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# Budget Preparation

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We hope this information will be useful to you; reference to it will assist you with many of the questions that will arise in your tenure with county government. However, the *Tennessee Code Annotated* and other relevant laws or regulations should always be consulted before any action is taken based upon the contents of this document.

Please feel free to contact us if you have questions or comments regarding this information or any other CTAS website material.

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# Budget Preparation

Reference Number: CTAS-719

## Budgeting Formula

Reference Number: CTAS-720

Preparing a budget is a systematic method of determining available funds and how the funds are to be expended. A basic formula has been developed to prepare a budget.

1. Establish beginning balances as of July 1 (accumulated funds from previous fiscal year)
2. **Add** estimated revenue for the next fiscal year
3. **Add** transfers from other funds (See Section 5 on GASB 54)
4. A, B, and C equals estimated available funds for expenditures
5. **Subtract** estimated expenditures for the next year
6. **Subtract** transfers to other funds (See Section 5 on GASB 54)
7. All of the above equals estimated ending balances as of June 30

This formula applies to each separate fund for which a budget is prepared. In preparing a budget using this formula, the accepted principle in determining budget estimates is to *conservatively estimate revenues and adequately estimate expenditures*. More details about the basic formula.

Over-estimating revenues and under-estimating expenditures will jeopardize the financial condition of the local government, since it has no way to print money or borrow funds for current operations past June 30 of the current fiscal year. A soundly planned and financed budget is imperative to the local government's financial condition, especially when it must issue long-term bonds or notes.

Recommended Practice: Periodically during the budget process, prepare an Operational Statement for all funds for the proposed budget.

## Fund Balance Classifications-GASB Statement 54

Reference Number: CTAS-728

In February 2009, the Governmental Accounting Standards Board (GASB) issued Statement 54, Fund Balance and Governmental Fund Reporting. This latest GASB standard substantially alters the focus and terminology used for fund balance reporting. The purpose of the Statement is to improve financial reporting by providing fund balance categories and classifications that will be more easily understood. Three considerations led to the replacement of the previous components of governmental fund balance:

- The previous terminology (i.e., reserved, unreserved, designated) was not self-explanatory and frequently was misunderstood by financial statement users.
- The previous components were often applied inconsistently in practice.
- Some questioned whether the focus on availability for appropriation continued to best serve the needs of financial statement users.

While the Statement's purpose is clear, only time will tell if the expected end result is realized once the theory is applied to practice. Several factors will have to be considered about this new standard as the annual budget is prepared.

The Statement redefines the definitions of the five types of governmental funds. County management should review these definitions and ensure that all current and, especially, any proposed new governmental funds meet the definition to be a separate fund. As counties in Tennessee prepared annual budgets for the 2010-11 Fiscal Year, CTAS analyzed every county special revenue fund statewide and worked closely with the counties and State Comptroller to identify and close over 100 governmental funds, across the State, which no longer met the definition of a separate governmental fund. Therefore, counties should have few, if any, governmental funds that currently do not meet the standard to be separate funds. However, as county management may consider creating new governmental funds in the future, management should be aware of each of the governmental fund definitions.

### **New governmental fund definitions**

General Fund--The general fund should be used to account for and report all financial resources not

accounted for and reported in another fund. It is the principal operating fund of the county for governmental purposes.

Special Revenue Funds--Special revenue funds are used to account for and report the proceeds of specific revenue sources that are restricted or committed to expenditure for specified purposes other than debt service or capital projects. The term "proceeds of specific revenue sources" establishes that one or more specific restricted or committed revenues should be the foundation for a special revenue fund. The restricted or committed proceeds of specific revenue should be expected to continue to comprise a substantial portion of the inflows reported in the fund. Special revenue funds should not be used to account for resources held in trust for individuals, private organizations or other governments.

Capital Project Funds--Capital project funds are used to account for and report financial resources that are restricted, committed or assigned to expenditure for capital outlays, including the acquisition or construction of capital facilities and other capital assets. Capital project funds exclude those types of capital-related outflows financed by proprietary funds or for assets that will be held in trust for individuals, private organizations, or other governments.

Debt Service Funds--Debt service funds are used to account for and report financial resources that are restricted, committed, or assigned to expenditure for principal and interest. Debt service funds should be used to report resources if legally mandated. Financial resources that are being accumulated for principal and interest maturing in future years also should be reported in debt service funds.

Permanent Funds--Permanent funds should be used to account for and report resources that are restricted to the extent that only earnings, and not principal, may be used for purposes that support the reporting government's programs – that is, for the benefit of the government or its citizenry. Permanent funds do not include private-purpose trust funds, which should be used to report situations in which the government is required to use the principal or earnings for the benefit of individuals, private organizations, or other governments.

Besides clarifying the existing governmental fund type definitions, the objective of Statement 54 is to enhance the usefulness of fund balance information by providing clearer fund balance classifications that can be more consistently applied. No longer will reserves be reported in governmental fund balances and the term "undesignated fund balance" will also cease to be used. Because generally accepted accounting principles dictate that the financial report and the budget are inseparable elements in the financial administration process, county management must take the steps to ensure compliance with the new fund balance reporting requirements as they prepare the annual operating budget. Before converting existing fund balance classifications to be GASB Statement 54 compliant, county management (finance/budget officer) must become familiar with the new fund balance classifications and the definitions of each of these new terms.

### **New fund balance classifications**

Nonspendable Fund Balance--Portion of fund balance that includes amounts that cannot be spent because they are either (a) not in spendable form or (b) legally or contractually required to be maintained intact.

Restricted Fund Balance--Portion of fund balance that reflects constraints placed on the use of resources (other than nonspendable items) that are either a) externally imposed by creditors (such as through debt covenants), grantors, contributors, or laws or regulations of other governments; or b) imposed by law through constitutional provisions or enabling legislation.

Committed Fund Balance--Amounts that can only be used for specific purposes pursuant to constraints imposed by formal action of the government's highest level of decision-making authority.

Assigned Fund Balance--Amounts that are constrained by the government's intent to be used for specific purposes, but that are neither restricted nor committed (excluding stabilization arrangements). Assigned fund balance will be the minimum level of residual fund balance in all governmental funds except the county general fund and general purpose school fund.

Unassigned Fund Balance (formerly undesignated)--Residual classification for the general fund and the general purpose school fund. This classification represents fund balance that has not been assigned to other funds and that has not been restricted, committed, or assigned to specific purposes within the general fund and general purpose school fund. While it is noted that the general purpose school fund is a special revenue fund, in Tennessee counties it is recognized as the general fund of the school component unit, and therefore, unassigned fund balance amounts are permissible per the State Comptroller.

Once county management (finance/budget officer) has become familiar with the new fund balance classifications, all existing governmental fund balances should be converted to the new fund balance classifications (preferably before the budget process for Fiscal Year Ending June 30, 2012 begins and no later than June 30, 2011). County management that finds a need for assistance with fund balance classification conversion pursuant to GASB Statement 54 should contact their CTAS field consultant.

GASB Statement 54 also encourages counties with fund balance policies to place these policies in writing and formally adopt them. However, a minimum fund balance policy is not required by the statement. Additionally, counties are encouraged to adopt formal spending prioritization policies (i.e. spend assigned amounts before committed). While GASB Statement 34 required counties to have a policy for determining whether restricted or unrestricted amounts were spent first, in practice very few counties have actually approved such policies. In counties that have not formally approved a spending prioritization policy, the Statement provides a "default" policy that stipulates that committed amounts would be reduced first, followed by assigned amounts, and then unassigned when expenditures are incurred for purposes for which amounts in any of those unrestricted fund balance classifications could be used.

While fund balance reserves will no longer be used in external financial reporting, numerous Tennessee state laws require counties to track certain restricted unspent funds (certain litigation taxes, sex offender fees, courtroom security, etc). Counties should be tracking the beginning and end of year reserve balances, with the yearly activity for these reserves already and posting to the general ledger at June 30th. CTAS recommends counties to maintain a simple subsidiary ledger for these reserves on a Microsoft Excel (or similar) spreadsheet and then convert these amounts at year end to the proper restricted equity accounts (per the uniform chart of accounts) and then post these end of year restricted balances to the general ledger on June 30th.

One of the more interesting aspects of GASB Statement 54 fund balance reporting was the discontinuance of reporting a reserve for encumbrances in the governmental funds. The GASB discussed the question of whether encumbrances meet the criteria to be included in the restricted, committed or assigned fund balance classifications and arrived at the conclusion that an encumbrance does not represent any further constraint on the use of amounts than is already communicated by the established Statement 54 fund balance classifications. With this in mind, the end of year encumbrance balance will be reclassified into restricted, committed or assigned fund balance. See Balance Sheet Governmental Funds.

However, for budgetary reporting purposes, the year-end encumbrance reserve will be reversed at the beginning of the next year (out of the restricted, committed or assigned fund balance classifications) and carried forward as a prior-year encumbrance reserve (along with any current year encumbrance reserves) for interim financial reporting purposes. County management (budget/finance officer) needs to be aware that when reviewing the prior year audited financial statements (after Statement 54 implementation) they will no longer see a reserve for encumbrances on the face of the financial statements. However, information about significant encumbrances should be disclosed in the notes to the financial statements in the audit report and management should be able to locate this information there.

#### Reserve Equity Accounts

Recommended Practice: Develop a series of spreadsheets for each common reserve prior to the end of the fiscal year. Review the prior year audit, the specific revenue and expenditure as noted in T.C.A. to calculate if any reserve exists. If one does, then ensure the accounting records reflect the reserve at year end closing.

## Forms and Supplementary Schedules

Reference Number: CTAS-732

Using the forms provided by the budget coordinator, departments should complete the documents with accurate information. Also, if the forms do not adequately present the needs of the department, supplementary schedules or information should be added to the standard forms. Though it may not seem to be of utmost importance relating to budgets, communication is at least the second greatest problem in adopting annual budgets. The use of appropriate forms and supplementary schedules can assist in keeping budgetary communications clear.

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