Technical Bulletins: Incorporation: Things to Consider Before and After

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INCORPORATION
Things to Consider Before and After

By Pat Hardy
MTAS Municipal Management Consultant
INTRODUCTION

This document is intended to address the process of incorporation under the mayor-aldermanic charter. However, if you are considering incorporation, you would be wise to look at incorporating under one of the other general law charters such as the city manager-commission charter — one of the other charters may better fit your area’s needs.

With the recent passage of Public Chapter 98, a number of mechanisms that previously restricted incorporation under the mayor-aldermanic charter have been temporarily removed. The purpose of this guide is to provide information to areas considering incorporation under this “window” provided by Public Chapter 98.

Included you will find information on the following:

- why your area may want to incorporate;
- alternatives to incorporation;
- the process of incorporation under the mayor-aldermanic charter;
- budgetary and planning considerations;
- steps to take after incorporation;
- what you will need to do once you have incorporated;
- things you will probably want to do once incorporated;
- a sample plan of service; and
- financial hints for new cities.
WHY INCORPORATION?

So your area may want to incorporate. Why? And why not? These are the first questions you should ask.

Providing a Higher Level of Service

First of all, there is really only one reason to incorporate. That reason should always be because the residents want to provide a higher level of service than can be obtained under the existing arrangement, which is usually a county government. If there are any other reasons behind the incorporation, it's almost guaranteed there will be many problems as the new "city" tries to survive.

Provided it meets specific criteria, establishing a certain area as a city will allow citizens to provide services that can be tailored to meet the specific needs of the area. Some of these needs include better police and fire protection, sewer services, orderly development of the community through zoning, subdivision regulations and the adoption of building codes, improved parks and recreation services, trash collection, streets and traffic improvements, and control of nuisances such as stray animals, loud noises, etc.

With these opportunities, however, come constraints. These are usually in the form of limited resources. Remember, although citizens in your area may want a higher level of service, they will also have to be willing to pay for it. Though some revenues will come to you by mere virtue of your status as an incorporated city, other revenues will have to be generated locally.

Impact on other Government Entities

One way counties are funded is through local sales taxes. One-half of these taxes automatically goes to the local school system. The other half is distributed to the local government in which the sales tax was generated. When a new city incorporates, it therefore take one-half of the sales tax that is generated in that city and previously went to the county. For this reason, counties are normally considered the financial "losers" when an incorporation takes place. Any county resident who doesn't live in the new city will have to pay for existing services in another way. In other words, counties are hurt when new cities are established.

All cities receive "state-shared revenues" from the state of Tennessee. These are distributed on a per capita basis, and come from dollars generated by a variety of state sales and use taxes as well as miscellaneous sources in lieu of taxes such as TVA. The "pie" containing these revenues does not increase in size when a new city incorporates. Instead, the new city's share must be pulled from the limited sources that already exists thus, decreasing the share of revenues that would otherwise flow to existing cities. More simply, any time a new city incorporates, all existing cities receive proportionately fewer state-shared revenues. Therefore, all cities are hurt each time a new city is created.
**Fixed Costs**

There are many state and federal laws that must be complied with regardless of the size of the city. One only needs to look at the Fair Labor Standards Act (FLSA) or the Americans With Disabilities Act (ADA) to understand the financial effect mandatory laws can have on cities. Many times, these considerations are overlooked when a new city incorporates.

A new city will also have many "fixed" costs. For example, there will be insurance for errors and omissions, liability insurance, advertising of public meetings, office space, a city recorder, a city attorney, record keeping, elections, and the list goes on. It goes without saying that a larger city has more citizens and thus, a larger tax base in which to share these obligations. Conversely, smaller cities have fewer citizens and each must share a greater portion of these "fixed" costs. In other words, there is an "economy of scale" associated with both providing services and meeting fixed-cost obligations. Many new cities drastically underestimate these costs and find that fewer dollars are available to provide basic services such as street repair, public safety, and other services.

**Provisions of Services**

Many new cities think they can simply contract with the county to continue providing the same services provided before the incorporation. However, it's not that simple. First, counties are under no obligation to provide these services to the new city. If the county says "no" to a new city's request to contract for services, the new city will be left to provide services from day one of its existence. Second, counties are only authorized to provide certain services to cities under contractual arrangements. And most counties soon realize that the true cost of providing services is higher than expected. Over time, county attitudes change. You don’t have to look too far to understand the adversarial relationship that many times exists between cities and counties. This is to be expected, given the city-county boundary that delineates "who does what" and "who pays for what." Over time, a new city should not expect the county to provide services without adequate compensation, if at all.

Many new cities think they can simply become a "city" and not provide any additional services. However, circumstances change, and it's not realistic to think that things will continue as they have in the past. This is also why you must take a long-range view when considering incorporation. Sooner or later, enough residents will come forward with complaints. They don't want a run-down mobile home moving next door; or a vicious, loose dog attacking their child; or a neighbor inadvertently draining water on their property creating a stagnant pond; or loud parties being held at the neighbor's house every Saturday night. But they may want a new street constructed or a traffic signal installed — not to mention the inevitable demands for water or sewer service, or increased police or fire protection.

Many, many issues and requests for services will arise over time, and city residents will expect action. The need for new dollars to pay for services is almost inevitable. That's why most cities have a property tax. Many citizens, however, think they will be able to vote via a referendum as to whether or not a property tax is imposed — but that's not what the law says. The law states that the governing body has the sole authority for imposing a property tax and at what rate (*Tennessee Code Annotated (T.C.A.) 67-5-103 and 6-2-201(1)).
Level of Commitment

For these and many other reasons, incorporation should only be considered if residents want, and are willing to pay for, a higher level of service. Operating a city is very difficult and it can't be done without commitment from qualified elected officials, commitment from quality employees, and most of all, commitment from citizens who are willing to shoulder the responsibility associated with becoming city residents.

Far too many times citizens consider incorporation because of the “threat,” real or perceived, of annexation by a neighboring city. This is ill-founded logic. In order to avoid becoming part of a city, it makes no sense to become a city — and become a city you will. As mentioned above, if incorporation is successful, many demands for services will make their way to your agenda. Over time, you will have to respond to these demands.

This is not to say that incorporation should never occur. In fact, many incorporations are very successful because of the desire and need for a greater level of service, combined with the willingness to pay for and accept responsibility for providing these services. However, becoming a city is not something to be taken lightly.

 Alternatives to Incorporation

Before deciding if incorporation is the best way to deliver a higher level of service to the residents, there are a few alternatives to incorporation worth considering.

- Ask your county commissioners or utility district to provide the service(s) that residents in your area need.
- Request annexation by a neighboring city. It may be that the services your residents desire can be delivered more efficiently by another city.
THE PROCESS OF INCORPORATION
UNDER THE MAYOR-ALDERMANIC CHARTER

The next step you should take when considering incorporation is to obtain a copy of the mayor-aldermanic charter (T.C.A. 6-1-101 et seq). The charter will serve as your "constitution." In it you will find answers to many important questions such as "what are the specific steps we must take to incorporate," or "what powers will our city have?" It is essential that you obtain a copy of the charter as well as any amendments such as Public Chapter 98.

You will also want to consult an attorney. There are some provisions of the charter that apply only to certain counties and others that are somewhat complex. He or she will be able to answer many legal questions you may have and will also be able to interpret key provisions of the charter that you may not understand.

Here are some basic steps you will need to follow in order to incorporate under the mayor-aldermanic charter.

Population and Boundary Requirements

- You must have at least 225 residents. (Note: This will be 1,500 persons in April 1998.)
- The incorporation cannot take place if the proposed city is within three miles of an existing city or within five miles of a city of more than 100,000 in population. (Note: This provision does not apply until after April 1998.)

Petition for Incorporation

You must have a letter signed by at least one resident of the proposed area of incorporation. (Note: As of Dec. 31, 1997, a letter will no longer be sufficient. A petition signed by 33.3 percent of the registered voters will be required.)

- The petition must be submitted in the form provided in T.C.A. 6-1-209.
- It must include a description of the boundaries of the proposed area, and if the population of the new city will be greater than 5,000, the boundaries of the proposed wards. These descriptions must contain references to tax maps kept in the office of the county assessor.
- The petition must contain the proposed name of the municipality.
- You must attach a list of the names of all persons who at the time of filing the petition are qualified voters in the area.
The petition must contain a plan of services that includes the following:

- an identification and projected timing of services to be provided
- considerations for police and fire services, water, sanitary sewage, solid waste disposal, road and street construction and repair, recreational facilities, and a proposed five-year operational budget including projected revenues and expenditures and local sources of revenues. (Note: Any city not producing local source revenues in any year shall not receive any state-shared revenues the next year.)

(See Appendix A for a sample plan of services.)

You must file a cash bond with the county election commission at the time of filing the petition that is equivalent to the cost of the election to incorporate.

Public Notice

You must hold a public hearing on the question of incorporation prior to filing the petition with the county election commission. Time and location of the hearing must be advertised in a newspaper of general circulation for two consecutive weeks prior to the scheduled date.

Withdrawal of Petition or Substitution of a New Petition

You may withdraw the petition or amend it to call for a smaller area of incorporation anytime up to 30 days prior to the election. The amended or withdrawn petition must be signed by at least 51 percent of those who signed the original petition. Once this is done, the original petition is null and void.

If the incorporation fails, it cannot be attempted again for either two or five years, depending on certain circumstances.
BUDGETARY AND PLANNING CONSIDERATIONS

As reviewed above, you are required to have a “plan of services” that examines the scope of services you may provide. A good tool to use when considering the plan is the use of a sample budget. In Appendix A, you will find a sample plan of services that includes a simple budget that can be used to guide your discussions. In essence, the budget serves as a fiscal plan of services, and the numbers represent services and levels of service. By developing a budget, the bigger picture of how your city will operate will become clearer. For instance, your budget will provide information such as where your money will come from, how it will be spent, services that will be provided, and at what level.

A word of caution — you may have noticed that Public Chapter 98 also changes the timing of local revenues received by a newly-incorporated city. Now, sales taxes generated locally are only available to the new city as of July 1 following the incorporation. This is also true for state-shared revenues. Remember, however, that a new city would not qualify for state-shared taxes on July 1 unless it has generated “local own source revenues” such as property taxes, permit fees, etc., during the fiscal year prior to July 1. This means your new city will have almost no money to operate until July 1 following the incorporation. Therefore, you will need to consider other means to provide necessary funding such as donations or deferring payment on expenses to the next fiscal year.

STEPS TO TAKE AFTER INCORPORATION

This section provides a list of steps to take after you’ve incorporated. Following this section, you will find a discussion about what you must do and what you will probably want to do after you incorporate. But for now, this section gives you a sense of what happens after the incorporation.

There are a few general considerations listed first, but the remainder of the items are presented in “meeting” form. That is, they are presented in the form of your meeting agendas. This will help you understand what to expect during your first few meetings.

1. County election commission certifies to the secretary of state the results of the election.
2. Within 62 days after the incorporation vote, the county election commission shall hold an election to choose municipal officers who shall take office immediately following the election.
3. Refer to T.C.A. 6-1-208 for obligations of the new city (i.e., contracts, existing zoning, etc.)
4. Decide and publicize the place of the first meeting.
AT THE FIRST MEETING

- Designate a temporary person to take minutes.
- Administer the oath of office to the mayor. (The oath is usually given by a General Sessions Judge, but can be administered by any person that is authorized to issue oaths.)
- Administer the oath to Alderpersons (given by the mayor).
- Elect the vice mayor.
- Establish rules of procedure for conducting meetings (i.e., Roberts Rules of Order).
- Establish date and time for regular meetings (preferably by ordinance), and publicize it.
- Establish official address for city hall.
- To qualify for funds, provide for certification of population to the State Planning Office. If a census was not conducted prior to incorporation, make plans for a special census.
- Send incorporation papers and other documents such as a legal description, a map, and names of public utilities serving the area to the Division of the State Assessed Properties of the Comptroller’s Office.
- Appoint a city recorder and treasurer (may be the same person).
- Provide for bonding of officials.
- Obtain insurance. At first you will only need general liability and errors and omissions insurance.
- Designate depository of municipal funds (by ordinance).
- Establish accounting system and checking accounts.
- Designate fiscal year (by ordinance).
AT THE SECOND OR ONE OF THE FIRST FEW MEETINGS

- Set city election dates.
- Establish ordinance and resolution numbering system.
- Provide for minutes and ordinance books.
- Discuss duties of the mayor, city administrator, etc. Establish governmental structure. Under the mayor-aldermanic charter, the mayor has broad administrative powers unless by ordinance the governing body redistributes those powers.
- Establish compensation of the mayor and board.
- Provide for an audit.
- Establish and adopt a budget in accordance with the Municipal Budget Law of 1982 (T.C.A. 6-56-201).
- Establish a property tax rate (if needed).
- Appoint a city attorney.
- Adopt a beer ordinance, and notify affected businesses of the need to obtain a city beer permit.
- Obtain a listing of beer wholesalers serving the city, if any. Mail them an affidavit describing the area of incorporation, effective date of incorporation, and where to begin making payment of the wholesale beer tax after July 1.
- Send a copy of the incorporation and map to the Tennessee Department of Transportation.
- Send a list of businesses, and a certified copy of election results, the charter, and population of the new city to the Division of Sales and Use Tax of the State Department of Revenue.
- Send a copy of the incorporation and map to the county assessor.
- Consider services that will be offered (i.e., street maintenance, police protection, fire suppression, recreation, etc.), and determine how they will be provided (i.e., directly, by contract, etc.).
- Adopt an official map of the city and mail to the U.S. Bureau of the Census.
- Establish a street and house numbering system that complies with the needs of the E-911 system (i.e., address location identifiers).
ADDITIONAL RESPONSIBILITIES ONCE YOU ARE INCORPORATED

1. Hold elections every two years.
2. Publish the caption of all ordinances in the newspaper.
3. Adopt and publish an annual budget with annual projections and comparisons of prior years.
4. Hold meetings, and provide adequate notice of meetings.
5. Keep a permanent record of all meetings and business transacted. Keep a number of other records.
6. Provide for collection of taxes and all other revenue.
7. Contract to have an annual audit.
8. Adhere to the provisions of, and provide for:
   - state comptroller’s standards for accounting, budgeting, and auditing. In other words, you have to provide an accounting system, which usually requires a computer and related software. (Note: These standards are numerous and can be complex.)
   - comply with OSHA and other standards, and
   - comply with all applicable federal and state laws such as ADA and FLSA. (These generally require a fair amount of paperwork.)
10. Provide for the construction, replacement, and maintenance of streets. This should include mowing and maintenance of ditches, drainage, and other high-exposure areas.
11. If you intend to adopt and enforce municipal ordinances, appoint or hire a city judge who will hold city court. This will require office space, records retention, etc. If the judge is to have concurrent jurisdiction, he or she must be elected.
THINGS YOU’LL WANT TO DO OR WILL PROBABLY HAVE TO DO

Beyond the list of “Things You Have to Do,” here is a list of things you will want to do or will probably have to do. We say “probably” because in many cases the law does not specifically state that something must be done, but logic tells us so. For example, nothing in the law says you must provide insurance. However, your new city could soon be out of business without it. The loss of one large lawsuit could bankrupt the city if you don’t have it.

Here’s the list of other things you’ll either want to do or should at least consider doing.

1. Obtain insurance such as general liability, auto liability, errors and omissions, etc. Once incorporated, members of the board, both individually and collectively, can be sued.

2. Provide for police and fire protection. Both services may be contracted with the county. Such services can also be provided through a mutual aid district (T.C.A. 12-9-108).

3. Provide a place to meet that also includes office space, and establish hours to conduct business. You will also need to consider purchasing or leasing office equipment such as a computer, typewriter, telephone, fax machine, etc.

4. Provide reimbursement for expenses to board members.

5. Hire or contract for legal services (a city attorney).

6. Provide bonds for the board and certain positions such as the city recorder and treasurer.

7. Join the Tennessee Municipal League and attend the annual conference. You should also be prepared to attend training sessions offered by The University of Tennessee Center For Government Training, Government Finance Officers Association, Municipal Clerks Association, and/or other agencies.

8. Provide for zoning and/or building standards. This usually entails a planning commission and a certified building inspector. Planning and zoning services may be contracted with the Local Planning Assistance Office of the Tennessee Department of Economic and Community Development. If a county zoning is in place at the time of incorporation, you will need to coordinate with the county to ensure that county regulations remain in effect until city regulations can be adopted.


10. Provide for enough cash reserves to meet emergency needs.

11. And you may want to appoint a city administrator to handle daily cooperation of the city.
CONCLUSION

Incorporation is a serious step for any community. Hopefully, you will have considered all of the questions raised in this document before you proceed with your effort. Remember, incorporation should only occur in order to provide a higher level of service than you now have. The University of Tennessee’s Municipal Technical Advisory Service (MTAS) can provide only limited assistance through the incorporation process due to state law that stipulates that MTAS is to work with “municipalities.” And until the incorporation is complete, you are not a municipality. Once you have incorporated, MTAS will be available to assist your city in any way possible.
PROPOSED PLAN OF SERVICES
SAMPLE CITY, TENNESSEE

The proposed plan for services for the town of Sample City, Tennessee is as follows:

POLICE PROTECTION
Will continue with county sheriff’s department, which consists of two (2) to four (4) officers patrolling the county on a constant, 24-hour basis. As funding is available, a police department will be added.

FIRE PROTECTION
There is no expected change from the current protection provided by the Sample City Volunteer Fire Department. The incorporation will allow the city to contribute to the department financially.

WATER SERVICE
This area is currently served by multiple utility districts. This will continue as currently structured.

WASTEWATER
This area does not currently have sanitary sewers. It is presently served by private septic tanks. Because of geographic and economic impediments in this area, sanitary sewers are not possible at this time. (However, as an incorporated area, the city will be better able to coordinate the efforts to bring sanitary sewers into the area.)

SOLID WASTE DISPOSAL
The city does not currently provide refuse service for existing area residents. This area is currently served by private contractors.

ROAD AND STREET CONSTRUCTION AND REPAIR
A combination of current state revenue and revenue raised within the city limits of Sample City will be used to maintain and repair roads.

RECREATIONAL FACILITIES
As funding becomes available, recreational facilities will be added or improved.

STREET LIGHTING
Once state revenues have been received, street lighting will be paid for through a facility rental fee to the utility company. Street lights will be provided in substantially developed areas within approximately three (3) years. In undeveloped areas, street lights will be furnished when funding for this purpose is available.

STREET NAME SIGNS
Within two (2) years of incorporation, street signs will be installed where needed.
Appendix A

TRAFFIC CONTROL
Traffic signals, traffic signs, street markings, and other traffic control devices will be installed as the need is established through appropriate studies and traffic standards, and as revenues are available.

PLANNING AND ZONING
Any code administration and inspection services will begin in the incorporated area as soon as codes are adopted and an inspector is hired. It is anticipated that initially the inspector will be hired on a contract basis and will be paid from the fees generated by building permits.

BUDGET
The proposed five-year operational budget is attached.
## Estimated Annual Revenues

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## Estimated Annual Expenditures

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<td>$276,157</td>
<td>$304,529</td>
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Appendix A

Comparison of Revenues to Expenditures

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* FY 96-97 estimates are for 9 months (October through June)

BUDGET EXPLANATIONS AND SUPPORTING DETAIL

Expenditure Budget

1. General government expenditure includes the following:
   - Start-up and ongoing office supplies and printing
   - Salary and benefits of part-time city recorder
   - Salaries of mayor and aldermen
   - City attorney contract costs
   - Rental/purchase of meeting and storage space
   - Special census costs
   - Election costs
   - Postage
   - Bank fees and audit expenses
   - Other general governmental costs
   - Utilities
   - Advertising
   - Telephone

Future year general government expenses are conservatively estimated at 15 percent annual increases from FY 97-98.

2. Insurance would include general liability, worker’s compensation, and auto insurance if the town obtains any vehicles.
Police and fire protection expenses include funds to allow the board of mayor and aldermen to contract with the sheriff's department for additional police coverage, or hire a police officer(s) if they so choose. Funds are also included to allow the board of mayor and aldermen to assist the Sample City Volunteer Fire Department in providing fire enhanced fire protection within the Town of Sample City.

4. Street maintenance and traffic control includes emergency and routine repairs and maintenance, snow and ice removal, street lights, street name signs, and traffic control devices.

5. Besides general government, all other expenditure estimates for future years were increased 5 percent from FY 97-98.

Revenue Budget

1. Local option sales tax revenue estimates are based on 40 percent of the unincorporated county local sales tax revenue Allocation of local option sales tax proceeds will not begin until July 1 after incorporation. Future year estimates increase 5 percent.

2. State-share revenue estimates are based upon FY 95-96 per capita rates of $61.64 for the general fund and $26.70 for the road fund and an estimated population of 1,500. If the special census results in a certified population greater than 1,500, this amount will increase. Allocation of state-share revenues will not begin until July 1 after incorporation.

3. The wholesale beer tax is a 17% tax paid directly to the city by beer wholesalers with retail customers in the Town of Sample City. The estimated amount is based upon the number of beer stores and the per store amount currently collected in other similar towns. Collection of wholesale beer tax proceeds will not begin until July 1 after incorporation.

4. Permits, fines, etc includes revenues from building permits, beer permits, ordinance violation fines, etc.

5. State law authorizes cities to collect a tax on the privilege of conducting a business. This tax is in lieu of ad valorem taxes on inventories of merchandise held for sale or exchange. The exact tax rates will be set by the Board of Mayor and Aldermen.
Appendix B

FINANCIAL HINTS FOR NEW CITIES

Budgets

- New cities will operate under the Municipal Budget Law, which requires budget authorization before incurring expenditures.
- Specific budget information must be publish in the local newspaper at least 10 days before final passage.
- A budget hearing must be held before final passage.
- Show financial comparative data for three years.
- Show revenues by specific source and expenditures by specific function or classification.
- The tax rate cannot be set and approved prior to approving the budget.

Receipts

- Use a duplicate receipt book and retain one copy.
- Write a receipt or maintain a receipt stub for all collections.
- Deposit all collections in approved depository within three working days.

Expenditures

- Expenditures must be specifically authorized or designated for a municipal purpose.
- Pre-numbered checks or an approved method of payment must be used.
- Maintain supporting documentation for cash payouts.
- Employee travel policy must be adopted before reimbursing travel expenses.
- Contributions to qualified, non-charitable organizations have specific budget and authorization requirements.
Appendix B

Accounting
• Cities must operate general and special revenue funds under the modified accrual basis of accounting. Revenues are recognized when, within 60 days of the end of the fiscal year, they are available to you and you are able to know the amount. Expenditures are recognized at the time the goods are received or the service is performed. There are some exceptions to these rules, but generally it is rather easy to determine each.
• It is usually best to begin a city with a manual accounting system until everything settles. Eventually you will want to consider computerizing all accounting and other functions. It is not necessary to spend large amounts for accounting services until the city is settled and operating.

Auditing
• Cities are required to have annual audits. However, in the first year you may want to request permission from the state comptroller to extend the audit period through the next fiscal year, rather than have the expense of a part year audit.
• Cities can have an audit at any time, but at least one audit must be approved by the state comptroller. The audit contract is a three-way contract between the city, the auditor, and the state comptroller.

Purchasing
• Cities are required to operate in accordance with provisions of the 1983 Municipal Purchasing Law.
• Competitive bidding and public advertising are required for most purchases of $2,500 and more. The city board can increase that amount up to $5,000. Like kind purchases are cumulative for the entire fiscal year.
• Purchases of $1,000 or less may be made without public advertising and competitive bidding.
• Purchases of less than $2,500, but more than $1,000, may be made in the open market without public advertisement. However, an attempt should be made to obtain three competitive bids.
• Purchases may be made without public advertising and competitive bidding when bought from, or through, the state, counties, utility districts, or other cities.