

Basics of Budget Preparation

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Topic covered

- Budget basics
- Budget function and purpose
- Budget preparation
- Governmental funds
- Governmental accounting

Focus on recurrent budgets as opposed to capital budgets

- Recurrent budgets: Financing current expenditures with current revenues
- Capital budgets: Financing large expenditures with a multiyear lifespan with future tax revenues (e.g., debt financing) due to fairness issues

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Basics to
Budgeting

Budget
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Basics to Budgeting

Your Personnel Budget

Personnel budget situation

- Planned allocation of money to various categories such as housing, food, apparel, or health care.
- Various (competing) considerations regarding allocation based on marital status, number of children, expected income, etc.
- Availability of rainy day funds
- Distinction between routine expenditures (e.g., food) and long-term investments (e.g., car, TV)

Likely improvement of personnel financial situation due to presence of budget

Budgeting

- Process of developing, implementing, and evaluating a budget

Aaron Wildavsky (Political Scientist, 1930-1993)

- *“The budget is the lifeblood of the government, the financial reflection of what the government does or intends to do.”*
- *“The crucial aspect of budgeting is whose preferences are to prevail in disputes about which activities are to be carried on and to what degree, in the light of limited resources.”*

Budget as a plan to allocate public resources. No policy without a budget!

Budgets as a Decision Guide

Decision guide for the provision of goods and services

- (Policy) choices made by the government by revenue collection and expenditures

Some aspects to consider

- Types and extent of goods and services provided
- Size of government relative to the private sector
- Relative size of departments and agencies within the government
- Methods to raise revenue

Budgets and Public Policy I

Multiple objectives

- Example 1: Subsidizing school lunches both feed children and create income support
- Example 2: Needle exchange for drug users to reduce public health risk of HIV infections and cost (\$379,668 lifetime treatment cost)

Conflicting objectives

- Example: Empty reservoir for flood control versus full reservoir for recreation

No standard measure for objectives

- Measuring gains from cleaner waterways versus measuring reductions in traffic fatalities

Budgets and Public Policy II

Place-based versus **people-based** resource allocation

- *Simple treatments of abandoned buildings and vacant lots returned conservative estimates of between \$5.00 and \$26.00 in net benefits to taxpayers and between \$79.00 and \$333.00 to society at large, for every dollar invested (Source: [New Yorker](#) “The other side of broken windows”)*

Implications for the budgeting process

- Participatory
- Confrontational
- Compromising

Budgets and Reality

Forecasts as basis for budget development

- Likely changes in forecasts over budget time horizon
- Example I: Effect of economic growth on tax revenue and expenditures in terms of transfer payments for unemployment insurance
- Example II: Amount of snowfall (forecast) and response (policy) by Department of Transportation
- Different policies based on identical forecast \Rightarrow different budgets

Budgets and rhetoric

- Political statement: *"For education, I maintain our commitment from last year and note that my budget includes direct educational grants to cities and towns of \$2,026,000,000."*
- Potential issue: Decrease in services due to inflation and more students

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Budget Function and Purpose

Budget functions

- ① Financial plan: Financial resource allocation to government programs, projects, and services
- ② Operations guide: Specification of activities to achieve policy goals and measures of performance
- ③ Policy document: Setting of policy priorities by allocating more resources to areas that are considered higher-priority
- ④ Communication device: Budget as a tool for transparency and accountability to taxpayers

Focus of initial budgets on theft prevention

Financial Plan

Financial implications of governance given anticipated operating environment

- Specification of revenue-raising policies and resource allocation
- Projection of revenue and spending over budget period
- Plan to ensure solvency (i.e., expenditures limited by available resources)
- Actions in the case of differences between revenues and expenditures

Fiscal discipline and control

- Guides expenditures to ensure funds are spent for specified purposes only
- Assigns responsibility for resources (prevention of corruption)
- Increase control of operating units

Provides legal authorization for expenditure

Operations guide

Outline of efficient and (cost) effective public service provision

- Description of activities, services, and functions by organizational units
- Measures of goals for agencies, units, and programs
- Personnel used

Legal implications:

- Conformity of activities to legislative intent and legal restrictions regarding revenue-raising policies and expenditures

Mechanism for transparency of fiscal operations

Policy Document and Communication Device

Policy document

- Articulation of (long-term) non-financial goals and objectives
- Presentation and evaluation of alternatives to achieve objectives
- Specification of long-term financial challenges
- Specification of priorities

Communication device

- Facilitation of discussions among policy makers
- Communication of priorities and policy directives to stakeholders
- Information of government activities to citizens
- Transparency and accountability

More on Budgets

Systemic way of structuring budgetary information provided to stakeholders:

- Administrative: Provision of services and management of funds by agency (e.g., fire, police)
- Economic: Type of expenditure (e.g., wages and salaries, utilities)
- Functional: Purpose of the expenditure (e.g., education, health, defense)

Prudence in budgeting in the case of unexpected events such as economic downturn

- Budget stabilization fund
- Under-estimate revenue
- Over-estimate expenditure

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Budget Preparation

Public Budget Cycle

Recurring and overlapping process between legislative and executive branches involving four steps:

- ① Executive preparation
- ② Legislative review and approval
- ③ Budget implementation
- ④ Audit and evaluation

Executive Preparation

Forecast of economic climate and projections in terms of revenue and expenditure

- Example: Snow forecast and responses given amount of snowfall such as which roads are cleared first

Budget call and guidelines

- Executive priorities, limits of expenditure growth driven by revenue forecasts
- Budget preparation instructions
- Definition of fiscal year (October 1 for federal government)

Preparation and submission of budget by agencies

- Response of agencies to public demand for service

Executive budget as a message of policy

Legislative Review and Approval

Legislative priorities, constituency interests, appropriation within limits

- Recommendations and reconciliation
- Hearings and modifications
- Adoption
- Final appropriation bills

Executive veto and legislative response

Budget Implementation and Audit and Evaluation

Budget implementation: Service delivery by agencies using appropriations

- Implementation and execution
- Executing the public programs
- Legal spending of funds and in accordance with budget
- Avoidance of deficit spending

Audit and Evaluation: Financial, management, and program audits (after end of fiscal year)

- Financial audit: Were the funds spent legally?
- Management audit: Performance of the agency.
- Program audit and evaluation

External review of budget execution with report to legislature and the public

Budget Documents

Budget documents include:

- Budget year: Budget plan for current year
- Out years: Budget plan beyond the current year
- Progress report year: Tracking and comparison of actual expenditures and revenue to budget
- Final report year: Previous year's budget and outcome

Budget Message and Summary Tables

Budget message

- Goals, objectives, key challenges, and constraints
- Strategies for addressing challenges
- Initiatives to promote goals and objectives
- Economic climate, policy priorities, circumstances, constraints, and key changes

Summary tables

- Revenue and expenditure trends (by function and object)
- Workforce trends
- Major budget drivers

Detailed Departmental Budgets

Break-down of budget by unit

- Organization chart
- Mission, objectives, achievements
- Budget summary
- Detailed line item budget
- Personnel detail
- Program/sub-unit specific budgets

Budget Examples

Example of biennial budget

- Indiana budget
- Current budget: 2023–2025 Budget

Example of an annual budget

- Indianapolis
- Federal Aviation Administration

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Governmental Funds Structure

Separation into self-balancing accounting entities used to record assets, liabilities, revenues, and expenditures associated with government functions

- ① Governmental funds
- ② Proprietary funds
- ③ Fiduciary funds

Governmental Funds

General fund

- Revenues (e.g., tax revenue) and expenditures
- Operating fund: Largest fund and similar to a personnel checking account

Special revenue fund

- Specific revenue and expenditure items usually earmarked for special purposes, e.g., fuel tax revenue, federal aid fund

Debt service fund

- Repayment of short- and long-term debt (principal and interest)

Capital projects fund

- For specific projects with fund ending at project termination

Proprietary and Fiduciary Funds

Proprietary funds (self-sufficient funds)

- Enterprise funds: Coverage of self-supporting government operations (e.g., utilities, public transportation)
- Internal service funds: Transactions between government agencies

Fiduciary funds: Funds held by the government for others and which cannot be used for government operations

- Pension funds: Funds held on behalf of employees
- Trust funds whose interest payments are available for public use

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Governmental Accounting

Standards

- Governmental Accounting Standards Board (GASB): Sets accounting and financial reporting standards for the public sector in the U.S.
- Annual Comprehensive Financial Report (formerly Comprehensive Annual Financial Report): Financial statements of states, municipal, and local governments

Basis for accounting

- Timing of transaction and events

Measurement focus

- What transaction and events should be recorded

Basis for Accounting

Office of the New York State Comptroller:

- “[T]he basis of accounting refers to when revenues, expenditures, expenses, and transfers—and assets, deferred outflows of resources, liabilities, and deferred inflows of resources—are recognized in the accounts and reported in the financial statements. The accounting basis determines when the economic consequences of transactions and events are reflected in financial statements.”

Three bases for accounting

- Cash
- Accrual
- Modified Accrual

Inflow and Outflow of Funds

Inflow of funds

- **Cash:** Recorded when cash received
- **Accrual:** Recorded when earned independent of whether payment has been received
- **Modified accrual:** Recording of measurable and available revenues

Outflow of funds

- **Cash:** Recorded when cash paid
- **Accrual:** Recorded when the resources have been used in service production independent of when payment for resource occurs
- **Modified accrual:** Recorded when resources are contractually committed or obligated (obligation or encumbrance)

Measurement Focus

Inseparable link between basis of accounting and measurement focus.

Office of the New York State Comptroller:

- “[A] measurement focus identifies what transactions and events should be recorded. The measurement focus is concerned with the inflow and outflow of resources that affect a fund’s operating statement.”

Governmental vs. Proprietary Funds

Governmental funds

- Focus on current financial resources using modified accrual basis of accounting,
- Recognition of increases and decreases in financial resources to the extent that they reflect near-term inflows or outflows of cash.

Proprietary funds

- Focus on total economic resources employing accrual basis of accounting
- Recognition of increases and decreases in economic resources as soon as event or transaction occurs.

Cash Accounting

Recording of expenditures and revenues when physical received or expended

- Cash as the only asset with no liabilities
- No receivables or payables under strict cash basis
- Measurement of in- and outflows from an organization to assure adequate cash on hand

Used for cash flow forecasts and cash management

- Straightforward way of recording transactions for small businesses

Accrual Accounting

Revenue and expense recorded when received or used independent of timing

- Economic resource measurement focus
- Used by for-profits, nonprofits, state and local governments, government enterprises (e.g., public universities, hospitals)
- Reporting of all assets and liabilities on the balance sheet, including long-term assets, such as buildings and equipment, and long-term liabilities, such as debt, pension obligations

Modified Accrual

Expenditure recorded when the legal commitment to pay arises

- Objective: Assurance of financial control for general government functions
- Measurement focus: Current financial resources (or budgetary period)
- Focus is on current assets, such cash and short-term investments, and current liabilities, such as accounts payable and short-term debt (or principal and interest due in the budgetary period or the next 12 months).

Example: Revenues and Expenditures

Revenue

- Modified accrual: Governmental funds recognize revenues as cash is received during or soon after the end of the year and when it is earned and both measurable and available (within 60 days).
- Accrual: Recognize the revenue in the fiscal year in which the agency earns the revenue and it is measurable. Availability is not a factor.

Expenditures

- Modified accrual: [E]xpenditures are recognized in the fiscal year in which they are expended or when they are subject to accrual. Accruals are recorded when they are expected to use expendable financial resources.
- Accrual: [E]xpenditures are recognized in the fiscal year in which the agency incurs a liability.

From [Contrasts between Modified and Full Accrual](#)

Example: Capital Asset Acquisition

Modified accrual

- Recognize the expenditure at the acquisition date.

Accrual

- Recognize the cost of the asset and depreciate the value over the expected useful life of the asset.

From [Contrasts between Modified and Full Accrual](#)

Example: City of Pembroke Pines (Florida)

Adopted budget from September 30, 2023

- Government funds
 - Basis: Modified accrual
 - Focus: Flow of current financial resources
- Proprietary funds
 - Basis: Accrual
 - Focus: Flow of economic resources
- Fiduciary funds
 - Basis: Accrual
 - Focus: Account for assets