



County Technical Assistance Service

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Budgeting and Accounting for Capital Improve- ments

Dear Reader:

The following document was created from the CTAS electronic library known as e-Li. This online library is maintained daily by CTAS staff and seeks to represent the most current information regarding issues relative to Tennessee county government.

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 e-Li material.

Sincerely,

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Budgeting and Accounting for Capital Improvements

Reference Number: CTAS-1710

The budget and accounting structures differ for operating budgets and capital budgets. The comptroller of the Tennessee treasury issues a uniform chart of accounts for county governments. Operating budgets include the General Fund and Fund account (101), Special Revenue Funds (111-149), and Debt Service Funds (151-159).

Capital project funds include funds for education, highways, and other general needs. These fund numbers are 171 through 189. The [How a County Budget is Organized](#) graph is a pictorial representation of the accounting structure for county governments. As such, the county government is like one company with multi-independent companies operating to create the one company. These individual companies are referred to as funds. The diagram shows the funds that have annual revenue must adopt annual budgets. Whereas capital project funds may not have annual revenue and thus annual budgets are not required. However, project budgets are highly recommended. Any issuance of debt represents approval for a project budget. If a county does put annual revenue in a capital projects fund, annual budgets must be approved.

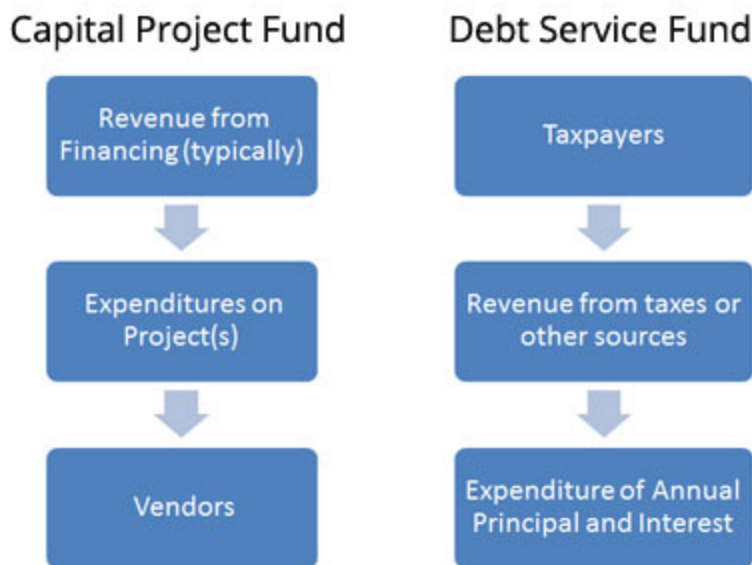
Revenue and expenses also differ for these two budgets. Annual county revenue can contribute to all funds, mainly general, special revenue and debt service. However, capital project funds are generally funded by debt, such as capital outlay notes (CON), bonds, and grants.

Flow of Money

Reference Number: CTAS-1711

One common misconception when budgeting capital projects is the difference in the flow of money between capital funds and debt service funds. Almost always revenue for debt service will come from property taxes and other county money. As we have already noted, most money for capital projects funds are borrowed from financial institution (banks) by capital outlay notes and bonds are deposited into the respective capital project fund.

The outflow of money from debt service funds and capital project funds is also different. The outflow of money from the debt service fund is to pay back the bank for the expenditures of annual principal and interest. The outflow of money from the capital projects fund is for the expenditures on projects such as paying the vendors.



Capital Accounting by Sub-Funds

Reference Number: CTAS-1712

Accounting for capital projects begins with fund number 171. The [Accounting for Capital Projects](#) diagram shows an example of accounting for capital projects by sub-funds within Fund 177. For each fund number, there is a balance sheet, statement of revenues, and statement of expenditures. Within this fund there can be sub-funds noted by three letters or numbers. Each sub-fund will also have a balance sheet, statement of revenues, and statement of expenditures. This allows for appropriate organization and documentation when maintaining the capital projects budget. Sub-fund accounting allows the managers of each project to have a separate accounting for their project and allows a separate reporting of the project to department heads, county commission, school boards, and the public. Sub-funds are often used to help insure the cost credibility of each project by not commingling funds from different projects. It is recommended that counties consider using sub-fund accounting for large individual projects and smaller projects by yearly sub-funds. Various examples are as follows:

1. A county has fire marshal deficiencies in various schools that total \$2 million dollars— the county may consider establishing a FIR sub-fund for all fire marshal improvements in their schools.
2. A county is building a new high school estimated at \$50 million dollars and a new middle school estimated at \$25 million dollars—the county may establish a HS sub-fund with \$50 million and MS sub-fund with \$25 million.
3. A county has a group of 20 small projects, some of which may take two years to complete. The total estimated cost of these projects is \$500,000 dollars. The county may establish a sub-fund 009 for these 20 projects noting that they are 2009 projects. Then the next year have a group of 2010 projects sub-fund 010. During this next year the county could still have 009 open and 010 open. A further recommendation would be that a small sub-fund be closed after the second year and any remaining funds be used for the new sub-fund year, such as 2011 or sub-fund 011.

Recommended Practice: Establish sub-funds within a Capital Project Fund if your county has a number of separate projects.

Recommended Practice: If your county has a number of capital improvement grants, you should consider establishing a Capital Project Fund and related sub-funds for the grants.

Encumbrances

Reference Number: CTAS-1713

An encumbrance is an obligation of a contract of the county's money to a vendor. Counties may have encumbrances for capital projects that will take years to complete. However, counties should encumber all of that money for the current budget year.

Accounting Procedures for Capital Improvement Projects

Reference Number: CTAS-1714

The local government accounting department should use a fund accounting system with general accounting, budgetary, and encumbrance features in order to account for capital projects.

When a contract is awarded, it should be encumbered against the authorized appropriations (budget), and when "change orders" are authorized, these should also be reflected in the accounting records. The procedures used should reflect the original approved amount for the project as a budget, the amount of contract as encumbered and any change orders for additional encumbrances, the amount paid to-date, the amount unpaid, and the unencumbered amount (available budget). Since capital projects often exceed the fiscal year, a manual accounting generally is required to reestablish the available budget and encumbrances after a fiscal year has been closed. The accountants may need to discuss specific posting with their auditors.

Status reports for the Capital Project Fund and related sub-funds should be prepared and distributed to the appropriate department heads and local legislative bodies as needed.

At stake in this process is the credibility for future projects.

Recommended Practice: File Capital Project Fund and sub-fund financial reports with the county legislative body at least quarterly for inclusion in the commission minutes. Financial credibility is at stake.

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