

CHAPTER 1

GOVERNMENTAL AND NONPROFIT ACCOUNTING: ENVIRONMENT AND CHARACTERISTICS

ANSWERS TO QUESTIONS

Question 1-1

- a. The *similarities* of accounting for profit-seeking and G&NP organizations include:
1. Double-entry system of accounts.
 2. Most accounting mechanics, e.g., basic transaction documents, journals, ledgers, charts of accounts.
 3. Where a G&NP organization has a business-type activity, e.g., a municipal electric utility, the accounting largely parallels that for a similar private business (e.g., electric utility).
- b. Among the unique aspects of G&NP organization accounting are:
1. Fund accounting—designed to separate resources according to the purposes for which they may be used and to account for their uses and balances.
 2. Budgetary control techniques—to help assure appropriations are not overexpended and all resources due the G&NP organization are received by it.

Difficulty: 1

Learning Objective: 1

AACSB: Reflective thinking

Question 1-2

- a. A fund of a government organization is an independent fiscal and accounting entity. Each fund has a separate self-balancing set of accounts in which are recorded the resources segregated for specific purposes, the related liabilities and residual equity (fund balance or net assets), and the changes therein. Financial statements typically must be presented to report the financial position and operating activities of a fund of a government.
- b. As the term is generally used in commercial accounting, a "fund" merely indicates that a portion of an organization's assets is set aside and/or restricted to certain uses, e.g., a petty cash fund or a bond sinking fund. Such "funds" are not separate accounting entities, but are accounted for by establishing appropriately titled asset and liability accounts within the organization's general ledger.
- c. No, the creation of a fund does not constitute authority to spend or obligate its resources. In most not-for-profit organizations, particularly governments, authority to spend or obligate

fund resources is conferred only upon an appropriation(s) being made by the legislative body or governing board.

Difficulty: 2

Learning Objective: 1

AACSB: Reflective thinking

Question 1-3

1. *Governmental* (expendable) funds are used to account for the financial assets; related liabilities; changes in net financial assets from revenues, expenditures, and other financing sources (uses); and the balances that may be expended in a G&NP organization's "governmental" or other" nonproprietary" activities.
2. *Proprietary* (nonexpendable) funds are used to account for the revenues, expenses, assets, liabilities, and equity of a G&NP organization's "business-type" activities, which in the most clear cut situations are intended to sustain their operations through user charges.

Difficulty: 1

Learning Objective: 4

AACSB: Reflective thinking

Question 1-4

"*Expenditures*" may be defined as the amount of net financial resources expended during an accounting period for current operations, capital outlay, and long-term debt principal retirement and interest. (Expenditures are measured in governmental fund accounting.) "*Expenses*," on the other hand, are the costs of assets or services consumed (expired) during an accounting period. (Expenses are measured in proprietary fund accounting.) When equipment is purchased for instance, expenditures are incurred; but expenses are incurred during its period of use.

Difficulty: 1

Learning Objective: 2

AACSB: Reflective thinking

Question 1-5

- a. ***Organizational objectives.*** The determination of net income, earnings per share, change in owner(s) equity, and the like are very important in accounting for profit-seeking organizations. Because the basic purpose of a business is to generate revenues sufficient to cover all costs of providing the services and to generate a return for owners, these measurements relate directly to the objectives of the owners and are seen to indicate management success or failure during a given period of time.

On the other hand, a G&NP organization exists to provide certain goods or services to a community or society as a whole. The objective of such organizations is to provide as many goods or as much service as available resources permit. For most government and not-for-profit entity services, there is no expectation that providing the services will generate revenues or that any revenues raised through user charges will cover costs. Emphasis in this environment is therefore upon acquiring and using appropriable financial resources—cash flow, working capital, and budgetary position—rather than the determination of net income or earnings per share.

- b. ***Sources of financial resources.*** Profit-seeking organizations generally rely on equity investors, debt issuances, and profits from the sale of goods and services to its customers to generate financial resources. In contrast, G&NP organizations do not have “investors,” and generally do not have a profit motive. G&NP organizations generally rely on the receipt of taxes and donations as their primary sources of financial resources although they also rely, to some degree, on proceeds from debt issuances. Grants and subsidies from governments are primary sources of financial resources for many G&NP organizations as well. Bureau of the Census statistics indicate that resources received from senior levels of government actually exceed taxes for many local governments.
- c) ***Evaluating Performance and Operating Results.*** Profit-seeking organizations rely on profits from the sale of its goods or services to continue to operate. The operations of a profit-seeking organization generally are evaluated based on the amounts of profits (or its net income) over a period of time. G&NP organizations must be measured differently because G&NP organizations generally do not have a profit motive. Evaluating the performance of governments is extremely difficult because there is no open market supply and demand test of the value of the services that they provide. Also, the relationship between resource providers and the recipients of services is remote and indirect for G&NP organizations. Therefore, other controls must be substituted for the profit test/regulator where G&NP organizations are involved. Thus, G&NP organizations, particularly governments, are subjected to a variety of legal and administrative controls over such factors as (1) organization structure, (2) personnel policies and procedures, (3) sources of resources, (4) uses of resources, (5) accounting, (6) reporting, and (7) auditing. The most obvious result of such alternative controls is the extensive use of fund accounting and reporting and budgetary accounting and reporting by G&NP organizations

Difficulty: 2

Learning Objective: 3

AACSB: Reflective thinking

Question 1-6

1. The *Governmental Accounting Standards Board (GASB)* was established in 1984 as the recognized body to set authoritative standards for state and local government accounting and financial reporting. The GASB recognized the effective National Council on Governmental Accounting (NCGA) pronouncements and excerpts from certain AICPA publications as "authoritative" in 1984, and subsequently has issued numerous Statements and Interpretations.
2. The *Financial Accounting Standards Board (FASB)* assumed responsibility for all nonbusiness organization accounting and financial reporting standards except those for state and local governments in 1979. The FASB establishes accounting and financial reporting standards for all nonprofit organizations except for government nonprofit organizations.

(Although not discussed in chapter 1, it may be interesting to note that the FASB issued Statement of Financial Accounting Standards (SFAS) No. 116, "Accounting for Contributions Made and Contributions Received" and SFAS 117, "Financial Statements of Not-for-Profit Organizations" in June 1993. The FASB has since issued two additional standards specifically addressing not-for-profit organization accounting issues. These standards established the general guidelines for financial reporting for all nongovernment not-for-profit organizations—including nongovernment not-for-profit hospitals, colleges and universities, voluntary health and welfare organizations, and other not-for-profit organizations. Government not-for-profit entities of these types, e.g., state universities, are prohibited from applying the guidance in these standards, which are not included in the FASB's Accounting Standards Codification.)

Difficulty: 1

Learning Objective: 6

AACSB: Reflective thinking

Question 1-7

User charges of *profit-seeking organizations* may be presumed to be set at a level that is expected to maximize short-run or long-run profitability. A potential user who cannot pay the user charges is denied the goods or services.

In *G&NP organizations*, on the other hand, user charges may be set at modest levels that assure that most or all people needing the goods or services can obtain them. The user charges may be made more as a matter of assuring that the users truly need the goods or services and/or to assure that the self-respect of those who will not accept "charity" is protected. In other G&NP activities user charges may be set at a "break even" level or at levels that provide some "profit" to be used to expand or improve its services.

Difficulty: 1

Learning Objective: 3

AACSB: Reflective thinking

Question 1-8

The term "generally accepted accounting principles" has been defined broadly as:

1. encompassing the conventions, rules, and procedures necessary to define accepted accounting practice at a particular time, and
2. including not only broad guidelines of general application, but also detailed practices and procedures. (APB Statement No. 4, par. 138). Thus, GAAP is an "umbrella" term that encompasses many "subsets" in the private sector (e.g., motion pictures, oil and gas, banking) as well as in the public sector (e.g., state and local governments, hospitals, colleges and universities, and not-for-profit organizations).

Difficulty: 1

Learning Objective: 6

AACSB: Reflective thinking

Question 1-9

- a. The GASB (i.e., government) *GAAP "hierarchy"* guidelines provide accountants and auditors a ranking device by which to evaluate the relative authoritativeness of various standards pronouncements and other accounting and reporting publications in order to determine what constitutes "generally accepted accounting principles" for a given type of organization and the transactions and events affecting its financial condition and/or operating results.

- b. The *government GAAP hierarchy* establishes GASB Statements and Interpretations as the most authoritative literature guiding financial reporting for state and local government entities. Therefore, in preparing GAAP financial statements, a government should apply the guidance in a GASB Statement even when it conflicts with guidance provided in an AICPA audit and accounting guide (or in any other literature).

Difficulty: 1

Learning Objective: 6

AACSB: Reflective thinking

Question 1-10

The GASB and FASB jointly established a *definition* of “state and local government entities” that appears in various AICPA audit and accounting guides (Illustration 1-1, page 8). Whether a specific not-for-profit organization should follow GASB guidance or FASB guidance depends on whether the organization qualifies as a government organization under this definition.

If the organization *meets* the *definition* of “state and local government entities,” it is under the GASB’s jurisdiction and should follow *GASB* guidance.

If the organization does *not* meet the “state and local government entities” definition, it is under the FASB’s jurisdiction and should follow *FASB* guidance.

Difficulty: 1

Learning Objective: 7

AACSB: Reflective thinking

SOLUTIONS TO EXERCISES

Exercise 1-1

1. d
2. d
3. c
4. b
5. a
6. d
7. e
8. c
9. c
10. c

Difficulty: 1

Learning Objective: 1, 2, 3, 4, 6

AACSB: Reflective thinking

Exercise 1-2

	(a) <u>Expenses</u>	(b) <u>Expenditures</u>
1. Salaries and other personnel costs	\$100,000	\$100,000
2. Rent and utilities.....	24,000	24,000
3. Debt service:		
a) Interest on note	5,500	5,500
b) Note principal payment	—	10,000
4. Capital outlay/Depreciation:		
a) Capital outlay	—	30,000
b) Depreciation of equipment		
i) $\$150,000/15 = \$10,000$		
ii) $(\$30,000-\$6,000)/6 = \underline{4,000}$	14,000	—
5. Other	<u>4,500</u>	<u>4,500</u>
Total	<u>\$148,000</u>	<u>\$174,000</u>

Difficulty: 2

Learning Objective: 3, 4

AACSB: Analytical Skills

SOLUTIONS TO PROBLEMS

Problem 1-1

1.

General Fund
Hatcher Township
Worksheet to Derive Accrual Basis Statement of Revenues and Expenditures
FYE December 31, 20X9
(\$)

	Budgetary (Cash) Basis	Accruals		GAAP Basis
		1/1/X9	12/31/X9	
Revenues:				
Taxes	\$595,000	\$ —	\$ 6,000	\$601,000
Licenses	206,000	—	—	206,000
Intergovernmental	110,000	(9,000)	1,000	102,000
Other	<u>45,000</u>	<u>(5,000)</u>	<u>—</u>	<u>40,000</u>
	<u>956,000</u>	<u>\$(14,000)</u>	<u>\$ 7,000</u>	<u>949,000</u>
Expenditures:				
Salaries	704,000	\$(17,000)	\$11,000	698,000
Utilities	85,000	—	—	85,000
Supplies	64,000	—	7,000	71,000
Equipment	58,000	(2,000)	12,000	68,000
Other	<u>31,000</u>	<u>—</u>	<u>—</u>	<u>31,000</u>
	<u>942,000</u>	<u>\$(19,000)</u>	<u>\$30,000</u>	<u>\$953,000</u>
Excess of Revenues Over (under) Expenditures .	<u>\$ 14,000</u>			<u>\$ (4,000)</u>

Reconciliation (Not Required):

Excess of Revenues Over (Under) Expenditures—Budgetary (Cash) Basis	\$14,000
Decrease in Revenue accruals at 12/31/X9	(7,000)
Increase in Expenditure accruals at 12/31/X9	<u>(11,000)</u>
Excess of Revenues Over (Under) Expenditures—GAAP Basis	<u>\$ (4,000)</u>

Problem 1-1 (continued)

2. Yes, readers would get differing impressions of the 20X9 "operating results" of the Hatcher Township General Fund from statements of revenues and expenditures prepared on the budgetary (cash) and GAAP bases. For example:
 - a. Revenues exceeded expenditures by \$14,000 on the budgetary (cash) basis; but expenditures exceeded revenues by \$4,000 on the GAAP basis.
 - b. Revenue and expenditure analyses and evaluations would differ:

	<u>Budget</u>	<u>Actual (Budgetary Basis)</u>	<u>Actual (GAAP Basis)</u>
Revenues:			
Taxes	\$600,000	\$595,000	\$601,000
Intergovernmental	100,000	110,000	102,000
Other	50,000	45,000	40,000
Expenditures:			
Salaries	700,000	704,000	698,000
Supplies	70,000	64,000	71,000
Equipment	60,000	58,000	68,000

Difficulty: 2

Learning Objective: 5

AACSB: Analytical Skills

Problem 1-2

The possible sources of guidance found for each issue are listed below in decreasing order of authoritativeness. Documents at the same level of authority are given the same rank since one does not always take precedence over the other. (Levels A-D are from the GAAP "Hierarchy" in Illustration 1-4, page 12, of the textbook.)

Issue 1

1. (a)—GASB Interpretation
2. (b)—GASB Technical Bulletin
2. (b)—AICPA SLG Audit and Accounting Guide ("cleared" by the GASB)
5. Nonauthoritative—FASB Statement (now a section or portion of a section in the FASB Accounting Standards Codification)
5. Nonauthoritative—Leading governmental accounting textbook

Problem 1-2 (continued)

Issue 2

1. (d)—GASB staff Implementation Guide
2. Nonauthoritative—Leading governmental accounting textbook
2. Nonauthoritative—Article in a leading auditing journal
2. Nonauthoritative—Speech by a leading governmental accounting professor

Issue 3

1. (a)—GASB Statement
2. (b)—AICPA SLG Audit and Accounting Guide (“cleared” by the GASB)
3. Nonauthoritative—Journal article summarizing current practice on
3. Nonauthoritative—Notes from a conversation with the GASB director of research
3. Nonauthoritative—FASB Interpretation

Issue 4

1. (b)—GASB staff Technical Bulletin
1. (b)—AICPA Statement of Position (“cleared” by the GASB)
3. Nonauthoritative—Article by international public accounting firm managing partner
3. Nonauthoritative—FASB Technical Bulletin

Issue 5

1. (b)—AICPA SLG Audit and Accounting Guide (“cleared” by the GASB)
2. (d)—GASB Codification section on a GASB staff Implementation Guide (has the same level of authority as the Implementation Guide)*
3. Nonauthoritative—Four articles from The Journal of Accountancy
3. Nonauthoritative—Leading governmental accounting textbook

*Implementation guidance is not included in the Codification. The purpose of the question was to point out that the guidance in the Codification includes material with various levels of authority. The paragraph numbering system indicates with the authoritative status of the specific guidance. Nonauthoritative guidance has paragraph numbers ranging from .900 to .999. Please forgive the unintended error in the question.

Difficulty: 2

Learning Objective: 6, 7

AACSB: Reflective thinking

Problem 1-3

Work on P1-3 should be evaluated by reviewing the brief (1-3 pages) critiques required and any attachments. The addresses of these sites are:

1. GASB (<http://www.GASB.org>)
2. FASB (<http://www.FASB.org>)
3. AICPA(<http://www.AICPA.org>)
4. GFOA (<http://www.GFOA.org>)

5. AGA (<http://www.AGACGFM.org>)
6. NASACT (<http://www.NASACT.org>)
7. NACUBO (<http://www.NACUBO.org>)
8. ASBOINTL (<http://ASBOINTL.org>)

Problem 1-4

The GASB White Paper can be found at the GASB website (www.gasb.org). The executive summary to the White Paper is a brief summary that identifies the key differences between governments and for-profit business enterprises.

Difficulty: 1

Learning Objective: 6, 7

AACSB: Reflective thinking

CHAPTER 2

STATE AND LOCAL GOVERNMENT ACCOUNTING AND FINANCIAL REPORTING MODEL: THE FOUNDATION SOLUTIONS MANUAL

ANSWERS TO QUESTIONS

Question 2-1

Governments operate in a different environment than businesses. Governments must comply with the many ***finance-related legal and contractual requirements, regulations, restrictions, and agreements*** that affect their financial management and accounting. Such compliance must be demonstrable and be reported on regularly. Governments should also prepare financial statements in conformity with generally accepted accounting principles (GAAP), which provide uniform minimum national standards of and guidelines for annual financial reporting to groups and persons outside the government. Therefore, one fundamental feature of a government's accounting system is that it must maintain and provide information that accomplishes multiple purposes.

Whereas business accounting systems must provide data both for GAAP reporting and for income tax reporting, governmental accounting systems must provide data both for external reporting in conformity with GAAP and for controlling and reporting on finance-related legal compliance matters. This necessitates having different accounting systems for businesses and governments.

Difficulty: 2

Learning Objective: 1

AACSB: Reflective thinking

Question 2-2

The measurement focus for the three fund categories are:

1. ***Proprietary Funds***—economic resources (revenues and expenses) measurement focus, which is the measurement focus used by business enterprises.
2. ***Governmental Funds***—the current financial resources measurement focus.
3. ***Fiduciary Funds***—the same measurement focus as proprietary funds—the economic resources measurement focus.

An **economic resources** measurement focus results in accounting for *all* assets—both *current* and *noncurrent*—and *all* liabilities—both *current* and *long-term*. A **current financial resources** measurement focus results in accounting for financial assets and related liabilities. Noncurrent

assets and long-term liabilities are not reported under a current financial resources measurement focus.

Difficulty: 1

Learning Objective: 2, 3

AACSB: Reflective thinking

Question 2-3

For governmental funds:

1. Revenues must be (1) "*available*"—collectible within the period or soon enough thereafter to be used to pay for the expenditure liabilities incurred during the period, as well as levied or earned—and (2) *measurable* to be recognized.
2. Expenditures are financial assets expended during a period for current operations, capital outlay, and debt service including (a) long-term debt principal retirement and (b) interest on both short-term and long-term indebtedness.

For proprietary funds:

1. Revenues are recognized when earned and measurable. There is no “availability” criterion for revenues recognized in proprietary funds.
2. Expenses are costs consumed or expired during a period.

Difficulty: 1

Learning Objective: 2, 3, 5

AACSB: Reflective thinking

Question 2-4

General capital assets are not considered appropriable resources and unmatured general long-term liabilities are not current liabilities. Hence, these assets and liabilities would not appropriately be accounted for within a municipality's governmental (expendable) funds, which are net current financial resource entities. Further, general capital assets are considered to belong to the government as a whole, not to a particular department or enterprise; and unmatured general long-term liabilities are likewise considered obligations of the government, not of a specific fund. Thus, neither fits conveniently into the existing fund structure of state and local governmental accounting and both are accounted for through the General Capital Assets and General Long-Term Liabilities nonfund accounts. They are reported only in the government-wide financial statements.

Difficulty: 2

Learning Objective: 4

AACSB: Reflective thinking

Question 2-5

Capital assets and long-term liabilities are accounted for in:

- General Capital Assets and General Long-Term Liabilities accounts
- Enterprise Funds
- Internal Service Funds
- Trust Funds (some)

General capital assets and general long-term liabilities are accounted for in the General Capital Assets and General Long Term Liabilities accounts. They are related to general government (governmental) activities.

- Difficulty: 1
- Learning Objective: 4
- AACSB: Reflective thinking

Question 2-6

A Special Revenue Fund should be 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.

A Capital Projects Fund should be 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.

A Debt Service Fund should be used to account for and report financial resources that are restricted, committed, or assigned to expenditure for principal and interest on general long-term liabilities.

- Difficulty: 1
- Learning Objective: 6
- AACSB: Reflective thinking

Question 2-7

Proprietary funds include Enterprise Funds and Internal Service Funds. Proprietary fund financial statements include a balance sheet (statement of net assets), statement of revenues, expenses, and changes in net assets, and statement of cash flows.

- Difficulty: 1
- Learning Objective: 6, 7
- AACSB: Reflective thinking

Question 2-8

Governmental funds include the General Fund, Special Revenue Funds, Capital Projects Funds, Debt Service Funds, and Permanent Funds. Governmental fund financial statements include a balance sheet (or statement of net assets), statement of revenues, expenditures, and changes in fund balance-GAAP basis, and statement of revenues, expenditures, and changes in fund balance-budget and actual (on the budgetary basis of accounting).

Difficulty: 1

Learning Objective: 6, 7

AACSB: Reflective thinking

Question 2-9

Fiduciary funds include Private-Purpose Trust Funds, Investment Trust Funds, Pension Trust Funds, and Agency Funds. Trust fund financial statements include a statement of net assets and a statement of changes in net assets. Agency Fund financial statements include a statement of net assets and a statement of changes in agency fund assets and liabilities (required in a comprehensive annual financial report but not in the basic financial statements).

Difficulty: 1

Learning Objective: 6, 7

AACSB: Reflective thinking

Question 2-10

One only: General Fund and General Capital Assets and General Long-Term Liabilities accounts

One, none, or many - - all other fund types:

Special Revenue Funds	Internal Service Funds	Private-Purpose Trust Funds
Capital Projects Funds	Enterprise Funds	Investment Trust Funds
Debt Service Funds		Pension Trust Funds
Permanent Funds		Agency Funds

Difficulty: 1

Learning Objective: 2, 6

AACSB: Reflective thinking

Question 2-11

Interfund loans are amounts provided by one fund to another *with a requirement for and expectation of repayment*. Interfund loans are the only type of interfund transaction that initially

affects only balance sheet accounts. Because interfund loans are expected to be repaid, a loan is reported as a receivable (asset) in the lending fund and as a payable (liability) in the debtor fund.

Interfund transfers are flows of assets (such as cash or goods) from one fund to another *without equivalent flows of assets or services in return and without a requirement for repayment.*

- In **governmental** funds, transfers should be reported as *other [nonexpenditure] financing uses* in the funds making transfers and as *other [nonrevenue] financing sources* in the funds receiving transfers.
- In **proprietary** funds, transfers should be reported as the last item before the subtotal for changes in net assets.

Difficulty: 2

Learning Objective: 7

AACSB: Reflective thinking

Question 2-12

The Basic Financial Statements, which must be accompanied by Management's Discussion and Analysis and certain other required supplementary information, include the government-wide financial statements (Statement of Net Assets and Statement of Activities), the three sets of fund financial statements (governmental fund financial statements, proprietary fund financial statements, and fiduciary fund financial statements), and the related notes. The Comprehensive Annual Financial Report (CAFR) of a governmental unit includes the basic financial statements, but is much more extensive. A CAFR contains:

1. Introductory materials, e.g., letter(s) of transmittal.
2. Management's Discussion and Analysis,
3. Basic Financial Statements and notes,
4. Combining financial statements (for nonmajor governmental funds, nonmajor Enterprise Funds, Internal Service Funds, Trust Funds, and Agency Funds—if there are two or more funds in these categories. These are a minimum. Other combining statements may be presented.)
5. Individual fund financial statements and schedules (where appropriate),
6. Narrative explanations (notes for combining or individual fund financial statements), and
7. Statistical section.

Items 2 through 6, including the auditor's report, are called the financial section of a CAFR.

Difficulty: 2

Learning Objective: 7

AACSB: Reflective thinking

Question 2-13

Government-wide financial statements are prepared using the same measurement and basis of accounting that is used for proprietary funds—the *economic resources* measurement focus and the *accrual* basis of accounting.

Difficulty: 1

Learning Objective: 3

AACSB: Reflective thinking

Question 2-14

The accounting equation for a governmental fund is:

$$(\text{Financial Assets} + \text{Deferred Outflows}) - (\text{Related Liabilities} + \text{Deferred Inflows}) = \text{Fund Balance}$$

Difficulty: 1

Learning Objective: 2

AACSB: Reflective thinking

Question 2-15

The accounting equation for a proprietary fund is:

$$\text{Assets} + \text{Deferred Outflows} - \text{Liabilities} - \text{Deferred Inflows} = \text{Net Position}$$

Difficulty: 1

Learning Objective: 2

AACSB: Reflective thinking

Question 2-16

Deferred outflows and deferred inflows result from delaying operating statement recognition of certain changes in the net amount of assets less liabilities. The GASB requires these changes to be classified as deferred outflows instead of assets (or as deferred inflows instead of liabilities) when the GASB views the change as related to future periods.

Deferred outflows are reported similarly to assets, and changes in deferred outflows affect the operating statement in essentially the same way as changes in assets. Likewise, deferred inflows are reported similarly to liabilities, and changes in deferred inflows affect the operating statement in essentially the same manner as changes in liabilities.

Difficulty: 2
Learning Objective: 2
AACSB: Reflective thinking

Question 2-17

The General Fund is always a major fund. In addition, any other governmental fund or Enterprise Fund that meets both of the following "size" criteria must be reported as a major fund. The quantitative major fund criteria are:

1. Total assets, liabilities, revenues, or expenditures/expenses (excluding extraordinary items) of that individual governmental fund or Enterprise Fund are at least 10% of the corresponding total (assets, liabilities, revenues, or expenditures/expenses) for all funds of that category or type (i.e., total governmental funds or total Enterprise Funds)
2. The same element that met the 10% criterion in (a) is at least 5% of the corresponding element total for all governmental funds and Enterprise Funds combined.

A governmental fund or Enterprise Fund that does not meet the size criteria may still be treated as a major fund if the government deems it of sufficient importance to statement users. Thus, a government must identify as a major fund each governmental fund or Enterprise Fund for which statement users are likely to need individual fund information.

Difficulty: 2
Learning Objective: 2
AACSB: Reflective thinking

SOLUTIONS TO EXERCISES

Exercise 2-1

1. a
2. b
3. d
4. a
5. b
6. d
7. c
8. d
9. a
10. d

Difficulty: 1

Learning Objective: 2, 3, 4

AACSB: Reflective thinking

Exercise 2-2

1. b
2. c
3. a
4. d
5. b
6. c
7. c
8. c
9. a
10. c

Difficulty: 1

Learning Objective: 2, 3, 4

AACSB: Reflective thinking

Exercise 2-3

1. Special Revenue Fund
2. Capital Projects Fund
3. Enterprise Fund
4. General Fund
5. General Capital Assets and General Long-Term Liabilities accounts
6. General Capital Assets and General Long-Term Liabilities accounts
7. General Capital Assets and General Long-Term Liabilities accounts
8. Debt Service Fund
9. Enterprise Fund
10. Internal Service Fund

Difficulty: 1
Learning Objective: 2, 4, 6
AACSB: Reflective thinking

Exercise 2-4

- a. Special Revenue
- b. Debt Service
- c. Capital Projects
- d. Special Revenue
- e. Internal Service
- f. Enterprise, if criteria met; otherwise Special Revenue if the revenues are restricted or committed and General Fund if not
- g. Agency
- h. General
- i. Enterprise
- j. Capital Projects
- k. Debt Service
- l. Permanent
- m. Capital Projects
- n. Pension Trust

Difficulty: 1
Learning Objective: 5
AACSB: Reflective thinking

Exercise 2-5

a, b, c, and d

Difficulty: 1
Learning Objective: 3
AACSB: Reflective thinking

Exercise 2-6

Name of Government
Governmental Fund
Statement of Revenues, Expenditures, and Changes in Fund Balances
Time Period Report Covers

Revenues (by source) c
Expenditures (by function) d, f, g, h, i
Excess of Revenues Over (Under) Expenditures
Other Financing Sources (Uses) a, (b)
Special and Extraordinary Items* e, k
Net Change in Fund Balance

Fund Balance (Total), Beginning
Fund Balance (Total), Ending

*The amounts reported for special items and extraordinary items would be proceeds received or expenditures incurred for those items, not gains and losses.
Note: Depreciation expense (j) is not recorded in this statement.

Difficulty: 2
Learning Objective: 7
AACSB: Analytical Skills

Exercise 2-7

Name of Government
Proprietary Fund
Statement of Revenues, Expenses, and Changes in Net Assets
Time Period Report Covers

Operating revenues (by source) c
Total operating revenues
Operating expenses (detailed) d, i
Total operating expenses
Operating income
Nonoperating revenues and
expenses (detailed) h, k
Income before capital contributions, special and extraordinary items, and transfers
Capital contributions
Special and extraordinary
items (detailed) e, j
Transfers b
Increase (decrease) in net assets
Net assets—beginning of period

Net assets—end of period

Note: Proceeds from issuing bonds (a), Expenditures for purchases of equipment (f), and Expenditures for principal retirement of long-term liabilities (g) are not reported in this statement.

Difficulty: 2

Learning Objective: 7

AACSB: Analytical Skills

Exercise 2-8

Name of Government
Governmental Fund
Balance Sheet
Fiscal Year-End

Assets a, d, g

Liabilities and fund balance

Liabilities j

Fund balance c, i

Total liabilities and fund balance

Note: Unrestricted net assets (b), Land (e), Bonds payable (f), Current portion of bonds payable (h), and Buildings and equipment (k) are not reported in this statement.

Difficulty: 2

Learning Objective: 7

AACSB: Analytical Skills

Exercise 2-9

Name of Government
Proprietary Fund
Balance Sheet
Fiscal Year-End

Assets

Current Assets:	a, d, g
Noncurrent Assets:	
Capital Assets	e, k
Total Assets	

Liabilities

Current liabilities	h, j
Noncurrent liabilities	f
Total liabilities	

Net Assets	b
-------------------	----------

Total liabilities and net assets

Note: Nonspendable fund balance (c) and Unassigned fund balance (i) are not reported in this statement.

Difficulty: 2

Learning Objective: 7

AACSB: Analytical Skills

Exercise 2-10

(1) Proprietary fund

Analysis of Transactions for Business-Type Activities								
Proprietary Funds								
	CA	+	NCA	–	CL	–	LTL	= NA
a.	(\$5,100)				\$200			(\$5,300)
b.	3,000							3,000
c1.	2,000				2,000			
c2.					150			(150)
d.	(2,200)				(2,150)			(50)
e.	200							\$200
f.	1,000						\$1,000	
g.	(100)							(100)
h.	(800)						(800)	
i.	(900)		\$900					
j.			(280)					(280)
k.	35		(60)					(25)

*Calculations for:

- c2. Interest accrual at year-end, $\$2,000 \times .10 \times 9/12 = \150
- d. Liability reduction equals principal of \$2000 plus accrued interest payable of \$150.
- k. Capital asset carrying value at disposal equals \$60 (Cost of \$900 less accumulated depreciation after three years of \$840). Proprietary fund loss on sale of the capital asset is \$35 (proceeds) less \$60 (carrying value) or \$25.

(2) Governmental fund and nonfund accounts

Analysis of Transactions for General Government Activities									
Governmental Funds					General Capital Assets and General Long-Term Liabilities Accounts				
	FA	–	RL	= FB	GCA	–	GLTL	=	NA
a.	(\$5,100)		\$200	(\$5,300)					
b.	3,000			3,000					
c1.	2,000		2,000						
c2.			150	(150)					
d.	(2,200)		(2,150)	(50)					
e.	200			200					
f.	1,000			1,000			\$1,000		(\$1,000)
g.	(100)			(100)					
h.	(800)			(800)			(800)		800
i.	(900)			(900)	\$900				900
j.					(280)				(280)
k.	35			35	(60)				(60)

Exercise 2-10 (Continued)

Legend

Proprietary Funds		Governmental Fund; General Capital Assets and General Long-Term Liabilities Accounts	
CA	Current Assets	FA	Financial Assets
CL	Current Liabilities	RL	Related Liabilities
LTL	Long-Term Liabilities	FB	Fund Balance
NA	Net Asset	GCA	General Capital Assets
NCA	Noncurrent Assets (including capital assets)	GLTL	General Long-Term Liabilities
		NA	Net Assets

Difficulty: 3

Learning Objective: 4

AACSB: Analytical Skills

SOLUTIONS TO PROBLEMS

Problem 2-1 (a)

Analysis of Transactions for General Government Activities

Governmental Funds						General Capital Assets and General Long-Term Liabilities Accounts				
Fund	FA	–	RL	=	FB	GCA	–	GLTL	=	NA
<i>E. GF</i>	<i>8,000[†]</i>				<i>8,000[†]</i>					
1. GF			\$75,000		(\$75,000)					
2. CPF	\$9,000,000				9,000,000			\$9,000,000		(\$9,000,000)
3. CPF	(5,000,000)				(5,000,000)	\$5,000,000				5,000,000
4. GF			60,000		(60,000)	60,000				60,000
4* GF			1,200**		(1,200)					
5. GF	(8,000,000)				(8,000,000)					
6.								3,000,000		(3,000,000)
7. DSF	(11,000,000)				(11,000,000)			(10,000,000)		10,000,000
8. GF	1,500				1,500	(1,000)				(1,000)

[†]The text (page 64) shows parenthesis around this number. It is an increase, therefore should not be in parenthesis.

*Year-end entry.

**(\$60,000 x .06 x 4/12)

Legend

FA	Financial Assets	GF	General Fund
RL	Related Liabilities	CPF	Capital Projects Fund
FB	Fund Balance	DSF	Debt Service Fund
GCA	General Capital Assets	GLTL	General Long-Term Liabilities
NA	Net Assets		

Analysis of Transactions for Business-Type Activities

Airport Enterprise Fund

	CA	+	NCA	–	CL	–	LTL	=	NA
5.	\$8,000,000								\$8,000,000

Problem 2-1 (b)

1. Expenditures of \$75,000 reported in General Fund.
2. Other Financing Sources—Bond Proceeds of \$9,000,000 reported in Capital Projects Fund.
3. Expenditures of \$5,000,000 reported in Capital Projects Fund.
4. Expenditures of \$60,000 reported in General Fund.
At year-end, expenditures of \$1,200 interest reported in General Fund.
5. Other Financing Uses (Transfer to Other Fund) of \$8,000,000 reported in General Fund.
Transfers from Other Fund of \$8,000,000 reported in Airport Enterprise Fund.
6. No operating statements are prepared for GCA-GLTL accounts.
7. Expenditures of \$11,000,000 reported in Debt Service Fund.
8. Other Financing Sources of \$1,500 reported in General Fund.

Enterprise Fund Legend

CA	Current Assets
CL	Current Liabilities
LTL	Long-Term Liabilities
NA	Net Assets
NCA	Noncurrent Assets (including capital assets)

Difficulty: 2

Learning Objective: 4

AACSB: Analytical Skills

Problem 2-2 (a)

Governmental Funds

	Fund	Financial Assets	-	Related Liabilities	=	Fund Balance
1.	GF	(\$500,000)				(\$500,000)
2.	SRF	(38,000)				(38,000)
4a.	GF	50,000		50,000		
4b.*	GF			2,500		(2,500)
5.	CPF	15,000,000				15,000,000
6.	CPF	(185,000)				(185,000)
7.	CPF	(14,715,000)				(14,715,000)
8a.**	CPF	(100,000)				(100,000)
8b.	DSF	100,000				100,000
9a.	GF	(1,500,000)				(1,500,000)
9b.	DSF	1,500,000				1,500,000
10.***	DSF	(1,200,000)				(1,200,000)
11.****	GF	(53,750)		(52,500)		(1,250)
13.	GF	(100,000)		10,000		(110,000)
14.	GF	4,000				4,000
15.	DSF	(110,000)				(110,000)

* \$50,000 x .10 x 6/12

** \$15,000,000 - \$185,000 - \$14,715,000

*** \$15,000,000 x .08 x 1

**** \$50,000 x .10 x 3/12 = \$1,250

General Capital Assets (GCA) and General Long-Term Liabilities (GLTL) accounts

	GCA	-	GLTL	=	Net Assets
2.	\$38,000				\$38,000
5.			15,000,000		(15,000,000)
6.	185,000				185,000
7.	14,715,000				14,715,000
14.*	(9,000)				(9,000)
15.			(100,000)		100,000

* \$15,000 less accumulated depreciation of (\$15,000 - \$7,000) x 3/4

Proprietary Funds

	Fund	Current Assets (CA)	+	Non-CA	-	Current Liabilities	-	Long-term Liabilities	=	Net Assets
3a.	EF	\$5,000,000						\$5,000,000		
3b.*	EF					\$75,000				(\$75,000)
12.	EF	1,000,000								1,000,000
13.	EF	110,000								110,000

* \$5,000,000 x .06 x 3/12

Problem 2-2 (b)

REPORTING in the Statement of Revenues, Expenditures, and Changes in Fund Balance of the:

1. GF—Expenditures, \$500,000
2. SRF—Expenditures, \$38,000
- 4b. GF—Expenditures, \$2,500
5. CPF—Other financing sources—Bonds \$15,000,000
6. CPF—Expenditures, \$185,000
7. CPF—Expenditures, \$14,715,000
- 8a. CPF—Other financing uses—Transfer to other funds, \$100,000
- 8b. DSF—Other financing sources—Transfer from other funds, \$100,000
- 9a. GF—Other financing uses—Transfer to other funds, \$1,500,000
- 9b. DSF—Other financing sources—Transfer from other funds, \$1,500,000
10. DSF—Expenditures, \$1,200,000
11. GF—Expenditures, \$1,250
13. GF—Expenditures, \$110,000
14. GF—Other financing sources of \$4,000
15. DSF—Expenditures, \$110,000

REPORTING in the Statement of Revenues, Expenses, and Changes in Net Assets

- 3b. Nonoperating expense (Interest expense), \$75,000
12. Operating revenues, \$1,000,000
13. Operating revenues, \$110,000

Difficulty: 3

Learning Objective: 4, 7

AACSB: Analytical Skills

Problem 2-3 (1)**Governmental Funds**

	Fund	Financial Assets	-	Related Liabilities	=	Fund Balance
1.	CPF	\$4,000,000				\$4,000,000
2.	CPF	(2,200,000)		600,000		(2,800,000)
3a.	GF	(120,000)				(120,000)
3b.	DSF	120,000				120,000
4.	GF	(315,000)				(315,000)

General Capital Assets (GCA) and General Long-Term Liabilities (GLTL) accounts

	GCA	-	GLTL	=	Net Assets
1.			\$4,000,000		(\$4,000,000)
2.	\$2,800,000				2,800,000
4.			(300,000)		300,000

Proprietary Funds

	Fund	Current Assets (CA)	+	Non-CA	-	Current Liabilities	-	Long-term Liabilities	=	Net Assets
5a.	EF	\$14,000,000						\$14,000,000		
5b.*	EF					\$210,000				(\$210,000)

* \$14,000,000 x .06 x 3/12

Problem 2-3 (2)

REPORTING in the Statement of Revenues, Expenditures, and Changes in Fund Balance of the:

1. CPF—Other financing sources—Bonds , \$4,000,000
2. CPF—Expenditures, \$2,800,000
- 3a. GF—Other financing uses—Transfer to other funds, \$120,000
- 3b. DSF—Other financing sources—Transfer from other funds, \$120,000
4. GF—Expenditures, \$315,000

REPORTING in the Statement of Revenues, Expenses, and Changes in Net Assets

- 5b. Nonoperating expense (Interest expense), \$210,000

Difficulty: 2

Learning Objective: 4, 7

AACSB: Analytical Skills

Problem 2-4 (a)

Governmental Funds

	Fund	Financial Assets	-	Related Liabilities	=	Fund Balance
1.*	GF	(\$3,000,000)		(\$18,000)		(\$2,982,000)
2.**	CPF	10,000,000				10,000,000
3.	No entry required.					
4.	CPF	(5,000,000)		346,500		(5,346,500)
5a.***	GF	(1,400,000)				(1,400,000)
5b.	DSF	1,400,000				1,400,000
5c.****	DSF	(1,400,000)				(1,400,000)
6.	GF	(500,000)				(500,000)
7.	GF	1,500,000				1,500,000
8.	GF	15,000				15,000

* Related Liabilities: $\$50,000 - \$32,000 = \$18,000$ decrease during year

** Though not required by the problem, some students may analyze the first (mid-year) semiannual interest payment on these bonds. This payment decrease DSF financial assets and fund balance by $(\$10,000,000 \times .08 \times .5, \text{ or } \$400,000)$. Interest expenditures of \$400,000 would be reported in the DSF operating statement.

*** Interest Paid: $\$10,000,000 \times .08 \times 1/2 = \$400,000$

**** Principal $(\$1,000,000) + \text{Interest } (\$400,000)$

General Capital Assets (GCA) and General Long-Term Liabilities (GLTL) accounts

	GCA	-	GLTL	=	Net Assets
2.			\$10,000,000		(\$10,000,000)
4.	\$5,346,500				5,346,500
5c.			(1,000,000)		1,000,000
6.			7,000,000		(7,000,000)
7.*	(500,000)				(500,000)
8.	(20,000)				(20,000)

* The problem does not state explicitly that the land sold is a general capital asset. If not, it likely would be land of an enterprise activity in which case neither the GF nor the GCA are affected. As an EF transaction, the analysis would be CA (+ \$1,500,000), NCA (-\$500,000), and NA (+\$1,000,000). The \$1,000,000 increase in net assets would be reported in the EF operating statement as a nonoperating gain unless determined to qualify as a special item.

Problem 2-4 (b)

REPORTING in the Statement of Revenues, Expenditures, and Changes in Fund Balance of the:

1. GF—Expenditures, \$2,982,000
2. CPF—Other financing sources—Bonds, \$10,000,000
3. No effect.
4. CPF—Expenditures, \$5,346,500
- 5a. GF—Other financing uses—Transfer to other funds, \$1,400,000
- 5b. DSF—Other financing sources—Transfer from other funds, \$1,400,000
- 5c. DSF—Expenditures, \$1,400,000
6. GF—Expenditures, \$500,000
7. GF—Other financing sources of \$1,500,000 unless it qualifies as a special item
8. GF—Other financing sources of \$15,000

Difficulty: 2

Learning Objective: 4, 7

AACSB: Analytical Skills

Problem 2-5 (a)

Though the statement presented, with minor modification, would be appropriate to present the sources and uses of the financial resources of a governmental (expendable) fund such as the General Fund, the operation of this bus line service is a long-term “business-type” undertaking. All assets, liabilities, and equity associated with the bus line should be accounted for through an Enterprise Fund. All expenses (not expenditures)—including depreciation, inventories consumed, and interest—should be reported in order for the operating results of such an activity to be assessed validly.

While the General Fund-based operating statement shown reports a “net profit,” an accrual basis statement would reflect different information once depreciation expense, inventory consumption and interest expense are included.

Problem 2-5 (b)

Mobiline County Enterprise Fund Bus Line
Statement of Revenues and Expenses
For the Nine Month Period Ending October 31, 20X3

Operating Revenues:			
Passenger fares—routine route service.....	\$77,000		
Special charter fees (1)	<u>4,000</u>	\$81,000	
Operating Expenses:			
Salaries (superintendent, drivers, mechanics).....	52,000		
Depreciation -			
Buses (2)	\$21,000		
Building (3).....	6,000		
Shop equipment (4)	<u>1,125</u>	28,125	
Fuel and lubrication	12,000		
Tires and parts (5).....	13,000		
Contracted repairs and maintenance	8,000		
Miscellaneous	<u>1,000</u>	<u>114,125</u>	
Operating Loss			(33,125)
Nonoperating Revenues and Expenses:			
Interest expense (6)		<u>13,500</u>	
Decrease in Net Assets.....			(46,625)
Net assets, February 1, 20X3.....			<u> </u>
Net assets, October 31, 20X3.....			<u><u>\$(46,625)</u></u>

Computations:

- (1) $\$3,000 \text{ collected} + \$1,000 \text{ accrued} = \$4,000$
- (2) $\frac{3}{4}(\$140,000/5) = \$21,000$
- (3) $\frac{3}{4}(\$80,000/10) = \$6,000$
- (4) $\frac{3}{4}(\$15,000/10) = \$1,125$
- (5) $\$15,000 \text{ acquired } 2/1/X3 + \$1,000 \text{ purchased} - \$3,000 \text{ on hand} = \$13,000$
- (6) $.06(10 \times \$30,000) \frac{3}{4} = \$13,500$

Difficulty: 3

Learning Objective: 3, 4, 7

AACSB: Reflective thinking

Problem 2-6 (a)

		<u>Cash Basis</u>		<u>Modified Accrual Basis</u>		<u>Accrual Basis</u>	
		<u>Dr.</u>	<u>Cr.</u>	<u>Dr.</u>	<u>Cr.</u>	<u>Dr.</u>	<u>Cr.</u>
1-1	Accounts Receivable			4,000		4,000	
	Revenues				4,000		4,000
1-3	Expenditures			500			
	Inventory of Supplies					500	
	Accounts Payable				500		500
1-5	Expenditures			30,000			
	Truck					30,000	
	Accounts Payable				30,000		30,000
1-11	Cash	2,000		2,000		2,000	
	Accounts Receivable				2,000		2,000
	Revenues		2,000				
1-15	Expenditures			3,000			
	Expenses					3,000	
	Wages Payable				3,000		3,000
1-17	Expenditures	500					
	Accounts Payable			500		500	
	Cash		500		500		500
1-21	Expenditures	3,000					
	Wages Payable			3,000		3,000	
	Cash		3,000		3,000		3,000
2-3	Expenditures	30,000					
	Accounts Payable			30,000		30,000	
	Cash		30,000		30,000		30,000
2-5	Expenses					200	
	Inventory of Supplies						200
2-6	Depreciation Expense					500	
	Accumulated Depreciation						500

Problem 2-6 (b)

The modified accrual and accrual bases are similar in that accruable revenue is recognized prior to cash receipt. They are also similar in that liabilities are recognized when incurred. However, the accrual basis measures expenses (costs expired) while the modified accrual basis measures expenditures (net financial assets expended for current operations, capital outlay, long-term debt principal retirement, and interest).

Difficulty: 2
Learning Objective: 3, 4
AACSB: Reflective thinking

SOLUTION TO CASES

Case 2-1

1. Special Revenue Fund
2. Internal Service Fund
3. Debt Service Fund
4. Enterprise Fund
5. Capital Projects Fund
6. Capital Projects Fund
7. Capital Projects Fund
8. Internal Service Fund
9. Agency Fund
10. Internal Service Fund
11. Enterprise Fund
12. Pension Trust Fund
13. Special Revenue Fund

Students discussion and questions may demonstrate that they have made good progress on mastering the fund structure even when an answer is incorrect. For instance, a student who notes that item 10 does not explicitly state the charges are intended to reimburse the costs of services provided might give a response other than an Internal Service Fund. Raising this point reflects that the student has learned the Internal Service Fund definition. However, the fact that it is named a revolving fund suggests the “capital maintenance” notion, which is a primary consequence of cost-reimbursement based charges.

Difficulty: 2
Learning Objective: 7
AACSB: Reflective thinking

Case 2-2 (a)

Governmental Funds

	Fund	Financial Assets	-	Related Liabilities	=	Fund Balance
1.	GF	(\$67,000,000)		\$1,240,000		(\$68,240,000)
2.*	GF	133,110,000		2,610,000		130,500,000
3.	CPF	121,750,000				121,750,000
4.	CPF	(68,818,000)		12,400,000		(81,218,000)
5.	GF	(17,600,000)				(17,600,000)
6a.**	SRF	(690,000)				(690,000)
6b.***	SRF	690,000				690,000
7a.	GF	(6,077,000)				(6,077,000)
7b.	DSF	6,077,000				6,077,000
8.	DSF	(7,400,000)				(7,400,000)

* Financial Assets: Taxes Receivable (\$135,000,000) less Allowance for Uncollectible Taxes (\$1,890,000)

Revenues: Financial Assets (\$133,110,000) less Deferred Revenues (\$2,610,000)

** To record expenditures by school district for deaf and hearing-impaired program.

*** To record grant proceeds from federal government.

General Capital Assets (GCA) and General Long-Term Liabilities (GLTL) accounts

	GCA	-	GLTL	=	Net Assets
3.			\$121,750,000		(\$121,750,000)
4.	\$81,218,000				81,218,000
8.			(1,400,000)		1,400,000

Case 2-2 (b)

REPORTING in the Statement of Revenues, Expenditures, and Changes in Fund Balance of the:

1. GF—Expenditures, \$68,240,000
2. GF—Revenues, \$130,500,000
3. CPF—Other financing sources—Bonds, \$121,750,000
4. GF—Expenditures, \$81,218,000
5. GF—Expenditures, \$17,600,000
- 6a. SRF—Expenditures, \$690,000
- 6b. SRF—Revenues, \$690,000
- 7a. GF—Other financing uses—Transfer to other funds, \$6,077,000
- 7b. DSF—Other financing sources—Transfer from other funds, \$6,077,000
8. DSF—Expenditures, \$7,400,000

Difficulty: 2

Learning Objective: 4, 6, 7

AACSB: Reflective thinking