Introductory Governmental Accounting
Part I
For State and Local Governments
FINANCIAL MANAGEMENT CERTIFICATE
TRAINING PROGRAM

INTRODUCTORY GOVERNMENTAL ACCOUNTING
PART I

COURSE OBJECTIVES

Upon completion of this course, the participant should be able to:

- Understand the basic accounting equation and how certain transactions affect the accounting equation.
- Recognize the elements of certain financial statements including the balance sheet/statement of net assets and the operating statements.
- Understand the relationship between the balance sheet/statement of net assets and the operating statements.
- Use double entry accounting to record financial transactions.
- Record financial transactions using the modified accrual basis of accounting.
- Record financial transactions in journals and post ledgers.

This course provides an introduction to basic governmental accounting concepts and systems. The principles and procedures of sound record keeping and the maintenance of accurate financial data are examined in detail. The course assumes little or no experience with governmental or commercial accounting. The course concludes with a case study.
This class is an introductory course in governmental accounting. It is designed for people with little or no accounting experience. For those of you who are currently accounting paraprofessionals, the importance of your role or routine as it relates to the big picture is often difficult to perceive. We hope this class helps clarify that perception and introduce you to what are known as generally accepted accounting principles (GAAP).

The objective and ultimate goal of governmental accounting is to produce financial statements that provide accountability to the public as to how their tax dollars were spent. Therefore, we will start this class by introducing you to the financial statements published at the conclusion of the state’s or your local government’s fiscal year. Defining the financial statements clarifies for the student and practicing professional the goals and objectives all of us employed in governmental accounting are seeking to achieve.

Once we have our goal clearly focused in our minds, we can begin to explore the details and lay down the framework on our journey to understanding generally accepted accounting principles. You will work hard in this class, however we trust it will be an enjoyable experience as the reward for your labors will be a greater understanding of governmental accounting.

Good luck!

University of Georgia
Carl Vinson Institute of Government
Financial Management Programs
Governmental Training, Education and Development

The Carl Vinson Institute of Government
University of Georgia
© 2010 by the Carl Vinson Institute of Government
All rights reserved.
Chapter 1
BASIC ACCOUNTING THEORY
At the Fund Level

OBJECTIVES

This chapter provides the basics of accounting theory. It is essential that each participant understand the chapter’s contents. After completing this chapter, you should be able to:

- Understand the terms economic condition and financial position.
- Understand the basic accounting equation.
- Identify asset and liability accounts.
- Understand the relationship of the balance sheet/statement of net assets to the operating statement.
- Explain how revenues and expenditures/expenses affect fund equity.

INTRODUCTION

The Governmental Accounting Standards Board (GASB), an organization responsible for setting accounting standards for state and local governments, has decreed that governments should prepare financial statements that communicate the entity’s financial position and economic condition. The difference in these two terms is significant. To satisfy the Board’s requirement, different types of financial statements are required. Before we can explain the content of the statements it would be helpful to know what the terms mean.

Financial position – Conceptually, financial position represents a measure of a government’s individual funds ability to meet its obligations as they become due. Financial statements demonstrate this by comparing expendable financial resources with short-term obligations.

Economic condition – This is a conceptual measure of an organization’s overall wealth. Financial statements demonstrate this by comparing the organization’s total resources and total obligations.
In simpler terms, financial position is an indicator of whether or not you’ll be able to pay your bills, whereas economic condition is a measure of wealth. These terms are not necessarily analogous. An individual may accumulate tremendous wealth, however if their wealth is not in the form of cash or cash equivalents they may not have two dimes to rub together.

In this course we will only address the accounting and financial reporting requirements that exist at the fund level. Discussion of government-wide presentations will be deferred to Intermediate Governmental Accounting.

**NATURE AND PURPOSE**

The ultimate goal of accounting is to demonstrate accountability. Accountability is communicated through the preparation of various types of financial statements. At the fund level of reporting the basic financial statements present information concerning:

- Where a fund stands financially on a certain date, and
- The results of operations (i.e., revenues and expenditures/expenses) for a fund during a period of time ending on that date.

Two types of financial statements used to communicate this information are:

- A balance sheet or statement of net assets - a financial statement that shows where a fund stands financially on a certain date (financial position or economic condition).
- An operating statement - a financial statement reflecting changes in a fund’s equity and results of operations during a period ending on a certain date.

**BALANCE SHEET/STATEMENT OF NET ASSETS**

The financial information presented on the balance sheet/statement of net assets includes:

- What a government owns.
- What a government owes.
- The difference between the two which is a measure of the net worth or equity.
Balance sheets/statements of net assets are presented as of a particular date (e.g., the year ended, June 30). The elements of statements of position and their relationship to each other are mathematically summarized in the following basic accounting equation:

\[ \text{OWNS} - \text{OWES} = \text{NET WORTH} \]

In accounting terminology, assets are things that a government owns, liabilities are things that it owes, and equity is their net worth. By applying this terminology to the accounting equation, we can restate it as follows:

\[ \text{OWNS} - \text{OWES} = \text{NET WORTH} \]
\[ \text{or} \]
\[ \text{ASSETS} - \text{LIABILITIES} = \text{EQUITY} \]

**The Accounting Equation** - To illustrate the accounting equation, assume a government has assets valued at $9,000 and liabilities of $6,000. What is its equity? Since assets (i.e., what is owned) minus liabilities (i.e., what is owed) equals equity, the equity in this example is $3,000:

\[ \text{ASSETS} - \text{LIABILITIES} = \text{EQUITY} \]
\[ \$9,000 - \$6,000 = \$3,000 \]

To expand on the equation, assume that the same government has $240,000 in the bank (i.e., an asset) at June 30. However, it owes salaries to employees (i.e., a liability) of $165,000. What is its equity? Since equity equals assets minus liabilities, then:

\[ \text{ASSETS} - \text{LIABILITIES} = \text{EQUITY} \]
\[ \$240,000 - \$165,000 = \text{EQUITY} \]
\[ \$75,000 = \text{EQUITY} \]
If we know the value of liabilities and equity, can we figure out the value of the assets?

The preceding example states that “assets minus liabilities equal equity.” Using the amounts from the preceding example for equity and liabilities, we can determine the amount of the assets as follows:

\[
\text{ASSETS} - \text{LIABILITIES} = \text{EQUITY}
\]

\[
? - \$165,000 = \$75,000
\]

Using simple algebra, we may change the accounting equation by moving the "liabilities" account from the left side of the equation to the right side of the equation and changing the sign. In algebra, when a number is moved from one side of the accounting equation to the other side of the equation, the sign (i.e., plus or minus sign) for the moved number changes. Therefore, the “liabilities” account changes from minus to plus:

\[
\text{ASSETS} = + \text{LIABILITIES} + \text{EQUITY}
\]

\[
\text{ASSETS} = + \$165,000 + \$75,000
\]

\[
\text{ASSETS} = \$240,000
\]

To summarize, when you know two of the three elements of the equation, you can always determine the third element by simple addition and subtraction.

We have now stated the basic accounting equation two ways:

1. \[
\text{ASSETS} - \text{LIABILITIES} = \text{EQUITY}
\]
   \[
   \$240,000 - \$165,000 = \$75,000
   \]
   \[
   \$75,000 = \$75,000
   \]

2. \[
\text{ASSETS} = + \text{LIABILITIES} + \text{EQUITY}
\]
   \[
   \$240,000 = + \$165,000 + \$75,000
   \]
   \[
   \$240,000 = \$240,000
   \]
The accounting equation can change (i.e., added to or subtracted from) if additions and subtractions to both sides of the equation are in the same amount. Remembering that the equation must always be equal or balanced on both sides of the “equals sign” is important.

There are instances when the total liabilities may be greater than the total assets. In these instances, a negative equity (not a good thing), known as a deficit, occurs. For example:

**ASSETS - LIABILITIES = EQUITY**

\[
\$240,000 - \$255,000 = -$15,000
\]

**Classification of Assets and Liabilities** – Assets are further classified according to their degree of “liquidity” (i.e., how soon the asset can be converted to cash or be consumed).

Assets (things we own) are classified into two categories:

- Current assets
- Capital assets

Current assets are commonly defined as assets that are cash or likely to be converted to cash or used up within the next year.

Examples of current assets include:

- Cash
- Investments
- Receivables
- Inventories

Capital assets or noncurrent assets are longer lived assets. Examples include:

- Land
- Buildings
- Equipment
Similarly, liabilities (things we owe for) are also classified into two categories:

- Current liabilities
- Noncurrent liabilities

Current liabilities are those that are payable within one year from the balance sheet date and noncurrent liabilities are the balance of the liabilities.

Examples of current liabilities include:

- Accounts payable
- Contracts payable
- Accrued salaries payable
- Payroll deductions payable

Examples of noncurrent liabilities might include:

- Bonds payable
- Capital leases payable

Certain liabilities may be classified as both current and noncurrent. For example, part of a liability (e.g., bonds payable) may be due and payable (i.e., a current liability) and the balance due over the next ten years (i.e., a noncurrent liability).

We classify the difference between current assets and current liabilities as **net current assets**. Net Current Assets is a measure of a fund’s liquidity or financial position. The following equation summarizes these elements of a government’s liquid financial position and their relationships to each other:

\[
\text{CURRENT ASSETS} - \text{CURRENT LIABILITIES} = \text{NET CURRENT ASSETS}
\]

Net current assets represent how much is available for additional spending or budgeting after we pay all our current bills.
FUND ACCOUNTING

Although fund accounting is presented in a separate chapter in this book, an introduction to the subject is needed here to better understand the balance of this chapter. Often different functions of a state’s or local government’s activities require different controls for management purposes. To satisfy this need, generally accepted accounting principles (GAAP) establish separate accounting entities that we call funds to account for resources affected by different types of spending restrictions. Fund accounting is this process.

States and local governments organize their accounting records along the lines of funds, each of which is considered a separate entity with a separate set of self-balancing accounts and financial statements. For example, capital construction may be accounted for in one fund, and tax-supported operational programs in another.

GAAP classifies all individual funds broadly into three categories: governmental, proprietary, and fiduciary. However, for purposes of this chapter, we introduce the governmental and proprietary funds now. Chapter 5 includes a detailed discussion of fund accounting.

The Governmental Category of Funds

Governmental funds are those funds through which most government functions are financed. An example of a governmental fund is the general fund. Generally, governmental funds report only current assets and current liabilities on their balance sheets and primary operating statement reports only revenues and expenditures. Equity for governmental funds consists of "fund balance" accounts.

Fund balance represents a measure of "available spendable financial resources" (i.e., net current assets or what is available to spend).

Individual balance sheets may be presented with financial data only for the latest fiscal period, or at the discretion of the preparer, comparative statements which display
information for each of the latest two periods may be prepared. Exhibit 1-1 illustrates a comparative balance sheet for a governmental fund.

**Exhibit 1-1**

<table>
<thead>
<tr>
<th>McGraw-Hill Education Fund</th>
<th>GAAP Education Fund</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Balance Sheet</strong></td>
<td><strong>Balance Sheet</strong></td>
</tr>
<tr>
<td><strong>June 30, 20X1</strong></td>
<td><strong>June 30, 20X0</strong></td>
</tr>
<tr>
<td><strong>Assets:</strong></td>
<td></td>
</tr>
<tr>
<td>Cash</td>
<td>$ 102,371</td>
</tr>
<tr>
<td>Investments</td>
<td>284,515</td>
</tr>
<tr>
<td>Interest Receivable</td>
<td>1,592</td>
</tr>
<tr>
<td>Due from other funds</td>
<td>593</td>
</tr>
<tr>
<td><strong>Total Assets</strong></td>
<td><strong>$389,071</strong></td>
</tr>
<tr>
<td><strong>Liabilities:</strong></td>
<td></td>
</tr>
<tr>
<td>Salaries payable</td>
<td>$15,934</td>
</tr>
<tr>
<td>Accounts payable</td>
<td>104</td>
</tr>
<tr>
<td>Contracts payable</td>
<td>18,239</td>
</tr>
<tr>
<td><strong>Total Liabilities</strong></td>
<td><strong>34,277</strong></td>
</tr>
<tr>
<td><strong>Fund Balance</strong></td>
<td>354,794</td>
</tr>
<tr>
<td><strong>Total Liabilities and Fund Balance</strong></td>
<td><strong>$389,071</strong></td>
</tr>
</tbody>
</table>

**The Proprietary Category of Funds**

Proprietary funds are used to account for activities that are financed and operated similarly to private business enterprises (e.g., the local grocery store or hotel) and/or where the intent of the legislature is that they finance the activities primarily from user charges (e.g., a port authority fund, water and sewer). Therefore, proprietary funds report **all** assets and **all** liabilities, whether current

```PROPRIETARY FUNDS
STATEMENT OF NET ASSETS GENERALLY REPORTS TOTAL ASSETS AND TOTAL LIABILITIES.
EQUITY CONSISTS OF NET ASSETS.
```
or non-current, on their statement of net assets. Exhibit 1-2 illustrates a statement of net assets for a proprietary fund.

### Exhibit 1-2

**STATEMENT OF NET ASSETS**

**PROPRIETARY FUNDS**

*December 31, 20X5*

<table>
<thead>
<tr>
<th>Assets</th>
<th>Enterprise Funds</th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash and cash equivalents</td>
<td>$ 64,170</td>
<td>$ 13,778</td>
<td>$ 77,948</td>
<td></td>
</tr>
<tr>
<td>Accounts receivable, net</td>
<td>60</td>
<td>-</td>
<td>60</td>
<td></td>
</tr>
<tr>
<td>Due from other funds</td>
<td>44,383</td>
<td>3,775</td>
<td>48,158</td>
<td></td>
</tr>
<tr>
<td>Inventories</td>
<td>20,330</td>
<td>-</td>
<td>20,330</td>
<td></td>
</tr>
<tr>
<td><strong>Total Current Assets</strong></td>
<td><strong>128,943</strong></td>
<td><strong>17,553</strong></td>
<td><strong>146,496</strong></td>
<td></td>
</tr>
</tbody>
</table>

**Long-term Assets:**

**Capital Assets**

| Land and improvements      | 1,700,876        | -       | 1,700,876|
| Infrastructure             | -                | 9,720   | 9,720    |
| Construction in progress   | 15,470           | -       | 15,470   |
| Buildings                  | 45,986           | 1,420,480| 1,466,466|
| Equipment and furniture    | 260,066          | 249,392 | 509,458  |
| Less accumulated depreciation | (270,268)      | (569,451)| (839,719)|
| **Total Non-Current Assets** | **1,752,130**   | **1,110,141**| **2,862,271**|

**Total Assets**

<table>
<thead>
<tr>
<th>Golf Course</th>
<th>Meeks Park</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>$ 1,881,073</td>
<td>$ 1,127,694</td>
<td>$ 3,008,767</td>
</tr>
</tbody>
</table>

**Liabilities and Net Assets**

**Liabilities:**

**Current Liabilities:**

| Accounts payable          | $ 4,823       | -       | $ 4,823  |
| Due to other funds        | 28,502        | 38,703  | 67,205   |
| Other accrued expenses    | 1,867         | -       | 1,867    |
| Capital lease, due within one year | 6,205 | 3,163 | 9,368 |
| **Total Current Liabilities** | **41,397** | **41,866**| **83,263**|

**Long-term Liabilities:**

| Capital lease, net of current portion | 14,426 | 6,295 | 20,721 |

**Total Liabilities**

<table>
<thead>
<tr>
<th>Golf Course</th>
<th>Meeks Park</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>55,823</td>
<td>48,161</td>
<td>103,984</td>
</tr>
</tbody>
</table>

**Net Assets:**

| Invested in capital assets, net of related debt | 1,731,499 | 1,100,683 | 2,832,182 |
| Unrestricted                                      | 93,751    | (21,150)  | 72,601    |
| **Total Net Assets**                             | **1,825,250** | **1,079,533**| **2,904,783**|

**Total Liabilities and Net Assets**

<table>
<thead>
<tr>
<th>Golf Course</th>
<th>Meeks Park</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>$ 1,881,073</td>
<td>$ 1,127,694</td>
<td>$ 3,008,767</td>
</tr>
</tbody>
</table>
OPERATING STATEMENTS

Operating statements are financial statements reflecting changes in the equity of funds. Operating statements can be measured and reported in several different ways.

We call increases and decreases in cash “receipts and disbursements.” We call an operating statement that summarizes cash flow during a period, therefore, a statement of cash receipts and disbursements.

Revenues and expenditures are increases and decreases in net current assets/fund balance (i.e., the difference between current assets and current liabilities). Therefore, a statement of revenues and expenditures summarizes a fund’s sources and uses of its net current assets. Since net current assets are considered a measure of liquid or "expendable" resources, this operating statement presents a summary of the spending and financing activities of a fund during a fiscal period.

Revenues and expenses are increases and decreases in net assets. The principle way in which expenses differ from expenditures is that expenses include the cost of using capital assets over time (i.e., a charge for depreciation) although the expenditures for those costs (i.e., when they purchase the capital assets) may occur in a different accounting period (we explain the difference between expenses and expenditures in detail in Chapter 6). Therefore, a statement of revenues and expenses summarizes the effect a fund’s operations have had on its net assets during a fiscal period.
The Governmental Category of Funds

Current year revenues always increase fund balance and current year expenditures always decrease fund balance at year-end as illustrated in the following equation:

\[
\begin{align*}
\text{FUND BALANCE} & \quad \text{+ REVENUES} \quad \text{- EXPENDITURES} \quad = \quad \text{FUND BALANCE} \\
\text{(At start of year)} & \quad \text{(During the year)} \quad \text{(During the year)} & \quad \text{(At end of year)} \\
$45,000 & \quad + \quad $185,000 \quad - \quad $190,000 \quad = \quad $40,000
\end{align*}
\]

In other words, the current year’s revenues are added to the beginning fund balance that results in the amount of resources available for expenditures.

- Beginning fund balance: $45,000
- Current year’s revenues: $185,000
- Total resources available for expenditures: $230,000

Then we reduce this amount by the current year’s expenditures which results in the fund balance at the end of the year.

- Beginning fund balance: $45,000
- Current year’s revenues: $185,000
- Total resources available for expenditures: $230,000
- Current year’s expenditures: $(190,000)
- Ending fund balance: $(40,000)

We expand the above equation to illustrate the relationship between an operating statement (i.e., a statement of revenues and expenditures) and a balance sheet as indicated in the following accounting equation:

\[
\begin{align*}
\text{FUND BALANCE} & \quad \text{+ REVENUES} \quad \text{- EXPENDITURES} \quad = \quad \text{FUND CURRENT BALANCE} \quad = \quad \text{FUND CURRENT ASSETS} \quad - \quad \text{LIABILITIES} \\
\text{(At start of year)} & \quad \text{(During the year)} \quad \text{(During the year)} & \quad \text{(At end of year)} \quad \text{(At end of year)} \quad \text{(At end of year)} \\
$45,000 & \quad + \quad $185,000 \quad - \quad $190,000 \quad = \quad $40,000 \quad = \quad $160,000 \quad - \quad $120,000
\end{align*}
\]

The first four columns are included on the operating statement and the last three on the balance sheet.
An example of a limited governmental fund operating statement is included below in Exhibit 1-3.

### Exhibit 1-3

#### STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES

For the Year Ended June 30, 20X5

<table>
<thead>
<tr>
<th></th>
<th>General Fund</th>
<th>Hotel &amp; Entertainment Bonds</th>
<th>Multi-Purpose Improvement Bonds</th>
<th>Other Governmental Funds</th>
<th>Total Governmental Funds</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>REVENUES</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Property taxes</td>
<td>$10,125,000</td>
<td>$2,750,000</td>
<td>$12,875,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sales taxes</td>
<td>2,410,000</td>
<td>842,000</td>
<td>3,252,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other taxes</td>
<td>922,000</td>
<td>1,615,000</td>
<td>2,867,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fees</td>
<td>2,700,000</td>
<td>496,000</td>
<td>3,196,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Intergov. Grants</td>
<td>907,000</td>
<td></td>
<td>1,090,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Investment income</td>
<td>347,000</td>
<td>103,000</td>
<td>730,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other</td>
<td>1,565,000</td>
<td></td>
<td>1,532,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Total Revenues</strong></td>
<td>18,776,000</td>
<td>1,718,000</td>
<td>25,542,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>EXPENDITURES</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Current operating:</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>General government</td>
<td>1,610,000</td>
<td>295,000</td>
<td>1,905,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Public safety</td>
<td>6,950,000</td>
<td>877,000</td>
<td>7,827,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Streets</td>
<td>2,175,000</td>
<td>293,000</td>
<td>2,468,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Recreation and parks</td>
<td>647,000</td>
<td>242,000</td>
<td>1,188,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Health and welfare</td>
<td>2,842,000</td>
<td>148,000</td>
<td>2,990,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Education</td>
<td>6,500,000</td>
<td></td>
<td>6,500,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Debt service:</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Principal</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Interest</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Capital Expenditures</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Total Expenditures</strong></td>
<td>20,724,000</td>
<td>299,000</td>
<td>4,250,000</td>
<td>6,440,000</td>
<td>31,713,000</td>
</tr>
<tr>
<td>Excess (deficiency) of revenues over expenditures</td>
<td>(1,948,000)</td>
<td>(1,419,000)</td>
<td>(4,089,000)</td>
<td>(1,553,000)</td>
<td>(6,171,000)</td>
</tr>
<tr>
<td><strong>OTHER FINANCING SOURCES (UES)</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Issuance of Long-term debt</td>
<td></td>
<td>4,500,000</td>
<td>1,200,000</td>
<td>5,700,000</td>
<td></td>
</tr>
<tr>
<td>Transfers in</td>
<td>45,000</td>
<td></td>
<td>715,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Transfers out</td>
<td>(547,000)</td>
<td>(115,000)</td>
<td>(695,000)</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Total Other Financing Sources And Uses</strong></td>
<td>(502,000)</td>
<td>(115,000)</td>
<td>4,500,000</td>
<td>1,837,000</td>
<td>5,720,000</td>
</tr>
<tr>
<td><strong>SPECIAL ITEMS</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Proceeds from sale of real estate</td>
<td>1,890,000</td>
<td></td>
<td></td>
<td></td>
<td>1,890,000</td>
</tr>
<tr>
<td><strong>Net Change in Fund Balances</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>1,439,000</td>
</tr>
<tr>
<td>Fund Balances—Beginning</td>
<td>8,325,000</td>
<td>2,586,000</td>
<td>3,324,000</td>
<td>6,361,000</td>
<td>20,596,000</td>
</tr>
<tr>
<td>Fund Balances—Ending</td>
<td>7,765,000</td>
<td>3,890,000</td>
<td>3,735,000</td>
<td>6,645,000</td>
<td>22,035,000</td>
</tr>
</tbody>
</table>
The Proprietary Category of Funds

The operating statement of a proprietary fund reports revenues and expenses and reflects changes during the year in the equity of the proprietary funds as shown by the accounting equation:

\[
\text{NET ASSETS} + \text{REVENUES} - \text{EXPENSES} = \text{NET ASSETS} \\
\text{(At start of year)} \quad \text{(During the year)} \quad \text{(During the year)} \quad \text{(At end of year)}
\]

\[
$10,000 + $300,000 - $285,000 = $25,000
\]

Similar to governmental funds, adding assets and liabilities will expand the equation:

\[
\text{TOTAL NET ASSETS} + \text{TOTAL REVENUES} - \text{TOTAL EXPENSES} = \text{TOTAL NET ASSETS} = \text{ASSETS} - \text{LIABILITIES} \\
\text{(At start of year)} \quad \text{(During the year)} \quad \text{(During the year)} \quad \text{(At end of year)} \quad \text{(At end of year)} \quad \text{(At end of year)}
\]

\[
$10,000 + $300,000 - $285,000 = $25,000 = $210,000 - $185,000
\]

Note that the equations for illustrating the relationships of the balance sheet/statement of net assets and operating statement for the proprietary fund types and the governmental fund types are similar.

The exhibit below summarizes how the operating statement changes the data presented by states and local governments on their balance sheets/statement of net assets.

An example of an operating statement for the proprietary category of funds is included on the following page in Exhibit 1-4.
### EXHIBIT 1-4

**Proprietary Funds**

**Statement of Revenues, Expenses, and Changes in Fund Net Assets**

For the Year Ended June 30, 20X1

<table>
<thead>
<tr>
<th></th>
<th>Utilities Authority</th>
<th>Municipal Airport</th>
<th>Other Enterprise Funds</th>
<th>Total</th>
<th>Internal Service Funds</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Operating Revenues</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Charges for services</td>
<td>$36,000,000</td>
<td>$175,000,000</td>
<td>$6,250,000</td>
<td>$217,250,000</td>
<td>$13,450,000</td>
</tr>
<tr>
<td>Charges for services—rental income—security for Terminal A revenue bonds</td>
<td>—</td>
<td>30,000,000</td>
<td>—</td>
<td>30,000,000</td>
<td>—</td>
</tr>
<tr>
<td>Charges for services—rental income—security for Terminal B revenue bonds</td>
<td>—</td>
<td>22,000,000</td>
<td>—</td>
<td>22,000,000</td>
<td>—</td>
</tr>
<tr>
<td>Miscellaneous</td>
<td>10,000</td>
<td>60,000</td>
<td>42,000</td>
<td>112,000</td>
<td>17,000</td>
</tr>
<tr>
<td><strong>Total Operating Revenues</strong></td>
<td>$36,010,000</td>
<td>277,000,000</td>
<td>6,292,000</td>
<td>269,302,000</td>
<td>13,467,000</td>
</tr>
<tr>
<td><strong>Operating Expenses</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Personal services</td>
<td>22,022,000</td>
<td>161,025,000</td>
<td>7,804,000</td>
<td>190,851,000</td>
<td>6,925,000</td>
</tr>
<tr>
<td>Contractual services</td>
<td>11,220,000</td>
<td>33,550,000</td>
<td>1,680,000</td>
<td>46,450,000</td>
<td>2,100,000</td>
</tr>
<tr>
<td>Repairs and maintenance</td>
<td>700,000</td>
<td>2,100,000</td>
<td>450,000</td>
<td>3,250,000</td>
<td>1,650,000</td>
</tr>
<tr>
<td>Other supplies and expenses</td>
<td>729,000</td>
<td>1,795,000</td>
<td>230,000</td>
<td>2,754,000</td>
<td>366,000</td>
</tr>
<tr>
<td>Insurance claims and expenses</td>
<td>21,000</td>
<td>100,000</td>
<td>15,000</td>
<td>154,000</td>
<td>29,000</td>
</tr>
<tr>
<td>Depreciation</td>
<td>3,025,000</td>
<td>3,370,000</td>
<td>456,000</td>
<td>6,851,000</td>
<td>5,582,000</td>
</tr>
<tr>
<td>Miscellaneous</td>
<td>5,000</td>
<td>70,000</td>
<td>33,000</td>
<td>108,000</td>
<td>22,000</td>
</tr>
<tr>
<td><strong>Total Operating Expenses</strong></td>
<td>$37,722,000</td>
<td>202,010,000</td>
<td>10,606,000</td>
<td>250,938,000</td>
<td>16,675,000</td>
</tr>
<tr>
<td><strong>Operating Income (loss)</strong></td>
<td>(1,712,000)</td>
<td>25,090,000</td>
<td>(4,094,000)</td>
<td>18,264,000</td>
<td>(3,208,000)</td>
</tr>
</tbody>
</table>

**Non-Operating Revenues (Expenses)**

<table>
<thead>
<tr>
<th></th>
<th>Utilities Authority</th>
<th>Municipal Airport</th>
<th>Other Enterprise Funds</th>
<th>Total</th>
<th>Internal Service Funds</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interest and investment revenue</td>
<td>400,000</td>
<td>1,200,000</td>
<td>40,000</td>
<td>1,640,000</td>
<td>25,000</td>
</tr>
<tr>
<td>Interest</td>
<td>(450,000)</td>
<td>(1,220,000)</td>
<td>(33,000)</td>
<td>(1,763,000)</td>
<td>(369,000)</td>
</tr>
<tr>
<td>Operating grants and contributions</td>
<td>—</td>
<td>—</td>
<td>100,000</td>
<td>100,000</td>
<td>370,000</td>
</tr>
<tr>
<td>Miscellaneous</td>
<td>(110,000)</td>
<td>(265,000)</td>
<td>5,000</td>
<td>(367,000)</td>
<td>(8,000)</td>
</tr>
<tr>
<td><strong>Total Non-Operating Revenue (Expenses)</strong></td>
<td>(180,000)</td>
<td>(288,000)</td>
<td>115,000</td>
<td>(359,000)</td>
<td>78,000</td>
</tr>
<tr>
<td>Income (loss) before capital contributions and transfers</td>
<td>(1,872,000)</td>
<td>24,765,000</td>
<td>(4,259,000)</td>
<td>18,634,000</td>
<td>(3,130,000)</td>
</tr>
<tr>
<td>Capital contributions</td>
<td>1,250,000</td>
<td>2,000,000</td>
<td>250,000</td>
<td>3,500,000</td>
<td>490,000</td>
</tr>
<tr>
<td>Transfers in</td>
<td>—</td>
<td>—</td>
<td>140,000</td>
<td>140,000</td>
<td>40,000</td>
</tr>
<tr>
<td>Transfers out</td>
<td>—</td>
<td>—</td>
<td>—</td>
<td>—</td>
<td>(50,000)</td>
</tr>
<tr>
<td><strong>Special Item—gain on sale of parking lot</strong></td>
<td>—</td>
<td>—</td>
<td>5,500,000</td>
<td>5,500,000</td>
<td>—</td>
</tr>
<tr>
<td>Change in net assets</td>
<td>(622,000)</td>
<td>26,765,000</td>
<td>(359,000)</td>
<td>25,774,000</td>
<td>(2,659,000)</td>
</tr>
<tr>
<td><strong>Total Net Assets—Beginning</strong></td>
<td>16,019,000</td>
<td>73,608,000</td>
<td>7,440,500</td>
<td>95,675,500</td>
<td>15,875,500</td>
</tr>
<tr>
<td><strong>Total Net Assets—Ending</strong></td>
<td>$15,397,000</td>
<td>$100,373,000</td>
<td>$5,271,800</td>
<td>$121,041,800</td>
<td>$10,228,500</td>
</tr>
</tbody>
</table>
EFFECTS OF TRANSACTIONS ON THE ACCOUNTING EQUATION

Displaying the effect of financial transactions on accounts by using the accounting equation is possible. Amounts may be added to or subtracted from the equation if equal amounts are applied to both sides of the equation. The accounting equation must always be in balance.

Many transactions affect revenues and expenditures/expenses. However, certain types of transactions affect only asset and liability accounts and, therefore, only the balance sheet/statement of net assets. For example,

1. An asset may increase and another asset may decrease by an equal amount. For example, an investment (an asset) is purchased at a cost of $15,000 and cash (an asset) is disbursed. The asset account "Investment" increases, but the asset account "Cash in bank" decreases by the same amount, $15,000. As illustrated in the following example, total assets remain the same, and neither liabilities nor fund balance is affected:

   \[
   \text{ASSETS} = \text{LIABILITIES} + \text{FUND BALANCE}
   \]

   **Beginning Equation**
   \[
   \begin{align*}
   \text{Beginning Equation} & \quad \text{\$60,000} = \quad \text{\$22,000} & + & \quad \text{\$38,000} \\
   \text{Transaction} & \quad (\text{\$60,000} + \text{\$15,000} - \text{\$15,000}) = \text{\$22,000} + \text{\$38,000} \\
   \text{Ending Equation} & \quad \text{\$60,000} = \quad \text{\$22,000} & + & \quad \text{\$38,000}
   \end{align*}
   \]

2. An asset may increase and a liability may increase by an equal amount. For example, a government borrows $18,000 by issuing revenue anticipation notes (resulting in a current liability) and receives cash (resulting in an asset). This increases both the asset account “Cash” and the liability account "Notes payable" by the same amount, $18,000, as follows:

   \[
   \text{ASSETS} = \text{LIABILITIES} + \text{FUND BALANCE}
   \]

   **Beginning Equation**
   \[
   \begin{align*}
   \text{Beginning Equation} & \quad \text{\$60,000} = \quad \text{\$22,000} & + & \quad \text{\$38,000} \\
   \text{Transaction} & \quad (\text{\$60,000} + \text{\$18,000}) = (\text{\$22,000} + \text{\$18,000}) + \text{\$38,000} \\
   \text{Ending Equation} & \quad \text{\$78,000} = \quad \text{\$40,000} & + & \quad \text{\$38,000}
   \end{align*}
   \]
3. A liability may increase and another liability may decrease by an equal amount. For example, a government has a cash flow problem and cannot pay a vendor the amount owed of $24,000. The government signs a 90-day note to the vendor with interest of 7%, thereby swapping the accounts payable for a note payable. The liability account "Accounts Payable" decreases and another liability account “Notes Payable” increases by the same amount, $24,000, as follows:

\[
\text{ASSETS} = \text{LIABILITIES} + \text{FUND BALANCE}
\]

Beginning Equation \( $60,000 = \$22,000 + \$38,000 \)
Transaction \( $60,000 = ($22,000 + $24,000 - $24,000) + $38,000 \)
Ending Equation \( $60,000 = \$22,000 + \$38,000 \)

4. An asset may decrease and a liability may decrease by an equal amount. For example, a government issues checks (reducing an asset) totaling $14,000 to vendors to pay accounts payable (reducing a liability). This decreases both the liability account "Accounts payable" and the asset account "Cash" by the same amount, $14,000, as follows:

\[
\text{ASSETS} = \text{LIABILITIES} + \text{FUND BALANCE}
\]

Beginning Equation \( $60,000 = \$22,000 + \$38,000 \)
Transaction \( ($60,000 - $14,000) = ($22,000 - $14,000) + $38,000 \)
Ending Equation \( $46,000 = \$8,000 + \$38,000 \)

There are two types of transactions that ultimately (i.e., at year-end) affect fund balance (or equity): revenue transactions and expenditure transactions. Revenues increase fund balance (equity) and expenditures decrease fund balance (equity).
The accounting equation now expands to reflect both revenues and expenditures.

ASSETS = LIABILITIES + (FUND BALANCE + REVENUES - EXPENDITURES)

The following sample transactions illustrate the expanded equation.

1. The government receives payment of fines in the amount of $17,000. We can recognize revenue, so this transaction increases both the asset account “Cash” and the "Revenue" account by the same amount, as follows:

   \[
   \begin{array}{ccc}
   \text{FUND} \\
   \text{ASSETS} & \text{LIABILITIES} & = \text{(BALANCE + REVENUES - EXPENDITURES)} \\
   \text{(At end of year)} & \text{(At end of Year)} & \text{(At start of year)} & \text{(During the year)} & \text{(During the year)} \\
   \end{array}
   \]

   \[
   \begin{array}{ccc}
   \$60,000 & - & \$22,000 & = & (\$38,000) \\
   \end{array}
   \]

   \[
   \begin{array}{ccc}
   (\$60,000 + \$17,000) & - & \$22,000 & = & (\$38,000 + \$17,000 - \$0) \\
   \end{array}
   \]

   \[
   \begin{array}{ccc}
   \$77,000 & - & \$22,000 & = & (\$38,000 + \$17,000) \\
   \end{array}
   \]

   The above transaction ultimately increases the fund balance by $17,000 (i.e., by increasing revenues that at year-end will be added to fund balance) while maintaining the balance in the accounting equation since the value of the assets increased by a similar amount.

2. Office supplies are received and invoices are approved totaling $14,000. This transaction increases "Expenditures" and it increases the liability account "Accounts Payable," as follows:

   \[
   \begin{array}{ccc}
   \text{FUND} \\
   \text{ASSETS} & \text{LIABILITIES} & = \text{(BALANCE + REVENUES - EXPENDITURES)} \\
   \text{(At end of year)} & \text{(At end of Year)} & \text{(At start of year)} & \text{(During the year)} & \text{(During the year)} \\
   \end{array}
   \]

   \[
   \begin{array}{ccc}
   \$60,000 & - & \$22,000 & = & (\$38,000) \\
   \end{array}
   \]

   \[
   \begin{array}{ccc}
   \$60,000 & - & (\$22,000 + \$14,000) & = & (\$38,000 + \$0 - \$14,000) \\
   \end{array}
   \]

   \[
   \begin{array}{ccc}
   \$60,000 & - & \$36,000 & = & (\$38,000 + \$0 - \$14,000) \\
   \end{array}
   \]

   The preceding transaction decreased the fund balance by $14,000 (by increasing expenditures that at year-end will be deducted from fund balance) while maintaining the balance in the accounting equation since liabilities increased by a similar amount.
SUMMARY

1. A balance sheet/statement of net assets is a financial statement that presents either financial position or economic condition as of a given date. This financial statement shows where a fund stands financially on a certain date, such as June 30, 20XX.

2. An operating statement is a financial statement that presents changes in equity and results of operations during a fiscal period, such as “for the year ended June 30, 20XX”.

3. Assets are things a state or local government owns.

4. Current assets are cash or other assets that a state or local government could convert to cash or use up within one year. Receivables are converted to cash as collected and inventories are used up.

5. Liabilities are amounts a state or local government owes.

6. Current liabilities are liabilities due within one year. We classify all other liabilities as non-current.

7. Equity is the excess of assets over liabilities. Assets - Liabilities = Equity.

8. Net current assets or fund balance is the difference between current assets and current liabilities.

9. Revenues and expenditures, respectively, are increases and decreases in fund balance.

10. Revenues and expenses, respectively, are increases and decreases in net assets.

11. Fund accounting is used to permit accounting separately for resources affected by different types of spending restrictions and/or accounting principles.

12. All governmental funds generally report only current assets, current liabilities and net current assets, which is called fund balance.

13. All proprietary funds report total assets, total liabilities and total fund equity, which is called net assets.
Chapter 2
ACCOUNTS AND CODING
The Chart of Accounts

OBJECTIVES

This chapter explains how accounting information and data are organized through a chart of accounts.

Upon completion of this chapter, the participant should be able to:

• Define “chart of accounts”.

• Explain how a chart of accounts is structured.

• Use a chart of accounts for processing transactions.

INTRODUCTION

The first step in setting up an accounting system is to decide what you need to keep track of. The chart of accounts is what fuels the accounting system. A chart of accounts is simply a listing of the accounts in an accounting system and is kept by every government to record and follow specific entries. The chart of accounts is the foundation of every accounting system and provides an organizing framework for budgeting, recording, and reporting on all financial transactions.

This chapter describes the chart of accounts from a theoretical point of view and also how charts of accounts are maintained within the State of Georgia for both state and local governments.

DEFINITION AND FUNCTION

A chart of accounts is a listing of all accounts available for use in an individual accounting system. The basic function of an account is to serve as a classification that identifies the nature or characteristics of the financial information that the accountant records in the account. For example, as a state or local government issues purchase orders, the account to be charged should be included on the purchase order. An account number from the chart of accounts identifies this account.
Accounts are assigned a number and are arranged so that they may be identified with similar accounts (e.g., all asset accounts are together). Each account contains only a single kind of transaction, such as cash in bank or the amount of receivables due to the government from sales taxes. The number of accounts used should be the minimum that will provide proper management information and meet external reporting needs. General ledger accounts are classified as:

- Balance sheet/statement of net assets accounts
- Revenue accounts
- Expenditure/expense accounts

For State Government: The State Accounting Office is responsible for maintaining the comprehensive chart of accounts developed for the State of Georgia. This uniform chart of accounts is continually updated to reflect the informational needs of management, legislators, regulators, and users of the State’s financial reports. For a complete, updated chart of accounts, visit the State Accounting Office website at http://sao.georgia.gov.

For Local Governments: House Bill 491, passed in 1997, lays the groundwork for local government’s chart of accounts within the State of Georgia. The Department of Community Affairs (DCA) was tasked with the responsibility of maintaining and developing the chart based on the legislation passed in House Bill 491. DCA, working with many local governments and other state agencies, developed a comprehensive chart of accounts; however, it is continually updated to reflect the informational needs of management, legislators, regulators, and users of the local government’s financial reports. For a complete, updated chart of accounts, visit the DCA’s website at www.dca.state.ga.us.

DEVELOPING THE CHART OF ACCOUNTS (THEORY)

If a small government is maintaining a manual accounting system, the number of accounts included in the chart of accounts should be limited since the capability of presenting data in various formats is not feasible. Normally in a computerized accounting system there is far more flexibility in the size of the chart of accounts governments use. Often, computer systems use an account number scheme with a limited number of digits. However, governments can usually reorganize and report the financial data in various reporting formats.

In a computerized accounting system, all account types normally use a common account structure (i.e., the same number of digits). Each account number is composed of segments called *dimensions*. Each dimension provides different types of data (i.e., different dimensions) that are combined into a single overall account number. For
example, when a government receives cash they use one dimension to identify the fund (01) to which it belongs, and another dimension to identify the type of asset (101).

For purposes of this introductory course we will only identify balance sheet/statement of net asset accounts with both a fund dimension and a dimension that simply describes the type of account used; for example, general fund cash in bank. In real life you will probably add additional dimensions. For example, you may want to add a code to identify which bank and in the type of account the money is deposited.

Each state and units of local government within each state are unique in how they structure their funds, departments, and agencies. In some scenarios a government may be structured so that multiple agencies are reported in just one fund. However, sometimes you may find multiple funds managed by just one agency or department. The State of Georgia employs a limited number of funds, and a majority of the agencies and departments of the State are contained within the General Fund. However, in some instances there are agencies that are responsible for multiple funds.

### Exhibit 2-1
**Chart of Accounts for State and Local Governments**

<table>
<thead>
<tr>
<th>Local Govt.</th>
<th>State Govt.</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>11.1110</td>
<td>101000</td>
<td>CASH IN BANKS</td>
</tr>
<tr>
<td>11.1111</td>
<td>101001</td>
<td>Cash in Banks Operating Account Wachovia 1</td>
</tr>
<tr>
<td>11.1112</td>
<td>101002</td>
<td>Cash in Banks Operating Account Wachovia 2</td>
</tr>
<tr>
<td>11.1113</td>
<td>101003</td>
<td>Cash in Banks Operating Account Wachovia 3</td>
</tr>
<tr>
<td>11.1114</td>
<td>101004</td>
<td>Cash in Banks Operating Account Wachovia 4</td>
</tr>
<tr>
<td>11.1120</td>
<td>101020</td>
<td>Cash in Banks Operating Account Nations Bank 1</td>
</tr>
<tr>
<td>11.1121</td>
<td>101021</td>
<td>Cash in Banks Operating Account Nations Bank 2</td>
</tr>
<tr>
<td>11.1122</td>
<td>101022</td>
<td>Cash in Banks Operating Account Nations Bank 3</td>
</tr>
<tr>
<td>11.1123</td>
<td>101023</td>
<td>Cash in Banks Operating Account Nations Bank 4</td>
</tr>
<tr>
<td>11.1124</td>
<td>101024</td>
<td>Cash in Banks Operating Account Nations Bank 5</td>
</tr>
<tr>
<td>11.1125</td>
<td>101025</td>
<td>Cash in Banks Operating Account Nations Bank 6</td>
</tr>
</tbody>
</table>

In the scenario where you have multiple agencies accounted for in one fund, it may not be necessary for the individual coding a transaction to input the fund or agency identifier. System controls may be designed to limit input from your terminal to transactions only affecting the fund and agency in which you are employed. However, if your agency is responsible for multiple funds then you would be required to input a fund identifier.
Fund Identifiers

The following is a sample of fund identifiers:

Exhibit 2-2
Fund Identifiers for State and Local Governments

<table>
<thead>
<tr>
<th>LOCAL GOVT FUND</th>
<th>STATE FUND</th>
<th>TITLE</th>
<th>DEFINITION</th>
</tr>
</thead>
<tbody>
<tr>
<td>100</td>
<td>1</td>
<td>General Fund</td>
<td>This fund should be used to account for resources not required to be accounted for in another fund.</td>
</tr>
<tr>
<td>200</td>
<td>11</td>
<td>Special Revenue Fund</td>
<td>Fund sources (programs) in this range should be used for specific purposes.</td>
</tr>
<tr>
<td>710</td>
<td>6</td>
<td>Agency Funds</td>
<td>Used to account for assets held by a government organization as an agent for individuals, private organizations or other governments and/or funds.</td>
</tr>
<tr>
<td>450</td>
<td>8</td>
<td>Permanent Funds</td>
<td>Used to account for trust agreements which stipulate only earnings, not the principal of the trust, may be expended for purposes that support the government’s programs. Earnings must be expended in accordance with legal requirements of the trust.</td>
</tr>
</tbody>
</table>
Revenues

Usually, states and local governments classify revenues by fund and source (i.e., two dimensions) at the financial statement level. Let’s turn to our appendix and look at the more common revenue sources. Note: Appendix A contains a sample of accounts for the State of Georgia. Appendix B contains a sample of accounts for local governments.

Expenditures

Choosing which expenditure dimension to use is a most difficult decision. A smaller government might use a limited number of digits in its account number. However in most governments we have a greater fiduciary responsibility to the public to budget and report in a more detailed manner. States and large local governments need to be able to account and report in a variety of formats and detail to satisfy GAAP, regulators, other governments, legislators, taxpayers, and management. Therefore information in the accounting database related to expenditures might include dimensions for:

- Fund
- Agency/Organization/Department
- Program/Function/Activity
- Object
- Sub-object, and in some cases
- Element/Other

In most cases individuals coding or inputting data will not have to define each of the dimensions because the system controls only allow you to assign object codes to the activity for which you account. Therefore, additional dimensions are preset with the other required data.

Control Accounts

Some large governments use control accounts on their general ledger for revenue and expenditure/expense accounts. A “control account” is a total of all revenue or expenditure accounts. These control accounts are supported by subsidiary ledgers which show the details of individual revenue or individual expenditure account.
SUMMARY

1. A chart of accounts is a listing of all accounts available for use in an individual accounting system.

2. Dimensions are segments of an account number that we combine into a single account number to represent a single account.

3. The balance sheet accounts will normally be the easiest to code and input because of fewer dimensions.

4. At a minimum, revenues are classified by fund and source dimensions.

5. Expenditures usually require detailed coding and may be classified by fund, character, function and/or program, activity and object.

6. In many governments’ accounting systems, control accounts are used for revenues and expenditures/expenses, and these accounts are supported by detailed coding resident within the computer system’s database.
Chapter 3
DOUBLE ENTRY ACCOUNTING

OBJECTIVES

Some would say that with the common use of computers, accountants do not need to understand double entry accounting. For example, an accounts payable clerk usually just enters the expenditure/expense account number into the computer but makes no entry to the accounts payable account. In other words, the computer program records the transaction in the specific account.

Although computers do most of the accounting work, the accountant still needs to understand what the computer is doing, particularly if an error occurs. When experienced accountants have an accounting problem, often they draw “T” accounts to follow the entries through the accounting system.

As we illustrated in Chapter 1, each financial transaction increases or decreases a government’s accounts. The primary purpose of this chapter is to explain the relationship of increases or decreases and the accounting terms "debits" and "credits."

This chapter provides the basics of how accountants should record transactions.

After completing this chapter, you should be able to:

- Record transactions using debits and credits.
- Understand how debits and credits affect accounts.
- Understand how PeopleSoft’s use of (+) and (-) relates to debits and credits. (For those employed by the State of Georgia).
DEBITS AND CREDITS

Increases or decreases in a government's accounts are classified as debits or credits. Sometimes, the abbreviations for these terms in the accounting records are "DR" for debit and "CR" for credit. Before the use of computers for governmental accounting purposes, accountants pictured a general ledger account as looking like a "T." The left side of the "T" account was the debit side and the right side was the credit side. As illustrated below, the debits are on the left, the credits are on the right.

With the use of various levels of sophisticated computer equipment in governmental accounting, the "T" account no longer is visible in computer systems. However, an awareness of the notion of the "T" account is useful in understanding double entry accounting.
CHANGES IN ACCOUNT BALANCES

Transactions in accounting systems are simply changes in account balances. Changes in account balances, (i.e., a debit or credit) will result in an increase or decrease in an account balance depending upon where that account appears in the accounting equation. Using the presentation below, we may analyze each transaction individually to decide which accounts we increase and decrease, resulting in either debits or credits.

DEBITS AND CREDIT

<table>
<thead>
<tr>
<th>ACCOUNT</th>
<th>NORMAL ACCOUNT BALANCE</th>
<th>DEBIT</th>
<th>CREDIT</th>
</tr>
</thead>
<tbody>
<tr>
<td>Assets</td>
<td>Debit</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Liabilities</td>
<td>Credit</td>
<td>Decrease</td>
<td>Increase</td>
</tr>
<tr>
<td>Fund Equity</td>
<td>Credit</td>
<td>Decrease</td>
<td>Increase</td>
</tr>
<tr>
<td>Revenues</td>
<td>Credit</td>
<td>Decrease</td>
<td>Increase</td>
</tr>
<tr>
<td>Expenditures/Expenses</td>
<td>Debit</td>
<td>Increase</td>
<td>Decrease</td>
</tr>
</tbody>
</table>

Some accounting systems such as PeopleSoft graphically represent debits and credits in their reports and input documents using (+) and (-) symbols. The theory behind this relates back to the basic accounting equation.

\[
\text{ASSETS} = \text{LIABILITIES} (+) \text{ EQUITY}
\]

\[
+ \quad - \quad (+) \quad -
\]

The sum of the numbers on one side of the equation must equal the sum of the numbers on the other side. The (+) represents something that goes on the left and a (-) represents something that goes on the right.
We learned in a previous chapter that revenues increase equity and expenditures/expense decrease equity, and in this chapter we learned equity normally has a credit (-) balance. Therefore logic dictates that the normal balance for a revenue account would be a credit and expenditures/expenses a debit.

+ EQUITY -

EXPENDITURES  REVENUES
+ -
Debit        Credit

The following expanded accounting equation illustrates when debits and credits appear as increases or decreases (for purposes of illustration, we use the term expenditures with fund balance; however, we could have substituted the term expenses/net assets):

\[
\text{ASSETS} = \text{LIABILITIES} + \text{FUND BALANCE} + \text{REVENUES} - \text{EXPENDITURES}
\]

\[
\begin{array}{cccccc}
\text{Debit} & \text{Credit} & \text{Debit} & \text{Credit} & \text{Debit} & \text{Credit} \\
\text{Inc.} & \text{Dec.} & \text{Dec.} & \text{Inc.} & \text{Dec.} & \text{Inc.} \\
+ & - & + & - & + & - \\
\end{array}
\]

Since the accounting equation must always be in balance, every transaction must always consist of the total debit amounts equal to the total credit amounts. Double entry accounting requires that for every entry (or entries) made to the debit side of an account(s), we make an entry (or entries) for the same total amount to the credit side of another account(s). The following examples illustrate the use of debits and credits.

Note in each of the transactions that the debits equal the credits.
1. A government begins the year with assets of $600, no liabilities and, therefore, a fund balance of $600.

\[
\text{ASSETS} = \text{LIABILITIES} + \text{FUND BALANCE} + \text{REVENUES} - \text{EXPENDITURES}
\]

<table>
<thead>
<tr>
<th>Debit</th>
<th>Credit</th>
<th>Debit</th>
<th>Credit</th>
<th>Debit</th>
<th>Credit</th>
<th>Debit</th>
<th>Credit</th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>$600</td>
<td>$600</td>
<td>$600</td>
<td>$600</td>
<td>$600</td>
<td>$600</td>
<td>$600</td>
<td>$600</td>
<td>$600</td>
<td>$600</td>
</tr>
</tbody>
</table>

2. The government receives cash payments for fines (a revenue) totaling $6,000. This transaction increases assets (i.e., a debit) and increases revenues (i.e., a credit) by the same amount.

\[
\text{ASSETS} = \text{LIABILITIES} + \text{FUND BALANCE} + \text{REVENUES} - \text{EXPENDITURES}
\]

<table>
<thead>
<tr>
<th>Debit</th>
<th>Credit</th>
<th>Debit</th>
<th>Credit</th>
<th>Debit</th>
<th>Credit</th>
<th>Debit</th>
<th>Credit</th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>$600</td>
<td>$600</td>
<td>$600</td>
<td>$600</td>
<td>$600</td>
<td>$600</td>
<td>$600</td>
<td>$600</td>
<td>$600</td>
<td>$600</td>
</tr>
<tr>
<td>$6,000= + + $600 + -</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>$6,600= + + $600 + $6,000 -</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Note that the revenue increased so we credited the revenue account. The asset account increased, therefore, we debited. The total debits still equal the total credits (i.e., $6,600).

3. The government receives invoices for expenditures totaling $7,000. This transaction increases expenditures (i.e., a debit) and increases liabilities (i.e., a credit).

\[
\text{ASSETS} = \text{LIABILITIES} + \text{FUND BALANCE} + \text{REVENUES} - \text{EXPENDITURES}
\]

<table>
<thead>
<tr>
<th>Debit</th>
<th>Credit</th>
<th>Debit</th>
<th>Credit</th>
<th>Debit</th>
<th>Credit</th>
<th>Debit</th>
<th>Credit</th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>$600</td>
<td>$600</td>
<td>$600</td>
<td>$600</td>
<td>$600</td>
<td>$600</td>
<td>$600</td>
<td>$600</td>
<td>$600</td>
<td>$600</td>
</tr>
<tr>
<td>$6,000= + + $600 + $6,000 -</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>$7,000= + + $600 + $6,000 -</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Note that expenditures increased so we debited them. Liabilities increased so we credited them.
4. The government borrows $4,500 from the bank to cover future operating expenditures. This transaction increases assets (i.e., a debit) and increases liabilities (i.e., a credit).

\[
\begin{array}{cccccc}
\text{ASSETS} & = & \text{LIABILITIES} + & \text{FUND BALANCE} + & \text{REVENUES} - & \text{EXPENDITURES} \\
\hline
\text{Debit} & \text{Credit} & \text{Debit} & \text{Credit} & \text{Debit} & \text{Credit} \\
\text{Inc.} & \text{Dec.} & \text{Dec.} & \text{Inc.} & \text{Dec.} & \text{Inc.} \\
$600 & = & + & $600 & + & - \\
$6,000 & = & + & + & $6,000 & - \\
= & $7,000 & + & + & - & $7,000 \\
$4,500 & = & $4,500 & + & + & - \\
= & $11,500 & $600 & + & $6,000 & - & $7,000 \\
\end{array}
\]

The accounting equation still balances (i.e., $11,100 = $11,500 + $600 + $6,000 - $7,000). Also, note that the recording of each transaction results in debit amounts equal to credit amounts (i.e., $18,100).

---

**The Golden Rules of Double Entry**

1. *The term debit simply means something goes on the left side of a T account. It is neither good or bad.*

2. *The term credit simply means something goes on the right side of a T account. It is neither good or bad.*

3. *A (+) symbol simply means something goes on the left side of a T account. It does not mean add.*

4. *A (-) symbol simply means something goes on the right side of a T account. It does not mean subtract.*
SUMMARY

1. Debits are entries to the left side of any general ledger account in a manually maintained accounting system.

2. Credits are entries to the right side of any general ledger account in a manually maintained accounting system.

3. Assets, expenditures and expenses normally have debit balances.

4. Liabilities, revenues and equity normally have credit balances.

5. A government with a positive fund balance would have a credit balance in its fund equity account, and a government with a fund balance deficit would have a debit balance in its fund equity account.

6. Debits increase asset balances, and credits decrease asset balances.

7. Credits increase liability balances, and debits decrease liability balances.

8. Credits increase fund equity balances, and debits decrease fund equity balances.

9. Credits increase revenue balances, and debits decrease revenue balances.

10. Debits increase expenditure or expense balances, and credits decrease expenditure or expense balances.

11. Double entry accounting means that for every entry (or entries) made to the debit side of accounts, we must make equal entry (entries) to the credit side of the accounts.
Chapter 4
ACCOUNTING SYSTEMS AND RECORDS

INTRODUCTION

Governmental accountants record all financial transactions in the accounting records to maintain management control and provide the basis for financial reporting. Organized methods are necessary for a government to utilize the accounting process properly and accurately. These methods are reflected in part by the type of accounting records used. In order to heighten your understanding of the accounting process and the relevancy of certain types of accounting records and reports, we will describe within this chapter how a traditional (manual) system functions, and then discuss the facets of a computerized system.

Journals and ledgers are the two primary classifications of accounting records. With the sophistication of computer accounting systems, often specific journals and ledgers are not visible in the same way they are in an accounting system that a government maintains without a computer. This fact applies to most governments since the use of computers for accounting today is not an option.

ACCOUNTING records
• journals
• ledgers

OBJECTIVES

After completing this chapter, you should be able to:

• Understand the difference between journals and ledgers.
• Relate the journals and ledgers illustrated in this chapter to computer records.
• Understand how accounting systems take and process information into reports.
• Record transactions in journals and post to ledgers.
• Be aware of the value and purposes of a trial balance.
ACCOUNTING SYSTEMS (MANUAL)

All accounting transactions begin with a source document. Source documents provide evidence of the original transaction. These documents should include sufficient details of the financial transaction to simplify recording the transaction in the accounting system. Internal documents might include a purchase order, a property tax bill, a cash receipt, or a check. Third parties prepare external documents as evidence of goods provided, services rendered or fees paid. These documents might include shipping slips, vendor invoices and taxpayer or customers' checks.
**JOURNALS**

A journal is a book of original entry. It is like a log book or diary. Transactions are entered into a journal in the sequence in which they occur (i.e., chronological order). In an accounting system, the first step is to record transactions in a journal. We classify this recording as a journal entry and it could contain a summary of the transaction as follows:

- The date on which the transaction occurred
- The accounts affected
- How they are affected (i.e., whether debited or credited and by how much)
- A brief description of the nature of the transaction

**Types of Journals**

Journals are classified as either a general journal or a special journal.

**Special Journals.** Special journals are used to record transactions of a like nature. Special journals might include:

- A cash receipts or cash disbursements journal (i.e., a cash journal)
- A revenue and cash receipt journal
- An expenditure and cash disbursement journal
- A payroll journal
- A purchases journal

In this course, we will only use a general journal.
**General Journals.** States and local governments use a general journal to record transactions that do not fit in a special journal. Though not practical, governments could record all transactions in a general journal. A general journal might include columns for:

- A date
- Account titles and explanation
- The account number
- A column to indicate we have posted the transaction to a ledger
- Columns for debit and credit amounts

The following illustrates a manually maintained general journal:

![General Journal table]

As an example of a general journal entry in a non-computer system, assume that on July 28, U.S. Treasury bills are purchased with a face value of $10,000 as an investment at a cost of $9,542 and we issued a check for the purchase price.

![General Journal example]
Note that the account debited is listed first, and the account credited is listed second and indented—this is the accepted format in a manual accounting system. A brief explanation of the transaction follows the recording of the account titles.

**LEDGERS**

A ledger is an accounting record that accountants may use to summarize the financial activity in each account (e.g., accounts payable) of a governmental entity.

We call ledgers “books of final entry.”

Ledgers are the primary source of accounting data for the preparation of periodic management reports as well as annual financial statements.

In a manual accounting system we usually maintain a separate page for each ledger account.

Ledgers are classified as either a general ledger or as a subsidiary ledger.

**General Ledgers.** The general ledger contains the basic accounts of a government and serves as the source of data for preparing financial statements (e.g., the balance sheet). A general ledger might include the traditional “T” account information (as illustrated in Chapter 3) but is usually modified to include columns to maintain a running total (i.e., current balance) for each account. The balance in the account will be a debit or credit amount depending upon the totals of the entries in the debit and credit columns.

The following is an example of the account "Cash in bank" in the general ledger for the general fund in a manual accounting system with a balance at the beginning of the fiscal period of $323,500.
The posting reference (PR) column in the general ledger indicates the source of the posting (e.g., which journal and page number of a journal). The check mark indicates a balance carried forward from the prior year's general ledger. The balance columns in the general ledger allow the accountant to maintain a running balance (i.e., current balance) in the account. Usually, each time the general ledger is posted, the accounts are totaled and the balance is entered in the appropriate column as a debit or credit.

In a computer system, posting references usually don't relate to separate journals. However, when a transaction is entered into the system, a transaction reference number might be affixed to each transaction.

Accounts normally included in the general ledger are:

- Individual asset accounts (e.g., cash in bank)
- Individual liability accounts (e.g., accounts payable)
- Individual equity accounts (e.g., fund balance)
- Individual revenue accounts or a revenue control account (e.g., revenues)
- Individual expenditure/expense accounts or an expenditure/expense control account (e.g., expenditures)

**Subsidiary Ledgers.** Subsidiary ledgers provide detailed subdivisions of selected general ledger accounts. The most common subsidiary ledgers are for the budgetary, the revenue and the expenditure accounts. For example, the general ledger might utilize a single account (e.g., the expenditure control account) to record the total year-to-date
expenditures for a specific fund. Then the subsidiary ledger supporting the expenditure control account would include separate accounts for each individual expenditure (e.g., policemen's salaries). The total of the expenditure subsidiary ledger equals the control account in the general ledger. Therefore, the use of control and subsidiary accounts provides a system of checks and balances.

Some accounting systems, usually for smaller governments, do not use control accounts and each individual revenue or expenditure account (e.g., property taxes or office supplies) is included separately in the general ledger. States and large local governments generally use control accounts.

With an automated system, subsidiary ledgers are generated from a data base using the computer's report writing capabilities.

**POSTING TRANSACTIONS**

Posting is the process of taking information from journals and recording this data in the various ledgers. In other words, transactions are originally recorded in a journal and then recorded in a summarized form in ledgers. We call this process "posting."

In an automated system, the process of journalizing and posting may occur simultaneously. This is one primary advantage of using a computer accounting system. Since we record a single transaction in both the journal and ledger with a single entry into the computer, we reduce or eliminate the chance that we would post (i.e., record the amount) an error.

![Diagram: General Journal --------Posting--------General Ledger]

**THE TRIAL BALANCE**

If the accounts have been posted correctly, the total of all the debits should equal the total of all the credits. This is true because for every debit entry, there has been a credit entry of an equal or offsetting amount.

At the end of the reporting period (e.g., a month), one of the accountant's tasks is to prepare a trial balance. The trial balance is simply a listing of all the accounts and account balances in the general ledger. The trial balance confirms that the general ledger is in balance. For example, we illustrate a trial balance for a manual accounting system as follows:
ANY GOVERNMENT
TRIAL BALANCE
GENERAL FUND
JULY 31, 20XX

<table>
<thead>
<tr>
<th>General Ledger</th>
<th>Account No.</th>
<th>Account Title</th>
<th>Account Balance</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>100</td>
<td>Cash in Bank</td>
<td>$ 71,548.90</td>
</tr>
<tr>
<td></td>
<td>122</td>
<td>Intergovernmental receivables</td>
<td>11,000.00</td>
</tr>
<tr>
<td></td>
<td>150</td>
<td>Inventory</td>
<td>3,500.00</td>
</tr>
<tr>
<td></td>
<td>107</td>
<td>Investments</td>
<td>9,542.00</td>
</tr>
<tr>
<td></td>
<td>200</td>
<td>Accounts payable</td>
<td>---</td>
</tr>
<tr>
<td></td>
<td>215</td>
<td>Accrued taxes payable</td>
<td>---</td>
</tr>
<tr>
<td></td>
<td>380</td>
<td>Unassigned fund balance</td>
<td>---</td>
</tr>
<tr>
<td></td>
<td>400</td>
<td>Revenue control</td>
<td>---</td>
</tr>
<tr>
<td></td>
<td>500</td>
<td>Expenditure control</td>
<td>16,221.72</td>
</tr>
</tbody>
</table>

$111,812.62 $111,812.62

As indicated above, the total of the debits should equal the total of the credits in a trial balance. If they do not agree, either a posting error has occurred (i.e., the wrong amount was posted from a journal to an account in the ledger) or either the journal does not foot or crossfoot or the general ledger does not foot or crossfoot.

The information in the trial balance is what will eventually be used to construct the financial statements – balance sheet/statement of net assets and operating statement.

ACCOUNTING SYSTEMS (AUTOMATED)

When computers were first integrated into the accounting process in the 1960’s, tremendous gains in efficiency were experienced while maintaining the traditional structure and architecture of the accounting systems. Today the level of sophistication and complexity inherent in the technological design of information management systems is challenging many long held beliefs of what an accounting system is or how it’s supposed to function. Some futurists have even speculated that the terms accounting and accountants will become obsolete within the next decade.
A simplified description of leading edge systems is that they store all of an organization’s information in large data bases (data warehousing), and that users (information technicians) can employ report writing software (data mining or extraction) to generate any reports they want. The obvious advantage of this approach is speed and flexibility in generating custom information. However, there is a tradeoff. The role of the accountant and accounting paraprofessional is becoming increasingly focused on input and output, while their knowledge of process decreases.

Even though accounting systems were first automated in the 1960’s, until the mid 1980s the automation manifested itself primarily in the recording of transactions to electronic journals that then posted to an electronic general ledger. The most time efficient applications were directed at sub-routines that focused on subsidiary ledgers such as accounts payable, receivables, and payroll. Repetitive transactions of a volume nature were performed on the subsystems with cumulative batch totals recorded in the appropriate general ledger account. On a daily basis, larger systems would print out journals/logs of the day’s transactions, and ledger cards (heavy paper almost like a thin cardboard) were run through an electronic posting machine which updated all of the general ledger accounts. Today’s database systems are much more efficient.

In today’s accounting systems, when a transaction occurs an input is made to the accounting system. Unlike manual accounting systems, the input bypasses the traditional journal and is made directly to the database. To accomplish this insertion of data all that is required is an individual sitting at a computer to pull down the appropriate screen and fill out the required fields.

With computer accounting systems, accountants make most journal entries directly into a computer terminal either from a source document (e.g., a bank deposit) or from a computer input form.
Often, we generate a transaction report from the data added to the computer system, which is the equivalent of a general journal. As with input forms, the output and format on the transaction report will vary. Most of the information included in the example of the manual general journal (Page 4-4) would appear in the transaction report except for the posting reference and an explanation of the transaction. However there might be a reference to a purchase order or a check that serves as the explanation.

In a computerized accounting system, a report writer is often used to compile a general ledger for each account. The report would include whatever information the person writing the query specified, however, it would be desirable to include a beginning balance, all transactions incurred during the fiscal period reported (e.g., a month), and an ending balance at the end of the fiscal period.

Computer systems allow direct access to review any account balance via a monitor and can view the current month's data and year-to-date data. Reviewing accounts through monitors is just like opening a manual general ledger and looking at the details of a specific account.

In most computer systems, the journal entries entered must balance or be rejected. Therefore, when the general ledger and any trial balances are generated they are usually in balance. When one transaction is recorded in the transaction report (i.e., the journal) and in the general and subsidiary ledgers simultaneously, the chance of the trial balance not balancing is minute. However, if a posting is made in the correct amount, but to the wrong account, the general ledger will balance but certain accounts will be misrepresented. This type of error, if immaterial, is often difficult to locate.
SUMMARY

1. In an accounting system, a journal entry is generated when a financial transaction occurs. This entry flows from a journal to a ledger.

2. A journal is an accounting record where transactions entered are originally recorded.

3. A journal is known as the “book of original entry.”

4. A ledger is an accounting record that summarizes financial transactions by type of account.

5. A ledger is known as the “book of final entry.”

6. The process of taking financial information from a journal and recording it in a ledger is called posting.

7. A general ledger contains the basic accounts of a government.

8. A subsidiary ledger contains details of a specific general ledger account.

9. A computer system contains the same data that is included in journals and ledgers even though it might not be readily accessible.

10. A trial balance is a listing of all the accounts used by the government and account balances.

11. The purposes of preparing a trial balance are to determine whether the debits and the credits in the general ledger balance and to prepare financial statements.
Chapter 5
FUND ACCOUNTING

OBJECTIVES

Governments account for and allocate resources in separate sub-entities, identified as funds, based upon the purposes for which they are to be expended and the means by which spending activities are legally controlled.

A fund is an accounting entity with a separate set of accounting records for resources, in which related liabilities and equities are segregated for conducting a specific activity. For example, a government might account for a federal grant in one fund. It could record the proceeds from a bond sale (e.g., a building bond) in a different fund. The more individual funds maintained, the more tedious the record keeping can become. However, many accounting systems are designed specifically for fund accounting that reduce potential record keeping problems.

After completing this chapter, you should be able to:

- Define each of the fund categories and generic funds within each category.
- Determine when to use each of the generic funds.
- Identify the basis of accounting used by each category and generic fund.

NUMBER OF FUNDS

Generally accepted accounting principles (GAAP) require that governments establish and maintain the minimum number of funds consistent with legal requirements and sound financial administration. In other words, the government should maintain as few funds as possible consistent with the above criteria. Usually the sophistication of the government’s accounting system determines the latter requirement. If the accounting system can segregate revenues, expenditures and fund equity for particular activities within a single fund, a government should use a single fund (e.g., the general fund).

However, there may also be political considerations that could impact the number of funds a government chooses to create and maintain. For example, if the government were to impose a new tax of a controversial nature where there is a high level of expectation for separate accountability, the creation of a separate fund for that one tax and its program expenditures could be warranted.
FUND CATEGORIES

For reporting purposes, governments must classify their individual funds within three categories. These categories are important since the accounting rules differ for each of the fund categories.

A brief explanation of these three categories follows:

A. **Governmental Funds** account for general operations of the government including administration, education, social services, natural resources, and transportation programs. The primary income source for these programs is taxes.

B. **Proprietary Funds** account for activities that are similar to the commercial sector (e.g., the Georgia Technology Authority, Georgia World Congress Center or sanitation services). In essence these are business-type activities that are owned and operated by the government. They are generally seen as being self-supporting and derive most, if not all, of their revenues from consumer fees.

C. **Fiduciary Funds** account for assets held by the government in a trustee or agent capacity such as taxes collected and held on behalf of local governments, pension plans, and trusts which receive external donations for the benefit of parties external to the government.

GENERIC FUNDS

The Governmental Accounting Standards Board (GASB) subdivides the fund categories into generic funds. The exhibit above presents a fund organizational chart illustrating the three categories and the discussions below depict their relationship with the generic funds.

Knowledge of the generic fund classifications is important for a thorough understanding of financial statements produced by a governmental entity.
The **Governmental Category** includes the following generic funds:

1. **The General Fund** accounts for all resources that are not required to be accounted for in another fund. Most financial transactions are reported in this fund. Only one general fund is permitted for reporting purposes.

2. **Special Revenue Funds** account for resources that are legally restricted for specific purposes. Examples of revenues that might be accounted for in a special revenue fund are federal grants or a special purpose tax.

3. **Capital Projects Funds** account for resources restricted for major capital outlays. The proceeds from a bond issue used to construct a new prison that will be repaid from general sales or income taxes would be accounted for here.

4. **Debt Service Funds** account for resources used to repay the principal and interest on general long-term debt, such as general obligation bonds.

5. **Permanent Funds** should be used to report resources that are legally 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*.

The following generic funds are included in the **Proprietary Category**:

1. **Enterprise Funds** account for activities financed and operated like those of business enterprises. The state farmer’s markets, the state lottery and the Georgia Ports Authority are examples of this fund type. Other examples are water and sewer services and sanitation funds.

2. **Internal Service Funds** account for operations similar to those accounted for in enterprise funds, but provide goods or services to other departments within the same government. Activities such as centralized data processing, a motor pool or a print shop could be accounted for as internal service funds. However, if the fees an activity collects is not sufficient for the activity to break even over time, the activity may be accounted for elsewhere, preferably the general fund.

The final category of funds is called the **Fiduciary Category** and includes the trust and agency generic funds. GAAP subdivide the fiduciary category into four generic funds:

1. **Agency Funds** are holding accounts for assets belonging to someone other than the government. For example, the state might account for the sales taxes that it collects for a local government in an agency fund. A local government example is the sheriff’s fund, where fees the sheriff’s office collects are transmitted to the general fund, to other local governments, and/or to state organizations.
2. **Pension Trust Funds** account for those assets maintained for single and/or multiple employer pension plans. In other words, the state or local government would report the assets that it holds for retirement payments to its employees (i.e., those who have or will retire) here. An expenditure for active employees is not recorded here, but in the fund in which the applicable employee works.

3. **Investment Trust Fund** is a fund that a government uses to account for the external portion of a government sponsored investment pool. The Georgia Fund I is an example of this generic fund.

4. **Private-purpose Trust Funds** should be used to report resources held and administered by the reporting government when it is acting in a fiduciary capacity for individuals, private organizations, or other governments. One example for local governments would be a cemetery fund. An example for the State of Georgia is the Keds Corporation Settlement fund which is responsible for the direct delivery of services to women between fifteen and forty-four years of age with specific priority being given to job training in non-traditional employment fields.

Each individual fund maintained in a government is classified into one of the three fund categories and within the eleven generic funds.

**BASIS OF ACCOUNTING**

Although we will discuss the term “basis of accounting” more fully in a later chapter, it is important to note that all generic funds within the governmental category, at the fund level, are accounted for on the modified accrual basis of accounting. At the government-wide level of reporting, the governmental fund information will be aggregated and reported on the accrual basis of accounting.

The proprietary and fiduciary funds are reported using the accrual basis of accounting at the fund level. At the government-wide level of reporting, the proprietary funds are reported using the accrual basis of accounting, and the fiduciary funds are not reported.
The following exhibit summarizes the basis of accounting for each generic fund at the fund level.

<table>
<thead>
<tr>
<th>Fund Type</th>
<th>Basis of Accounting</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Modified Accrual</td>
</tr>
<tr>
<td><strong>Governmental Funds:</strong></td>
<td></td>
</tr>
<tr>
<td>General</td>
<td>X</td>
</tr>
<tr>
<td>Special Revenue</td>
<td>X</td>
</tr>
<tr>
<td>Capital Projects</td>
<td>X</td>
</tr>
<tr>
<td>Debt Service</td>
<td>X</td>
</tr>
<tr>
<td>Permanent</td>
<td>X</td>
</tr>
<tr>
<td><strong>Proprietary Funds:</strong></td>
<td></td>
</tr>
<tr>
<td>Enterprise</td>
<td></td>
</tr>
<tr>
<td>Internal Service</td>
<td></td>
</tr>
<tr>
<td><strong>Fiduciary Funds:</strong></td>
<td></td>
</tr>
<tr>
<td>Private-Purpose Trust</td>
<td></td>
</tr>
<tr>
<td>Investment Trust</td>
<td></td>
</tr>
<tr>
<td>Pension Trust</td>
<td></td>
</tr>
<tr>
<td>Agency</td>
<td></td>
</tr>
</tbody>
</table>
SUMMARY

1. A fund represents that portion of a government recognized as a separate fiscal and accounting sub-unit, with a separate set of accounting records segregated for carrying on a specific activity(s).

2. The GASB has classified all individual funds into three categories: governmental, proprietary or fiduciary.

3. Governmental funds include general, special revenue, capital projects, debt service, and permanent generic funds.

4. Proprietary funds include the enterprise and internal service generic funds.

5. Fiduciary funds include the pension trust, private purpose trust, investment trust, and agency funds.

6. Governmental funds use the modified accrual basis of accounting at the fund level.

7. Proprietary funds and fiduciary funds use the accrual basis of accounting at the fund level.
Chapter 6
THE BASIS OF ACCOUNTING

INTRODUCTION

An important principle that the Governmental Accounting Standards Board (GASB) Codification of Governmental Accounting and Financial Reporting Standards includes within the code is the "basis of accounting." The basis of accounting:

“Refers to when revenues, expenditures, expenses and transfers, and the related assets and liabilities, are recognized in the accounts and reported in the financial statements.”

In other words, the basis of accounting governs the time at which the accounting system recognizes transactions. For example, the basis of accounting determines when a government should recognize a transaction as revenue, an expenditure or an expense. Should you recognize the revenue when it is earned, when it is received, or at some other point in time?

OBJECTIVES:

After completing this chapter, you should be able to:

• Define the phrase “basis of accounting.”

• Contrast the three common bases of accounting.

• Understand when to recognize revenues and expenditures under the modified accrual basis of accounting.

• Understand when to recognize revenues and expenses under the accrual basis of accounting.
BASES OF ACCOUNTING

The “three” common bases of accounting that a state or local government may use include:

1. Cash basis;
2. Accrual basis; and
3. Modified accrual basis.

THE CASH BASIS OF ACCOUNTING

Cash basis accounting recognizes transactions only when cash is received or disbursed. Even though used in some governments, the cash basis of accounting and reporting is not a desirable practice. Cash basis financial statements do not include assets and liabilities not arising from cash transactions (i.e., they ignore the effects of accounts receivable, accounts payable and other accruable items). Since these items are commonly of significant dollar amounts, cash basis financial statements generally do not present financial position or results of operations in conformity with generally accepted accounting principles (GAAP). The only instance in which cash basis financial statement representations are in conformity with GAAP is in the unlikely situation where all accounts receivable, accounts payable, and other accrued items are nonexistent or insignificant.

Cash basis accounting permits distortions in financial statement amounts due to shifts in the timing of cash receipts and disbursements reflecting underlying economic events near the end of a fiscal period. For example, a government may speed up or slow down cash collections and payments near the end of the period. These cash flow changes would affect the government's financial position and results of operations.
Summary of the Cash Basis of Accounting

Under the cash basis of accounting, revenues are recorded when cash is received and costs are reported when a check is written and cash is disbursed.

THE ACCRUAL BASIS OF ACCOUNTING

The accrual basis of accounting recognizes transactions when they occur regardless of the timing of related cash flows. The use of accrual accounting techniques prevents distortions in financial statement representations due to shifts in the timing of cash flow and related underlying economic events near the end of a fiscal period.

In other words, the receipt or disbursement of cash has no effect on the reporting of revenues and expenses. Accrual accounting techniques enhance the comparability of financial statements from period to period and from one governmental entity to another. All proprietary and fiduciary funds use the accrual basis of accounting in their fund financial statements under GAAP.

<table>
<thead>
<tr>
<th>COMPARISON OF ACCRUAL AND CASH BASIS ACCOUNTING</th>
</tr>
</thead>
<tbody>
<tr>
<td>(Accrual) Transaction occurs</td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td>(Cash) Cash Received or Disbursed</td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td>THE POINT IN TIME THAT A TRANSACTION IS RECOGNIZED</td>
</tr>
</tbody>
</table>

Revenue Recognition

Under the accrual basis of accounting, revenue recognition occurs in the accounting period in which the revenue becomes objectively measurable and earned. "Objectively measurable" means the amount can be determined accurately. Obviously, a transaction cannot be reported unless the amount of the transaction can be determined. The
accounting staff must either know the actual amount of a transaction or be able to estimate the amount. This criterion is applicable to the recording of all financial transactions.

For a government to earn revenue, it must have provided the goods or services. For example, the state rents the World Congress Center to a private group at $25 per participant:

- The revenue is earned when the group uses the Center.
- The revenue is measurable when the government knows how many participants attended.

After the above criteria are met, the government would record the transaction as revenue regardless of when the group pays the bill.

**Expense Recognition**

When using the accrual basis of accounting, expenses are recognized in the period incurred, if measurable. To incur an expense, the item purchased must **be received** and **consumed** (used) or the vendor must have **performed** the service. For example, the government must **receive** and **use** the purchased consumable (e.g., chemicals for the water plant) before it can report an expense for the cost of these supplies.

As another example, the exterminator must have completed all work at the water plant before the expense is incurred and the cost reported.

For an expense to be measurable, we must be able to determine the amount. Normally we know the amount when the invoice for the purchase of the service is received. However, if the amount is known as a result of a contract or the amount could be estimated, we can consider the amount as meeting the “measurable” criteria.
THE MODIFIED ACCRUAL BASIS OF ACCOUNTING

All governmental funds use the modified accrual basis of accounting.

Revenue Recognition

Under the modified accrual basis of accounting, revenues are recognized when a transaction meets two criteria:

- Measurable
- Available

As previously stated, revenues are considered objectively measurable if the amount can be determined accurately. Generally, some revenues such as licenses, fees and similar revenues are not considered measurable until they are received in cash. They become measurable when received (i.e., meeting one of the two revenue recognition criteria under the modified accrual basis of accounting).

The requirement that revenues must be available before recognizing them distinguishes the modified accrual basis revenue recognition from that of accrual basis. Available means that the revenue was collected during the year or will be collected soon enough after the end of year to pay liabilities of the current period. In practice, governments interpret the term "available" in different ways. Alternative interpretations include the following:

- Collections are within a period of time after year-end equal to the government's normal bill paying cycle.
- Collections are within a specified, standardized time period after year-end, such as 30, 60, or 90 days.
- Collections are within 12 months after year-end (i.e., the transaction results in a current asset at year-end).

As noted, GAAP allow flexibility when applying this criterion; however, a similar “available period” should be used consistently from year to year.
Expenditure Recognition

Expenditures are recognized under the modified accrual basis:

- when measurable;
- generally when the liability is incurred; and
- when the liability will be liquidated with current resources.

Governments normally consider expenditures measurable when an invoice is received for the goods or services. If the expenditure results from a bid (i.e., the cost is known), the amount could be estimated and the transaction could be considered measurable before the invoice is received.

To incur a liability, the goods must be received in satisfactory condition and/or the service must be performed. For example, the expenditure is recorded when goods or services are received (note that it is not necessary that the goods be used) or when repairs are completed (i.e., the liability is incurred) and the invoice is received (i.e., the transactions are measurable).

GASBI 6 defines the third expenditure criterion to mean that in the absence of an applicable accrual modification, governmental fund liabilities and expenditures should be accrued. Liabilities that governments normally pay in a timely manner and in full from expendable available financial resources (for example, salaries and utilities) should be recognized when incurred, without regard to the extent to which resources are currently available to liquidate the liability.

What this means is that if there are bills/liabilities that exist at year end, and these bills would normally be expected to be paid within the normal bill paying cycle, this criterion usually is considered met. Ordinarily, if a liability exists at year-end, this amount should be reported as an expenditure.
Consumable Inventories

GAAP have special rules regarding when to record an expenditure for consumable inventories (e.g., printing supplies). Governmental funds, using the modified accrual basis of accounting, may use either of two methods:

- Purchases method (when you buy it)
- Consumption method (when you use it)

When using the purchases method the expenditure is recorded when the inventory is purchased (expenditure criteria are met). The journal entry is as follows:

\[
\begin{array}{cc}
\text{DR} & \text{CR} \\
\text{Expenditures} & $4,000 \\
\text{Accounts payable (a liability account)} & $4,000 \\
\end{array}
\]

When using the consumption method, the government must record the expenditure when it uses (i.e., consumes) the inventory. For example, when the inventory is purchased the following journal entry applies:

\[
\begin{array}{cc}
\text{DR} & \text{CR} \\
\text{Inventory (an asset account)} & $4,000 \\
\text{Accounts payable (a liability account)} & $4,000 \\
\end{array}
\]

As the government uses inventories (e.g., they use $500 in value), the following journal entry would be made:

\[
\begin{array}{cc}
\text{DR} & \text{CR} \\
\text{Expenditures} & $ 500 \\
\text{Inventory (an asset account)} & $ 500 \\
\end{array}
\]

Note: Proprietary funds must use the consumption method.
Summary of the Modified Accrual Basis of Accounting

The modified accrual basis of accounting falls somewhere between the cash basis of accounting and the accrual basis of accounting. Revenue recognition under the modified accrual basis is similar to revenue recognition under the accrual basis, as long as the cash is received soon enough after year-end to pay current year liabilities (i.e., it is considered available). Generally an expenditure is recognized and recorded as it would be under the accrual basis, as long as the liability resulting from the expenditure is liquidated from current resources.

The timing of cash receipts for revenue transactions, and of liquidation of the liabilities resulting from expenditures, affect when a transaction is recorded under the modified accrual basis of accounting. When cash is received from the transaction determines when it considers revenue available. When the liability resulting from an expenditure is liquidated determines whether the liability was liquidated from current resources.

Summary Comparison of the Bases of Accounting

As indicated, there are major differences between the non-GAAP cash basis of accounting and the two GAAP methods of accrual accounting. The three bases we discussed above can be compared as they relate to cash received and disbursed as follows:

1. Cash basis – States or local governments report revenues and costs only when they receive or disburse cash. The cash basis of accounting is not an acceptable reporting basis.

2. Modified accrual basis – States or local governments normally recognize revenues if anticipated receipt of the revenue will occur during the year, or soon enough thereafter to pay the current year’s bills. Expenditures are recognized when drawn on current available expendable resources.

   However, in the absence of an applicable accrual modification, governmental fund liabilities and expenditures should be accrued.
Liabilities that governments normally pay in a timely manner and in full from expendable available financial resources (for example, salaries and utilities) should be recognized when incurred, without regard to the extent to which resources are currently available to liquidate the liability.

3. Accrual basis - States or local governments recognize revenues and expenses when the event occurs without regard to when they receive or disburse cash.

The following exhibit summarizes the two acceptable bases of accounting explained above.

**COMPARISON OF THE BASES OF ACCOUNTING**

<table>
<thead>
<tr>
<th></th>
<th>Accrual</th>
<th>Modified Accrual</th>
</tr>
</thead>
<tbody>
<tr>
<td>A. Revenues are recorded when:</td>
<td>Measurable (the amount can be determined) and Earned (the service has been provided)</td>
<td>Measurable (the amount can be determined) and Available (the revenue was collected in the current fiscal year or will be collected soon enough after the close of the fiscal year to pay liabilities of the current year)</td>
</tr>
<tr>
<td>B. Expenses/expenditures are recorded when:</td>
<td>(Expenses) Measurable (the amount can be determined) and Incurred and consumed (goods received and used or services performed)</td>
<td>(Expenditures) Measurable (the amount can be determined) and Incurred (the liability has been created and will normally be paid from current resources)</td>
</tr>
</tbody>
</table>
### RELATIONSHIP TO FUND ACCOUNTING

All generic funds must use either the accrual or the modified accrual basis of accounting as illustrated on this page. Governmental funds use the modified accrual basis of accounting and the proprietary and fiduciary funds use the accrual basis of accounting.

<table>
<thead>
<tr>
<th>Fund Type</th>
<th>Basis of Accounting</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Modified Accrual</td>
</tr>
<tr>
<td><strong>Governmental Funds:</strong></td>
<td></td>
</tr>
<tr>
<td>General</td>
<td>X</td>
</tr>
<tr>
<td>Special Revenue</td>
<td>X</td>
</tr>
<tr>
<td>Capital Projects</td>
<td>X</td>
</tr>
<tr>
<td>Debt Service</td>
<td>X</td>
</tr>
<tr>
<td>Permanent</td>
<td>X</td>
</tr>
<tr>
<td><strong>Proprietary Funds:</strong></td>
<td></td>
</tr>
<tr>
<td>Enterprise</td>
<td></td>
</tr>
<tr>
<td>Internal Service</td>
<td></td>
</tr>
<tr>
<td><strong>Fiduciary Funds:</strong></td>
<td></td>
</tr>
<tr>
<td>Private-Purpose Trust</td>
<td>X</td>
</tr>
<tr>
<td>Investment Trust</td>
<td>X</td>
</tr>
<tr>
<td>Pension Trust</td>
<td>X</td>
</tr>
<tr>
<td>Agency</td>
<td>X</td>
</tr>
</tbody>
</table>
SUMMARY

1. The basis of accounting determines when a state or local government records transactions in its financial statements.

2. Cash basis accounting cannot be used for external financial reporting; however, many governments use cash basis accounting (checkbook accounting) on a daily basis.

3. Under the accrual basis of accounting, states or local governments recognize revenues in the accounting period in which they become measurable and are earned.

4. Under the accrual basis of accounting, states and local governments recognize expenses in the accounting period incurred, if measurable. Incurred simply means the goods have been received and used or the services have been performed.

5. Proprietary and fiduciary funds use the accrual basis of accounting.

6. Under the modified accrual basis of accounting, revenues are recognized in the accounting period when they become susceptible to accrual, that is, when they become measurable and available (i.e., collected during the year or soon enough after year-end to pay liabilities of the current period).

7. Under the modified accrual basis of accounting, expenditures are recognized in the accounting period when measurable and generally when the liability is incurred and would normally be expected to be liquidated with current resources.

8. Governmental funds use the modified accrual basis of accounting at the fund level.
Chapter 7
PAYROLL AND BENEFIT ACCOUNTING

OBJECTIVES

For most governments, whether state or local, employee salaries and benefits are the single largest costs. Therefore, proper control should be established and maintained over the payroll function. A payroll system should provide the basis for:

- Accurate work and time reporting;
- Accurate and timely issuance of payroll checks;
- Distribution of salary costs to the appropriate cost center or budget activity;
- Accurate and timely tax and benefit reporting.

Over the years, general payroll and benefit accounting has changed. Tax shelters and various additional payroll deductions are the primary changes. Finally, as accounting systems have become more sophisticated, the distribution of salaries and wages to multiple accounts has become prevalent. The use of a computer system can greatly enhance the required payroll procedures.

After completing this chapter, you should be able to:

- Understand how employee earnings are determined.
- Distinguish a gross payroll, adjusted gross payroll, and net payroll.
- Define the various types of payroll deductions.
- Record the payroll.
- Record the employer’s share of employee benefits.
EMPLOYEE EARNINGS

Overall, salaries and wages are normally determined by an agreement between the employer and the employee. Many governments use a salary schedule for each type of position that includes both steps and years of experience.

Some employees are paid an annual salary, prorated over pay periods. Other employees are paid an hourly rate. Salaries and wages can be paid monthly, semimonthly, biweekly, or weekly.

State and local governments typically must conform to the requirements of the Fair Labor Standards Act. This Act requires state and local governments to pay a minimum rate of 150% of the regular payroll rate for all hours employees worked in excess of 40 hours per week. The law provides exemptions from the requirements for executive, administrative and certain supervisory positions.

Time Sheets

In many governments, the time sheet is the basis for determination of the periodic payroll. Generally each employee is responsible for maintaining an accurate account of hours they worked on a time sheet. The time sheet gives the payroll department the number of hours worked and aids with the distribution of payroll costs to appropriate cost centers (i.e., the various expenditure accounts). Time sheets will vary in format but usually include the following information:

- Employee name and number
- Pay period
- Dates worked
- Number of hours worked
- Account distribution
- Signatures of employee and supervisor

Sometimes, the supervisor of a group of employees might maintain a single time sheet for all employees under their supervision. This process reduces the number of time sheets employees submit each payroll period and is feasible when the government charges all the employees to a single cost center.
PAYROLL JOURNAL

Usually a special journal (sometimes we call this accounting record a payroll register) for the payroll is used to record all of the payroll information for each employee. The data included on the payroll journal originates either from period employee time sheets or from the Personnel Department (usually at the beginning of the fiscal year) for salaried employees (i.e., an employee who receives an annual salary prorated equally over the fiscal year).

The following information is typically included in a payroll journal:

- **Name of employee** (i.e., the payee).

- **Expenditure/expense classification** (s) for the adjusted gross payroll - Some employees are only charged to a single expenditure/expense account while other employees are charged to numerous expenditure accounts based upon how much time each employee spends working in the activity accounted for in each account.

- **Gross payroll** - The gross payroll of an employee is determined by contractual agreement (i.e., for those employees retained under contract) or by time sheets (i.e., for those employees paid on a period basis such as hourly or weekly). The gross salary for employees under contract is derived by dividing the contract amount by the number of pay periods in the contract. Hourly employees' gross payroll is computed by multiplying the hourly rate by the number of hours worked.

- **Adjustments to gross payroll** - There are instances when an employee's normal gross payroll is increased or decreased.

  Examples of decreases to gross payroll include:

  - An employee may take personal leave without pay.
  - An employee may use more than the allowable accumulated sick days.
  - Services required by a contract may not be performed.

  Examples of increases to gross payroll might include:

  - Performance stipends.
  - Holiday stipends.
• **Adjusted gross payroll** - This amount is the gross payroll plus or minus any adjustments to the gross payroll. *This is the amount actually charged to the applicable expenditure/expense accounts.*

• **Net payroll** – The amount of the employee’s paycheck.

**EXHIBIT 7-1 SAMPLE PAYROLL JOURNAL**

<table>
<thead>
<tr>
<th>Pay Description</th>
<th>Rate</th>
<th>Reg. Hrs.</th>
<th>O/T Hrs.</th>
<th>Amount</th>
<th>Withholdings</th>
<th>Amount</th>
<th>Deduction Desc.</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>2 - JANE DOE Check #101 09/01/20X5</td>
<td></td>
<td></td>
<td></td>
<td>1,281.67</td>
<td></td>
<td></td>
<td>United Way</td>
<td>5.00</td>
</tr>
<tr>
<td>Salaried Wages</td>
<td>1,281.67</td>
<td>0.0000</td>
<td>0.0000</td>
<td>1,281.67</td>
<td>62.82</td>
<td>271.58</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>FICA-Med</td>
<td>14.65</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Federal Wh</td>
<td>92.36</td>
<td>100.00</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>State Wh</td>
<td>34.19</td>
<td>40.1-k</td>
<td></td>
<td>51.27</td>
</tr>
<tr>
<td><strong>TOTALS</strong></td>
<td></td>
<td>0.0000</td>
<td>0.0000</td>
<td>1,281.67</td>
<td>203.82</td>
<td></td>
<td></td>
<td>427.85</td>
</tr>
<tr>
<td><strong>NET PAY:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>650.00</td>
</tr>
</tbody>
</table>

| 1 - JOHN SMITH Check #102 09/01/20X5 |      |           |          | 1,287.50 |              |        | United Way      | 5.00   |
| Salaried Wages       | 1,287.50 | 0.0000   | 0.0000   | 1,287.50 | 61.42        | 296.73 |                  |        |
|                      |       |           |          | FICA-Med | 14.37        |        |                  |        |
|                      |       |           |          | Federal Wh | 89.43      | 50.00  |                  |        |
|                      |       |           |          | State Wh | 28.18       | 401-k  |                  | 51.50  |
| **TOTALS**           |       | 0.0000    | 0.0000   | 1,287.50 | 193.60       |        |                  | 403.23 |
| **NET PAY:**         |       |           |          |         |              |        |                  | 890.87 |

**PAYROLL DEDUCTIONS**

From gross pay, various amounts are deducted to arrive at the net pay. Some deductions are mandatory while other voluntary deductions must be authorized by each employee. Payroll deductions are considered liabilities of the government until remitted to the appropriate organization or agency. The following deductions could be applicable:

• **Social Security tax** - The Federal Insurance Contributions Act (FICA) requires governments to withhold part of the employees’ earnings. The FICA tax withheld is the employees’ contribution to the combined federal programs for old-age and disability benefits, insurance benefits to survivors, and health insurance for the aged (i.e., Medicare).

The tax is a certain percentage (currently a combined rate of 7.65%) computed on an adjusted gross payroll. There is a maximum salary to which the deduction applies.
• **Federal income tax** - Federal laws require that employers withhold part of the earnings of their employees for payment of the employees’ liability for federal income tax. The amount withheld varies according to the amount of adjusted gross pay, marital status and the estimated deductions and exemptions claimed when employees file their annual income tax returns. The amount deducted is computed on an adjusted gross payroll less any tax-sheltered amounts (e.g., deferred compensation or annuities). For example, if an employee earns $2,000 per month and has $200 withheld for deferred compensation (see discussion below), the federal income tax deduction would be calculated on $1,800 (i.e. $2,000 less $200).

When hired, the employee must complete an Internal Revenue Service (IRS) Form W-4, Employee's Withholding Allowance Certificate. This form provides the information needed to compute the federal income tax deduction and includes the number of personal exemptions the employee is claiming. Very specific instructions accompany the form. This information is used to compute the payroll deduction for federal income tax.

• **State income tax** - Employers withhold part of the earnings of their employees for payment of the employees’ liability for state income tax. Generally, the same issues apply here that apply to federal income tax, including the deferred compensation exemption.

• **Deferred compensation** - Federal laws allow state and local government employees to defer part of their compensation to future periods. Besides deferring the compensation, federal and state income tax is deferred until the employee actually receives the compensation. This amount is subject to FICA.

• **Pension plans** - (i.e., the amount of employee contributions to retirement plans) - Many employees participate in pension plans offered by their employers. Usually the employer contributes to the plan as well as the employee.

• **Insurance** - This deduction could include the amount of an employee's share of employee insurance premiums.

• **Miscellaneous deductions** - Some of these deductions are mandatory, such as garnishments and liens, and some are optional, such as credit union dues, charitable contributions and child care. The tax law allows some payroll deductions to be deducted and the costs paid from gross payroll using pretax dollars. In other words, the taxable amount for federal income tax is reduced by the amount of payroll deductions. These deductions might include medical and dental insurance premiums and dependent care expenses. These are often referred to as “spending accounts.”
EXHIBIT 7-2 SAMPLE PAYROLL CHECK

NET PAYROLL

Net payroll is the amount of adjusted gross payroll less total deductions. In other words, this is the amount the employee actually receives in his/her check.

RECORDING THE PAYROLL

From the payroll journal (the book of original entry), the payroll must be posted to the general ledger (the book of final entry). Posting is usually done by recording the data directly from the payroll journal to the general ledger and the subsidiary expenditure ledgers. However, if the payroll module of the accounting software is integrated with the general ledger, the entries are automatically posted. If the posting is not automatic, then some states or local governments might prepare a general journal.
The journal entry required to record the payroll follows:

<table>
<thead>
<tr>
<th>DR</th>
<th>CR</th>
</tr>
</thead>
<tbody>
<tr>
<td>Expenditure control</td>
<td>$ 24,648</td>
</tr>
<tr>
<td>FICA payable (liability)</td>
<td>$ 1,866</td>
</tr>
<tr>
<td>Federal income tax (liability)</td>
<td>4,897</td>
</tr>
<tr>
<td>State income tax (liability)</td>
<td>1,275</td>
</tr>
<tr>
<td>Pension retirement payable (liability)</td>
<td>786</td>
</tr>
<tr>
<td>Deferred compensation payable (liability)</td>
<td>3,500</td>
</tr>
<tr>
<td>Cash in bank (asset)</td>
<td>12,324</td>
</tr>
</tbody>
</table>

The information required for the expenditure ledger comes from the payroll register summary as do the payroll deductions and withholdings. Individual payroll deductions and withholdings may be accounted for with separate balance sheet liability accounts, or a control account (i.e., accrued payroll deductions payable) may be used in the general ledger, with specific deductions or withholdings recorded in some separate subsidiary ledger accounts (e.g., federal withholdings, FICA withholdings).

**Employer's (State or Local Government) Share of Employee Benefits**

Often, the employer has a responsibility for paying its share of employee benefits. Usually, the employer should charge its share of benefits as an expenditure to the same funds and departments/programs where the employee’s salary is charged.

FICA is the most common benefit that employers must match. Other benefits, such as all or some employee insurance or part of the pension contributions, may also be paid by the employer.
The journal entry to record the employer’s share of benefits is as follows:

<table>
<thead>
<tr>
<th></th>
<th>DR</th>
<th>CR</th>
</tr>
</thead>
<tbody>
<tr>
<td>Expenditure control</td>
<td>$ 4,908</td>
<td></td>
</tr>
<tr>
<td>FICA payable (liability)</td>
<td></td>
<td>$ 2,573</td>
</tr>
<tr>
<td>Pension retirement payable (liability)</td>
<td></td>
<td>$ 2,335</td>
</tr>
</tbody>
</table>

EMPLOYEE EARNINGS RECORD

Employers maintain an employee earnings record for each employee. These records are normally computerized and in most instances will be a part of the payroll software used. The primary purpose of this record is to keep up with payroll data for each employee. Generally the record includes personal data for the employee and includes the details of each payroll period for the specific employee.

The employee’s earnings record normally is arranged to correspond to the format of the payroll journal. Usually, the individual earnings record provides spaces for recording all of the information needed to calculate the adjusted gross payroll for the employee and reflect deduction totals by calendar quarter, calendar year and fiscal year, as applicable.

Calendar quarter and year-end totals are required for reporting taxable gross payrolls, tax withholdings, and/or FICA information to federal and state taxing authorities. Fiscal year totals are required in connection with the annual audit to prove the accuracy of the amounts paid as compared with salary contracts, as applicable.
## EXHIBIT 7-3 SAMPLE EARNINGS REPORT

<table>
<thead>
<tr>
<th>PAY DATE</th>
<th>PAY W#</th>
<th>PAYEE</th>
<th>RATE</th>
<th>O/T 1</th>
<th>O/T 2</th>
<th>O/T 3</th>
<th>PAY AMOUNT</th>
<th>TAX TYPE</th>
<th>AMOUNT</th>
<th>NET PAY</th>
<th>CHECK # LOC</th>
</tr>
</thead>
<tbody>
<tr>
<td>1/11</td>
<td>TX TX 100</td>
<td>REG SALARY</td>
<td>2015.38</td>
<td>188.03</td>
<td>1411.77</td>
<td>11715</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1/04</td>
<td>TX TX 100</td>
<td>40HR 8.5 WT</td>
<td>-201.64</td>
<td>SOC. SEC.</td>
<td>122.29</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>TX TX 100</td>
<td>SEC. 125</td>
<td>-43.00</td>
<td>MEDICARE</td>
<td>20.60</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>TX TX 100</td>
<td>UNITED WAY</td>
<td>-29.15</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1/31</td>
<td>TX TX 100</td>
<td>REG SALARY</td>
<td>2015.38</td>
<td>188.03</td>
<td>1411.77</td>
<td>V:699999</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1/18</td>
<td>TX TX 100</td>
<td>40HR 8.5 WT</td>
<td>-201.64</td>
<td>SOC. SEC.</td>
<td>122.29</td>
<td>DIR DEP 1</td>
<td>1000.00</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>TX TX 100</td>
<td>SEC. 125</td>
<td>-43.00</td>
<td>MEDICARE</td>
<td>20.60</td>
<td>DIR DEP 2</td>
<td>361.77</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>TX TX 100</td>
<td>UNITED WAY</td>
<td>-29.15</td>
<td></td>
<td></td>
<td></td>
<td>DIR DEP 3</td>
<td>50.00</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2/08</td>
<td>TX TX 100</td>
<td>REG SALARY</td>
<td>2015.38</td>
<td>188.03</td>
<td>1411.77</td>
<td>V:699999</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2/01</td>
<td>TX TX 100</td>
<td>40HR 8.5 WT</td>
<td>-201.64</td>
<td>SOC. SEC.</td>
<td>122.29</td>
<td>DIR DEP 1</td>
<td>1000.00</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>TX TX 100</td>
<td>SEC. 125</td>
<td>-43.00</td>
<td>MEDICARE</td>
<td>20.60</td>
<td>DIR DEP 2</td>
<td>361.77</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>TX TX 100</td>
<td>UNITED WAY</td>
<td>-29.15</td>
<td></td>
<td></td>
<td></td>
<td>DIR DEP 3</td>
<td>50.00</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2/22</td>
<td>TX TX 100</td>
<td>REG SALARY</td>
<td>2015.38</td>
<td>188.03</td>
<td>1411.77</td>
<td>V:699999</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2/15</td>
<td>TX TX 100</td>
<td>40HR 8.5 WT</td>
<td>-201.64</td>
<td>SOC. SEC.</td>
<td>122.29</td>
<td>DIR DEP 1</td>
<td>1000.00</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>TX TX 100</td>
<td>SEC. 125</td>
<td>-43.00</td>
<td>MEDICARE</td>
<td>20.60</td>
<td>DIR DEP 2</td>
<td>361.77</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>TX TX 100</td>
<td>UNITED WAY</td>
<td>-29.15</td>
<td></td>
<td></td>
<td></td>
<td>DIR DEP 3</td>
<td>50.00</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**YEAR TO DATE:**

<table>
<thead>
<tr>
<th>PAY W#</th>
<th>PAYEE</th>
<th>RATE</th>
<th>O/T 1</th>
<th>O/T 2</th>
<th>O/T 3</th>
<th>PAY AMOUNT</th>
<th>TAX TYPE</th>
<th>AMOUNT</th>
<th>NET PAY</th>
<th>CHECK # LOC</th>
</tr>
</thead>
<tbody>
<tr>
<td>REG SALARY</td>
<td>2015.93</td>
<td>188.03</td>
<td>1411.77</td>
<td>11715</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>40HR 8.5 WT</td>
<td>-201.64</td>
<td>SOC. SEC.</td>
<td>122.29</td>
<td>DIR DEP 1</td>
<td>1000.00</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>SEC. 125</td>
<td>-43.00</td>
<td>MEDICARE</td>
<td>20.60</td>
<td>DIR DEP 2</td>
<td>361.77</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>UNITED WAY</td>
<td>-29.15</td>
<td></td>
<td></td>
<td>DIR DEP 3</td>
<td>50.00</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
SUMMARY

1. In some governments, time sheets (i.e., the source document) may be used as the basis for determining the amount of the payroll.

2. Most governments use a payroll journal or register (a book of original entry) to determine the information to record the payroll.

3. The adjusted gross payroll is the amount charged to the expenditure accounts on the operating statement.

4. Payroll deductions are reported as liabilities on the balance sheet/statement of net assets of the government until paid.

5. When hired the employee must complete various forms to determine the amount of income taxes and other deductions to be withheld from a paycheck.

6. Most computer payroll systems provide the capability to charge an employee's salary to more than one expenditure account.

7. Some employees' payroll deductions must be matched by contributions from the employer (e.g., FICA).

8. An employee's earnings record provides payroll data indicating the gross payroll, the adjusted gross payroll, payroll deductions and net payroll.

9. The Accrued Salaries and Wages account is reported as a current liability on the government’s balance sheet.
Chapter 8
ACCOUNTING FOR INTERFUND TRANSACTIONS

OBJECTIVES

In the private sector, many corporations (known as the parent) own subsidiary companies. Often transactions occur between these subsidiary companies and the parent company.

In the public sector, states and local governments have similar activities. For example, a government might maintain seventy accounting funds each with its own set of self-balancing accounting records. It’s easy to understand that each fund is analogous to that of a subsidiary corporation since they are both separate. In other words, each fund is a separate accounting entity, and it treats other funds as third parties. Transactions between funds of the same government are known as interfund transactions.

After completing this chapter, you should be able to:

• Understand the difference between interfund loans and transfers.

• Record interfund loans and transfers.

BACKGROUND

It’s just a fact of life (accounting life, that is) that the more individual funds that a government maintains, the more interfund transactions occur. The Governmental Accounting Standards Board (GASB) provides guidance regarding the classifying and reporting of interfund transactions.

Only two types of interfund transactions are introduced in this chapter: loans and transfers. A temporary reallocation of resources is basically a loan between funds and is reported on the balance sheet/statement of net assets only. Transfers are permanent reallocations of assets in that there is no intent to repay and are reported in much the same way as revenues and expenditures on the operating statement.

As a rule, interfund transactions should be treated consistently in both the funds that are paying resources and the funds that are receiving resources. In other words, each fund that is a party to the transaction must record their side of the transaction. For example, an interfund loan receivable is reported as an asset in the fund that is loaning resources, while the fund that borrowed the money should report an interfund loan payable as a liability.
INTERFUND LOANS

Interfund loans are temporary reallocations of resources. When monies are loaned between funds, they must be repaid. Interfund loans are reported only on the balance sheet.

For example, if the general fund lends a special revenue fund $25,000, the following journal entries must be made:

<table>
<thead>
<tr>
<th>DR</th>
<th>CR</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>General fund:</strong></td>
<td><strong>Special revenue fund:</strong></td>
</tr>
<tr>
<td>Interfund loan receivable (asset)</td>
<td>$25,000</td>
</tr>
<tr>
<td>Cash in bank (asset)</td>
<td>$25,000</td>
</tr>
<tr>
<td>Cash in bank (asset)</td>
<td>$25,000</td>
</tr>
<tr>
<td>Interfund loan payable (liability)</td>
<td>$25,000</td>
</tr>
</tbody>
</table>

In the above transactions, each of the accounts affected are balance sheet accounts, therefore there is no affect on equity. We have swapped one asset for another. In fact, an interfund loan is the only interfund transaction that has no effect on equity.
INTERFUND TRANSFERS

Interfund transfers are permanent reallocations of resources. Transfers of monies between funds are reported in the same manner that revenues and expenditures/expenses are reported in the accounting records. In other words, transfers are reported on the operating statement.

For example, if the general fund transfers $30,000 to a special revenue fund, the journal entries that the accountant must make are as follows:

<table>
<thead>
<tr>
<th>General fund:</th>
<th>DR</th>
<th>CR</th>
</tr>
</thead>
<tbody>
<tr>
<td>Transfers out (expenditure)</td>
<td>$30,000</td>
<td></td>
</tr>
<tr>
<td>Cash in bank (asset)</td>
<td></td>
<td>$30,000</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Special revenue fund:</th>
<th>DR</th>
<th>CR</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash in bank (asset)</td>
<td>$30,000</td>
<td></td>
</tr>
<tr>
<td>Transfers in (revenue)</td>
<td></td>
<td>$30,000</td>
</tr>
</tbody>
</table>
SUMMARY

1. Because of fund accounting, governments often have transactions between funds. These are called interfund transactions.

   INTERFUND LOANS - ARE REPAID AT SOME POINT IN TIME AND ARE REPORTED ON THE BALANCE SHEET/STATEMENT OF NET ASSETS

   INTERFUND TRANSFERS - ARE NOT REPAID AND ARE REPORTED ON THE OPERATING STATEMENT

2. Loans are temporary reallocations of resources.

3. Loans are reported on the balance sheet/statement of net assets only and not on the operating statement.

4. Transfers are permanent reallocations of resources.

5. Transfers are recorded like revenues and expenditures in the accounting records.

6. Each fund that is a part of an interfund transaction must record an entry for their share of the transaction.
ACCOUNTING SYSTEM. The methods and records established to identify, assemble, analyze, classify, record and report a government’s transactions and to maintain accountability for the related assets and liabilities.

ACCOUNTS PAYABLE. A current liability account reflecting amounts owed to private persons or organizations for goods and services received by a government.

ACCOUNTS RECEIVABLE. A current account reflecting amounts due from private persons or organizations for goods and services furnished by a government (but not including amounts due from other funds or other governments).

ACCRUAL BASIS. The recording of the financial effects on a government of transactions and other events and circumstances that have consequences for the government in the periods in which those transactions, events and circumstances occur, rather than only in the periods in which cash is received or paid by the government.

ACCRUED INTEREST PAYABLE. A current liability account reflecting certain interest costs that have been incurred but is not due until a later date.

ACCRUED SALARIES AND WAGES PAYABLE. A current liability account reflecting salaries and wages earned by employees but not due until a later date.

ACCUMULATED DEPRECIATION. A contra-asset account used to report the accumulation of periodic credits that reflect the expiration of the estimated service life of capital assets.

AD VALOREM TAX. A tax based on value (e.g., a property tax).

ADVANCE FROM OTHER FUNDS. A liability account used to record noncurrent portions of a long-term debt owed by one fund to another fund within the same reporting entity. See DUE TO OTHER FUNDS and INTERFUND RECEIVABLE/PAYABLE.

ADVANCE TO OTHER FUNDS. An asset account used to record noncurrent portions of a long-term loan from one fund to another fund with the same reporting entity. See DUE FROM OTHER FUNDS.

AGENCY FUND. A fund normally used to account for assets held by a government as an agent for individuals, private organizations or other governments and/or other funds.
ALLOWANCE FOR UNCOLLECTIBLES. A contra-asset valuation account used to indicate the portion of a receivable not expected to be collected.

ANNUAL FINANCIAL REPORT. A financial report applicable to a single fiscal year.

APPROPRIATION. A legal authorization granted by a legislative body to make expenditures and to incur obligations for specific purposes. An appropriation usually is limited in amount and time it may be expended.

ASSET. A probable future economic benefit obtained or controlled by a particular entity as a result of past transactions or events. (What you own.)

ASSIGNED FUND BALANCE. A portion of fund balance that includes 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).

BALANCE SHEET. A financial statement disclosing the assets, liabilities and equity of an entity at a specified date in conformity with GAAP.

BASIS OF ACCOUNTING. A term used to refer to when revenues, expenditures, expenses, and transfers - and the related assets and liabilities - are recognized in the accounts and reported in the financial statements. Specifically, it relates to the timing of the measurements made, regardless of the nature of the measurement, on either the cash or the accrual method.

BOND. Most often, a written promise to pay a specified sum of money (called the face value or principal amount), at a specified date or dates in the future, called the maturity date(s), together with periodic interest at a specified rate. Sometimes, however, all or a substantial portion of the interest is included in the face value of the security. The difference between a note and a bond is that the latter is issued for a longer period and requires greater legal formality. See GENERAL OBLIGATION BONDS PAYABLE and REVENUE BONDS PAYABLE.

BONDS PAYABLE. Generally, the face value of bonds issued and unpaid. In the case of deep-discount and zero-coupon bonds, however, only the accreted value of the security is reported as bonds payable on the balance sheet.

BUILDINGS AND BUILDING IMPROVEMENTS. A capital asset account reflecting the acquisition cost of permanent structures owned or held by a government and the improvements thereon.

BUSINESS-TYPE ACTIVITIES. Those activities of a government carried out primarily to provide specific services in exchange for a specific user charge.
CAPITAL ASSETS. Long-lived tangible assets obtained or controlled as a result of past transactions, events or circumstances. Capital assets include buildings, equipment, infrastructure, improvements other than buildings and land. In the private sector, these assets are referred to most often as property, plant and equipment.

CAPITAL EXPENDITURES. Expenditures resulting in the acquisition of or addition to the government's general capital assets.

CAPITAL GRANTS. Grants restricted by the grantor for the acquisition and/or construction of capital assets. See OPERATING GRANTS.

CAPITAL LEASE. An agreement that conveys the right to use property, plant or equipment, usually for a stated period of time, that meets one or more of the criteria set forth in SFAS No. 13 for lease capitalization.

CAPITAL PROJECTS FUND. A fund 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 projects 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.

CASH BASIS. A basis of accounting under which transactions are recognized only when cash is received or disbursed.

COMMITTED FUND BALANCE. A portion of fund balance that includes 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.

COMPENSATED ABSENCES. Absences from work, such as vacation, illness and holidays, for which it is expected employees will be paid. The term does not encompass severance or termination pay, postretirement benefits, deferred compensation or other long-term fringe benefits, such as group insurance and long-term disability pay.

CONSTRUCTION IN PROGRESS. A capital asset account reflecting the cost of construction work for projects not yet completed.

CONSUMPTION METHOD. The method under which inventories are recorded as expenditures/expense when used. See PURCHASES METHOD.

CONTRACTS PAYABLE. A current liability account reflecting amounts due on contracts of goods or services furnished to a government. Amounts withheld as guarantees on contracts should be classified separately in an account entitled "Retainage payable." See ACCOUNTS PAYABLE.
CONTRIBUTED CAPITAL. Contributed capital is created, when a general capital asset is "transferred" to a proprietary fund or when a grant is received that is externally restricted to capital acquisition or construction. Contributions restricted to capital acquisition and construction and capital assets received from developers and customers, also would be reported in this category. GASB 34 changed the recording of contributed capital. This statement requires that capital contributions be reported in the operating statement as a separate item after nonoperating revenues and expenses, rather than direct additions to a contributed capital equity account.

CURRENT. As applied to budgeting and accounting, designates the operations of the present fiscal period as opposed to past or future periods. It usually connotes items likely to be used up or converted into cash within the current operating cycle or shortly thereafter.

DEBT. An obligation resulting from the borrowing of money or from the purchase of goods and services. Debts of governments include bonds, time warrants and notes. See ACCOUNTS PAYABLE, BOND, NOTE PAYABLE, LONG-TERM DEBT and GENERAL LONG-TERM DEBT.

DEBT SERVICE FUND. A fund 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.

DEFERRED REVENUE. Amounts for which asset recognition criteria have been met, but for which revenue recognition criteria have not been met. Under the modified accrual basis of accounting, amounts that are measurable but not available is one example of deferred revenue. Another example is the receipt of cash in advance of the period of applicability.

DEFICIT. (1) The excess of the liabilities of a fund over its assets. (2) The excess of expenditures over revenues during an accounting period or, in the case of proprietary funds, the excess of expenses over revenues during an accounting period.

DEPRECIATION. (1) Expiration in the service life of capital assets, other than wasting assets, attributable to wear and tear, deterioration, action of the physical elements, inadequacy and obsolescence. (2) The portion of the cost of a capital asset, other than a wasting asset, charged as an expense during a particular period. In accounting for depreciation, the cost of a capital asset, less any salvage value, is prorated over the estimated service life of such an asset, and each period is charged with a portion of such cost. Through this process, the entire cost of the asset is ultimately charged off as an expense.
DISBURSEMENT. A payment in cash or by check. In the cash basis of accounting expenses are only recognized at the time physical cash is disbursed. See CASH BASIS and STATEMENT OF CASH RECEIPTS AND DISBURSEMENTS.

DOUBLE ENTRY. A system of bookkeeping or accounting requiring that for every entry made to the debit side of an account or accounts, an entry or entries be made for an equal amount to the credit side of another account or accounts.

DUE FROM OTHER FUNDS. A current asset account used to indicate amounts owed to a particular fund by another fund for goods sold or services rendered. This account includes only short-term obligations on open account, not interfund loans. See ADVANCE TO OTHER FUNDS and INTERFUND RECEIVABLE/PAYABLE.

DUE TO OTHER FUNDS. A current liability account reflecting amounts owed by a particular fund to another fund for goods sold or services rendered. These amounts include only short-term obligations on open account, not interfund loans. See ADVANCE FROM OTHER FUNDS and INTERFUND RECEIVABLE/PAYABLE.

ENABLING LEGISLATION. Legislation that authorizes a government to assess, levy, charge, or otherwise mandate payment of resources (from external resource providers) and includes a legally enforceable requirement that those resources be used for the specific purposes stipulated in the legislation.

ENCUMBRANCES. Commitments related to unperformed (executory) contracts for goods or services. Used in budgeting, encumbrances are not GAAP expenditures or liabilities, but represent the estimated amount of expenditures ultimately to result if unperformed contracts in process are completed.

ENTERPRISE FUND. (1) A fund established to account for operations financed and operated in a manner similar to private business enterprises (e.g., water, gas and electric utilities; airports; parking garages; or transit systems). In this case the governing body intends that costs (i.e., expenses, including depreciation) of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges. (2) A fund established because the governing body has decided that periodic determination of revenues earned, expenses incurred and/or net income is appropriate for capital maintenance, public policy, management control, accountability or other purposes.

EQUITY ACCOUNTS. Those accounts presenting the difference between assets and liabilities of the fund. A governmental fund’s equity account is referred to as fund balance, whereas the equity account of proprietary and fiduciary funds are called net assets.

EXPENDITURES. Decreases in net financial resources. Expenditures include current operating expenses requiring the present or future use of net current assets, debt
service and capital outlays, and intergovernmental grants, entitlements and shared revenues.

**EXPENSES.** Outflows or other using up of assets or incurrences of liabilities (or a combination of both) from delivering or producing goods, rendering services or carrying out other activities that constitute the entity's ongoing major or central operations.

**FIDUCIARY FUNDS.** The trust and agency funds used to account for assets held by a government unit in a trustee capacity or as an agent for individuals, private organizations, or other government units.

**FINANCIAL RESOURCES.** Cash and other assets that, in the normal course of operations, will become cash.

**FISCAL YEAR.** A 12-month period to which the annual operating budget applies and at the end of which a government determines its financial position and the results of its operations.

**FLOW OF CURRENT FINANCIAL RESOURCES.** A measurement focus that recognizes the net effect of transactions on current financial resources by recording accruals for those revenue and expenditure transactions which have occurred by year end that are normally expected to result in cash receipt or disbursement early enough in the following year either (a) to provide financial resources to liquidate liabilities recorded in the fund at year end or (b) to require the use of available expendable financial resources reported at year end. Under this measurement focus, only current assets and current liabilities are reported on the balance sheet. Also, the modified accrual basis of accounting is associated with this measurement focus, with the result that operating statements report expenditures rather than expenses.

**FLOW OF ECONOMIC RESOURCES.** The measurement focus used in the commercial model and in proprietary and similar trust funds to measure economic resources, the claims to those economic resources and the effects of transactions, events and circumstances that change economic resources and claims to those resources. This focus includes depreciation of capital assets, deferral of unearned revenues and prepaid expenses, and amortization of the resulting liabilities and assets. Under this measurement focus, all assets and liabilities are reported on the balance sheet statement of net assets, whether current or noncurrent. Also, the accrual basis of accounting is used, with the result that operating statements report expenses rather than expenditures.

**FUND.** A fiscal and accounting entity with a self-balancing set of accounts in which cash and other financial resources, all related liabilities and residual equities, or balances, and changes therein, are recorded and segregated to carry on specific activities or attain certain objectives in accordance with special regulations, restrictions or limitations.
**FUND BALANCE.** The difference between fund assets and fund liabilities of governmental and similar trust funds.

**FUND TYPE.** Any one of three categories into which all funds are classified in governmental accounting. The eleven fund types are: general, special revenue, debt service, capital projects, permanent, enterprise, internal service, private purpose trust, pension trust, investment trust, and agency.

**GENERAL FUND.** The fund within the governmental category used to account for all financial resources except those required to be accounted for in another governmental fund.

**GENERAL JOURNAL.** A journal in which are recorded all entries not recorded in special journals. See SPECIAL JOURNAL.

**GENERAL LEDGER.** A record containing the accounts needed to reflect the financial position and the results of operations of a government. In double-entry bookkeeping, the debits and credits in the general ledger are equal (i.e., the debit balances equal the credit balances). See SUBSIDIARY LEDGER, and SUBSIDIARY ACCOUNT.

**GENERAL LONG-TERM DEBT.** Long-term debt expected to be repaid from governmental funds. See LONG-TERM DEBT.

**GENERAL OBLIGATION BONDS PAYABLE.** Bonds backed by the full faith and credit of government.

**GENERALLY ACCEPTED ACCOUNTING PRINCIPLES (GAAP).** Uniform minimum standards and guidelines for financial accounting and reporting governing the form and content of the financial statements of an entity. GAAP encompass the conventions, rules and procedures necessary to define accepted accounting practice at a particular time. Included in GAAP are not only broad guidelines of general application but also detailed practices and procedures, a standard by which to measure financial presentations. The primary authoritative body on the application of GAAP to state and local governments is the GASB. See GOVERNMENTAL ACCOUNTING STANDARDS BOARD.

**GOVERNMENTAL ACCOUNTING.** The composite activity of analyzing, recording, summarizing, reporting and interpreting the financial transactions of governments.

**GOVERNMENTAL ACCOUNTING STANDARDS BOARD (GASB).** The authoritative accounting and financial reporting standard-setting body for government entities.

**GOVERNMENTAL FUNDS.** Funds used to account for the acquisition, use and balances of expendable financial resources and the related current liabilities - except those accounted for in proprietary funds and fiduciary funds. In essence, these funds are accounting segregations of financial resources. Expendable assets are assigned to
a particular government fund type according to the purposes for which they may or must be used. Current liabilities are assigned to the fund type from which they are to be paid. The difference between the assets and liabilities of governmental fund types is referred to as fund balance. The measurement focus in these fund types is on the determination of financial position and changes in financial position (sources, uses and balances of financial resources), rather than on net income determination. The statement of revenues, expenditures and changes in fund balance is the primary governmental fund type operating statement. It may be supported or supplemented by more detailed schedules of revenues, expenditures, transfers and other changes in fund balance. Under current GAAP, there are five governmental fund types: general, special revenue, debt service, capital projects and permanent.

**INTERFUND RECEIVABLE/PAYABLE.** Short-term loans made by one fund to another of the same government, or the current portion of an advance to or from another fund.

**INTERFUND SERVICES PROVIDED AND USED.** (Prior to GASB 34 referred to as quasi-external transactions). Interfund transactions that would be treated as revenues, expenditures or expenses if they involved organizations external to the government unit (e.g., payments in lieu of taxes from an enterprise fund to the general fund; internal service fund billings to departments; routine employer contributions to a pension trust fund and routine service charges for inspection, engineering, utilities or similar services provided by a department financed from one fund to a department financed from another fund). These transactions should be accounted for as revenues, expenditures or expenses in the funds involved.

**INTERFUND TRANSACTIONS.** Transactions between funds of the same government reporting entity. They include (1) **INTERFUND SERVICES PROVIDED and used**, (2) **REIMBURSEMENTS**, (3) **OPERATING TRANSFERS** and (4) **INTERFUND LOANS**.

**INTERFUND TRANSFERS.** All interfund transactions except loans, interfund services provided and used, and reimbursements. GASB 34 requires the recognition of all interfund transfers on the operating statement.

**INTERGOVERNMENT PAYABLE.** A liability account reflecting amounts owed by the reporting government to another government.

**INTERGOVERNMENTAL RECEIVABLE.** An asset account reflecting amounts due to the reporting government from another government. These amounts may represent grants-in-aid, shared taxes, taxes collected by another unit, loans and charges for services rendered by the government for another government.

**INTERGOVERNMENTAL REVENUES.** Revenues from other governments in the form of grants, entitlements, shared revenues or payments in lieu of taxes.

**INTERNAL SERVICE FUND.** A generic fund type within the proprietary category used to account for the financing of goods or services provided by one department or agency
to other departments or agencies of a government, or to other governments, on a cost-
reimbursement basis.

**INVENTORY.** (1) A detailed list showing quantities, descriptions and values of property
and, frequently, units of measure and unit prices. (2) An asset account reflecting the
cost of goods held for resale or for use in operations.

**INVESTMENTS.** Most commonly, securities and real estate held for the production of
revenues in the form of interest, dividends, rentals or lease payments. The term does
not include capital assets used in government operations.

**LAND.** A capital asset account reflecting the cost of land owned by a government.

**ledger.** A group of accounts in which are recorded the financial transactions of an
entity. See **GENERAL LEDGER** and **SUBSIDIARY LEDGER.**

**LIABILITIES.** Probable future sacrifices of economic benefits, arising from present
obligations of a particular entity to transfer assets or provide services to other entities in
the future as a result of past transactions or events. *(What you owe.)*

**LONG-TERM DEBT.** Unmatured debt with a maturity date in excess of 1 year.

**MATURED BONDS PAYABLE.** A liability account reflecting unpaid principal of bonds
that have reached or passed their maturity date.

**MATURED INTEREST PAYABLE.** A liability account reflecting unpaid interest on
bonds that have reached or passed their maturity date.

**MEASUREMENT FOCUS.** The accounting convention that determines (1) which
assets and which liabilities are included on a government's balance sheet and where
they are reported there, and (2) whether an operating statement presents information
on the flow of financial resources (revenues and expenditures) or information on the
flow of economic resources (revenues and expenses).

**MODIFIED ACCRUAL BASIS.** The accrual basis of accounting adapted to the
governmental fund-type measurement focus. Under it, revenues and other financial
resource increments (e.g., bond issue proceeds) are recognized when they become
susceptible to accrual, that is when they become both "measurable" and "available to
finance expenditures of the current period." "Available" means collectible in the current
period or soon enough thereafter to be used to pay liabilities of the current period.
Expenditures are recognized when the fund liability is incurred and expected to be paid
from current resources except for (1) inventories of materials and supplies that may be
considered expenditures either when purchased or when used, and (2) prepaid
insurance and similar items that may be considered expenditures either when paid for
or when consumed. All governmental funds are accounted for using the modified
accrual basis of accounting in fund financial statements.
NET ASSETS. The difference between assets and liabilities on the statement of net assets. Net assets should be displayed in three broad components—invested in capital assets, net of related debt; restricted (distinguishing between major categories of restrictions); and unrestricted.

NET INCOME. Proprietary fund excess of operating revenues, nonoperating revenues and operating transfers in over operating expenses, nonoperating expenses and operating transfers out.

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.

NOTE PAYABLE. In general, an unconditional written promise signed by the maker to pay a certain sum of money on demand or at a fixed or determinable time either to the bearer or the order of a person designated therein.

NOTE RECEIVABLE. A legal right to receive payment of a certain sum of money on demand or at fixed or determinable time, based on an unconditional written promise signed by the maker.

OPERATING EXPENSES. Proprietary fund expenses related directly to the fund's primary activities.

OPERATING GRANTS. Grants that are restricted by the grantor to operating purposes or that may be used for either capital or operating purposes at the discretion of the grantee. See CAPITAL GRANTS.

OPERATING INCOME. The excess of proprietary fund operating revenues over operating expenses.

OPERATING REVENUES. Proprietary fund revenues directly related to the fund's primary activities. They consist primarily of user charges for goods and services.

OPERATING STATEMENT. The financial statement disclosing the financial results of operations of an entity during an accounting period in conformity with GAAP. In governmental financial reporting, operating statements and statements of changes in fund equity are combined into "all-inclusive" operating statement formats.

OTHER FINANCING SOURCES. Governmental fund general long-term debt proceeds, amounts equal to the present value of minimum lease payments arising from capital leases, proceeds from the sale of general capital assets, and operating transfers in. Such amounts are classified separately from revenues on the governmental operating statement.
OTHER FINANCING USES. Governmental fund operating transfers out and the amount of refunding bond proceeds deposited with the escrow agent. Such amounts are classified separately from expenditures on the governmental operating statement.

PENSION TRUST FUND. A trust fund used to account for a PERS. Pension trust funds, use the accrual basis of accounting and the flow of economic resources measurement focus.

PERMANENT FUNDS. A generic fund type under the governmental category used to report resources that are legally 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 when the government is required to use the principal or earnings for the benefit of individuals, private organizations, or other governments).

POSTING. The act of transferring to an account in a ledger the data, either detailed or summarized, contained in a book or document of original entry.

PREPAID ITEMS. Payment in advance of the receipt of goods and services in an exchange transaction. Prepaid items (e.g., prepaid rent and unexpired insurance premiums) differ from deferred charges (e.g., unamortized issuance costs) in that they are spread over a shorter period of time than deferred charges and are regularly recurring costs of operations.

PRINCIPAL. In the context of bonds other than deep-discount debt, the face value or par value of a bond or issue of bonds payable on stated dates of maturity.

PROPRIETARY FUNDS. Sometimes referred to as income determination or commercial-type funds, the classification used to account for a government's ongoing organizations and activities that are similar to those often found in the private sector (i.e., enterprise and internal service funds). All assets, liabilities, equities, revenues, expenses and transfers relating to the government's business and quasi-business activities are accounted for through proprietary funds. Proprietary funds should apply all applicable GASB pronouncements and those GAAP applicable to similar businesses in the private sector, unless those conflict with GASB pronouncements. These funds use the accrual basis of accounting in conjunction with the flow of economic resources measurement focus.

PURCHASE ORDER. A document authorizing the delivery of specified merchandise or the rendering of certain services and the making of a charge for them.

PURCHASES METHOD. The method under which inventories are recorded as expenditures when acquired. See CONSUMPTION METHOD.
RECEIPT. The act of receiving something such as the amount of cash received. A written or printed acknowledgment that things such as sums of money have been given to the person who issues the acknowledgment. In cash basis of accounting revenues are only recognized at the time physical cash is actually received. See CASH BASIS and STATEMENT OF CASH RECEIPTS AND DISBURSEMENTS.

REIMBURSEMENTS. (1) Repayments of amounts remitted on behalf of another party. (2) Interfund transactions that constitute reimbursements to a fund for expenditures for expenses initially made from it but that properly apply to another fund (e.g., an expenditure properly chargeable to a special revenue fund is initially made from the general fund, and is subsequently reimbursed). These transactions are recorded as expenditures or expenses (as appropriate) in the reimbursing fund and as reductions of expenditures or expenses in the fund reimbursed.

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.

REVENUE BONDS PAYABLE. Bonds whose principal and interest are payable exclusively from earnings of an enterprise fund. In addition to a pledge of revenues, such bonds sometimes contain a mortgage on the enterprise fund's property.

REVENUES. (1) Increases in the net current assets of a governmental fund type from other than expenditure refunds, operating transfers, and "other financing sources." (2) Increases in the net total assets of a proprietary fund type from other than expense refunds and transfers.

SHORT-TERM DEBT. Debt with a maturity of one year or less after the date of issuance. Short-term debt usually includes variable-rate debt, bond anticipation notes, tax anticipation notes and revenue anticipation notes.

SPECIAL JOURNAL. A journal in which are entered all entries of a particular type. Examples include cash receipts journals, cash disbursement journals and purchases journals. See GENERAL JOURNAL.

SPECIAL REVENUE FUND. A fund used to account for the proceeds of specific revenue sources (other than major capital projects) that are legally restricted to expenditure for specified purposes. GAAP only require the use of special revenue funds when legally mandated or for reporting the general fund of a blended component unit.

STATEMENT OF CASH RECEIPTS AND DISBURSEMENTS. A financial presentation summarizing an entity's cash transactions in an accounting period. This statement is not currently required by GAAP.
STATEMENT OF REVENUE AND EXPENDITURES. The financial statement that is the governmental fund GAAP operating statement. It presents increases (revenues and other financing sources) and decreases (expenditures and other financing uses) in an entity's net current assets. Statements of changes in equity of governments should be combined with operating statements into "all-inclusive" operating statement formats.

STATEMENT OF ACTIVITIES. An entity-wide financial statement which reports the operations of the reporting government. This financial statement should be presented in a format that reports the net (expense) revenue of its individual functions. An objective of using the net (expense) revenue format is to report the relative financial burden of each of the reporting government’s functions on its taxpayers. This format identifies the extent to which each function of the government draws from the general revenues of the government or is self-financing through fees and intergovernmental aid. This notion of burden on the reporting government’s taxpayers is important in determining what is program or general revenue. General revenues, contributions to term and permanent endowments, contributions to permanent fund principal, special and extraordinary items, and transfers should be reported separately after the total net expenses of the government’s functions, ultimately arriving at the “change in net assets” for the period.

SUBSIDIARY ACCOUNT. One of a group of related accounts supporting in detail the debit and credit summaries recorded in a control account (e.g., the individual property taxpayers’ accounts for the taxes receivable control account in the general ledger). See SUBSIDIARY LEDGER.

SUBSIDIARY LEDGER. A group of subsidiary accounts, the sum of the balances of which should equal the balance of the related control account. See GENERAL LEDGER and SUBSIDIARY ACCOUNT.

TRIAL BALANCE. A list of the balances of the accounts in a ledger kept by double entry, with the debit and credit balances shown in separate columns. If the totals of the debit and credit columns are equal or if their net balance agrees with a control account, the ledger from which the figures are taken is said to be in balance.

TRANSFERS. All interfund transfers (e.g., legally authorized transfers from a fund receiving revenue to the fund through which the resources are to be expended) where there is no intent to repay. GASB 34 requires all interfund transfers to be recorded on the operating statement. See INTERFUND TRANSFERS.

UNASSIGNED FUND BALANCE. Residual classification for the general 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. The general fund should be the only fund that reports a positive unassigned fund balance amount. In other governmental funds, if expenditures
incurred for specific purposes exceeded the amounts restricted, committed or assigned to those purposes, it would be necessary to report a negative unassigned fund balance.

**UNRESTRICTED FUND BALANCE.** The total of committed fund balance, assigned fund balance, and unassigned fund balance.