

Commonly Misunderstood Concepts in Budgeting

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The Budget

- Every local government in New York State is required to adopt a budget for all major operating funds it maintains. The budget is comprised of two major parts:
 - **Estimated Revenues:** The financing sources expected to be used to help finance operations.
 - **Estimated Appropriations:** The legally authorized limits for using the estimated revenues during a single fiscal year (or life of a capital project).



Budget Formula

- + (960) Appropriations (Cost of Operations)
- +(R960) Appropriations related to Reserves
- + (962) Budgetary Provisions for Other Uses
 - (510) Departmental Income
 - (510) State/Federal Aid or Grants
 - (510) Other Non-Property Tax Revenues
 - (511) Appropriated Reserves
 - (599) Appropriated Fund Balance
- = (1001) Amount to be Levied in Taxes**



Dictionary Definitions

- **Appropriate:** to set apart for or assign to a particular purpose or use appropriate money for a research program.
- **Appropriation:** Something that has been appropriated; specifically : money set aside by formal action for a specific use.
- **Expend:** to pay out; spend
- **Expenditure:** something expended : disbursement, expense



Appropriations in Government

- **Appropriation-** Authorized spending limit, granted by the governing board, for a particular purpose.
- Governing Board authorization is granted with the adoption of the budget and approved budget amendments made during a fiscal year.
- Although appropriations are shown in the budget in terms of money (\$), no actual money has been moved or “set aside” for the authorized purposes. All money still remains in the bank accounts of the local government.



Appropriations Example

- The governing board has adopted a budget with the following estimated appropriations:

1410.1 Clerk Salaries	\$50,000
1420.4 Law Contractual	\$40,000
1440.4 Engineer Contractual	\$30,000
1620.4 Operation of Plant	\$20,000
5130.2 Machinery (Capital)	<u>\$10,000</u>
Total Fund Appropriations	\$150,000



Expenditures in Government

- Expenditure: The disbursement of money or the use of assets in government, resulting in a reduction of Fund Balance.
- Expenditures can only be made where there are sufficient available appropriations. Expenditures reduce the Appropriations.
- Without available appropriations, there is no authority to enter into a contract or purchase.
- No Appropriation = No Authority
- Negative Appropriation = Violation



Expenditure Example

- Based on the budget previously shown:
 - As the department head, you find a piece of machinery you want to purchase costing \$6,000.
 - You would first go review your available appropriation balance:
5130.2 Machinery (Capital) \$10,000
 - After the purchase, your remaining authority to make purchases has reduced:
5130.2 Machinery (Capital) \$ 4,000



Expenditure Example (cont.)

- You now find a second piece of equipment you want to purchase costing \$8,000. Following the same process as before:
 - You first review your available budget and see you have an available appropriation of \$4,000 in 5130.2 Machinery (Capital).
 - What are your options?
 - What is correct?



Budget Modifications

- Before the second transaction your remaining budget balance is:

1410.1 Clerk Salaries	\$50,000
1420.4 Law Contractual	\$40,000
1440.4 Engineer Contractual	\$30,000
1620.4 Operation of Plant	\$20,000
5130.2 Machinery (Capital)	<u>\$ 4,000</u>
Total Fund Appropriations	\$144,000

- Remember, appropriations are not money, they are an authorization for you to spend.



Budget Modifications (cont.)

- The Board can authorize a budget modification by passing a resolution allowing a transfer from 1410.1 to 5130.2. After entering into the purchase your available budgeted appropriations would be:

1410.1 Clerk Salaries	\$46,000	
1420.4 Law Contractual	\$40,000	
1440.4 Engineer Contractual	\$30,000	
1620.4 Operation of Plant	\$20,000	*You no longer have authority to
5130.2 Machinery (Capital)	<u>\$ 0</u>	purchase additional equipment this FY.
Total Fund Appropriations	\$136,000	



Encumbrances

- **Encumbrance:** A contract, purchase order, payroll commitment, tax payable, or legal penalty that is chargeable to an account while awaiting a bill or invoice. It ceases to be an encumbrance when liquidated or when the actual liability amount is determined (by receiving a bill or invoice) and recorded as an expense.
- Encumbrances allow for budgetary control in **governmental funds** by putting a hold on available appropriations until an invoice comes in and an expenditure can be recorded.



Encumbrances (cont.)

- Assume we ordered the first \$6,000 piece of equipment and received it, but we had not yet been billed for it. After placing the order, your available appropriations still looks like this:

1410.1 Clerk Salaries	\$50,000
1420.4 Law Contractual	\$40,000
1440.4 Engineer Contractual	\$30,000
1620.4 Operation of Plant	\$20,000
5130.2 Machinery (Capital)	<u>\$10,000</u>
Total Fund Appropriations	\$150,000



Encumbrances (cont.)

- If we used encumbrances, our available appropriations would look like:

	<u>Budget</u>	<u>Encumbrances</u>	<u>Balance</u>
1410.1 Clerk Salaries	\$50,000		\$50,000
1420.4 Law Contractual	\$40,000		\$40,000
1440.4 Engineer Contractual	\$30,000		\$30,000
1620.4 Operation of Plant	\$20,000		\$20,000
5130.2 Machinery (Capital)	<u>\$10,000</u>	<u>(\$6,000)</u>	<u>\$ 4,000</u>
Total Fund Appropriations	\$150,000	\$-0-	\$144,000



Where does "My Money" go?

- Since a budget is only a plan for the estimated revenues and estimated appropriations for one fiscal year, at the close of a fiscal year the budget gets zeroed out and any authority associated with that budget no longer exists.

– The cash and assets you have in each fund balance of each operating fund does not get affected by the adoption or closing of a budget. The budget is simply the authorized plan for the use of the fund balance and any additional revenues you expect to receive. Generally, the only way for cash to be affected is through receiving revenues, or incurring expenditures.



“Use it or Lose it?”

- At the end of a fiscal year, any unused appropriation (authority to spend) lapses. This means that you no longer have the authority to initiate expenditures for the purpose originally authorized.
- Avoid feeling that you must spend everything you were authorized.
- Don't forget... At the end of the fiscal year, next year's budget is already adopted. There is no such thing as “taking it away”.

Think of it this way...

Shopping trip for Grandma (taxpayers):

1. **(Identify the fiscal year):** This shopping trip (Walk in store until walk out of store)
2. **(Establish a Budget):** Authority to spend up to \$200 to be funded with \$200 cash from grandma. Authority to spend (appropriations) to be split up as follows:

Shopping Budget	
Revenues (Cash):	\$200
Groceries:	(\$150)
Son:	(\$ 25)
Contingent:	(\$ 25)
Appropriations:	(\$200)
Balanced	

3. **(Submit Requisition):** My son brings an item to me and says he wants to buy it. \$15
4. **(Approve Req.):** Item is within the scope of what I authorized. I approve. \$15

Example (cont.)

5. **(Encumber):** We have not paid yet, so the \$15 is deducted from his \$25 authorization. Remaining Authorization is \$10.
6. **(Review Budget):** Son now wants to buy something for \$15. I determine it to be okay, but he only has \$10 left.
7. **(Modify Budget):** Authorize an extra \$10 from contingency to cover anything else he might find. New available authorization balance \$20. New Contingency balance \$15.
8. **(Submit Requisition):** Son shows me item that costs \$15 and asks if he can have it.
9. **(Approve Req.):** Item is within scope of what I authorized. I approve \$15.
10. **(Encumber):** We have not paid yet, so the \$15 is deducted from his new \$20 authorization. Remaining Authorization is \$5.
11. **(Audit/Approve Claim):** We bring items to the register and cash out. The cashier shows me the \$180 bill, I give the money to my son and authorize him to pay the cashier.
12. **(Expenditure):** My son pays the cashier \$180 cash and takes the bags with our items in it.
13. **(Close out FY):** We leave the store, this shopping trip is over.
14. **(Analyze Fund Balance):** I have \$20 remaining of Grandma's Money, \$5 for my son, \$15 contingency.

Example (cont.)

On the ride home, my son asks me to stop and get him some ice cream. I tell him that he already got 2 things, and the shopping trip is over. He says to me, "But dad, I still have \$5 I didn't spend at the store. I want to use that for ice cream."

1. Is that His \$5?
2. Was ice cream an authorized purpose?
3. Did I "take away" \$5 from him?
4. Would it be proper for him to go pick out \$5 worth of "Stuff" just so he didn't feel like he lost \$5?
5. Can we relate this to government?
6. DON'T WASTE GRANDMA'S MONEY



Ways to Avoid "Use it -or- lose it" mentality

- Fund reserves for needed purposes with unspent fund balance
- Understand budget modifications and Budgetary control.
- Understand it's not your money.
- Work together on the plan.
- Refer to multi year plans.
- Communicate.



What is Fund Balance?

Fund Balance = Assets - Liabilities

• Assets:

- | | |
|-----------------------|------------------|
| Cash | Inventory |
| Accounts Receivable | Prepaid Expenses |
| Interfund Receivables | Investments |

• Liabilities:

- | | |
|--------------------------------|--------------------|
| Debt Payable | Interest Payable |
| Deferred Revenues | Due to Other Funds |
| Compensated Absences (Current) | |
| OPEB (Current) | |



Types of Fund Balance

- Nonspendable – inventory, prepaid items.
- Restricted – legally established reserves.
- Committed – generally not used in NYS.
- Assigned – surplus in Operating Funds other than General Fund, amounts set aside by Board other than legal reserves, and Reserve for Encumbrances. Amount of unrestricted F/B to be used as a financing source in the budget.
- Unassigned – amount of surplus assets over liabilities remaining that is unrestricted or assigned in the General Fund, or deficit fund balance in all other funds.



Appropriated Fund Balance

- The amount of fund balance (assigned, restricted or unassigned) that management desires to legally authorize as a financing source to help fund specific expenditures.
 - Requires legal action by the Board, to authorize the use of fund balance for a specific purpose.
 - Legal action includes the adoption of the budget, or a resolution that formally modifies the budget. There are no other legal means to appropriate fund balance.



Effect of Appropriating

- Appropriating Fund Balance and using it normally results in an Operating Deficit.
- Appropriating Fund Balance and NOT using it, normally results in an operating surplus.
 - Which is better?



When to Appropriate

1. If you have a written and adopted Fund balance policy that clearly states the amount of fund balance you want to maintain, and you have exceeded the maximum threshold.
2. If you have a legally established reserve, and you are budgeting for the allowable use relating to the purpose originally identified when the reserve was created.
3. If you are unable or unwilling to increase real property taxes or user fees to the required level, or if you are unable or unwilling to reduce the cost of services to be provided, after completing the budget formula and thoroughly researching and estimating all revenue sources and costs.
4. If during the year, revenues will not be received in the amount you anticipated, or expenditures are expected to be more than anticipated, and there are not sufficient contingencies to cover the gap.

Avoiding Pitfalls

- Analyze Trends
- Adopt a written Fund Balance Policy.
- Adopt a written multi-year financial and capital plan.
- Review and discuss monthly financial reports including budget status reports.
- Obtain training to become educated on proper budgeting techniques.

Responsibilities

Board Responsibilities:

- Understand their role in budgetary control.
- Become educated on the terminology contained within the budget
- Obtain and understand budget estimates for better budget creation.
- Know your local government's operations.
- Remember you are custodians of taxpayers' money.
- Ask questions

Responsibilities (cont.)

Management/Department Heads:

- Be realistic in planning.
- Communicate current needs to the Board.
- Understand your role in budgetary control.
- Understand you are simply custodians of the taxpayers' money.
- Communicate future needs to the Board.
- Help establish multi year plans



Recap

- Appropriations provide spending authority to department heads and employees, but do not represent dollars set aside in their name.
- All expenditures must be approved by someone to ensure they fit the intended authority granted by the board.
- Any unused appropriations lapse at the close of a fiscal year.
- "Use it-or- Lose it" mentality results in a definite reduction in fund balance, whereas allowing unused appropriations to lapse allows cash to remain unaffected in fund balance.
- Adopting a budget with terminology in it that Local Officials do not understand, can cause significant fiscal stress.



Questions?

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