2. **BUDGETING**

2.2 **Budgeting Procedures**

2.2.4 **Proprietary Fund Budgets**

2.2.4.10 In the past, the statutory requirements for proprietary fund budgeting were met by establishing fixed dollar budgets for each object of expenditure, sometimes for each functional area of a proprietary operation. This method is still permitted; it is discussed in the following material as Option 1.

2.2.4.20 An alternative method of budgeting proprietary funds is now available, discussed in the following material as Option 2. This method, called *working capital budgeting*, is designed to satisfy statutory requirements and full-accrual financial accounting needs without dual accounting. Furthermore, because this method integrates the working capital concept into the budget process, it allows budget reports to be used as an important tool in managing daily operations.

2.2.4.30 Budgets are typically categorized as either *fixed* or f*lexible*, although each type may contain elements of the other. Fixed budgets embody estimates of specific dollar amounts or set maximums authorized to be levied or spent. Flexible budgets embody dollar estimates that vary according to the demand for the goods or services provided. Flexible budgets are based on standard rates for fees and costs for each unit of service; the budget is set essentially by multiplying the standard rate by the total number of units of service to be provided. Proprietary funds have a clear need for flexible budgeting in their day-to-day operations; but fiscal responsibility requires the control of fixed budgeting when commitments are made for plant expansion, debt service and other long-range objectives.

2.2.4.40 The budgets for Options 1 and 2 illustrated in Budget Calendar and Examples used the same data base, so the resulting budgets can be compared. However, the Option 2 budget follows an entirely different format and is directly related to the financial statements: It begins with the *bottom line* of the operating statement (net income) and it incorporates the significant long term changes from the balance sheet (capital assets, long-term debt, and contributions of capital). The operating statement, on which the working capital budget is based, is a *linking statement* between the balance sheet and the operating statement, and it shows all the changes in the fund's financial position.

2.2.4.50 More detail can, of course, be added to the working capital budget to meet local needs. The following items are not required, but the method is flexible enough to allow for them.

1. A fixed budget can be added for net increase or decrease in inventory, prepayments, and other changes in the liquidity of working capital.

2. Revenue restricted to debt service can be deducted from net income as an item not providing working capital, instead of showing only the net change in restricted assets as a single budgeted item.

OPTION 1: Budgeting by Object

2.2.4.60 This method of budgeting has been used by Washington State municipalities for many years. The 1981 revision of the BARS manual formally recognized this method of budgeting and provided high-level summary accounts to facilitate its use. It is a *fixed budget* meaning that the budget ordinance or resolution establishes a ceiling on expenditures, normally for each legal fund within the proprietary operation.

2.2.4.70 This option requires separating expenditures from expenses, that is the budget appropriates most cash disbursements, whether or not the transactions are accounted for as expenses.

2.2.4.80 The way to budget by object is to use the BARS accounts provided for water expenses, both operating (534) and nonoperating, and also to appropriate water expenditures in the 59X (debt principal and capital outlays). Certain expense elements and objects are not appropriated, even within expense account 534, such as depreciation expense and bad debt write-offs. Also, inventory and prepayments are appropriated as soon as item or service is purchased, although they are not expensed until consumed.

2.2.4.90 Either way, the accounting gets somewhat complicated. This method of budgeting has a second shortcoming: while it establishes the statutorily mandated control over expenditures, it is not useful for day-to-day management of a proprietary operation because it does not measure the full cost of operations and because it does not address fluctuations in the demand for the services of the proprietary entity.

2.2.4.100 Traditionally, each legal fund has been budgeted separately, both for revenues and for expenditures. This separation results in some deficit fund balances, in bond or debt service funds. This separation of funds also results in a lot of interfund transfer activity. Some examples shown in the illustration: bond proceeds are transferred to construction funds; operating fund resources are transferred to bond funds to pay debt service; and interest on customer deposits is transferred to the operating fund.

2.2.4.110 For local governments that use double-entry accounting (i.e., a general ledger), it is <u>not</u> necessary to establish separate legal funds for debt service, customer deposits, or construction projects of a utility or other proprietary-type function. This is true even though bond covenants may stipulate a *bond reserve fund, bond construction fund*, etc. The bond covenant use of term *fund* is <u>not</u> the same as the use in governmental accounting. For bond covenants, fund means only a segregation or separate account, not a self-balancing set of accounts. (See the 150 series of accounts in the BARS general ledger.)

2.2.4.120 The illustrations in Budget Calendar and Example the Option 1 water budget of the City of Example both ways: distributed among several legal funds and consolidated into one water fund.

<u>Revenues</u>

2.2.4.130 Note the level of detail provided for revenue items:

- Other than for intergovernmental revenues, the element level provides sufficient detail for budget purposes, although additional detail may be furnished if desired.

- When grants are a material anticipated resource, each grant should be separately identified by grant source code.

2.2.4.140 All budget reports in these examples include estimated and actual revenues as earned, NOT as received. So should yours: it is impossible to budget for timing differences a year in advance, and actual revenues should be on the same basis as the budgeted revenues.

Expenditures

2.2.4.150 The term *appropriation* is suitable for this expenditure budget because the amounts are fixed maximums authorized by the legislative body that adopted the budget.

2.2.4.160 Note the expenditure coding:

- The first 5 digits, 5XXXXPX, indicate that the expenditures being budgeted are those of a water utility.

- The sixth digit is called the object: each of the eight objects is budgeted separately for each legal fund of the water utility.

2.2.4.170 The budget document should be prepared at the object level, but the budget should be legally adopted (appropriated) at the fund level.

2.2.4.180 The formats to use for Option 1 budgeting of proprietary funds are the same as those used for other annual appropriated operating budgets.

OPTION 2: Working Capital Budgeting

2.2.4.190 This method of budgeting was developed to provide flexible budgeting of day-to-day operations and to eliminate the need for dual accounting systems: one for budget and another for financial accounting.

2.2.4.200 First, current operations are flexibly budgeted to result in a specified level of new cash inflow from operations (the excess of revenues over expenses, excluding depreciation and other items that do not provide/require cash currently). This portion of the budget normally reflects the anticipated results of setting specific rates/charges for goods and services that the fund routinely furnishes.

2.2.4.210 Second, all long-range sources and uses of assets are controlled by fixed budgeting. This portion of the budget controls the dollars that will be accumulated or spent on expansion or replacement of facilities-what the proprietary fund uses to provide its goods and services.

2.2.4.220 Finally, this method may be used to monitor or control the liquidity of current resources by budgeting the amount of current resources that can be expended for less liquid current assets (such as inventory and prepayments) before it is necessary to consume those resources in providing services.

2.2.4.230 The amount of detail shown goes beyond what is required for legal adoption of a working capital budget. The first amount actually budgeted is the *Total Working Capital Provided by Operations.* Similarly, the *Other Sources* and *Other Uses* should be adopted as total amounts although the detail should be included in the budget document. Estimated beginning working capital <u>is</u> also a budgeted resource.

2.2.4.240 The *Resources* and *Uses* columns are not a required part of the budget presentation; however, they are useful to non accountants because they parallel the budget presentation format for governmental type funds.

2.2.4.250 Budgetary integration is required for proprietary funds, just as for governmental type funds with annual/biennial appropriated budgets. However, the budget monitoring needs to be maintained <u>only</u> at the control account level (element digit). Budgetary control at the level of individual, detailed operating revenues and expense accounts is not required.

2.2.4.260 Neither this budget option nor Option l displays the reservations of fund position that frequently play an important part in planning future capital outlays for a proprietary fund. It is possible to display such reservations in the budget document, but it is not necessary because those reservations are the result of separate, explicit action by the municipality’s legislative body, recorded in the accounts when such action is taken.

2.2.4.270 The examples illustrate another possibility-establishing fixed budgetary control over some working capital.

Fund Name	Working Capital Budget	City/County/District	
Program		Budget For Year ______	Page
Department			

Account Number			Description	Resources	Uses	Next Year's Estimate	Current Year's Estimate	Changes Increase (Decrease)
Basub	Element	Object		(1)	(2)	(3)	(4)	(5)
			Enter account code titles from Chart of Accounts.	Columns: (1) Estimated revenues and other sources to be earned next year. (2) Estimated expenses and other uses to be incurred (3) Net budget for next year's operations. See the completed example for these calculations. (4) Net budget for current year's operations. (5) Changes from current year's operations subtract column 3 from column 4.				

<table>
<tr><td colspan="3">Fund Name</td><td colspan="3" rowspan="3">Working Capital Budget</td><td colspan="4">City/County/District</td></tr>
<tr><td colspan="3">Program</td><td colspan="2" rowspan="2">Budget For Year ______</td><td colspan="2" rowspan="2">Page</td></tr>
<tr><td colspan="3">Department</td></tr>
<tr><td colspan="3">Account Number</td><td rowspan="2">Description</td><td>Resources</td><td>Uses</td><td>Next Year’s Estimate</td><td>Current Year’s Estimate</td><td colspan="2">Changes Increase (Decrease)</td></tr>
<tr><td>Basub</td><td>Element</td><td>Object</td><td>(1)</td><td>(2)</td><td>(3)</td><td>(4)</td><td colspan="2">(5)</td></tr>
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