Understanding Budgetary Accounting: Core Concepts and Journal Entries

Budgetary accounting plays a crucial and unique role in the financial management of governmental entities, focusing on fiscal accountability and compliance with legislative mandates. Unlike for-profit accounting, governmental accounting often emphasizes adherence to a legally adopted budget, which dictates how much money can be spent and for what purposes.

Core Concepts of Budgetary Accounts

The fundamental objective of budgetary accounting is to **measure and control the use of resources according to the purposes for which budget authority was enacted**. This contrasts with proprietary accounting, which focuses on financial position (assets, liabilities, equity) and results of operations (revenues, expenses). In a comprehensive governmental accounting system, both budgetary and proprietary accounting elements are integrated, with transactions often affecting both simultaneously.

The basic accounting equation for governmental funds is adapted to reflect this focus, primarily using "expenditures" instead of "expenses" because governmental funds do not typically include long-term assets or liabilities. The residual portion of the equation is referred to as **fund balance** (or fund equity) instead of owner's equity. The core equation for governmental funds is: **Current Assets = Current Liabilities + Fund Balance + Revenue - Expenditures**.

For budgetary accounting, this equation is expanded to include specific budgetary terms:

- **Estimated Revenue**: The anticipated revenue that can be used as expendable resources for the fiscal period. This is added to the asset side of the equation in the expanded form.
- **Appropriations**: The estimated resources provided by the legislative body for expenditure during the period. These are included on the liability and fund balance side of the equation. Congress can appropriate funds as single-year, multi-year, or no-year appropriations, each with different availability periods.
- **Encumbrances**: Amounts used to obligate resources for goods and services that have been ordered but not yet received. They indicate a commitment to expend resources. Encumbrances are subtracted from the liability and fund balance side of the equation.
- **Reserve for Encumbrances**: Used to allocate a portion of the appropriations for goods and services ordered but not yet received, appearing as an addition to the fund balance side.

An expanded equation for budgetary accounting of governmental funds is: **Assets + Estimated Revenue + Expenditures + Encumbrances = Liabilities + Fund Balance + Revenue + Appropriations + Reserve for Encumbrances**. This demonstrates how debits (e.g., increases in assets, estimated revenue, expenditures, encumbrances) and credits (e.g., increases in liabilities, fund balance, revenue, appropriations, reserve for encumbrances) are managed within the budgetary accounting framework.

Journal Entries for Budget Adoption

The first step in the expenditure cycle is the **recording of the legally adopted budget**. This entry establishes the anticipated revenues and authorized spending for the fiscal period.

- **Estimated revenues** and **estimated other financing sources** are recorded as **debits**.
- **Appropriations** (authorized spending) and **other financing uses** are recorded as **credits**.
- The **Budgetary fund balance** account is used to balance the entry. A **credit** to this account indicates an anticipated **increase** in the fund balance, while a **debit** indicates an anticipated **decrease**.

Example of Budget Adoption Entry (City of Sunbury, Pennsylvania): If the City of Sunbury's annual budget anticipates $37,500,000 in revenues, $2,500,000 in other financing resources, $31,000,000 in appropriations, and $1,500,000 in other financing uses, the entry would be:

Account	Debit	Credit
Estimated revenues	37,500,000	
Estimated other financing sources	2,500,000	
Appropriations		31,000,000
Estimated other financing uses		1,500,000
Budgetary fund balance		7,500,000

This entry results in total debits of $40,000,000 ($37,500,000 + $2,500,000) and total credits of $40,000,000 ($31,000,000 + $1,500,000 + $7,500,000), indicating a balanced budget with an anticipated increase in fund balance due to expected revenues exceeding appropriations and other uses.

Journal Entries for Encumbrances

When an item or service is ordered, a commitment to expend resources is made, and this is reflected by journalizing an **encumbrance**. This step helps to ensure that funds are reserved for future expenditures and are not overcommitted.

Example of Purchase Order Issued (City of Sunbury, Pennsylvania): When the City of Sunbury places a purchase order for a new police car expected to cost $75,000, the entry is:

Account	Debit	Credit
Encumbrances	75,000	
Budgetary fund balance—reserve for encumbrances		75,000

Once the item or service is received, the corresponding encumbrance is reversed. At this point, the actual expenditure and a liability (e.g., Accounts Payable) are recorded.

Example of Goods and Services Received (City of Sunbury, Pennsylvania): When the police car is delivered and the final invoice price is $76,250, two entries are made:

1. **Reversal of Encumbrance**: | Account | Debit | Credit | | :-- | :------- | :------- | | Budgetary fund balance—reserve for encumbrances | 75,000 | | | Encumbrances | | 75,000 |
2. **Recording Expenditure and Liability**: | Account | Debit | Credit | | :------------- | :------- | :------- | | Expenditures | 76,250 | | | Accounts payable | | 76,250 |

Closing Entries in Budgetary Accounting

Closing entries are critical year-end processes that **transfer temporary (nominal) account balances to permanent (real) accounts**, effectively **zeroing out** the temporary accounts in preparation for the new fiscal year. In governmental accounting, this process involves both budgetary and non-budgetary (proprietary) temporary accounts. The goal is to ensure that the financial records accurately reflect the organization's activities and are ready for the next fiscal period.

The budgetary accounts that typically need to be closed are Estimated Revenues, Appropriations, Estimated Other Financing Sources, and Estimated Other Financing Uses. These are closed into the **Budgetary Fund Balance** account. Encumbrances, if they do not lapse (meaning they carry over to the next fiscal year), may be treated differently.

There are generally two methods for making closing entries at the end of the fiscal year:

1. **Reversing the original budget adoption transactions**.
2. **Closing the actual revenue account to the estimated revenue account and the actual expenditures account to the appropriation account**, with any differences then closed to the fund balance account.

Mechanics of Closing Budgetary Accounts:

- Accounts with **debit balances** (like Estimated Revenues) are **credited** to bring them to zero.
- Accounts with **credit balances** (like Appropriations) are **debited** to bring them to zero.
- The balancing amount of these entries is posted to the **Budgetary Fund Balance** account.

For instance, to close the budgetary accounts (Estimated Revenue, Appropriations, Estimated Other Financing Uses, and Estimated Other Financing Sources) at year-end, the following type of entry would occur:

Account	Debit	Credit

Appropriations	[Original Debit]	
Estimated Other Financing Uses	[Original Debit]	
Budgetary Fund Balance	[Balancing Debit if needed]	[Balancing Credit if needed]
Estimated Revenues		[Original Credit]
Estimated Other Financing Sources		[Original Credit]

This reverses the balances in these temporary budgetary accounts, transferring their net effect to the Budgetary Fund Balance, preparing them for the next fiscal year's budget adoption.

The systematic process of budgetary accounting, from budget adoption to managing encumbrances and performing closing entries, is vital for governments to maintain fiscal control, ensure compliance, and provide transparent financial reporting. Regular analysis and reconciliation of these accounts are also essential to identify and correct discrepancies promptly.