

FINANCIAL MANAGEMENT
FOR
SMALL MISSOURI MUNICIPALITIES

Volume I
BUDGETING

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FOREWORD

Financial Management for Small Municipalities is a three-volume set of nontechnical handbooks for officials of small Missouri cities – those under 1,000 population and/or those with budgets under \$500,000. It is intended to help part-time officials, generally unfamiliar with municipal financial management, to establish a comprehensive and simple financial management system.

This first volume deals with municipal budgeting. Once the financial management system is in place, the preparation of the budget marks the beginning of each fiscal cycle. The first comprehensive budget may be difficult to prepare due to inadequate records and insufficient experience. Subsequent efforts, however, will be considerably less work.

Beyond the preparation of the budget, the use of the document as a tool in financial management often is overlooked. Besides explaining how to put one together, this manual also suggests ways to use the budget during the year to make better financial decisions.

WHY MUNICIPALITIES NEED BUDGETS

In its simplest form, a budget is an estimate of the expected revenues of a municipality and a proposed plan of expenditures. State statutes require every municipality to annually prepare and formally adopt a budget (Section 67.010 RSMo). Beyond that, a budget is an essential tool in the planning and operation of any unit, whether it be a personal financial plan or plans for an industrial operation or a governmental unit. It is an essential administrative tool, without which no individual, industry or government can operate efficiently.

Budgets provide the municipal governing body with the opportunity: 1) to evaluate current programs – their goals, their effectiveness and their efficiency; 2) to establish the level of services and programs to be provided; and 3) to determine the staffing and supporting supplies and equipment required to carry out the programs. By looking at the budget as a whole, the governing body can weigh the need for one program against another and balance the program needs against the tax burden required to finance them.

Budgets also: 1) serve as the end product of administrative planning – being the annual dollar expression of a government’s personnel and material plans; 2) serve as a compact and convenient means of informing the citizens of governmental plans and their anticipated costs and benefits; and 3) provide officials with a guide to action and a measure of their stewardship – being an important tool of direction and control as well as a legal basis for action and a mechanism for accountability.

WHERE TO BEGIN

The budget process begins in the city’s accounting system. The budget should specify the expenditures for each of the city’s “funds”¹ and identify the sources of revenue required to support these expenditures. If you already have established “funds” for your city’s receipts and expenditures, these same categories should be used for the budget. If you have not yet established “funds,” you should refer to Volume 2 and determine the categories you wish to use.

The budget also requires a great deal of historical information, which also is obtained from the accounting system. If you are changing to a new accounting system, this information may be difficult, if not impossible, to obtain. If that is the case, any time information for a previous year is required but not available, you should leave the space blank.

Finally, the budget requires current information on what is expected to happen in the coming year. Before preparing the budget, you must talk with other city personnel (police chief or marshal, street superintendent, utilities superintendent) and the Board of Aldermen or Board of Trustees to determine what they expect to happen in the city in the coming year. This allows you to include, for example, a new pick-up truck for the street department that might otherwise be overlooked.

¹The idea of “fund” is explained in detail in Volume 2 of this series. An integral part of setting up an accounting system is specifying which funds the city will use for keeping track of revenues and expenditures. The budget merely uses the same “funds” to show how city money is expected to be raised and spent.

You should expect to use information from budgets for prior years and the current year, cash basis financial statements for prior years and the current year, and accounting records for prior years and the current year. Once the records are gathered, you are ready to begin drafting a budget.

All the forms mentioned in this manual are in the Appendix. These may be reproduced and used for your own budget.

ESTIMATING REVENUES

The first step will be to estimate how much revenue the city can expect to receive in the coming year. Following is a list of revenue sources available to fourth class cities and villages. Choose the ones your city uses and list them in Column 1 of Form B-1.

PROPERTY TAXES:

- Real Property – current
- Real Property – delinquent
- Personal Property – current
- Personal Property – delinquent
- Railroad and Utilities
- Interest and Penalties

FRANCHISE TAXES: (Gross Receipts or Gross Receipts Utility Taxes) (Fourth Class Cities Only)

- Electric
- Telephone
- Gas
- CATV

LICENSES:

- Business
- Motor Vehicle
- Liquor
- Dog

FEES:

Building, Inspection, Zoning Fees
Cemetery Lots
Park Fees
Court Fees/Costs
Court Fines
Parking Meters
Other Fees

OTHER TAXES:

Sales Tax
Cigarette Tax
Motor Fuel Tax

MISCELLANEOUS REVENUE:

Interest on Investments
Sale of Materials/Land
Rental Income
Contributions
Federal Grants
Other (specify)

UTILITY REVENUE (Enterprises):

Electric
Gas
Water
Sewer
Garbage and Refuse

Columns 2 and 3 of Form B-1 can be obtained from financial statements from prior years. For each revenue source listed in Column 1, include the amount actually received during the fiscal year that ended two years ago (Column 2) and the fiscal year that ended last year (Column 3). Audits of prior years also contain this information.

Column 4 requires you to look at the amount you expected to receive during the current year (as shown in the current budget) and determine the amount actually received (as shown in the revenue ledgers). Since your original estimate for the current year was made a year ago, and now you have roughly three-fourths of the current fiscal year complete, you can make a pretty accurate estimate of what actually will be received for the full year. For example, if your fiscal year begins July 1, you should have a very good idea of your property tax collections by the end of January, since almost all payments are received by then. You can, therefore, revise your original budget estimate with confidence since delinquent tax collections generally are small in comparison to total tax revenue.

You now are ready to fill in Column 5 – your estimate of revenue you expect to receive during the next fiscal year. This estimate is based on the historic information you have included in Columns 2-4 and on how you think current factors (inflation, recession, etc.) might affect the particular revenue source. For example, property tax revenues are pretty “recession-proof” – if

the economy goes down, these revenues tend to remain static. Sales tax revenues, on the other hand, are subject to considerable influence by inflation and recession. Other factors that can influence the accuracy of your estimates include legislative actions (e.g., exemption of an item from sales tax) or major real estate development (e.g., a new industry about to come on the tax rolls).

Remember, a budget is only an estimate of what you think will happen during the next year. It is not expected to be exact. You should, however, make an effort to be as close as possible. While you may wish to be conservative in revenue forecasts, it is not appropriate to use this to “hide money” by not including funds you expect to receive or to make the end of the year “look good” by consciously underestimating revenues. Further, overly conservative budgeting could cause a city or village to roll back property tax rates further than is necessary.

There are a number of ways to calculate estimates using information from prior years. Some are exceedingly complicated (e.g., multiple regression) and should be ignored. Others are more simple, though less accurate; they should, however, be adequate for our purposes.

For each revenue source, figure the percent change for the three years (percent change between two years ago and one year ago, and percent change between one year ago and current year). If the two figures are fairly close, and you know of no unusual circumstances that would affect the specific source of revenue, use the figure to estimate receipts for next year.

For example, sales tax receipts two years ago were \$56,241.83. Last year, they were \$58,824.19, and this year they will be approximately \$62,000. The percent change from year-to-year is shown below.

<u>Two years ago</u>	<u>One year ago</u>	<u>This year</u>	<u>2002</u>
\$56,241.83	\$58,824.19	\$62,000.00	
percent change		percent change	
5.0%		5.4%	

To estimate the revenue for the budget, you may 1) be very conservative and estimate a 5% increase over the current year, 2) average the two percentages and estimate a 5.2% increase, or 3) expect the growth rate to continue and anticipate a 5.8% increase in revenue.

On the other hand, you may have read a number of predictions that the economy is about to enter a recession. Since sales taxes are directly tied to the economy, you then may predict only a very modest 1% or 2% increase. If you are really gloomy, you may even budget a decrease in revenue.

The following is an alternate method for estimating the amount of property taxes necessary for a particular fund.

Property Taxes Needed for X Fund for Upcoming FY

1.	Estimated expenditures		\$xx,xxx
	1.a. Estimated revenues (non property tax)	\$x,xxx	
	1.b. Plus beginning balance in fund	<u>xxx</u>	
2.	Less revenue available (1.a. + 1.b.)		- <u>x,xxx</u>
3.	Net property tax required (1-2)		\$xx,xxx
	3.a. Plus delinquent property taxes	xxx	
	3.b. Less delinquent property tax collections	<u>xxx</u>	
	3.c. Adjustment for uncollected delinquent taxes		+ <u>xxx</u>
4.	Adjusted property tax required		\$xx,xxx
	4.a. Plus required ending balance		<u>xxx</u>
5.	Property tax receipts required		\$xx,xxx

This method begins with the total estimated expenditures (1) for a particular fund. Subtracted from this estimate are revenues other than property taxes (1a) and any beginning balance for this fund (1b). This shows the net amount of property tax needed to support the fund. An allowance is now made for delinquent property taxes that will not be collected. This will be determined from the past performance of your city in collecting delinquent taxes.

This adjustment is added to the net property tax required for the fund (4). Item 4.a. may not be necessary in this estimation, but if an ending balance is required for a particular fund, it should be added to the adjusted property tax required.

After preparing property tax estimates for each fund, they should be added together to provide an estimate of the total amount of property tax that will be needed to support all funds.

In short, there are no “magic” ways to prepare budget estimates. Rely on historic performance tempered with your knowledge of conditions that might affect these estimates.

Once you have prepared estimates of revenue for each source, complete Form B-1 by filling in column 5 and totaling the figures in each column.

Revenues now must be allocated to each city “fund.” Usually, property tax levies for bond payments are put in the Bond Sinking Fund, operating revenue from utilities go to the Utility Enterprise Fund and everything else goes to the General Fund. Additional funds are not necessary, but for expenditure purposes, it might be clearer to add, for example, a Street Fund or a Park Fund. Regardless, each fund your city or village uses should be shown in the budget.

Form B-2A can be used to allocate revenues. This usually will be only a work sheet, but it

could be made part of the budget document if you wish.

In Column 1, list the same sources of revenue used in Column 1 of Form B-1. In Column 2, list the estimates shown in Column 5 of Form B-1. These totals then are allocated to each fund. This can be done by the clerk or by the Board during its budget review. Each column should be totaled to give an estimate of revenue available in each fund.

Most cities and villages will find they carry over surplus money from year to year. The amounts to be carried forward should be added to the expected revenues for the year in order to come up with a total "Available Revenue" or "Available Resources." This total is the amount of money actually available for allocation by the Board. Form B-2 should be used to show the computation of "Available Resources."

ESTIMATING EXPENDITURES

Generally speaking, a Board of Aldermen or Board of Trustees has little control over a municipality's revenues. They can, of course, increase or decrease some levies, or perhaps even impose a new tax, but, in practice, their real impact on municipal finance is in the area of expenditures. The Board determines employee salaries, when to buy a new pump, how many miles of street to pave and, most important, which of these gets priority. Initial work on municipal expenditures is in the form of budget requests.

Form B-3 is used to give your Board some historic information on expenditures from each fund as well as an initial idea of how much you expect is needed for operations this year. A separate form should be used for each fund.

In Column 1, you must detail the type of expenditures being budgeted. Listed below is a suggested format of classifications for expenditures. At a minimum, the items listed without brackets should be included in any budget. The items listed in brackets may or may not be included depending on the amount of detail desired. You should be consistent, however, and use the same categories for each fund.

- I. Personal Services
 - A. Salaries and Wages
 - [1. Full-time]
 - [2. Part-time]
 - [3. Overtime]
 - B. Fringe Benefits
 - [1. Life Insurance]
 - [2. Health Insurance]
 - [3. Other Insurance]
 - [4. Retirement]
 - [5. FICA]
 - [6. Worker's Compensation]
 - [7. Other]

- II. Operating Expenses
 - A. Travel and Transportation
 - [1. Training Fees]
 - [2. Conference Registration]
 - [3. Travel Expenses]
 - B. Utilities Expense
 - [1. Electricity]
 - [2. Gas]
 - [3. Water]
 - [4. Sewer]
 - [5. Refuse and Garbage]
 - [6. Street Lights]
 - [7. Traffic Signals]
 - C. Office Supplies
 - [1. Paper]
 - [2. Other Office Supplies]
 - [3. Cleaning Supplies]
 - [4. Printing]
 - [5. Publication expenses]
 - D. Other Supplies
 - [1. Uniforms]
 - [2. Clothing Allowance]
 - [3. Gasoline]
 - [4. Oil and Lubricants]
 - [5. Tires and Batteries]
 - [6. Tools]
 - [7. Vehicle Parts]
 - [8. Miscellaneous]
 - E. Equipment Rental
 - [1. Xerox Machine]
 - [2. Cars and Trucks]
 - [3. Heavy Equipment]
 - [4. Other Office Equipment]

- F. Maintenance Costs
 - [1. Vehicle Maintenance]
 - [2. Equipment Maintenance]
 - [3. Machinery Maintenance]

- III. Capital Expenditures
 - A. Contracts
 - [1. Buildings]
 - [2. Streets]
 - B. Purchase of Capital Items
 - [1. Buildings]
 - [2. Equipment]
 - [3. Vehicles]
 - [4. Rights-of-way]
 - C. Capital Supplies
 - [1. Rock]
 - [2. Paving Material]
 - [3. Water Meters]
 - [4. Pipe]
 - D. Bond Retirement
 - [1. Principal]
 - [2. Interest]

Columns 2, 3, and 4 are similar to the respective columns on Form B-1 and rely on historical information that can be obtained from your accounting system – generally, in financial statements or audits.

Column 5 becomes the basis for budget decisions. It is an estimate by the clerk and/or the city’s department heads of the amount of money needed for each activity of the city for the coming year. These estimates are made on a “Budget Request Form,” Form B-4. This is an activity-based form, not a fund-based form, and may or may not be included in the final budget document. A separate form should be used for each activity. Most commonly, this would mean a form for police, public works (or streets) and general. In some cities, forms may be needed for fire, utilities (water, sewer, trash collection) or parks.

There are five major items on the Budget Request Form. First is a description of the activity itself. This is a good place to identify basic information such as how many miles of streets are in the city and how much work was done on them last year. Second is the historic information on how much was budgeted for the current year (or further back, if you wish). Third is a request for funds for the coming fiscal year, including an explanation of major differences from the budget of the current year. Fourth is a request for revenues by source, indicating which fund will contribute to the activity. If more than one fund contributes revenues to the activity, a separate form should be used for each. Fifth, and most important, is an explanation of changes from the current year’s budget. Reasons for increase or decrease in personnel or salaries should be explained here, as well as support for increases in operating expenses and purchases of capital equipment.

This form can be expanded, if desired, to provide more detail. For example, under

Personnel, Operating Expenses and Capital Expenses, the subcategories listed on pages 10-12 could be added.

Finally, a Personnel Schedule, Form B-5, should be completed. In cities with more than 25 employees (including elected officials), one form for each activity should be completed. In cities with fewer than 25 employees, a single form for the entire city would be sufficient. Be sure to include elected officials, such as the mayor and board members, on the appropriate form.

After Forms B-4 and B-5 are completed, you are ready to finish Column 5 of Form B-3. Totals for each category from all Forms B-4 for each fund are recorded on the appropriate Form B-3 for that fund. For example, the General Fund will have only one Form B-3. However, it may have several Forms B-4. Personnel costs from each Form B-4 for the General Fund must be added together and recorded in Column 5 of the General Fund's Form B-3.

You now are ready to summarize the expenditures for each fund. Form B-6 requires only that you transfer information from other forms. List each fund in Column 1. Transfer appropriate information from Form B-2 (Columns 2, 3 and 4) to Form B-6, Columns 2, 3 and 4. Transfer information from Column 5 of the appropriate Form B-3 to Column 5 of Form B-6. Column 6 is computed by subtracting Column 5 from Column 4.

If you have activities that are supported by more than one fund, it may be helpful to summarize these. Form B-7 accomplishes this. List each activity in Column 1 with each fund that supports the activity in Column 2. The amounts for Columns 3 and 4 can be found on the appropriate Form B-4. A total should be included for each activity to show estimated total expenditures without regard to fund.

THE BUDGET DOCUMENT – PUTTING IT TOGETHER

You now are ready to assemble the draft budget document. At this point it is not important whether the proposed expenditures are less or more than expected revenues. In fact, most of the time, this will be the case. The clerk's job is not to decide where budget cuts or increases are to occur. The Board, in its deliberations, will determine where, if necessary, cuts are to be made, keeping in mind that municipalities are not allowed to enact a deficit budget.

The following forms, in the order given, allow the Board to see details of proposed expenditures and expected revenues, to make decisions on priority expenditures and to allocate funds in a comprehensive manner. (Repeat last three as needed.)

- Estimated Revenue by Source (Form B-1)
- Allocation of Revenues by Fund (Form B-2A)
- Estimated Expenditures by Fund (Form B-6)
- Estimated Expenditures by Activity (Form B-7)
- Expenditure Detail for _____ Fund (Form B-3)
- Budget Request for Each Activity (Form B-4)
- Personnel Schedule for Activity (Form B-5)

ADOPTION OF THE BUDGET

At this point, the city's Board of Aldermen (or village Board of Trustees) begins its most direct involvement in the budget process. Taking the information furnished in the draft budget, the Board decides if new revenue sources are needed, if expenditures need to be cut (and where), and if new programs or expenditures are appropriate.

During the Board's deliberations, it is helpful to have present all who participated in the preparation of the draft budget. Questions are bound to arise, and those who know what assumptions were used, or how amounts were figured, are best able to answer them.

After the Board has made the changes it feels are appropriate and necessary, the figures in the draft budget should be corrected. Be sure to check each form to carry through any changes.

With all the changes made, three more items must be added to complete the budget document.

The first item is a statement of the amount required to pay interest and principal on the bonded indebtedness of the city. Form B-8 should be completed and added to the end of the budget document. This form need be prepared only once, then used each year with only minor changes.

The second item is a budget message describing the important features of the budget and major changes from the preceding year. This generally is directed to the public and is prepared by the mayor, as a report from the Board.

The third item is a budget ordinance. This must be approved by the Board as the final step in adopting the formal budget. Form B-9 is a sample ordinance for this purpose.

There are no state statutes requiring public hearings before the Board takes final action on the budget ordinance.

USE OF THE BUDGET

After it is adopted, the budget should be filed away and forgotten until next year. **WRONG!** Unfortunately, too many cities do just that. They put a lot of work into developing a budget but never use it once it's adopted.

The city should monitor revenues and expenditures throughout the year and compare them to the amounts budgeted for these items. These comparisons are best made through monthly financial reports. (The preparation of these reports is discussed in detail in Volume III of this series.) These monthly reports show the financial activity of the city for the preceding month and for the full year-to-date compared to the budget figures for each category.

City officials can use these reports in a number of ways. They will warn you when revenues are falling short of expectations and allow you to withhold some expenditures until revenues catch up or alternate funding is found. Likewise, these reports will show when a department is

overspending its budget and allow corrective action.

These reports also can take the place of a monthly list of bills, used often in small cities. The financial report is far more useful in revealing the financial position of the city than a list of every check written during the past month.

Cities also can use the budget to evaluate the performance of department heads. Activities that are consistently overspending or underspending budgeted amounts are indications of problems and should be discussed with that employee.

You should expect to begin work on your annual budget at least six months before your fiscal year begins in order to give you enough time to gather all needed information, complete all forms, conduct any required public hearings and give the Board adequate time to review the document.

The following is a suggested timetable for the budgeting process.

<u>When</u>	<u>What</u>
Mid-year	Any new capital project proposals should be documented and submitted for consideration.
By 7th Month	Forms for documentation of work plans and for operating expenditure requests are distributed to supervisory personnel. Expenditure estimates from current year are included.
By 9th Month	Develop revenue estimates.
By 9th Month	Expenditure requests reviewed with supervisory personnel and compiled with all other requests by activity and object for each fund.
By 10th Month	Budget document assembled and submitted to Board.
By 12th Month	Board reviews budget, conducts public hearings if required and makes any changes in proposed expenditures. Budget adopted.
By Year End	New accounting records established and audit begun for year just completed.
Monthly/Quarterly	Status reports prepared on revenues and expenditures compared to budget. These reports are provided to the Board.

Since the budget is enacted by ordinance, any changes or amendments also must be done by ordinance. Amendments only should be made in unusual or emergency situations.

APPENDIX
BLANK FORMS

FORM B-1

City (Village) of _____

Fiscal Year Beginning _____

ESTIMATED REVENUE BY SOURCE

1 Revenue Source	2 Actual Receipts 2 Years Ago	3 Actual Receipts Last Year	4 Estimated Receipts Current Year	5 Estimated Receipts For Next Year
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FORM B-2

City (Village) of _____

Fiscal Year Beginning _____

TOTAL AVAILABLE RESOURCES

1 Fund	2 Unappropriated Balance From Previous Year	3 Expected Revenues Current Year	4 Total Resources Available For Expenditure
---------------	--	--	--

FORM B-2A

City (Village) of _____

Fiscal Year Beginning _____

ALLOCATION OF REVENUES BY FUND

1 Revenue Source	2 Estimated Receipts	3 Allocations				
		General Fund	Fund	Fund	Utility Enterprise Fund	Bond Sinking Fund

FORM B-3

City (Village) of _____

Fiscal Year Beginning _____

EXPENDITURES FOR _____ FUND

1 Expenditures Category	2 Actual Expenditures 2 Years Ago	3 Actual Expenditures Last Year	4 Estimated Expenditures Current Year	5 Request For Next Year
-------------------------------	--	--	--	----------------------------------

FORM B-4

City (Village) of _____

Fiscal year Beginning _____

BUDGET REQUEST FOR _____ (Activity)

Description of Activity:

OBJECT	Two Years Ago	Last Year	Current Year	Request For Next Year
Number of Personnel				
Personnel Costs				
Operating Expenses				
Capital Expenses				
TOTAL				

Explanation of changes from current year Revenue:

Source of
_____ Fund

FORM B-5

City (Village) of _____

Fiscal Year Beginning _____

PERSONNEL SCHEDULE

ACTIVITY _____ (if appropriate)

Position Title	Number of Employees	Total Salary One Year Ago	Estimated Salary Current Year	Proposed Salary For Budget
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FORM B-6

City (Village) of _____

Fiscal Year Beginning _____

BUDGET SUMMARY

1 Fund	2 Beginning Balance	3 Estimated Revenue	4 Available Resources	5 Estimated Expenditures	6 Ending Balance
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FORM B-7

City (Village) of _____

Fiscal Year Beginning _____

ESTIMATED EXPENDITURES BY ACTIVITY

1 Activity	2 Fund	3 Estimated Expenditure Current Year	4 Proposed Expenditure For Budget
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FORM B-9

Budget Ordinance

BILL NO. _____

ORDINANCE NO. _____

AN ORDINANCE ADOPTING AN ANNUAL BUDGET FOR THE FISCAL YEAR BEGINNING ON _____, AND APPROPRIATING FUNDS PURSUANT THERETO.

WHEREAS, the (City/Village) Clerk has presented to the Board of (Aldermen/Trustees) an annual budget for the fiscal year beginning on _____,

NOW, THEREFORE, BE IT ORDAINED BY THE BOARD OF (ALDERMEN/TRUSTEES) OF THE (CITY/VILLAGE) OF _____, MISSOURI, AS FOLLOWS:

Section 1. The annual budget for the (City/Village) of _____, Missouri, for the fiscal year beginning _____, a copy of which is attached hereto and made a part hereof as if fully set forth herein, having been heretofore submitted by the (City/Village) Clerk, is hereby adopted.

Section 2. Funds are hereby appropriated for the objects and purposes of expenditures set forth in said budget.

Section 3. This ordinance shall be in full force and effect from and after its passage by the Board of (Aldermen/Trustees).

Passed this _____ day of _____,
_____.

Mayor

Attest:

City Clerk

FORM B-10

NOTICE OF PUBLIC MEETING

A hearing will be held at _____ p.m., _____, 20____, at _____ at which citizens may be heard on the property tax rates proposed to be set by the City of _____. The tax rates are set to produce the revenues, which the budget for the fiscal year beginning _____, 20____, shows to be required from the property tax. Each tax rate is determined by dividing the amount of gross revenue needed by the current assessed valuation. (The result is multiplied by 100 so the tax rate will be expressed in cents per \$100 valuation.)

Assessed Valuation (By Categories)	Prior Tax Year	Current Tax Year
	20_____	20_____
Real Estate _____	\$ _____	\$ _____
Personal Property _____	_____	_____
Railroad and Utility _____	_____	_____
Total _____	\$ _____	\$ _____

The Following Tax Rates are Proposed

Fund	Amount of Property Tax Revenues Budgeted	Proposed Tax Rate (Per \$100)
General	\$ _____	\$ _____
	_____	_____
	_____	_____
Total	\$ _____	\$ _____

City Council of _____

By _____

Note: The figure to be placed under the heading "Amount of Property Tax Revenue Budgeted" is the amount shown by your budget as being needed from property tax revenue.