Government Finance Officers Association

Recommended Practice

Capital Project Budget (2007) (CEDCP and BUDGET)

Background. Once a government entity has adopted a multi-year capital plan (see GFOA Recommended Practice, *Multi-Year Capital Planning*), the next step in the capital process is to develop and implement a capital improvement projects budget (capital budget). A properly prepared and adopted capital budget is essential to ensure proper planning, funding and implementation of major projects. Most capital budgets are formally adopted as part of the annual or bi-annual budget process, officially incorporating the appropriate year(s) of the multi-year capital plan into the budget.

Capital projects are different from programs adopted in the operating budget, often representing very large financial obligations that may span two or more fiscal years. Therefore, it is important that they be properly planned, budgeted, and tracked. Because of the unique nature of capital projects, the processes for preparing, prioritizing and presenting them to the governing body may be different from the operating budget. Capital project budgets may also require additional information such as geographic location, multi-year funding sources, and impact on the operating budget. After the capital budget is adopted, it is important that an adequate system is in place to initiate and manage each authorized project through completion.

Recommendation. The Government Finance Officers Association (GFOA) recommends that governments prepare and adopt a formal capital budget as part of their annual or bi-annual budget process. The capital budget should be directly linked to, and flow from, the multi-year capital improvement plan. In many jurisdictions, the first year (or first two years in a bi-annual budget) of the multi-year capital plan would be adopted by the governing body. It may be necessary to modify projects approved in the capital plan before adopting them in a capital budget. Modifications may be necessary based on changes in project scope, funding requirements, or other issues. If these modifications are material, jurisdictions should consider the impacts these may have on their multi-year capital and financial plans.

Organizations should establish specific criteria early in the process to help prioritize capital submittals. The capital budget should be adopted by formal action of the legislative body, either as a component of the operating budget or as a separate capital budget. It should comply with all state and local legal requirements:

Preparing and Adopting the Capital Budget. The capital budget should include the following information:

- A definition of capital expenditure for that entity.
- Summary information of capital projects by fund, category, etc.

- A schedule for completion of the project, including specific phases of a project, estimated funding requirements for the upcoming year(s), and planned timing for acquisition, design, and construction activities.
- Descriptions of the general scope of the project, including expected service and financial benefits to the jurisdiction.
- A description of any impact the project will have on the current or future operating budget.
- Estimated costs of the project, based on recent and accurate sources of information.
- Identified funding sources for all aspects of the project, specifically referencing any financing requirements for the upcoming fiscal year.
- Funding authority based either on total estimated project cost, or estimated project costs for the upcoming fiscal year. Consideration should be given to carry-forward funding for projects previously authorized.
- Any analytical information deemed helpful for setting capital priorities (this can include any cost/benefit comparisons, and related capital projects).

Jurisdictions should provide a greater level of detail and information for *non-routine* capital projects than for *routine* projects. For example, a major new wastewater treatment plant or civic center will have greater service and cost implications than an ongoing project to resurface roads or maintain water lines. For *non-routine* projects, the capital budget should thoroughly describe the impact on the operating budget, number of additional positions required, tax or fee implications, and other financial or service impacts.

When developing the capital budget, entities should consider measures to mitigate risk related to undertaking major *non-routine* projects. Based on the size of the capital budget and the complexity of the capital projects, it may be appropriate for entities to budget additional reserves for project overruns or insurance coverage such as performance bonds or general liability coverage.

Reporting on the Capital Budget. GFOA recognizes the importance of timely and accurate reporting on projects adopted in the capital budget. Executive leadership, legislators, and citizens should all have the ability to review the status and expected completion of approved capital projects. Periodic reports should be issued routinely on all ongoing capital projects. The reports should compare actual expenditures to the original budget, identify level of completion of the project, and enumerate any changes in the scope of the project, and alert management to any concerns with completion of the project on time or on schedule.

References

- Distinguished Budget Presentation Awards Program, *Awards Criteria and Explanations of the Criteria*, GFOA.
- John Vogt, *Capital Budgeting and Finance: A Guide for Local Governments*, ICMA, 2004.
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- National Advisory Council on State and Local Budgeting, *Recommended Budget Practices: A Framework for Improved State and Local Government Budgeting*, 1998.
- Patricia Tigue, *Capital Improvement Programming: A Guide for Smaller Governments*, 1996
- John Fishbein, *Preparing High Quality Budget Documents*, GFOA, 2006.

Approved by the GFOA's Executive Board on March 2, 2007.