and requires that cities publish budget information each year.

A number of other financial reports and forms must be filed with the state auditor as explained in detail in Chapter 26 of the League's Handbook for Minnesota Cities.

C. Taxation notification procedure

Minn. Stat. § 275.065, subd. 3.
Handbook, *Property Tax Levy*.

Minn. Stat. § 275.065, subd. 1.

The law no longer uses the phrase "truth in taxation." However, many people still use it to refer to a process which requires cities to allow time for public input on city budgets. According to the Department of Revenue, cities with populations of 500 or less and all special taxing districts (except the Metropolitan Council, the Metropolitan Airports Commission, and the Metropolitan Mosquito Control Commission) are exempt from the requirement to hold a meeting with public input prior to adoption of the final levy. **Note:** Cities with populations of 500 or less must still certify proposed property tax levies to the county auditor on or before Sept. 30.

Minn. Stat. § 275.065, subd. 3.
Minn. Stat. § 275.066.

And small cities must certify the final property tax levy to the county auditor by or before five working days after December 20 each year. If a city misses this deadline, that city's final levy will stay the same as it was in the previous year.

Cities over 500 in population, even with the smallest levy increase, must follow the process described below. The requirement for a city phone number and address on parcel specific notices sent out by the county auditor does not require listing a personal telephone number or personal address. If the city informs the auditor that it has no public office, then no phone number or address is included in the notices.

RELEVANT LINKS:

MN Dep't of Revenue: Truth in Taxation.

Minn. Stat. § 275.065.

Taxation Notification Summary Chart	
Date	**Actions**
On or before Sept. 30.	Special taxing districts (EDAs, HRAs, port authorities, etc.) must adopt any proposed property tax levy and certify the proposed levy to the county auditor
On or before Sept. 30	At one meeting, the city council adopts the proposed property tax levy and announces the time and place of a future city council meeting at which the budget and levy will be discussed and public input allowed, prior to final budget and levy determination. This public input meeting must occur after Nov. 24 and must start at or after 6 p.m. The time and place of the public input meeting must be included in the minutes, but newspaper publication of the minutes is not required.
On or before Sept. 30	Cities must provide the county auditor with the following information: • The time and place of the meeting at which the budget and levy will be discussed, and public input allowed. (Again, meeting must occur after Nov. 24, and must not start before 6 p.m.) • A website address and phone number that city taxpayers may call if they have questions related to the auditor's property tax notice; this does not require listing a private phone number. • An address where comments will be received by mail; this does not require listing a private address. •
Nov. 11 to Nov. 24	County auditor prepares and sends parcel-specific notices.

RELEVANT LINKS:

Minnesota Department of Revenue: Certificate of Compliance, (form TNT), Truth in Taxation.

Nov. 25 to five working days after December 20	City councils hold meeting(s) to discuss the budget and property tax levy and, before a final determination, allow public input.
Nov. 25 to five working days after December 20	Cities must also file the certificate of compliance with the Department of Revenue within five working days of December 20.

*The dates listed reflect the dates established by statute. The Minnesota Department of Revenue uses the next business day if the statutory date falls on a weekend or holiday. As such, the calendar provided by Revenue may differ from the dates above.

*Cities that are in overlapping counties or are consolidating services have slightly different timelines to certify proposed and final tax levies.

X. Plan B cities

Minn. Stat. §§ 412.701 – 412.731.
Minn. Stat. § 412.651, subd. 7.

Handbook, *Local Government in Minnesota*.

Cities with the Plan B form of government must follow unique budgeting requirements in state law. In these cities, the city manager is responsible for the city budget and sets out the required budgeting structure. State law addresses citizen participation in budgeting, requires that the manager read the budget aloud and respond to council questions. As noted previously, once a Plan B city adopts a final budget, budget amendments require approval by a four-fifths vote of all members of the council.

Consult the city attorney when voting on budget amendments in a Plan B city to ensure compliance with the law.

XI. Charter cities

Councils in charter cities must review any special requirements related to city budgets and work with staff and the city attorney to ensure that the requirements in charter and law are met. A number of city charters make the city manager responsible for city budgeting, but the council must still play a role in budget planning and approval.

RELEVANT LINKS:

City of Hopkins City Budget.

XII. Conclusion

Accurate and complete budgeting is crucial to a city. It provides sound legal, financial and ethical basis for city operations. Done correctly, a budget shows the revenues and expenditures necessary to provide the services and programs desired by the community. It reflects the goals, objectives, and priorities the current council identifies, based on input from previous council decisions, the residents and taxpayers.