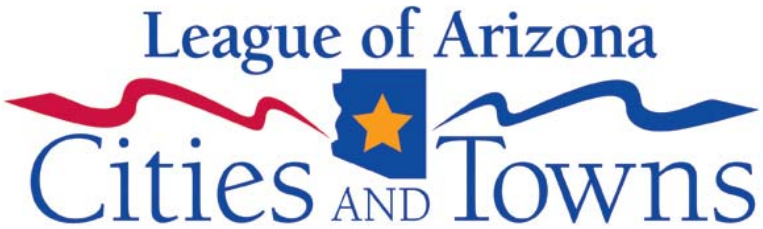
MUNICIPAL

BUDGET AND FINANCE

MANUAL

Prepared by



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FOREWORD

The unique nature and complexity of Arizona's state budget law for cities and towns first prompted the publication of a Budget Manual by the League in 1963. Since that time there have been several updates to the original publication. The spending and property tax limitations passed by the Legislature and by the people through a constitutional amendment in 1980 led to the publication of the last edition. Since that time the publication has been updated to reflect the authorization of the local transportation assistance fund, amendments to the uniform expenditure reporting system, and amendments to other budget and finance related areas. In order to simplify future updates of this manual, we have published this new edition on our computer system. The text has been updated to reflect minor changes in the law.

We hope this publication will be a useful document for elected officials and staff members concerned with the municipal budgetary process. Any comments, criticisms or suggestions on the publication will be appreciated.

Ken Strobeck
Executive Director

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SELLERS V. FROHMILLER

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INTRODUCTION

Municipal finance and the municipal budgetary process are, of necessity, central concerns for every city and town official. The mayor and council, as well as administrators, must have a basic understanding of these subject areas in order to govern and manage effectively and in compliance with state law.

A city or town budget should be more than a simple accounting mechanism. It is actually a policy statement outlining priorities for expenditure, needs of the citizens, proposed capital improvements, problem areas within the municipality, programs which will be initiated or abandoned and most importantly, the basic level of public services which the citizens will receive from their government.

The budget can and does express all of the above characteristics of a city or town, but in Arizona the state constitution and state law govern, to a large degree, the contents of the municipal budget and the methods for financing city operations.

This publication is designed to provide a basic outline of the budgetary process and general finance information for Arizona cities and towns. The manual is divided into three main areas covering the topics of budget preparation, state budget law requirements and financial management. The manual also contains an appendix with a number of documents helpful to the financial management of a city or town.

CHAPTER ONE

BUDGET PREPARATION

The first section of this chapter will list and explain the main revenue sources available to city and town governments in Arizona. Secondly, the chapter will provide some suggestions about the preliminary groundwork necessary to prepare a municipal budget.

REVENUE SOURCES

There are a variety of funding sources available to units of local government. This section is divided into the revenue sources available from the federal and state governments, as well as the revenues that can be raised by the local government itself.

State Shared Revenues

Cities and towns in Arizona are fortunate to be involved in a fairly progressive shared revenue program which passes through funds to Arizona municipalities from four state revenue sources. As a rule, municipalities in other states do not receive as great a share of revenues. The following are sources of shared revenue.

State Transaction Privilege Tax (Sales Tax). The current rate of the state sales tax is six and six-tenths percent (6.6 percent). (The voter-approved 1 percent increase passed in 2010 does not translate into additional state-shared revenue and will be repealed at the end of three years). Cities and towns share in a portion of the collection total. A municipality receives its share of the state shared sales tax based on the relation of its population to the total population of all incorporated cities and towns in the state according to the decennial census.[1] This money may be expended for any municipal public purpose; outside of this stipulation, there is no restriction on the expenditure of these revenues. The state sales tax revenues are distributed on a monthly basis.

State Income Tax. A 1972 citizen's initiative gave the cities and towns a 15 percent share of the state income tax. This source of money is officially called urban revenue sharing. This money is distributed to a city or town based on its population in relation to the total population of all incorporated cities and towns according to the decennial census.[2] The annual amount of urban revenue sharing money distributed is based on income tax collections from two years prior to the fiscal year in which the city or town receives these funds. There is no restriction on the expenditure of urban revenue sharing funds, except that they must be expended for a municipal public purpose. Revenues from this source are distributed on a monthly basis.

Highway User Revenues. This revenue source is commonly referred to as the gasoline tax; however, there are a number of additional transportation related fees including a portion of vehicle license taxes that are placed in the highway user revenue fund. Cities and towns receive 27.5 percent of the highway user revenues.[3] One-half of the monies that a city or town receives under this formula is distributed on the basis of the municipality's population in relation to the population of all incorporated cities and towns in the state according to the decennial census.[4] The remaining half of the highway user revenue monies is allocated on the basis of "county of origin" of gasoline sales and the relation of a municipality's population to the population of all incorporated cities and towns in the county. (The "county of origin" factor used in the formula is determined on the basis of the gasoline and other fuel sales in a county in relation to the sale of gasoline and other fuels in other counties in the state). The intent of the distribution formula is to

[1] A.R.S.§ 42-5029 (D) (1), § 42-5033 and § 42-5033.01
[2] A.R.S.§ 43-206, § 42-5033 and § 42-5033.01
[3] A.R.S.§ 28-6538 (A) (3)
[4] A.R.S.§ 28-6532, § 28-6540 and § 42-5033.01

spread a portion of the money across the state solely on the basis of population while the remaining money flows to those areas with the highest gasoline and other fuel sales. Three percent of the state portion of this fund is directed to cities with a population of more than 300,000.[5] Also, 7.67 percent of the state portion is allocated to certain projects in Maricopa and Pima Counties.[6] These monies are distributed on a monthly basis.

There is a state constitutional restriction on the use of the highway user revenues, which requires that these funds be used solely for street and highway purposes. Eligible expenditures would include the cost of right-of-way acquisition, construction, reconstruction, maintenance, repair, roadside development of city and town roads, streets and bridges and payment of the interest and principal on highway and street bonds.

It is the opinion of the League General Counsel that the use of these funds for street and highway purposes would include any construction or reconstruction occurring in the entire area defined as the public right-of-way.[7] This would include specific activities such as the paving of streets, construction of sidewalks, curbs, gutters, street lighting and placement of traffic signs. State law specifically prohibits the use of highway user revenues for the enforcement of traffic laws or the administration of traffic safety programs.

At the same time a provision was added that gives the Auditor General the authority, if requested by the joint legislative audit committee, to conduct performance audits of a city, town or county receiving highway user revenue fund monies to determine if the monies are being spent according to the constitutional and statutory provisions explained above.

There is a statutory requirement on the expenditure of highway user revenue by cities with a population over 30,000 in Maricopa and Pima Counties. The affected cities are required to maintain expenditures of local revenue for streets at a level to be computed as an average of local funds expended for any four of the fiscal years 1981-1982 through 1985-1986.[8] This average expenditure of local revenues does not include distributions from the highway user revenue fund. For the purposes of this calculation, the term "local revenues" is defined by reference to the definition contained in the constitution for the expenditure limit on cities and towns.[9] Thus, for example, bond funds expended for streets would not be included, while general fund expenditures would be included.

For those cities affected, your chief financial officer must certify that you have met the local effort requirement. A copy of your chief financial officer's certification must be sent to the Chief Financial Officer of the State Department of Transportation at 206 S. 17th Avenue, Mail Drop 200B, Phoenix, AZ 85007 and filed before December 31, following the completion of each fiscal year. Failure to file will be considered noncompliance.

The penalty for noncompliance with this requirement will be computed by subtracting the amount a city received in 1969-70 from the city's annual HURF distribution for the year of the violation. The resulting difference is the total amount to be deducted from future distributions. The penalty is applied to the monthly distributions for the fiscal year following the violation. A reduction of 1/12 of the penalty is applied to each of the city's monthly distributions.

Some jurisdictions have experienced serious fluctuations in HURF distributions. These happen for various reasons; many times they are due to amended reports filed by gasoline distributors. The Arizona Department of Transportation (ADOT), as the collection and distribution agency, has the authority to adjust distributions as amended reports are filed. However, they can only take up to 25 percent of a jurisdiction's normal monthly allocation in a given month to make up the adjustment. For further information contact Janie Kinsey, Revenue Accounting Manager, Department of Transportation, Motor Vehicle Division, 1801 W. Jefferson St., Mail Drop 519M, Phoenix, AZ 85007. Phone: 602.712.8480. Fax: 602.712.3230. E-mail: jkinsey@azdot.gov.

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[5] A.R.S.§ 28-6538 (A) (4)
[6] A.R.S.§ 28-6538 (B) (1) & (2)
[7] General Counsel Opinion 4-20-1987
[8] A.R.S.§ 28-6543
[9] Article IX, Section 20, Arizona State Constitution

Vehicle License Tax. Approximately 20 percent of the revenues collected for the licensing of motor vehicles are distributed to incorporated cities and towns. (Thirty-eight percent of the total revenues from this source are distributed to the highway user revenue fund and 4 percent to the state highway fund.) A city or town receives its share of the vehicle license tax collections based on its population in relation to the total incorporated population of the county. These monies are distributed on a monthly basis. The only stipulation on the use of this revenue is that it must be expended for a municipal public purpose.

Local Transportation Assistance Fund (LTAF & LTAF II). (Repealed.) In the legislative session of 2010, the state Legislature voted to sweep monies dedicated to these two funds as well as repeal the creation of the funds.

Population Reporting for State Shared Revenue Purposes (Annexations)

The census bureau has **suspended** this program of geographically updated population certification until at least January 1, 2013. When available, the program will involve a fee and an application process. The application and detailed information is available at the following website: www.census.gov/mso/www/certification/. These procedures affect the updating of populations for distribution of all types of state shared revenue.

Federal Revenues

The federal government has curtailed a number of programs that had revenues available for cities and towns. The amount of federal dollars, type of programs and the projects for which the money can be expended are constantly changing. Summarized below are the two general categories of federal revenue sources that remain.

Block Grant Programs. A block grant program, in theory, is designed to fund various Federal programs within a broadly defined area. An example of a block grant program is the Community Development Block Grant program (CDBG). This particular block grant program is designed to fund a variety of housing, public works and physical construction projects.

A portion of the CDBG program is directed to smaller cities and towns. Under this portion of the program, the state allocates community development monies to cities and towns with populations of less than 50,000 persons. This is not an entitlement program, cities and towns must apply to receive these grants. In most areas, the council of governments receives the applications and determines the allocation from this program.

Categorical Grants. Categorical grants are special federal appropriations of money to fund specific projects of a definite limitation and scope. For example, a federal grant to fund the construction of a wastewater treatment facility would be a categorical grant, since the construction of this facility would have the limited use and scope of "wastewater treatment." Categorical grants are usually awarded within a strict framework of federal guidelines governing this single purpose program. Cities and towns must meet specific guideline requirements to receive federal money. Securing a federal categorical grant also involves competition between various levels of government. At one point in time, categorical grants were more prevalent; however, this source of funding has become very limited in recent years.

Local Revenue Sources

Arizona's cities and towns under state law have the authority to establish certain taxes for revenue purposes. In addition to this power of taxation, there are a number of other fees and finance mechanisms available to cities and towns to support local services.

A law passed in the 2010 legislative session requires cities and towns to provide 60 days' notice on the home page of their websites prior to approving any new fee or tax or any increased fee or tax. The law also requires that cities and towns demonstrate that the new fee or tax or the increase in fee or tax was established in accordance with state statute.

Local Transaction Privilege Tax (Sales Tax). In recent years, the local sales tax has become the predominant means of financing municipal services. All incorporated cities and towns presently have a local sales tax. As the name implies, this is a tax on retail sales and other activities such as contracting. The statewide average local sales tax rate is 2.3 percent. Rates range from one and one-half percent to four percent. The authority for a local sales tax is contained in state statute.[10] A city or town may establish a local sales tax through adoption of an ordinance. The initiation of this tax does not have to be submitted to a vote of the people; however, there are a number of charter cities with charter provisions requiring voter approval to increase the sales tax above a specified limit. Cities and towns adopting a local sales tax may join the sales tax collection system administered by the Arizona Department of Revenue (ADOR) by entering into an intergovernmental agreement with ADOR. Under the system, the local sales tax is collected by ADOR at the same time the state sales tax is collected. The local sales tax collections are then returned to the city or town. Approximately 80 percent of municipalities are in the state collection system.

All of the cities and towns in the state that impose a local sales tax have adopted the model city tax code with various options. In order to keep taxpayers up to date on what a particular city either taxes or exempts, the ADOR maintains a website at http://modelcitytaxcode.az.gov that consists of a master version of the model city tax code with both model options and local options displayed within the code, a chart displaying which options each particular city or town has chosen and a section showing other specific information pertaining to each city and town.

The Municipal Tax Code Commission was created by the state Legislature to act as a forum for discussion of all changes to the model city tax code.[11] All changes to code must be submitted to the commission at least 60 days prior to any city taking action to change their code. The commission can hold hearings and must approve any changes before any city or town may make changes to its code and any changes approved by the commission must be adopted by each city or town council.[12] Changes in sales tax rates or adoption of model city tax code local or model options do not have to be reviewed, but such changes must be filed with the commission within 10 days after council action. All correspondence with the commission should be sent to: Cities Program Liaison, Arizona Department of Revenue, 1600 West Monroe, Phoenix, Arizona 85007.

A Guide for Amending Your Tax Code has been prepared and appears in the appendix as Exhibit K.

A law passed in the 2011 legislative session prohibits municipalities from imposing or increasing transaction privilege taxes on rental of residential property, unless the increase is approved by the voters at a regular municipal election. The law does not apply to health care facilities, long-term care facilities or hotel, motel or other transient lodging businesses.[13]

Use Tax. Another revenue source which is being used more in recent years is the use tax. Essentially, a use tax is an excise tax on the use or consumption of tangible personal property that is purchased without payment of a municipal tax to any city or town. In other words, it is a mechanism for taxing property that cannot be taxed using a local sales tax since the purchase was made outside the boundaries of the municipality where the personal property is used. The use tax, if enacted, is part of the model tax code discussed above.

Bed Tax. Most cities and towns have adopted a bed tax in addition to their local sales tax. A bed tax is a special excise tax on hotel and motel room rentals. Increases in the bed tax rate by cities are governed by state statute, which specifies how the proceeds from such increases must be used.[14] The imposition of this tax in most cities and towns comes under the model city tax code discussed above.

Property Tax. The property tax has been a traditional means of financing city and town services. While the importance of the property tax has been decreasing in recent years due to the increased revenues from

[10] A.R.S. § 9-240 (B)(18)
[11] A.R.S. § 42-6052
[12] A.R.S. § 42-6053
[13] A.R.S. § 42-6011
[14] A.R.S. § 9-500.06

sales taxes, it still is an important source of local revenue for many Arizona cities and towns. The property tax has also been one of the most stable sources of revenue, because it is not subject to the same fluctuations sometimes experienced with excise taxes.

Beginning with the 1980 tax year, property tax levies were divided into a primary property tax levy and a secondary property tax levy. A secondary property tax may only be levied to pay the principal and interest charges on bonds. The primary property tax levy is for all other purposes. There are no limits on the amount of secondary property taxes, while there are strict limits placed on the primary property tax. [15] These limitations are discussed in detail in Chapter Two of this manual.

Any city or town that wants to initiate a primary property tax must submit the proposed amount to be raised from the tax to the voters at an election to be held on the third Tuesday in May.[16] The amount approved by the voters will constitute the base on which future limitations on levies will be determined. If the voters approve the levy, the city or town council may levy the tax in the fiscal year immediately following the election. The city or town, however, is not required to levy the entire amount approved by the voters in the first year. Caution should be exercised in establishing this base levy because not only will it be used as the base for future limitations but also cities currently have no authority to override the limit once it is established. Procedures for establishing a primary property tax are discussed in greater detail in Chapter Two.

The Property Tax Oversight Commission was formed in 1988 to review the primary property tax levy limitations of each city, town, county and community college district in the State.[17] The county assessor is required to transmit and certify to the Property Tax Oversight Commission and the city or town council the values necessary to calculate the levy limit and the Truth in Taxation requirements. Those values are to be transmitted on or before the tenth day of February.[18] Each city or town is required to notify the Property Tax Oversight Commission in writing within ten days of its agreement or disagreement with the final levy limit. If a city receives notification of a violation of the levy limit, the city has until October 1 to appeal to the Commission. If the city continues to dispute the findings of the Commission after the hearing, it may appeal the decision to Superior Court within thirty days after the decision.

A city or town that incorporates or annexes land must give proper notice before levying a property tax in the next fiscal year. State law requires that notice must be given to the Department of Revenue and the appropriate county assessor. A map showing the boundaries of the newly incorporated or annexed area should be included along with the report. This notice must be given by November 1 of the year prior to the fiscal year when the tax will be levied.[19]

Business License Tax. The general law authority for a city or town to initiate a local sales tax is the same authority that allows a municipality to place a license tax on professions, occupations or businesses within the community. State law stipulates that a business license tax can only be issued for the period of one year and may not be less than $10 nor more than $5,000.[20] However, charter cities are not necessarily subject to this stipulation. Most cities and towns in Arizona have a business license tax structure of some type. Traditionally, there have been two means of levying these taxes on local businesses - a flat rate charge on a quarterly or annual basis or a flat rate charge based on the gross proceeds of sales. While most cities and towns have this type of tax, it has not been an important source of revenue. The tax has been used primarily as a means of regulating businesses within the community.

A city or town cannot increase business license taxes or fees on "hospitality industry businesses" without a corresponding equal dollar increase in the business license tax or fees imposed on all other businesses in the city or town. Also, a city or town may not increase the fees on hospitality businesses in any year by an amount that exceeds the amount of any increase in the consumer price index compared to the average of the last five years of consumer price indexes.

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[15] Article IX, Section 19, subsection 1, Arizona State Constitution
[16] A.R.S.§ 42-17056
[17] A.R.S.§ 42-17002
[18] A.R.S.§ 42-17052
[19] A.R.S.§ 42-17257
[20] A.R.S. § 9-240 (B)(19)

"Hospitality industry businesses" means a restaurant, bar, hotel, motel, liquor store, grocery store, convenience store or recreational vehicle park. This definition was amended to include rental car companies located within a county stadium district which has imposed a car rental surcharge.[21]

Franchise Tax. Cities and towns in Arizona are given exclusive control over all rights-of-way dedicated to the municipality. This exclusive control enables the municipality to grant franchise agreements to utilities using the city or town's streets in the distribution of utility services. As an example, many cities and towns in Arizona have granted franchises to natural gas companies to place gas lines underground within the public right-of-way. In conjunction with this franchise, a franchise tax can be charged by the municipality. To grant a franchise, state law requires the municipality to place the question before the voters of the community for approval and limits the term of a franchise agreement to a maximum of 25 years.

Magistrate Court Fines. Another revenue source for Arizona cities and towns is the money from fines paid to the municipal magistrate court. Specifically, this revenue comes from traffic violations and other fines paid for the violation of municipal ordinances. The courts, counties, cities and towns have the authority to contract with the Motor Vehicle Division to require payment of traffic fines, sanctions and penalties that total in excess of $200 prior to the renewal of automobile registrations.

User Fees. User fees are collected from municipal residents for the use of certain city and town facilities or services. Examples of user fees would include the amounts charged to use lighting in city or town parks or fees charged for the use of the sewer system. Cities and towns considering a rate increase for water and sewer service are required to prepare a written report or supply data supporting the rate increase, give at least 30 days notice of a rate increase and hold a public hearing on the proposal. A copy of the written report or data must be available to the public and must be filed in the clerk's office at least 30 days before the public hearing. Also, a copy of the notice of intention must be published one time in a newspaper of general circulation within the city or town at least 20 days before the public hearing date. A rate increase may be adopted by ordinance or resolution and becomes effective 30 days after adoption. [22] There is a vague requirement that all rates and charges for water and wastewater service shall be "just and reasonable." [23] Because "just and reasonable" are not defined in the statute, it is difficult to say what this statute requires.

Permit Fees. Revenues from this source include the fees collected from building permits, zoning permits and a variety of other programs.

Development (Impact) Fees. *In 2011, significant legislation passed amending the development fee statutes; review your local ordinances to be sure you are in compliance with the new legislation.* Cities and towns have the authority to impose fees that provide a direct benefit to a new development area for their proportionate share of items such as infrastructure, improvements, real property, engineering and architectural services, financing and professional services for preparation of an impact fee plan, certain kinds of equipment and public safety vehicles. If a city or town has impact fees, they must be assessed on residential, commercial and industrial property, although there can be different rates for the different categories of property. There are specific requirements for the preparation and imposition of these fees and special attention must be paid to state statute.[24] The League has prepared a model ordinance for implementing this statute.

Each city and town imposing impact fees must develop an annual report to account for the collection and use of development fees. The report is due within 90 days of the end of each fiscal year and is required to be maintained in the clerk's office. Copies of the report are required to be made available to the public upon request and posted on the city or town's website. The law allows the report to contain financial information that has not been audited. Additionally, there is a requirement for a biennial audit of impact fees OR creation of an Advisory Committee.

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[21] A.R.S. § 48-4234 & § 9-500.06
[22] A.R.S. § 9-511.01
[23] A.R.S. § 9-511.01
[24] A.R.S. § 9-463.05

State legislation outlines the approved uses of impact fees and requires that by August 1, 2014, a new Infrastructure Improvement Plan (IIP) and Fee Study be adopted before assessment of a new or modified fee. Cities and towns must discontinue fees that are no longer approved uses as of January 1, 2012. However, they may continue to collect fees at the existing level for approved uses until the 2014 deadline, or to pay debt service on loans pledged for a purpose prohibited after January 1 until that debt is paid.

An IIP is one or more written plans that individually or collectively identify each public service that is proposed to be the subject of a development fee and otherwise complies with the requirements of this section, and may be the municipality's capital improvement plan.

Before impact fees may be adopted or amended, a city or town must update local land use assumptions and have "qualified professionals" develop an impact fee report that: identifies the methodology for calculating the amount of the fee, explains the relationship between the fee and the IIP and includes documentation that supports the assessment of a new or modified fee. A graphical representation of the timeline for establishing or amending impact fees and for development of your IIP is located in the appendix as Exhibit M.

There are six specific areas that the Development (Impact) Fee annual report is required to address:

1. The amount of each type of development fee assessed by a city or town.
2. The balance of each fund at the beginning and end of the fiscal year maintained for each type of development fee.
3. The amount of interest or other earnings on monies in each fund as of the end of the fiscal year.
4. The amount of development fees used to repay either (a) bonds issued by the municipality to pay the cost of a capital improvement project for which the development fee was assessed or (b) monies advanced by the city or town from funds other than development fee funds to pay for a capital improvement project for which a development fee was assessed.
5. The amount of development fees spent on each capital improvement project for which a development fee was assessed and the physical location of each capital improvement project.
6. The amount of development fees spent for each purpose other than a capital improvement project for which a development fee was assessed.

Failing to comply with these reporting requirements will prohibit the municipality from collecting development fees until the report is filed.

Refunds are due to the property owner if infrastructure for which a fee has been collected is not completed within 10 years, or 15 years for water and wastewater facilities.

Effective August 1, 2014, if a city or town has a differential construction sales tax rate in addition to an impact fee program, the impact fees must be offset against the amount collected from the impact fees.

Please refer to the League's model ordinance for specific definitions and details.

Capital Improvement Plan. A bill passed in 2012 requires a municipality to post its capital improvement plan (CIP) on its website. Furthermore, a utility is entitled to receive, upon request, copies of the CIP, along with information on any new or accelerated projects.

Government Property Lease Excise Tax. State law provides an excise tax as the successor to the tax on possessory interests.[25] The law imposes an excise tax on buildings that are owned by a city or town, leased by a private party and occupied and used for commercial, residential rental or industrial purposes.

[25] A.R.S. § 42-6202

The excise tax is assessed on a per-square-foot basis with different rates for different uses, which are annually adjusted by the Arizona Department of Revenue based on the producer price index. A city or town is allowed to abate the tax for a period of eight years, from the date that the certificate of occupancy was issued, for both existing and new projects within redevelopment areas that are part of a single central business district. The County Treasurer of each county where a GPLET property is located acts as the collection agent for the tax, and distributes the revenues to the county, school district and community college district in that county. There are a number of exemptions including property used for airports, public housing, utility easements, convention and recreational facilities.

A city or town must record a memorandum of lease with the County Recorder and submit a copy of the lease to the respective County Recorder, County Treasurer and Department of Revenue if the following conditions exist:

- The building is owned of record by the city or town.
- The building is leased in whole or part by a private party.
- The leased space is occupied for commercial, residential rental or industrial purposes.
- The duration of the lease is at least 30 days.
- The age of the building is less than 50 years.
- The abatement provisions in the law do not apply.
- The exemption provisions in the law do not apply.

Bonding

While bonding is definitely a source of revenue for Arizona cities and towns, this finance mechanism differs from the above mentioned revenues because once bonds are issued and revenue secured, a commitment is required from the municipality to repay the debt on the bonds. Revenues generated from bond sales must be spent only for the purposes specified in the call for the bond election. Also, after satisfying the purposes of a bond issue, unexpended monies can only be used to retire the bonded indebtedness. There are a number of different types of bonds that are discussed below.

General Obligation Bonds. General obligation bonds are perhaps the most common method used to raise revenues for large scale municipal projects. The bonds are referred to as general obligation or full faith and credit bonds because they are guaranteed by the full taxing power of the city or town. These bonds are retired from secondary property tax funds. The amount of indebtedness that a city or town can incur through the issuance of general obligation bonds is limited in the state constitution. The constitution states that for general municipal purposes a municipality cannot incur a debt exceeding 6 percent of the assessed valuation of taxable property in the city or town. Additional bonds amounting to 20 percent of the assessed valuation of taxable property can be issued for supplying such specific city and town services as water, artificial light, sewers, and for the acquisition and development of land for open space preserves, parks, playgrounds and recreational facilities. The Arizona Constitution allows projects concerning public safety, law enforcement, fire and emergency service facilities and streets and transportation facilities to be included in this 20 percent category.[26] In other words, a total of 26 percent of the assessed valuation can be bonded for these latter projects. Because the full taxing power of a municipality is pledged, general obligation bonds are considered more secure than other bonds. This tends to give them lower interest rates in comparison to other bonds. The issuance of general obligation bonds must be submitted to the voters for approval.

Revenue Bonds. This type of bond is used to finance a revenue producing facility such as a public utility or airport. The bonds are usually secured from revenues produced by the facility for which they were issued. Thus, if these revenues are insufficient to cover the repayment of the bonds, the city or town is not obligated to provide tax funds for repayment. Because these bonds are not secured by taxing

[26] Article IX, Section 8, paragraph 1, Arizona State Constitution

authority, they represent a somewhat greater risk for the investor; therefore, revenue bonds usually have a higher interest rate than do general obligation securities. Revenue bonds may be issued for such utility undertakings as electric light or power, water, sewer, gas, common carrier of passengers, garbage or rubbish plant or system, buildings, incinerators, dams and reservoirs, airport buildings or other airport facilities or buildings or structures to provide off-street parking of motor vehicles and such recreational facilities as swimming pools, parks, playgrounds, municipal golf courses and ballparks. Revenue bonds are not subject to the debt limitation in the state constitution; however, they must still be submitted to the voters of the community for approval.

Street Improvement Bonds. Arizona cities and towns may also issue bonds for constructing streets and highways within the municipality. To pay the principal and interest on this type of bond, the municipality may use its share of highway user revenues. There are limitations on the issuance of these bonds for which HURF revenues are pledged for repayment depending on the bond rating. These bonds are not subject to the debt limitation in the state constitution; however, to issue the bonds, the voters first must approve them. Street improvement bonds may also be secured by the full taxing power of a city or town; however, this is not required.

Special Improvement District Bonds. Special improvement district bonds can be issued by a city or town to finance improvements in specific areas of the municipality. The property owners benefiting from the improvements to the area are assessed to cover the cost of retiring the bonds. This type of finance mechanism has been used generally on such projects as paving streets, placement of sidewalks, extension of sewer and water lines and similar projects. State law permits a city or town by resolution to combine two or more municipal improvement district projects. The law also allows the construction of the improvements to be under one contract and allows for one series of improvement bonds. State law allows a reserve fund to be created for improvement district bonds.

Municipal Property Corporation. One of the more innovative methods of funding major municipal projects is the use of a municipal property corporation (MPC). There are a number of ways that MPCs can be used to finance a local government project. However, in most instances to date, a municipal property corporation has been formed and bonds issued to complete a revenue producing project. The revenue that is collected from the project is then used to retire the interest and principal on the bonds. When the bonds are retired, the title to the facility is then turned over to the city or town. Citizens of the community do not have to vote on this means of financing nor are the bonds subject to the constitutional debt limitation. Also, the revenues used to retire the bonds for the project will not affect local taxation if the project produces its own revenues.

Bonding Assistance

There are two state agencies that have specific programs that can improve a city or town's ability to use bonding as a revenue source. The Greater Arizona Development Authority (GADA) and the Water Infrastructure Finance Authority (WIFA) have statutory charges to help smaller to medium-sized communities pool their bond issues together to help lower the costs of issuing debt. They also have monies set aside to help secure the debt and allow the bonds to be issued at the lowest interest rate possible. WIFA's charge is specifically with water and wastewater projects. GADA's charge is broader to include public infrastructure projects.

The Arizona Department of Transportation (ADOT) established a loan program called the Highway Extension and Expansion Loan Program (HELP) at or below market interest rates to accelerate state highway projects. This program utilizes the new federally authorized concept of state infrastructure bank to assist communities in completing needed highway projects.

Currently, the funding for GADA and HELP is so low as to make them unviable.

Bond Election Publicity Pamphlet

Any election to authorize bonded indebtedness through the use of secondary property taxes must be held at the November general election. Along with other bond election requirements, state law requires the preparation and dissemination to all voters of an informational pamphlet not less than 10 days and not more than 50 days prior to a general obligation bond election. It is not clear whether this requirement applies to revenue bond elections. We suggest that you consult your bond attorney on this issue.

The pamphlet must contain information on the:

1. Amount of the bond authorization.
2. Maximum interest rate of the bonds.
3. Estimated debt retirement schedules for the proposed bond authorization and the current amount of bonds outstanding, showing both principal and interest payments and the current adopted tax rates, including the estimated average annual tax rate for the proposed bond authorization. In preparing this information, the projected total increase in secondary assessed valuation for any future year shall not exceed:
   (a) 5 percent if the average of the annual total increases in secondary assessed valuation in the political subdivision for the past five years is at least 10 percent.
   (b) 2.5 percent if the average of the annual total increases in secondary assessed valuation in the political subdivision for the past five years is less than 10 percent.
4. Source of repayment.
5. Estimated issuance costs.
6. Estimated tax rate impact of debt service on owner-occupied residence and class one commercial property for the current year in the political subdivision, assuming the assessed valuation of the property increases annually at 50 percent of the projected total annual increase in secondary assessed valuation over the term of the bonds using the average annual tax rate determined in no. 3 above. (Any written information provided by the political subdivision pertaining to the bond election shall include financial information showing the estimated average tax rate for the proposed bond authorization.) The tax impact shall be shown for an owner-occupied residence with a full cash value of $250,000; a commercial property valued at $1 million and an agricultural property valued at $100,000. The tax impact shall show the projected average annual cost of the proposed bond authorization, including principal and interest, over the life of the proposed bond authorization. The information on estimated tax impact shall be set forth in substantially the form found in A.R.S. § 35-454 using a table for each type of property.[27]
7. In bold-faced type, estimated total cost of the proposed bond authorization, including principal and interest.
8. Current outstanding general obligation debt and constitutional debt limitation.
9. Purpose for which the bonds are to be issued and, if applicable, in bold-faced type, that the amount of the proposed bond authorization combined with the current outstanding debt exceeds the political subdivision's constitutional debt limit.
10. Polling location for the addressee.
11. Hours during the day when the polls will be open.
12. Arguments for or against the authorization for one or more of the bond propositions. (State law passed in 2012 requires a city or town that is holding a bond authorization election to set a deadline to submit arguments for and against the authorization of one or more of the bond propositions at a public meeting. That deadline must be published in a newspaper of general circulation in the city or town.)

[27] A.R.S. § 35-454

A copy of the informational pamphlet must be submitted to the Department of Revenue within 30 days after the bond election. The Department of Revenue will maintain copies of the pamphlets. Failure of any one or more electors to receive the informational pamphlet will not be grounds to invalidate the election. Variations between the estimates are required to be in the pamphlet and the actual debt retirement schedule, issuance costs and tax rates will not invalidate the election or the bonds.

It is critical to note that a city or town cannot use its personnel, equipment, materials, buildings or other resources to influence the outcome of any election, and city or town employees cannot use the authority of their position to influence the vote or political activities of a subordinate. [28]

Bonded Indebtedness Report

The Arizona Department of Revenue (ADOR) requires a yearly bonded indebtedness report that includes information concerning the date of issuance, amount, denomination, rates of interest, maturity, dates of the bonds, certificates of participation or securities and other information the department requires.[29] Municipal property corporation debt must be reported. State law requires cities and towns to report to ADOR, within 60 days of issuance of bonds and securities, a report containing the following information:

1. The par amount of the bonds or securities.
2. The interest rate, by maturity of the bonds or securities.
3. The repayment schedule, showing both principal and interest for the issue.
4. The sources of repayment.
5. The original issue price and any premium or discount, by maturity, for the issue.
6. A detailed listing of all issuance costs, regardless of source of payment, including underwriter's compensation, bond counsel fees, financial advisor fees, verification agent fees, placement agent fees, investment securities brokerage fees, registrar fees, trustee fees, credit enhancement fees, rating agency fees, printing costs, registration fees, transfer and recording fees and any other costs directly or indirectly earned or paid as a result of the issuance of the bonds or securities, as determined by the department.
7. The total amount of parity bonds or securities outstanding, including the issue, at the time of issuance.
8. The total amount of any bonds or securities, senior or subordinate to the issue outstanding at the time of issuance.
9. The amount of any constitutional or statutory limitation on the issuance of bonds or securities of the type issued.
10. The remaining amount of bonds or securities that may be issued within the constitutional and statutory limitations.
11. The amount of any constitutional or statutory voter authorization applicable to the issuance of bonds or securities of the type issued.
12. The remaining amount of bonds or securities that may be issued within the constitutional and statutory authorization.
13. Any other similar or related information that ADOR may determine.

State law defines the "outstanding indebtedness," for the purposes of calculating debt capacity, as the total principal amount of all bonds outstanding at the time of calculation exclusive of any premium or discount.[30] It also limits the use of premium associated with original issue and refunding bonds and requires net premium not used to pay the costs of the bond issue to be deposited in a debt service fund and used to pay interest on the bonds.

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[28] A.R.S. § 9-500.14
[29] A.R.S. § 35-502
[30] A.R.S. § 35-503

CHAPTER TWO

STATE BUDGET LAW REQUIREMENTS

While the general concept behind the budgetary process in a city or town is relatively simple, there are several requirements in Arizona state law that add a certain amount of complexity to this process. To familiarize local officials with the state budget law, this chapter will cover the topics of funds, the state imposed expenditure limitation, alternatives to the state expenditure limitation, the property tax levy limitation and budget deadlines.

FUNDS

A fund within a municipal budget is a sum of money set aside as a separate and independent fiscal and accounting mechanism. Since a fund is only an accounting mechanism, a separate bank account is not required for each fund. State law requires only two budgetary funds, however, as indicated later in this chapter, additional budgetary funds may be created.

First of all, a city or town must have what is commonly called a "general fund." The term general fund is only a descriptive name, and there is no specific legal requirement to establish an account with this particular name. A general fund is required by state statute, which stipulates that each city or town "prepare a full and complete statement of the financial affairs of such political subdivision for the preceding fiscal year and an estimate of the different amounts which will be required to meet the public expense of each such political subdivision for the current fiscal year."[31]

The second fund that each city and town in Arizona must establish is the Highway User Revenue Fund (HURF).[32] The monies that go into this fund are collected by the state from the tax on the sale of gasoline, sale of diesel fuels and other transportation related fees. The state then passes a certain amount of this revenue on to cities and towns. As mentioned in Chapter One, the expenditure of highway user revenues is limited to projects within the public right-of-way.[33]

As indicated in the previous paragraphs, a total of two funds are required as a minimum in a city or town budget. This, however, does not restrict a city or town budget to only two funds as optional funds are a common occurrence in Arizona municipal budgets.

There are several national accounting standards that may be used as a guide of fund types you may wish to establish. For example, you may wish to establish a library or utility fund. If bonds are outstanding, certain funds may be required by the bond resolution, and there are also special requirements for improvement districts.

STATE IMPOSED EXPENDITURE LIMITATION

Provisions of the state imposed expenditure limitation appear in both the Arizona Constitution and the Arizona Revised Statutes.[34] The constitution sets forth the framework in some detail for the expenditure limit and the remaining details are provided in state law.

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[31] A.R.S. § 42-17101
[32] A.R.S. § 28-6533
[33] General Counsel Opinion 4-20-1987
[34] Article IX, Section 20, Arizona State Constitution; A.R.S. § 41-563

The state imposed limitation uses actual payments of local revenues for FY 1979-80 as the base limit. The Economic Estimates Commission (EEC) has determined this base limit for every city and town based on information supplied by each community in 1980. This base consists of those expenditures "controlled" by the state limitation and does not include those revenues specifically exempted from the limitation. The Uniform Expenditure Reporting System (UERS) Manual clarifies that the expending of development/impact fees are not excludable expenditures.

As a blanket statement, everything not specifically excluded is included under the expenditure limitation. Consequently, only the following items are exempt from the expenditure limit:[35]

1. Revenues received from the issuance of bonds or other long-term obligations. Bond principal and interest payments are also exempt.

2. Revenues received as payment of dividends or interest.

3. Trust and agency accounts.

4. Federal grants and aid of any type.

5. Other grants, aid, contributions or gifts of any type.

6. Amounts received from the state that is included under the state's own appropriations limitation. (Unfortunately, this does not exclude revenues received from regular state shared sources, but it does exempt such things as flood control money appropriated by the state that is distributed to a particular city.)

7. Interagency or interdepartmental transfers that are funded with monies already subject to the expenditure limit. (This means that you won't have to double count expenditures within the limit.)

8. Amounts or property accumulated for the purchase of land, buildings or improvements or for constructing buildings or improvements if the voters have approved such accumulation and purpose. This is a voter approved public works reserve fund for limited purposes.

9. Amounts received from the HURF over and above that received in FY 1979-80.

10. Revenues received from another political subdivision pursuant to an intergovernmental contract as long as the other entity includes the payments under their expenditure limit, if applicable. "Political subdivision" as used for this exemption includes a city or town, county, school district or community college district. Intergovernmental contracts with the state are also exempt under this provision.

11. Amounts expended for the construction, reconstruction, operation or maintenance of a hospital financially supported by a city or town prior to January 1, 1980.

12. Amounts to pay off warrants issued prior to July 1, 1979.

13. Refunds, reimbursements or other recoveries of amounts expended that were already included once under the expenditure limit or otherwise excluded from the limit.

14. Capital improvements from utility revenues and/or from excise taxes levied for a specific purpose.

In addition to the constitutionally specified exemptions from the expenditure limit, involuntary tort judgments are not subject to the expenditure limitation.[36]

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[35] Article IX, Section 20, subsection 3 D, Arizona State Constitution
[36] Attorney General Opinion (I86-031)

The EEC will determine each year how much each city and town under the state imposed limit can increase its budget for the next fiscal year. This determination will be made on the basis of a standard increase in inflation and the population growth of your particular community.[37] The inflation increase is to be measured by an index called the GDP implicit price deflator which is a U.S. Department of Commerce statistic. Population figures to be used in the calculation will be supplied by the ADOR.

State law requires that the EEC provide each city and town with a preliminary estimated expenditure limit for the coming fiscal year by February 1, and a final expenditure limit figure by April 1. If the estimate received by February 1 is felt to be inaccurate for any reason, the city or town may appeal to the EEC for an adjustment through a process detailed in Exhibit B in the appendix.

In addition, cities and towns should report all annexations to the Population Statistics Unit at the Department of Commerce, the Department of Revenue and your local council of governments (COG). The population in the annexed area will be considered when developing the population estimate which is used in determining the expenditure limitations by the EEC.

Annexations occurring after the EEC determines your expenditure limit (on or before April 1) but before the beginning of the fiscal year can also be used to adjust your population estimate for that year if they are submitted in time for both Revenue and the EEC to act. The EEC requires that requests for such adjustments be provided to them at least three weeks prior to the adoption of that city's tentative budget. Also, prior to action by the EEC, Commerce must review the requested population increase. The necessary materials should be provided to Commerce with sufficient lead time for their review.

If, on the other hand, the estimated state imposed limit appears to be correct but does not allow for the expenditure of sufficient funds to meet local needs, the budget law provides five options to potentially solve this problem:

1. Local Home Rule (Alternative Expenditure) Limitation.[38]
2. Permanent Base Adjustment.[39]
3. Capital Projects Accumulation Fund.[40]
4. One-time Override.[41]
5. Emergency Override[42]

All of these options require voter approval and, therefore, entail a certain amount of risk. If the voters say "no," then the city or town will be under or subject to the state imposed limitation. Procedures required to seek each of these options are detailed later in this chapter.

It is critical to note that a city or town cannot use its personnel, equipment, materials, buildings or other resources to influence the outcome of any election and city or town employees cannot use the authority of their position to influence the vote or political activities of a subordinate.[43]

NEW CITY OR TOWN LIMITATION

The Economic Estimates Commission by law must determine the base limit of a newly incorporated city or town. This will be accomplished by calculating the average amount of actual FY 1979-80 per capita payments of local revenues for all cities and towns within the county in which the new city or town is located. This average per capita figure will then be multiplied by the population of the new city or town resulting in the base limit for such community.[44]

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[37] A.R.S. § 41-563
[38] Article IX, Section 20, subsection 9, Arizona State Constitution
[39] Article IX, Section 20, subsection 6, Arizona State Constitution
[40] Article IX, Section 20, subsection 3 d viii, Arizona State Constitution
[41] Article IX, Section 20, subsection 2, paragraph c, Arizona State Constitution
[42] Article IX, Section 20, subsection 2, paragraph a, Arizona State Constitution
[43] A.R.S. § 9-500.14
[44] A.R.S. § 41-563 A (6)

EXPENDITURE LIMITATION OPTIONS

1. Home Rule (Alternative Expenditure Limitation) Option

Any city or town can adopt its own alternative expenditure limitation that is free from any ties to the state imposed limitation if a majority of the qualified electors voting on the issue at a city or town regular election vote in favor of the alternative limitation. An alternative limitation may be referred to the city or town voters by an affirmative vote of two-thirds of the members of the city or town council or qualified electors of the city or town may offer an alternative limitation through the initiative process.[45]

The city or town council contemplating the adoption of an alternative expenditure limitation must hold two public hearings on the proposed action. Notice of these hearings must be published once a week for at least two consecutive weeks in a newspaper of general circulation within the city or town. Immediately following the second hearing, the city or town council must convene in a special meeting and vote on the proposed alternative expenditure limitation. A record of the vote and, if approved, the amount of expenditure in excess of the state limitation and purposes for the excess expenditure must be published in a newspaper of general circulation within the city or town (Exhibit C).[46]

At least 60 days prior to the city or town election, the council or a person or group using the initiative process proposing the alternative expenditure limitation must submit a detailed analysis and summary of the alternative to the Auditor General for review. The Auditor General may request additional information necessary to clarify or correct the submitted materials. Within 15 working days of receiving these reports, the Auditor General must correct any errors or deficiencies in the analysis and summary and provide the city or town council with a copy of their reports. No revisions of the analysis or summary can be made after the Auditor General review is complete.[47] Exhibit C contains a sample detailed analysis and summary analysis.

Arguments supporting or opposing the alternative expenditure limitation, if any, must be filed with the city or town clerk not less than 90 days before the election.[48]

Not less than 10 days prior to the election, the city or town council must provide a publicity pamphlet that includes the summary of the alternative (as received from the Auditor General) to each household within the city or town containing a registered voter.[49] A copy of the printed publicity pamphlet must also be provided to the Auditor General prior to the election. In addition to the summary, the pamphlet must contain several items ranging from the date of the election to a section comparing the proposed alternative limitation to the state imposed limitation (Exhibit C).[50] Also, the detailed analysis of the alternative must be made available to registered voters upon voter request.

The ballot used for the election must contain a section comparing the proposed alternative to the state imposed limitation. If only one alternative limitation is offered to the voters, the ballot should be in the form used for initiatives and referendums (Exhibit C).[51] If there is more than one alternative, the ballot must be in a form that allows electors the opportunity to vote on each proposed alternative expenditure limitation.[52] If more than one alternative is approved, the alternative limitation receiving the highest number of votes will apply to the city or town. The city or town clerk must notify the Auditor General and the Economic Estimates Commission of the results of the election.[53]

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[45] Article IX, Section 20, subsection 9, Arizona State Constitution
[46] A.R.S. § 41-563.01
[47] A.R.S. § 41-563.03 (E)
[48] A.R.S. § 19-141 (C)
[49] A.R.S. § 19-141 (B)
[50] A.R.S. § 41-563.03 (C)
[51] A.R.S. § 19-125
[52] A.R.S. § 41-563.03 (G)
[53] A.R.S. § 41-563.03 (F)

When an alternative expenditure limitation is adopted it will be in effect for four consecutive years. Following the fourth year, the city or town alternative must be reapproved or a new alternative may be proposed. In other words, you must repeat the detailed procedure involving the Auditor General, publications, election, etc. every four years whether you are reaffirming a previously approved alternative limitation or adopting a new one. If the alternative limitation is defeated by a majority of the qualified electors, no new alternative expenditure limitation may be submitted to the voters for at least two years, and the city or town will be subject to the state limitation.[54]

See Exhibit D for a chronology of events that must occur when seeking the home rule option.

2. Permanent Adjustment of Expenditure Base

Any city or town can permanently adjust its state imposed expenditure limitation base if a majority of the qualified electors voting on the issue at a regular city or town election vote in favor of the adjustment. The issue can also be placed on a state general election ballot. A base adjustment may be referred to the voters by an affirmative vote of two-thirds of the members of the city or town council, or qualified electors of the city or town may propose an adjustment through the initiative process.[55]

Formerly, a city or town council contemplating the adoption of a permanent base adjustment was required to hold two public hearings on the proposed action, and to publish a record of the vote on the proposed permanent base adjustment. The Auditor General's office has issued an interpretation stating that A.R.S. § 41-563.01 does not apply to permanent base adjustment elections and thus the requirements for hearings and publications in that section are not applicable. However, the city or town council is still required to pass a resolution on the proposed permanent base adjustment in an open meeting, but no record of that vote needs to be published (Exhibit C).

At least 60 days prior to a regular election, the council or a person or group using the initiative process proposing the base adjustment must submit a detailed analysis and summary of the adjustment to the Auditor General for review. Within 15 working days of receiving these reports, the Auditor General must correct any errors or deficiencies in the detailed analysis and summary and provide the city or town council with a copy of each report. No revisions of the analysis or summary can be made after the Auditor General Review is complete (Exhibit C).[56]

Arguments supporting or opposing the proposed base adjustment, if any, must be filed with the city or town clerk not less than 90 days before the election.[57]

Not less than 10 days prior to the election, the city or town council must provide a publicity pamphlet that includes the summary of the adjustment (as received from the Auditor General) to each household within the city or town containing a registered voter. [58] A copy of the printed publicity pamphlet must also be provided to the Auditor General prior to the election. In addition to the summary, the pamphlet must contain several items ranging from the date of the election to a section stating the impact of the base modification (Exhibit C).[59] The detailed analysis of the base adjustment must also be made available to registered voters by the city or town clerk upon request.

The ballot used for the election must contain a section stating the impact of the modification. If only one proposed adjustment is offered to the voters, the ballot should be in the form used for initiatives and referendums (Exhibit C).[60] If there is more than one proposed adjustment, the ballot must be in a form that allows electors the opportunity to vote on each base limitation adjustment.[61]

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[54] Article IX, Section 20, subsection 9, Arizona State Constitution
[55] Article IX, Section 20, subsection 6, Arizona State Constitution
[56] A.R.S. § 41-563.03 (D)
[57] A.R.S. § 19-141 (C)
[58] A.R.S. § 19-141 (B)
[59] A.R.S. § 41-563.03 (B)
[60] A.R.S. § 19-125
[61] A.R.S. § 41-563.03 (G)

Any approved permanent base limitation adjustment must be used in determining a city or town's expenditure limitation beginning with the fiscal year immediately following the approval and every year thereafter or until the city or town again adopts a new base.[62]

Auditor General Review

As mentioned previously, the Auditor General must review your detailed and summary analysis for both the home rule option and permanent base adjustment. The Auditor General must correct any errors or deficiencies in the detailed analysis and summary and provide the city or town council with a copy of each report within 15 working days of receiving the reports. The Auditor General's staff use the following procedures in the review:

1. Review of the financial information contained in the analysis and summary submitted to determine if it complies with the requirements set forth in state statute.[63]

2. Determine if assumptions, factors or derived amounts are internally consistent.

3. Determine the mathematical accuracy of calculations and totals.

4. Compare the amounts in the detailed analysis to the summary analysis.

5. Determine if historical or independently determined data such as the base limit agree with the indicated sources.

If the Auditor General's staff finds any error or has any questions on the report, staff will contact the city or town for corrections. The Auditor General may request additional information necessary to clarify or correct the submitted materials. After the Auditor General has completed the review, staff will notify the city or town of acceptance of the report.

As a final note, the mailing address, fax number and email address of the Auditor General is 2910 North 44th Street, Suite 410, Phoenix, Arizona 85018; (602) 553-9702; and asd@azauditor.gov. Reports must be delivered to one of these addresses so that they arrive at the Auditor General at least 60 days prior to the election.

3. Capital Projects Accumulation Fund

A capital projects accumulation fund is another option under the state imposed expenditure limitation. This option is particularly appropriate for communities where the state expenditure limit is sufficient except in the area of capital outlays.

If the voters approve, you may exclude from your limited or "controlled" expenditures, revenues accumulated to pay for certain capital projects. The voters have to approve both the project and the accumulation of revenue. The project can be the purchase of land or the purchase or construction of buildings or improvements.

The only specific reference to establishing a capital projects accumulation fund is located in the state constitution.[64] It appears that the notice and hearing requirements do apply as well.[65] Elections for such a fund may be held at either a regular city election or a special election. However, in response to one city, we developed a suggested set of procedures. These are composed of general election and spending limit election requirements. The procedures include holding two public hearings, publishing notice prior to the hearings and preparing a publicity pamphlet.

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[62] Article IX, Section 20, subsection 6, Arizona State Constitution
[63] A.R.S. § 41-563.03
[64] Article IX, Section 20, Subsection 3 d viii, Arizona State Constitution
[65] A.R.S. § 41-563.01

These steps outline a suggested process for adopting a capital projects accumulation fund. [66]

1. Call election.
2. Publish notice of two public hearings once a week for two consecutive weeks in a newspaper of general circulation, prior to the hearings.
3. Hold public hearings after publishing the second notice.
4. Vote by the council on the capital projects accumulation fund immediately following the second public hearing.
5. Publish record of the vote and other required information immediately following the council's vote.
6. Receive supporting or opposing arguments to be published in the publicity pamphlet for the capital projects accumulation fund not less than 60 days prior to the election.
7. Post sample ballots not less than 10 days prior to the election.
8. Distribute publicity pamphlets not less than 10 days prior to the election.
9. Hold election at either a regular or special election.

As noted above, some of these procedures are only suggested and not necessarily required. You may wish to review the applicable statutes with your attorney.

4. One-Time Override

Any city or town may exceed its state imposed expenditure limitation by a one-time override. This override is effective for one year only and has no effect on your expenditure limitation base or any subsequent fiscal year expenditure limitation.

The one-time override can be sought if two-thirds of the members of the city or town council vote to present the proposed override to the qualified electors of the city or town. A majority of qualified electors voting at either a special election (to be held the third Tuesday in May) or at a regular election in the fiscal year prior to the fiscal year in which the excess is to occur must give their approval in order to expend the additional amount. [67]

A city or town council contemplating a one-time override must hold two public hearings on the proposed action. Notice of these hearings must be published once a week for at least two consecutive weeks in a newspaper of general circulation within the city or town (Exhibit E). Immediately following the second public hearing, the city or town council must convene in a special meeting and vote on the proposed excess expenditure. A record of the vote and, if approved, the purposes for the excess expenditure must be published in a newspaper of general circulation within the city or town (Exhibit E).[68]

The city or town council seeking a one-time override must provide arguments in support of the excess expenditure and must receive arguments against the override at least 30 days prior to the election.[69] These arguments must be included in the publicity pamphlet concerning the override that must be distributed to each household within the city or town containing a registered voter not less than 10 days nor more than 30 days before the election.[70] In addition to the arguments, the publicity pamphlet must contain several items ranging from the date of the election to a statement of the purpose or purposes for the excess amount to be expended.[71]

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[66] A.R.S. § 41-563.01
[67] Article IX, Section 20, subsection 2, paragraph C, Arizona State Constitution and A.R.S. § 41-563.02
[68] A.R.S. § 41-563.01
[69] A.R.S. § 41-563.02 (B) (8)
[70] A.R.S. § 41-563.02 (A)
[71] A.R.S. § 41-563.02 (B)

State law requires that expenditures for amounts authorized by an override election can only be made for purposes stated in the publicity pamphlet for such an election. Expenditures approved pursuant to a one-time override election have to be budgeted separately by the city or town. Although the Auditor General's office is not required by law to review the materials for the one-time override, submitting them to their office can be helpful in making sure the materials are prepared properly.

5. Emergency Overrides of State Limit

The budget law provides for emergency overrides of the state imposed expenditure limitation in two situations:

1. In the case of a governor-declared emergency.[72]

2. In the case of a local governing board-declared emergency not declared by the governor.[73]

A city or town faced with a governor-declared man-made or natural disaster can exceed its expenditure limitation by an amount necessitated by the disaster if two-thirds of the members of the city or town council vote in favor of the excess. However, prior to a vote of the council to authorize such an emergency override, the council must hold two public hearings on the proposed action. Notice of these hearings must be published once a week for at least two consecutive weeks in a newspaper of general circulation within the city or town (Exhibit E). Immediately following the second public hearing, the council must convene in a special meeting and vote on the proposed excess expenditure necessitated by the disaster. A record of the vote and, if approved, the amount of excess above the city or town's expenditure limitation and purposes for the excess expenditure must be published in a newspaper of general circulation within the city or town (Exhibit E).[74] If the governor declares the disaster, you do not need to take the emergency override to the people for a vote.[75]

A city or town faced with a natural or man-made disaster that is not declared by the governor needs an affirmative vote of 70 percent of the members of the council to exceed its expenditure limitation by an amount necessitated by the disaster. Again, prior to a vote of the council to authorize such an override, the council must hold two public hearings on the proposed action. Notice of these hearings must be published once a week for at least two consecutive weeks in a newspaper of general circulation within the city or town (Exhibit E). Immediately following the second public hearing, the council must convene in a special meeting and vote on the proposed excess expenditure necessitated by the disaster. A record of the vote and, if approved, the amount of excess above the city or town's expenditure limitation and purposes for the excess expenditure must be published in a newspaper of general circulation within the city or town (Exhibit E).[76]

If the council does not want to reduce the budget the year following the disaster by the amount of money expended on the disaster, they must seek voter approval for their authorization to expend the funds, after the fact. A majority of the qualified electors voting at either a special election (to be held on the third Tuesday in May) or at the city or town's next regular election following the disaster must approve the emergency override. It should be emphasized that if the council does not present the issue of the emergency override to the voters or if the voters do not approve the override at the election, the city or town must reduce its budget in the fiscal year following the disaster by the amount of excess funds expended due to the disaster.[77]

Should a natural or man-made disaster not declared by the governor resulting in excess expenditures occur within 90 days of the third Tuesday in May or within 90 days of the city or town regular election, such expenditures cannot be put to a vote of the people until the next subsequent regular or special election.[78]

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[72] Article IX, Section 20, subsection 2, paragraph a, Arizona State Constitution
[73] Article IX, Section 20, subsection 2, paragraph b, Arizona State Constitution
[74] A.R.S. § 41-563.01
[75] Article IX, Section 20, subsection 2, paragraph a, Arizona State Constitution
[76] A.R.S. § 41-563.01
[77] Article IX, Section 20, subsection 2, paragraph b, Arizona State Constitution
[78] A.R.S. § 41-563.02 (E)

A council seeking voter approval for excess expenditures due to an emergency not declared by the governor must provide publicity pamphlets concerning the excess to each household within the city or town containing a registered voter not less than 10 days or more than 30 days before the election.[79]

It should be emphasized that if the voters do not approve the excess expenditures, necessitated by a disaster not declared by the governor, the city or town must reduce its budget in the fiscal year following the disaster by the amount of excess expended due to the disaster.

UNIFORM EXPENDITURE REPORTING SYSTEM

To ensure compliance with the state imposed expenditure limitation, the Office of the Auditor General has been directed to develop forms and procedures for a uniform expenditure reporting system.[80] The uniform expenditure report must be filed by all cities and towns even if the community has adopted an alternative to the state imposed expenditure limit.

Specifically, the uniform reporting system establishes the following reporting requirements for cities and towns:

1. Annual expenditure limitation report,
2. Financial statements prepared in conformity with generally accepted accounting principles, and
3. Reconciliation of total expenditures from the financial statements to total expenditures on the expenditure limitation report for cities and towns.

Annual expenditure limitation reports, together with audited financial statements and the reconciliation report are to be submitted by cities to the Auditor General within four months after the close of the fiscal year. The expenditure limitation reports for towns are to be submitted within four months after the close of the fiscal year and the financial statements and reconciliation reports annually or biannually when audits are performed.

Figures used in these reports are to be audited figures. To meet the four month filing deadline you should contact your auditor soon after the close of the fiscal year. If you cannot meet this October 31 filing deadline, an extension of up to 120 days may be granted by the Auditor General. Such an extension must be requested in writing. An example of an extenuating circumstance may be that you were unable to obtain audited figures by the October filing deadline.

Examples of the required forms and instructions for completing them are contained in a manual prepared by the Auditor General entitled the "Uniform Expenditure Reporting System" (UERS). These forms are to be used to complete the three reports that make up the expenditure reporting system. This manual is available online at http://www.azauditor.gov/ASD/PDF/Other/UERS.pdf.

Expenditure Limitation Report

The expenditure limitation report is an annual report that includes budget totals expended for the fiscal year. The Auditor General has developed forms for completing this report that appear in the UERS Manual.

The first part of the report is a comparison between actual expenditures and the state expenditure limit or alternative a city or town has adopted. This form is a simple summary of expenditures.

The second form in the expenditure limitation report is a sample auditor opinion attesting that the report presents the information fairly.[81]

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[79] A.R.S. § 41-563.02 A
[80] A.R.S. § 41-1279.07
[81] A.R.S. § 41-1279.07

Total expenditures must be detailed by fund on the third form. Cities and towns that have adopted an alternative expenditure limitation are only required to fill out lines A and C of this form. Again, the expenditure limitation report must be filed annually by the October deadline unless an extension has been granted.

Financial Statement

Financial statements must be prepared in accordance with generally accepted accounting principles.[82] The financial statement must "... set forth the financial position and results of the operations for each fund and account of the city or town."[83] The auditor preparing the financial statement must also state an opinion on the financial statements and a justification must be given if no opinion can be expressed.

The two sections of law cited above also affect the filing date of your financial audits. State law requires that your annual or biannual audit be filed with the Auditor General by October 31 as part of your uniform expenditure report unless an extension for filing is requested in writing.[84] On the other hand, state law also requires that your audit be complete by December 31 when audits are performed.[85] This means that even if you request the 120-day extension for filing your financial statement, your audit must be complete by December 31. Detailed instructions for this report are included in the UERS Manual.

Reconciliation Report

The third report that must be filed is a reconciliation of total expenditures reported on the expenditure limitation report and expenditures reported on the financial statement. Differences between expenditures listed on these two reports must be identified and the reasons for the differences must be included on the reconciliation. This report must be submitted along with your financial statement. Details for completing this report may be found in the Auditor General's manual.

Responsibility for Filing Reports

An individual designated by the city or town council as responsible for submitting the annual expenditure limitation report, financial statements and reconciliation report must certify to the accuracy of the reports. The responsible individual's name needs to be provided to the Auditor General annually by July 31.

Additionally, state law directs that the uniform reporting system include sanctions and penalties for violating such provisions.[86] The sanctions and penalties provided in the uniform reporting system are specified by law. The designated chief fiscal officer who refuses to file reports within the prescribed time, or who intentionally files erroneous reports, will be guilty of a class 1 misdemeanor. A city or town exceeding its expenditure limitation without authorization will have a portion of its allocation of state income tax withheld and redistributed to the other incorporated communities in the state. This penalty will be imposed in the fiscal year subsequent to the hearing held by the Auditor General on such a violation.[87] The amount of state income tax to be withheld for exceeding the expenditure limitation will be determined as follows:

1. If the excess expenditures are less than 5 percent of the limitation, an amount equal to the excess expenditures will be withheld.

2. If the excess expenditures are equal to or greater than 5 percent but less than 10 percent of the limitation, an amount equal to triple the excess expenditures will be withheld.

3. If the excess expenditures are less than 5 percent of the limitation but it is at least the second consecutive instance of excess expenditures for the city or town, an amount equal to triple the excess expenditures will be withheld.

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[82] A.R.S. § 41-1279.07
[83] A.R.S. § 9-481
[84] A.R.S. § 41-1279.07
[85] A.R.S. § 9-481
[86] A.R.S. § 41-1279.07
[87] A.R.S. § 41-1279.07 (G) & (H)

4. If the excess expenditures are equal to or greater than 10 percent of the limitation, an amount equal to five times the excess expenditures or one-third of the allocation of a city or town's state income tax will be withheld, whichever is less.

PROPERTY TAX LEVY LIMITATION

The Arizona Constitution and state law also specify a property tax levy limitation system. This system consists of two levies, a limited levy known as the primary property tax levy and an unlimited levy referred to as the secondary property tax levy. The primary levy may be imposed for all purposes, while the secondary levy in cities and towns may only be used to retire the principal and interest or redemption charges on bonded indebtedness.

Primary Property Tax Levy Limit

There is a strict limitation on how much a city or town can levy as a primary property tax. This primary tax levy is limited to an increase of 2 percent more than the previous year's maximum allowable primary levy plus an increased dollar amount due to a net gain in property not taxed the previous year.[88] In November 2006, voters elected to reset the "base year" from which annual levy increases are calculated from 1979-80 to 2005-06. [89]

Note that the 2 percent increase is based on a city or town's "maximum allowable levy" for the prior year. That is, even if you do not adopt the maximum allowable levy from year to year, the 2 percent allowable increase will be based on the prior year's "maximum allowable levy" anyway. Also, it should be pointed out that the "net new property" factor is included in the calculation to take into account all new construction and any additional property added to a community due to an annexation. There is an Attorney General's Opinion that has been interpreted to state that a city or town can levy in excess of its maximum allowable levy limit for involuntary tort judgments.[90] The Property Tax Oversight Commission will recognize an involuntary tort judgment if:

1. The judgment is pursuant to a court order or settlement agreement; and
2. The judgment is approved for payment by the city or town council; and
3. The Attorney General certifies that the judgment is an involuntary tort judgment; and
4. The city or town submits copies of the court order or settlement agreement and the minutes of the meeting at which the council approved payment on or before the first Monday in July.

The primary property tax from all taxing jurisdictions for homeowners may not exceed 1 percent of their home's primary assessed value.[91] If the combined primary property tax (for the city or town, county, etc.) exceeds 1 percent of the primary assessed value of the home, the school districts will reduce their rate until the homeowners aggregate rate is equal to or less than the allowable 1 percent. The state will then subsidize the school district for the reduced revenue. Note that this 1 percent limitation only applies to primary property taxes and does not affect the secondary property tax levy.

Secondary Property Tax Levy

The two-tiered system includes a primary levy, discussed above, and a secondary property tax levy. The secondary property tax allows a city or town to levy a property tax for the purpose of retiring the principal and interest on bonded indebtedness. This levy is referred to as the "unlimited" levy. In other words, this property tax may be levied in an amount necessary to retire the bonded indebtedness of a city or town as is deemed necessary by the city or town.[92]

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[88] A.R.S. § 42-17051
[89] Article IX, Section 19, paragraph 4, Arizona State Constitution
[90] Attorney General Opinion (I86-031) (R85-121)
[91] Article IX, Section 18, Arizona State Constitution and A.R.S. § 42-17152
[92] Article IX, Section 19, subsection 2, paragraph a, Arizona State Constitution

Not only is the dollar amount of the secondary property tax levy "unlimited," the actual full cash value of property will be used in determining the tax rate.[93] This is unlike the primary tax system that uses a controlled assessment system to determine the tax rate for primary property tax purposes.

The bottom line on the secondary property tax system is that a city or town can levy the amount necessary to pay off its debt service.

ESTABLISHMENT OF A NEW PRIMARY PROPERTY TAX LEVY

A number of cities and towns in Arizona do not currently impose a primary property tax. Therefore, a method to establish such a tax if the city or town desires to do so has been provided in state law.

To establish a primary property tax, a city or town must present the proposed levy to the voters at an election on the third Tuesday in May. The ballot must state that the amount on the ballot will be the base for determining levy limitations for the city or town in subsequent years.

These steps outline the process to initiate a primary property tax:

1. The council passes a resolution calling the election to be held at the regular voting places. The call must state that the election is to establish a primary property tax. There is no longer a time requirement related to the call of election, but we suggest that it be done not less than 30 nor more than 150 days before the date of the election.[94]
2. The election conforms to the general election laws.[95]
3. The election is held on the third Tuesday in May.[96]
4. The returns are made to the council within 12 days after the election.[97]
5. The council meets within 20 days after the election to canvass and certify the vote.[98]
6. A certificate is filed with the county recorder, giving the purpose of the election, the total number of votes cast and the total number of votes for and against establishing the primary property tax, and stating that the tax has been ordered by the council.[99]

As mentioned in Chapter One, a city or town that incorporates or annexes land must give proper notice to the Department of Revenue and the appropriate county assessor prior to levying the tax. State law requires that notice be given by November 1 of the year prior to the fiscal year when the tax will be initiated.

BUDGET/TAX LEVY

The preparation of a municipal budget is a long and detailed process. The council and staff will undoubtedly have to set a number of administrative deadlines to make sure that the budget has been given full consideration prior to its final adoption. There are, however, a number of specific dates set in state law with which a city or town must comply when preparing a budget (Exhibit F). In this section the most important dates are outlined.

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[93] A.R.S. § 42-13304
[94] A.R.S. § 35-453 & § 35-454
[95] A.R.S. § 35-454
[96] A.R.S. § 42-17056
[97] A.R.S. § 35-454
[98] A.R.S. § 35-454
[99] A.R.S. § 35-454

Developing the Budget

The budget process is initiated by obtaining accurate estimates of incoming revenues. Estimates of projected state-shared revenues for the upcoming fiscal year are usually provided in lump sum figures from the state departments distributing the funds. If the estimates are made available in a reasonable amount of time prior to the preparation of the budget, the League will publish an estimate of revenues going to each city and town from the state sales tax, the state income tax, the highway user revenue fund and the vehicle license tax.

Estimates of revenues raised from local sources will again have to be developed by each city or town. Some municipalities prepare a budget report on a regular basis throughout the fiscal year that gives a current comparison of incoming revenues and expenditures. The budget report is mentioned in Chapter Three and an example of the form to use for this report is included in Exhibit G. This type of document is one of the most useful monitoring tools for detecting any trends in collection totals that might affect revenues during the upcoming year. Monitoring would be particularly helpful on local sales tax, building permits and other revenue sources that are highly dependent on the state of the economy. Local revenue estimates or any other revenue estimates that turn out to be too generous can come back to haunt city and town administrators. This is why it is extremely important that estimates be reasonably accurate or even conservative.

Once the finance officer is confident of the revenue estimates, the next step is to analyze the anticipated expenditures for the upcoming year. These estimates should have been developed in the budget preparation phase and will be based on some of the following considerations:

1. The variety, type and level of services that the city or town wants to provide. This would include the maintenance or abandonment of current programs as well as the initiation of any new services. This is an area where the city or town council should play a significant role.

2. Known cost factors would include such items as social security costs, contribution rates to employee pension and retirement funds, industrial compensation rates and other similar costs.

3. A fairly comprehensive price list should be developed for anticipated costs on items in the general category of supplies and contractual services. This list should include costs for any anticipated major capital expenditures because expenditures of this nature usually require a considerable amount of budget planning. Cost factors in this area tend to be more susceptible to inflation, and this should be anticipated when making estimates.

4. The cost of employee salaries is one of the largest if not <u>the</u> largest expenditure in the city or town budget. Therefore, careful attention should be given to any cost-of-living, or merit increases or any other major change in the employee salary schedule.

5. Insurance costs have been steadily increasing for city and town governments. Your insurance agents should be able to provide reasonable estimates of anticipated costs for insurance.

6. Changes in employee benefits would include any modifications to vacation policy, overtime, holidays, uniform allowances, health insurance and sick leave.

7. General economic fluctuations will be one of the most difficult considerations when preparing a budget. The most sophisticated economists in the world have difficulty predicting slow-downs and upswings in the economy. This consideration is mentioned only as a precaution and while economic fluctuations cannot be calculated accurately, administrators should be aware of the potential impact of general economic conditions on the local budget. Also, any local events impacting significantly on the local economy should be taken into consideration.

Once all anticipated expenditures have been taken into consideration, the problem then becomes adjusting the expenditures to the available revenues. This process may involve cutting some expenditure appropriations while expanding others. Again, this is a policy area where the city or town council must provide active leadership.

Budget Adoption

State law requires that on or before the third Monday in July of each fiscal year, the city or town council must adopt a tentative budget.[100] Once this tentative budget has been adopted, the expenditures may not be increased upon final adoption; however, they may be decreased.[101] With the adoption of the tentative budget, the council has set its maximum "limits" for expenditure, but these limits may be reduced upon final adoption. The tentative budget must be fully itemized in conformance with forms supplied by the Auditor General and entered upon the council meeting minutes.[102] A copy of the Auditor General budget forms required by law are available on the Auditor General's website, www.auditorgen.state.az.us. These budget forms include schedules A through E. These budget forms provide a framework for the development of a city or town budget.

Once the tentative budget has been adopted, it must be published once a week for at least two consecutive weeks following the adoption.[103] The complete set of auditor general forms can be published or a summary of those forms can be published. The summary must show sources and uses of funds, and include consolidated revenues and expenditures by category, department and fund.[104] It must also include truth in taxation calculations and primary and secondary property tax levies. If a summary is published, the complete budget must be made available at city or town libraries, and city or town administrative offices.[105] Along with publication of the budget as outlined, a notice of the final budget adoption meeting should also be published.[106]

State law passed in 2012 clarifies that, beginning in FY 2014, the annual estimate of expenses for cities and towns must include, by fund, estimated numbers of full-time employees. It must also include an estimate of total personnel compensation. This estimate must separately include employee salaries and employee related expenses for retirement costs and health care costs. The law also directs the governing body of each county, city, town, community college district and school district to fix and assess the amount to be raised from primary and secondary property taxation, adding restricted and unrestricted unencumbered balances from the preceding fiscal year to equal the total amount proposed to be spent in the budget for the current fiscal year. The information that is required will be requested on the Auditor General's forms Schedule A.

Final Budget Adoption

There is no specific date set by state law for adoption of the final budget. However, for those of you with a property tax, there is a deadline for adoption of the property tax levy - the third Monday in August. Since state law requires a period of at least 14 days between adoption of the final budget and adoption of the tax levy, the deadline becomes the first Monday in August. For those without a property tax, it is still recommended that final budget adoption take place by mid-August. The adoption of the final budget may take place through a simple motion approved by the council. Legislation passed in 2011 requires that estimates of revenues and expenses from the past five fiscal years must be posted prominently on your website. We suggest posting Schedule A of the Auditor General Budget Forms for those corresponding fiscal years.

Adoption of Tax Levy

Before adopting the property tax levy, the council must receive property value information from the county assessor. These values must be provided to the council on or before February 10 of the tax year.[107] These values must be made available for public inspection on or before February 15 of the tax year.[108] Along with the property values, the county assessor will transmit the final levy limit worksheet, and each city or town levying a property tax is required to notify the Property Tax Oversight Commission in writing within 10 days of its

[100] A.R.S. § 42-17101
[101] A.R.S. § 42-17105 (C)
[102] A.R.S. § 42-17102 (B) & § 42-17105
[103] A.R.S. § 42-17103 (B)
[104] A.R.S. § 42-17103 (A)
[105] A.R.S. § 42-17103 (A)
[106] A.R.S. § 42-17104
[107] A.R.S. § 42-17052
[108] A.R.S. § 42-17055

agreement or disagreement with the final levy limit. After adoption of the levy the Property Tax Oversight Commission will review the primary property tax levy to determine the adequacy of compliance.[109] Notice of any violation of the levy limit will be sent by September 15.[110] If a city or town disputes the findings of the commission it may request, on or before October 1, a hearing before the commission to attempt to resolve the dispute. If the city or town continues to dispute the findings of the commission after the hearing, it may appeal the matter to Superior Court within 30 days after the decision of the commission.[111]

Any money received in excess of the maximum allowable limit must be maintained in a separate fund and used to reduce the primary property tax levy in the following year.[112] However, additional amounts collected from escaped property and monies that are received from the payment of delinquent property taxes properly assessed in prior years are exempted from this requirement.[113] Escaped property are those parcels that did not appear on the assessment rolls for the tax year, but that would have appeared if they had been identified.

As mentioned previously, the tax levy for a city or town must be adopted on or before the third Monday in August.[114] Using the information provided by the county assessor, the council must specify the amount that will be levied in an ordinance that will become effective immediately.[115] The tax levy ordinance does not require a three-fourths vote or an extraordinary vote to make the levy effective immediately because this is an administrative matter and not an act of legislation. This determination is based on a state Supreme Court decision in that the court ruled that the state general appropriation bill was not legislation, but merely an administrative method of setting apart funds necessary for use and maintenance of state government.[116] This case also applies to the municipal budgetary process. The main dates and deadlines in the budgetary process are also outlined in the budget calendar (Exhibit F). See also the discussion in Chapter One of the property tax.

Property Tax Refund in Budget

Any affected political subdivision, including cities and towns, must include in their budgets for the next fiscal year the proportional amount of any property tax refund for which they are liable when the refund is for overpayment as a result of a change in the tax roll pursuant to state statute authorizing such change.[117]

Truth in Taxation

It is required that the county assessor, on or before February 10 of each year, transmit to each city and town an estimate of the total net assessed valuation of the city or town, including new property added to the tax roll.[118] If the proposed primary tax levy, excluding amounts attributable to new construction, is greater than the amount levied by the city or town in the previous year the council must publish a notice that meets the following requirements:[119]

1. The notice has to be published twice in a newspaper of general circulation in the city or town. The first publication shall be at least 14 but not more than 20 days before the date on which the proposed levy is to be discussed. The second publication must be at least seven but not more than 10 days before the hearing.

2. The notice has to be published in a location other than the classified or legal advertising section of the newspaper.

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[109] A.R.S. § 42-17055
[110] A.R.S. § 42-17005
[111] A.R.S. § 42-17004
[112] A.R.S. § 42-17005 (C)
[113] A.R.S. § 42-17051 (B)
[114] A.R.S. § 42-17151
[115] A.R.S. § 42-17151
[116] Sellers v. Frohmiller, 42 Arizona 239, 24 Pac. (2d) 666
[117] A.R.S. § 42-18061
[118] A.R.S. § 42-17107
[119] A.R.S. § 42-17107

3. The notice must be at least one-fourth page in size and shall be surrounded by a solid black border at least one-eighth inch in width.

4. The headline of the notice must read "Truth in Taxation Hearing - Notification of Tax Increase" in at least 18-point type and the text must be in substantially the same form as the statute (Exhibit L).

5. In addition to publishing the notice according to the above requirements, it is required that the city or town to issue a press release with the same information included in the notice required above.[120]

The law does provide that in lieu of publishing the notice it may be mailed to all registered voters in the city or town at least 10 but not more than 20 days before the hearing on the proposed levy.[121] The hearing is to be held on or before adoption of the city budget.[122] It also requires that a roll call vote be taken on the matter of adoption of the primary property tax levy if an increase is proposed.[123] Following the public hearing, the city or town must, within three days of the hearing, mail a copy of the truth in taxation notice, a statement of its publication or mailing and the result of the council's vote to the Property Tax Oversight Commission. [124] Both the hearing and the notice can be combined with the regular budget notices.[125]

The Legislature added a penalty to the truth in taxation law. If a city or town failed to comply with the notice and hearing requirements, then the next year the jurisdiction is prohibited from levying more than was levied in the prior year.[126]

Encumbrances

Occasionally there are costs that are still outstanding at the end of a fiscal year. Cities and towns now have the authority to encumber funds for any of these costs that are incurred during the fiscal year but are still outstanding after the fiscal year closes.[127] Encumbering is an accounting tool which is required pursuant to generally accepted accounting principles (GAAP). This tool provides a uniform procedure for handling expenses that are incurred toward the end of a budget year, but may not be paid until after the fiscal year closes. Payments may be made from encumbered funds for a period of 60 days following the close of the fiscal year.[128]

[120] A.R.S. § 42-17107
[121] A.R.S. § 42-17107
[122] A.R.S. § 42-17107
[123] A.R.S. § 42-17107
[124] A.R.S. § 42-17107
[125] A.R.S. § 42-17103 (C)
[126] A.R.S. § 42-17107
[127] A.R.S. § 42-17108 (A)
[128] A.R.S. § 42-17108 (B)

CHAPTER THREE

FINANCIAL MANAGEMENT

Once the city or town budget has been adopted, the municipality's finance officer must continue to manage the receipts and expenditures of the municipality throughout the fiscal year. While the task of administering the budget involves a wide variety of activities, this chapter of the manual will discuss the functions of accounting, audits, investment of public funds and purchasing.

ACCOUNTING

This publication does not include an analysis of accounting procedures or recommend one particular method over another. However, there are a number of general points to remember throughout the fiscal year.

Control of Expenditures

Arizona state law stipulates that no expenditures may be made for a purpose not authorized in the annual budget.[129] This makes it extremely important for the budget to be closely monitored to ensure that expenditures do not exceed the amount budgeted.

On occasion, it may be necessary to increase an expenditure in the budget above what was approved in the final budget, provided that a corresponding decrease is made in another budget expenditure and all of the following conditions apply:

1. The monies are available.
2. The transfer is in the public interest and based on a demonstrated need.
3. The transfer does not result in exceeding the community's expenditure limitation (state imposed limit or home rule option)
4. The majority of the members of the governing body vote affirmatively on the transfer at a public meeting.[130]

In addition, certain expenditures, notably capital expenditures, should be timed to coincide with the receipt of revenues from specific sources. As an example, it is a common practice to schedule major purchases, such as motor vehicles, to coincide with the receipt of property tax revenues. This type of budget planning can avoid cash flow problems.

The budget merely sets forth the purposes for which specific amounts of money may be expended, if and when the funds become available. Good budget administration ensures that no financial obligations are incurred until there is money in hand, and the budget has allocated the amount to be expended.

Financial Reports

The budget contains estimates on revenues to be received as well as anticipated expenditures. Revenues should be constantly monitored throughout the fiscal year to detect any fluctuations in the receipts. This practice is especially true of some excise taxes that are dependent upon the economy. The actual income derived from the various revenue sources should then be compared to the budget estimates to obtain a true picture of the city or town's financial condition at any point in time.

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[129] A.R.S. § 42-17106
[130] A.R.S. § 42-17106 (B)

If, upon close examination of the budget, it is found that revenues are not sufficient to support planned activities, the finance officer of the city or town should promptly make recommendations to the governing body for dealing with the situation. There may be unforeseen expenditures that arise during the budget year, which will cause considerable problems even in a well-planned budget. Any problem that arises should be handled immediately as financial problems have a way of escalating rapidly.

One helpful administrative tool in many cities and towns is a budget report prepared monthly by the clerk or finance officer to provide the council with current information regarding the collection and expenditure of funds. The report is usually organized to clearly present the budget items and reflect the condition of budgetary accounting funds.

In addition to the basic financial report, whenever there is an unusually large amount of money collected or expended during a particular month, a brief narrative is sometimes attached to the statement describing the nature of the transaction.

Exhibit G is an example of the format, which may be used for a budget report. This is only a suggested format and, of course, must be adapted to conform to your accounting format.

AUDITS

State law requires an audit of municipal operations to be made by a certified public accountant or a public accountant currently licensed by the Arizona State Board of Accountancy.[131] The audit is required each fiscal year for cities and at least once every two fiscal years for towns.[132]

The audit, as required by the uniform expenditure reporting system and Arizona state law, must include a financial statement of all accounts and funds of the municipality.[133] Audits must be conducted in accordance with generally accepted auditing standards.[134] This report must include the professional opinion of the auditor regarding the financial statements of the city or town, or a declaration of why such an opinion cannot be expressed.

The audit report must include a "determination" that HURF monies and other dedicated state transportation revenues received by the city or town were used solely for authorized purposes.[135] The Auditor General's office requires that the auditor specifically report this determination in the auditor's opinion on the financial statements or a separate report of the auditor within the city or town's audit report. All cities and towns will need to ensure the required determination is included in their annual fiscal audit report.

As stated in Chapter Two, the audit must be filed with the Auditor General by October 31 unless the 120-day extension for filing is requested in writing. Even with the extension, audits must be completed by December 31.[136]

Not less than three copies of the audit report are to be signed by the auditor and filed with the city or town. The city or town must immediately make one copy of the report a public record, open to the public for inspection. Also, one additional copy of the audit must be filed with the Arizona State Library, Archives and Public Records.[137]

More detailed instructions on audit requirements are contained in the UERS Manual prepared by the Auditor General.

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[131] A.R.S. § 9-481
[132] A.R.S. § 9-481
[133] A.R.S. § 9-481
[134] A.R.S. § 9-481 (B)
[135] A.R.S. § 9-481 (B)
[136] A.R.S. § 41-1279.07
[137] A.R.S. § 9-481 (D)

FEDERAL SINGLE AUDIT ACT

Several years ago, Congress enacted the Federal Single Audit Act that imposes minimum federal audit requirements for organization-wide audits of state and local governments that receive $500,000 or more in federal financial assistance. The purpose of the act was to improve financial accountability of state and local governments with respect to federal financial assistance programs.

If your city or town falls under the requirements of this act, you need to arrange for the performance of a single audit for the present fiscal year and all future years in which your city or town receives $500,000 or more in federal funds. Those of you that must conduct such an audit should include requirements for a single audit in your contract with your auditor.

In past years, biennial audits were an option; however, this option was discontinued with the Single Audit Act Amendments of 1996, and all Arizona cities and towns subject to this act are to have the single audit performed annually.

INVESTMENT OF PUBLIC FUNDS

The public deposit law applies to all "general law" cities and towns in the state. Charter cities are excluded from the coverage of this law, except that charter city funds are subject to the collateral requirements in state law. [138]

The procedures to be followed in complying with the public deposit law depend on how much money is available for investment. Funds of $100,000 or more must be invested according to the procedures specified in State law. For deposits of less than $100,000, there are procedures as specified by local ordinance or resolution that must be followed (Exhibit H).

Public Deposits of $100,000 or More

State law governs the investment of city and town funds in excess of $100,000 through bidding procedures, a list of eligible investments, minimum interest requirements on certificates of deposit, collateral and record keeping requirements.[139]

Eligible Investments

The following forms of investment with a five-year maximum maturity are specified as eligible investments:

1. Certificates of deposit in eligible depositories if the interest rate bid is 103 percent or more of the equivalent bond yield of the offer side of treasury bills. Eligible depositories include: banks insured by the Federal Deposit Insurance Corporation (FDIC); savings and loan institutions insured by the Federal Savings and Loan Insurance Corporation (FSLIC); and credit unions insured by the national credit union administration (NCUA). The banks and savings and loan institutions must have either a branch or its principal place of business in Arizona.

2. Certificates of deposit in one or more federally insured banks or savings and loan institutions in accordance with the following procedures:

   - The monies are initially invested through an eligible depository in this state selected by the investing entity.

   - The selected eligible depository arranges for the deposit of the monies in certificates of deposit in one or more federally insured banks or savings and loan institutions wherever located, for the account of the investing entity.

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[138] A.R.S. Title 35, Chapter 2, Article 2
[139] A.R.S. § 35-323

- The full amount of principal and any accrued interest of each certificate of deposit is insured by the FDIC.
- The selected eligible depository acts as custodian for the investing entity with respect to the certificates of deposit issued for its account.
- At the same time that the investing entity's monies are deposited and the certificates of deposit are issued, the selected eligible depository receives an amount of deposits from customers of other federally insured financial institutions equal to or greater than the amount of the monies initially invested by the investing entity through the selected eligible depository.
- Monies invested in accordance with all of the conditions prescribed in this section are not subject to any security or collateral requirements.

3. Interest bearing saving accounts in qualified banks and savings and loan institutions.
4. Repurchase agreements with maximum maturity of 180 days.
5. The pooled investment funds established by the state treasurer.[140]
6. Bonds or other evidence of indebtedness of the United States or any of its agencies or instrumentalities when the obligations are guaranteed as to principal and interest by the United States or by any agency or instrumentality of the United States.
7. Bonds or other evidences of indebtedness of this state, any county, city, town or school district.
8. Bonds, notes or evidences of indebtedness of any county, municipal or municipal district utility within this state that are payable from revenues or earnings specifically pledged for the payment of the principal and interest on the obligations, if they meet certain criteria as specified in state law.[141]
9. Bonds, notes or evidences of indebtedness issued by any municipal improvement district in this state to finance local improvements authorized by law, if the principal and interest of the obligations are payable from assessments on real property within the local improvement district. Once again certain criteria are established in state law for such investments to be eligible.
10. Commercial paper of prime quality that is rated “P1” by Moody's investors service or rated “A1” or better by Standard and Poor's rating service or their successors. All commercial paper must be issued by corporations organized and doing business in the United States.
11. Bonds, debentures and notes that are issued by corporations organized and doing business in the United States and that are rated “A” or better by Moody's investor service or Standard and Poor's rating service or their successors.[142]

Bid Procedures

To comply with the bid procedures in state law, cities and towns must:

1. Give notice to all banks, savings and loan institutions and credit unions located within the city or town and, at the option of the city or town, to any other financial institution in the state. Banks must be insured by the FDIC, savings and loan institutions by the FSLIC, and credit unions must be insured by the NCUA. Notice can be in writing or by telephone.
2. The city or town must specify in the notice, the time the bids will be opened, the amount of funds to be deposited and the time period for deposit.
3. The bids must be announced in public and the funds must be awarded to the highest bidder.[143]

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[140] A.R.S. § 35-323 & § 35-326 (B)
[141] A.R.S. § 35-323
[142] A.R.S. § 35-323
[143] A.R.S. § 35-323

State law requires that a report listing the bidders, the bids received and the amount awarded be prepared. The city or town council must be provided with a copy of the report. These records must be kept on file with the city or town for at least two years and be available for public inspection. Exhibit I in the appendix is an example of a sample notice of bids and Exhibit J is an example of a form for the financial institution to use when submitting a bid.[144]

In the bidding procedure, banks and other eligible depositories must specify the rate of interest the institution will pay before the deadline for bids. In addition, banks must limit the amount of funds received to no more than two times the capital structure of the bank. This is the clear responsibility of the financial institution.[145]

If the highest bidder only bids for a portion of the funds, then the remaining funds go to the next highest bidder. If two or more identical bids are received, the funds are awarded to the institution with the lowest ratio of public deposits to its capital structure. The depositories will supply you with this information.[146]

Collateral

For any deposit over $100,000, the bank or other depository must provide a surety bond, certain securities or if eligible, a safekeeping receipt as collateral to equal at least 100 percent of the deposit. Public deposits up to and including $100,000 are insured by the FDIC, FSLIC or NCUA.[147]

Restrictions

1. A city or town may not award any bids for certificates of deposit for less than 103 percent of the equivalent yield of the offer side of U.S. Treasury bills.

2. Operating fund monies may not be invested for more than three years.[148]

Trust Funds and Sinking Funds

Procedures for investment of trust funds are also specified in state law.[149]

Pooled Investment Funds

The state treasurer maintains several pooled investment funds for collective investment of public funds.[150] Cities and towns may participate in these funds. Cities and towns making deposits into this fund must specify the period of time that the funds will remain on deposit.

For more detailed information on these funds, such as monthly earning rates, types of investments involved and other characteristics of the various pools, contact the Office of the State Treasurer (www.aztreasury.gov).

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[144] A.R.S. § 35-323
[145] A.R.S. § 35-323
[146] A.R.S. § 35-323
[147] A.R.S. § 35-323
[148] A.R.S. § 35-323
[149] A.R.S. § 35-324, § 35-327 and § 35-328
[150] A.R.S. § 35-326

PURCHASING

Bidding Procedures For Municipal Purchasing

In general, municipal purchasing procedures are an issue of local concern. However, in a few situations, state law dictates specific competitive bidding procedures. These situations are as follows:

1. State law dictates what construction projects cities and towns can complete with their own regularly employed personnel or with volunteer labor and which projects are subject to a state-mandated competitive bidding procedure. The law includes the following provisions:[151]

   - A city or town may complete a project that it believes can be advantageously done by its own employees provided that the total cost of the work, excluding materials and equipment previously acquired by bid, does not exceed a threshold amount that is adjusted annually for inflation. The threshold amount for FY2012-13 is $19,806, FY2013-14 is $20,115, FY2014-15 is $20,409 and FY2015-16 is $20,745.[152]
   - A city or town may use its own employees for street, road, bridge, water or sewer work, other than a water or sewer treatment plant or building, without advertising for bids if the total cost of the project does not exceed a threshold amount that is adjusted annually for inflation. The threshold amount for FY2012-13 is $212,205, FY2013-14 is $215,520, FY2014-15 is $218,670 and FY2015-16 is $222,270.[153]
   - A city or town may construct, reconstruct, install or repair a natural gas or electric utility and distribution system, owned and operated by the city or town, with their employees without going to bid unless otherwise prohibited by charter or ordinance.[154]
   - A city or town, without going to bid, may make a contribution for the financing of public infrastructure pursuant to a development agreement up to a threshold amount that is adjusted annually for inflation. The threshold amount for FY2012-13 is $141,470, FY2013-14 is $143,680, FY2014-15 is $145,780, and FY2015-16 is $148,180.[155]
   - A city or town without going to bid, may construct recreational projects, including trails, playgrounds, ballparks and other similar facilities excluding buildings, structures, or additions or alterations to structures or buildings, with volunteer workers or workers provided by a nonprofit organization without advertising for bids for labor and materials provided that the total cost of the work does not exceed a threshold amount which is adjusted annually for inflation. The threshold amount for FY2012-13 is $187,680, FY2013-14 is $190,455, FY2014-15 is $193,245 and FY2015-16 is $196,440.[156]

The penalty for violating the aforementioned bid procedures is as follows:

- $10,000 for a first violation
- $25,000 for a second violation
- $75,000 for a third violation

- A city or town is required to submit plans and specifications to any construction news reporting service that files an annual request with the city or town.
- Any construction done by a city or town under this section of law must comply with generally accepted accounting principles.

2. State law requires a city or town to use competitive bids in an improvement district.[157] Under this bidding procedure, however, the governing body of a city or town may reject any or all bids when deemed for the public good.[158] In this situation, the law requires that the invitation for bids be published twice in

[151] A.R.S. § 34-201
[152] A.R.S. § 34-201 (C) (1)
[153] A.R.S. § 34-201 (D) (1)
[154] A.R.S. § 34-201 (F) (1)
[155] A.R.S. § 34-201 (G) (1)
[156] A.R.S. § 34-201 (F) (2)
[157] A.R.S. § 48-581
[158] A.R.S. § 48-584 (B)

one or more daily newspapers or once in a weekly or semi-weekly newspaper that is published and circulated in the city or town.[159] Additionally, there is a requirement that a copy of the notice be posted for five days on or near the door of the meeting place of the city or town council.[160]

In addition to the above requirements for municipal purchasing, state law requires a formal bid process for the sale of any real or personal property by a general law city or town unless the property is sold to another political subdivision. State law allows an exchange of property for property of substantially equal value.[161]

Procuring Professional Services

One other area of purchasing where there are state regulations is in the area of contracting for professional services (architects, engineers, etc.). Some of these specifics include the opportunity to use alternative forms of contracting, e.g. design-build, construction manager at-risk, etc. If you are interested in how these alternatives might be used, please consult A.R.S. Title 34, Chapter 6.

The preceding paragraphs specify formal bid requirements as set forth in the Arizona Revised Statutes. However, this section of the manual is not intended as a substitute for the advice of counsel, and it is suggested that in any specific situation the city or town attorney be consulted with regard to the application of statutes and local charter or ordinance requirements.

It should be noted that the practice of requiring competitive bidding in the letting of municipal contracts is generally for the purposes of inviting competition, guarding against favoritism, and to secure the best work or supplies at the lowest price practicable. In this regard, most municipalities require either by charter provision or by ordinance that purchases over a specified dollar amount be handled with a formal bidding procedure while lesser purchases are handled through an informal bidding process. We recommend consideration of such a local ordinance.

We also suggest consideration of centralized control of municipal purchasing procedures. Although centralized control of purchasing is not required, it is a good method to ensure sound budget control. Because a department has authority in the budget to purchase items does not mean that expected revenues are forthcoming. This pay-as-you-go budget control provides a more precise way to time your expenditures upon the receipt of revenue.

Developing an effective centralized purchasing program should begin with the authorizing of a purchasing officer to be responsible for the scheduling and making of purchases. The purchasing officer is also responsible for developing standard purchasing procedures and seeing that the purchasing schedule and procedures are followed. To ensure that the best products are obtained for the least price, it is essential to maintain a current list of qualified suppliers. Inventory and surplus goods may also be controlled with this program. Therefore, we suggest that such control, along with up-to-date information, may assist you in this budget related area.

DAVIS-BACON ACT

If federal funds are used in construction projects, federal requirements from the Davis-Bacon Act regarding prevailing wages in construction contracts may apply. For example, if federal funds are used to finance 25 percent or more of a contracted construction project costing more than $2,000, then the city or town must ensure compliance with the prevailing wage rate and labor standards established by the Davis-Bacon Act. This act is administered by the U.S. Department of Labor. We suggest your local city or town attorney be consulted on any construction project that will be paid for, either fully or partially, by federal funds.

[159] A.R.S. § 48-584 (D)
[160] A.R.S. § 48-581
[161] A.R.S. Title 9, Chapter 4, Article 1

APPENDIX

EXHIBIT A: ARTICLE IX, SECTION 20, ARIZONA STATE CONSTITUTION

EXHIBIT B: ECONOMIC ESTIMATES COMMISSION APPEALS PROCEDURE

EXHIBIT C: STATE LAW REQUIREMENTS AND SAMPLE FORMS FOR HOME RULE OPTION AND PERMANENT BASE ADJUSTMENT

EXHIBIT D: CHRONOLOGY OF EVENTS FOR AN ALTERNATIVE EXPENDITURE LIMITATION ELECTION

EXHIBIT E: PUBLIC NOTICE - SAMPLE FORMS FOR ONE-TIME AND EMERGENCY OVERRIDES

EXHIBIT F: BUDGET CALENDAR

EXHIBIT G: BUDGET REPORT

EXHIBIT H: SAMPLE RESOLUTION FOR THE DEPOSIT OF FUNDS

EXHIBIT I: SAMPLE NOTICE OF BID

EXHIBIT J: SAMPLE FORM FOR FINANCIAL INSTITUTION TO SUBMIT BID

EXHIBIT K: GUIDE FOR AMENDING YOUR TAX CODE

EXHIBIT L: TRUTH IN TAXATION HEARING NOTICE

EXHIBIT M: TIMELINE ESTABLISHING OR AMENDING IMPACT FEES

ATTORNEY GENERAL OPINION: R83-116

ATTORNEY GENERAL OPINION: R85-121

GENERAL COUNSEL OPINION: APRIL 20, 1987

SELLERS V. FROHMILLER

FEDERAL SINGLE AUDIT ACT 2003

BASE LIMIT