Beginning Governmental Accounting

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WMCA Workshop March 19, 2014

Please turn your cell phone to vibrate mode.... Thank you

Agenda

- Basic Accounting Theory
 - Understanding the basic accounting equation
 - Identify asset and liability accounts
- Double Entry Accounting
 - Record transactions using debits and credits
 - Understand how debits and credits affect accounts
- Accounting System and Records
 - Understand the difference between journals and ledgers
 - Relate the journals and ledgers to computerized records
 - Learn the value and purpose of a trial balance
- The Basis of Accounting
 - Define the basis of accounting
 - Contrast the three common bases of accounting
 - Understand when to recognize a revenue or expense under the modified accrual basis of accounting.
- Budgets
 - Why are they important
 - Analysis of the budget

Basic Accounting Theory

Why Use Accounting?

Generally Accepted Accounting Principles (GAAP) is a set of rules for businesses and governments to follow so their financial statements/reports can easily be compared to other businesses. Without GAAP, businesses could record and report data in any manner – making comparison difficult.

Government vs. Private Business

- Providing services
- Fiscal and operational accountability
- Must comply with finance related legal and contractual issues
- Sometimes Revenues will not cover the cost of governmental activites

- Profit driven
- Value for the owner or shareholder is a major focus
- Income is expect to be more than the cost (Revenues must exceed expenses to be profitable)

Understanding the Accounting Equation

• The basic accounting equation is the cornerstone of the accounting process.

• It is the foundation in performing every procedure necessary to fulfill the purpose of accounting.

$$A = L + OE + (R - E)$$

Understanding the Accounting Equation $A = \mathbb{L} + \mathbb{O}\mathbb{E}$

- For "regular" business the accounting equation is stated as above.
 - Assets
 - Liabilities
 - Owner's Equity (can be called Stockholder's Equity) and the "contra" accounts
 - Revenues
 - Expenses
 - Owner's Withdrawals
 - Retained Earnings

Understanding the Accounting Equation

$\mathbb{A} = \mathbb{L} + \mathbb{E}$

- For fund accounting (governmental) the accounting equation is stated as above.
 - Assets
 - Liabilities
 - Equity (Can be called: Fund Balance, Retained Earnings or Investment in Fixed Assets)



- According to GASB concepts Statement No. 4..."Assets are probable future economic benefits obtained or controlled by a particular entity as a result of past transactions or events"
- In real terms, assets are resources owned by a business or government.
 - Examples: Cash, Investments, Land, Buildings, Roads, Equipment, Accounts Receivables, Inventories, Capital Assets (Current Financial Resources)

- According to FASB concepts Statement No. 6..." Liabilities are 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"
- In real terms, liabilities are the rights of creditors or debts of the business.
 - Examples: Accounts Payable, Payroll Withholding Payable, Debt Payable, Loans Payable

• According to FASB concepts Statement No. 6..." Equity or net assets is the residual interest in the assets of an entity that remains after deducting its liabilities. In a business enterprise, the equity is the ownership interest. In a not-for-profit organization, which has no ownership interest in the same sense as a business enterprise, net assets is divided into three classes based on the presence or absence of donor-imposed restrictions—permanently restricted, temporarily restricted, and unrestricted net assets"

- In real terms, equity is the rights of the owners to claims against the assets (for business) and Fund Equity (for government) is the difference between the Fund's Total Assets and its Total Liabilities.
 - Examples: Owner's Equity, Fund Balance,
 Retained Earnings, Investment in Fixed Assets.

- Contra Equity Accounts:
 - Revenues (Taxes, User Fees, Utility Sales)
 - Expenses (Expenditures)
 - For business additional contra accounts include:
 - Owner's Withdrawals
 - Retained Earnings

Keeping the Expanded Accounting Equation in Balance A = L + R - R

- At all times the Accounting Equation must be kept in balance which requires two entries (a debit and a credit). This is called double entry accounting.
- Anything that impacts one side of the equation must have an impact on the same side or opposite side of the equal sign. Handout # 1

Double Entry Accounting

• Every transaction must be recorded into at least two accounts. A transaction would be incomplete if only one side were recorded (out of balance).

Refer to handout # 1

• Transactions are recorded in a journal and then transferred to a ledger.

Understanding How Debits and Credits Affect Accounts • Expanded accounting equation:

As	sets	=	Liab	ilities	+	Eq	uity	+	Reve	enues	-	Exp	enses
Debit	Credit		Debit	Credit		Debit	Credit		Debit	Credit		Debit	Credit
\uparrow				\uparrow			\uparrow			\uparrow		\uparrow	
NB	v		·	NB		v	NB		v	NB		NB	v

• All accounts have a normal balance. An accounts normal balance appears on the increase side (which can be either debit or credit depending on the account).

Understanding How Debits and Credits Affect Accounts

- DEBIT only means the LEFT side and CREDIT only means the right side.
- Debits and credits are not "good" or "bad"
- Increases and decreases to an account is determined by the account type. For all accounts, increases are recorded on one side and decrease are recorded on the opposite side (changes by account type).

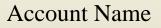
Using Debits and Credits

•A shorted form of the ledger is called the Taccount because it takes the form of a letter T. The vertical line divides the account into its left and right sides, with the account name at the top.

•The left side of the Taccount is called the debit side (DR) and the right side is called the credit side (CR).

TTTT

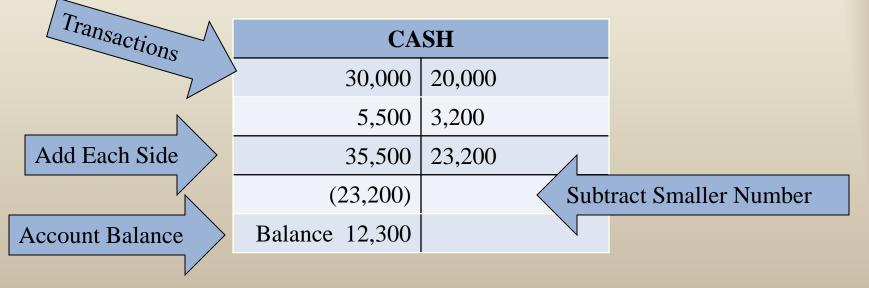
DEBIT



CREDIT

Understanding How Debits and Credits Affect Accounts

• T-accounts can be used to determine the amount remaining in an account or the *balance* of the account.



Accounting System and Records

- Transactions are first recorded in a journal, which is the record of transactions in date order.
- Journalizing transaction records the data only in the journal but not in the ledger.
- The ledger holds all of the accounts of the entity.

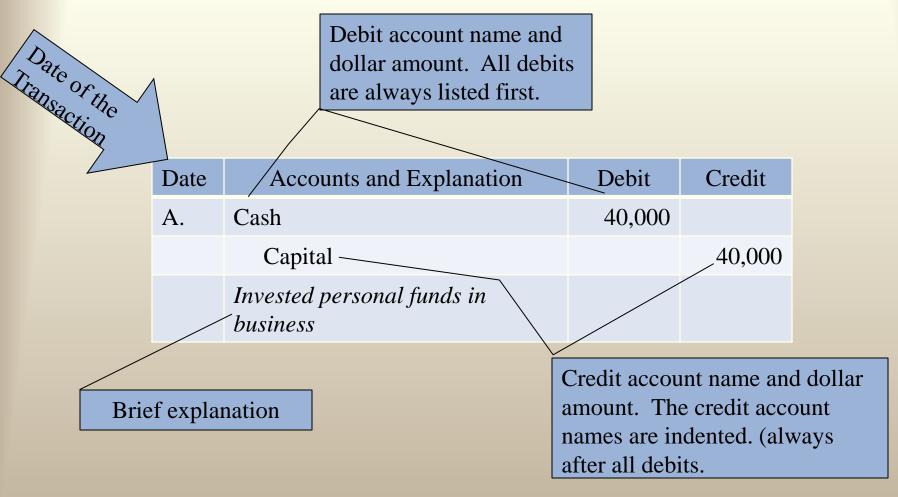
5 Steps to Journalizing & Posting1. Identify the accounts and the account type (asset, liability, or equity).

		ASSETS	=	Liabilities	+	Equity				
	Cash	Accts. Rec.	Supplies	Accts Payable	Capital	Fees Earned	Rent Expense	Salaries Expense	Auto Expense	
а	<mark>+\$40,000</mark>				<mark>+\$40,000</mark>					

 Decide whether each account increases or decreases using the rules of debits and credits.

As	sets	=	Liab	ilities	+	Eq	uity	+	Reve	nues	-	Exp	enses
Debit	Credit		Debit	Credit		Debit	Credit		Debit	Credit		Debit	Credit
			\checkmark			\checkmark			\checkmark			\uparrow	\checkmark

5 Steps to Journalizing & Posting3. Record the transaction in the journal.



5 Steps to Journalizing & Posting4. Post the journal entry to the ledger. (T)

Cash		Acct No. 00)1-000.300		
Date	Item	Post Ref.	Debit	Credit	Balance
A.		J1	40,000		40,000

Capital		Acct No. 001-000.400			
Date	Item	Post Ref.	Debit	Credit	Balance
А.		J1		40,000	40,000

5 Steps to Journalizing & Posting

5. Determine whether the accounting equation is in balance. We know this from analysis in #1, but when there are multiple transactions it is best to use a trial balance.

		ASSETS	=	Liabilities	+ Equity				
	<mark>Cash</mark>	Accts. Rec.	Supplies	Accts Payable	Capital	Fees Earned	Rent Expense	Salaries Expense	Auto Expense
а	<mark>+\$40,000</mark>				<mark>+\$40,000</mark>				

Journals & Ledgers in the Computer

- When you POST a transaction in your computer, it does all the work done we just completed behind the scenes.
- Invoices will decrease cash and increase an expenditure.
- Cash payments will increase cash and decrease an accounts payable.

0011	Business Financial Statement	Equivalent Government Statement
	Income Statement	Statement of Activities or Operating Statement
	Balance Sheet	Statement of Net Assets or Statement of Net Position

Income Statement

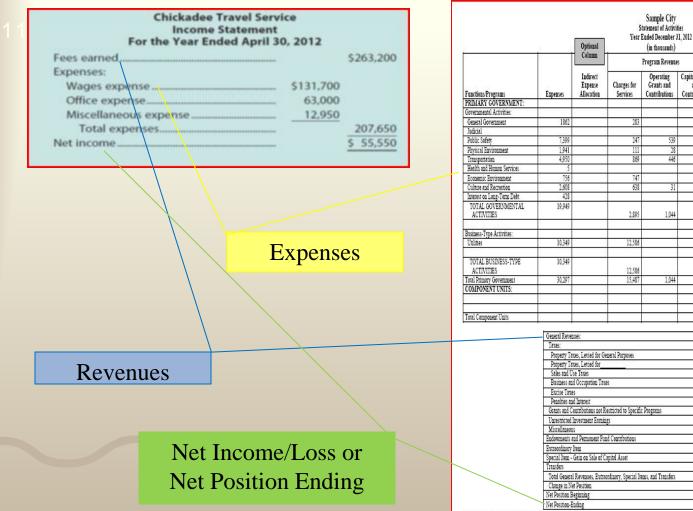
⁰⁰ Revenues – Expenses = Net Income or Loss

- The income statement is one of the three primary financial statements used to assess a company's performance and financial position. The income statement summarizes the revenues and expenses generated by the company over the entire reporting period.
- Simple equation above.

Statement of Activities

- The statement of activities distinguishes between governmental and businesstype activities.
- Internal service funds are not reported on the statement of activities unless they provide goods or services to entities outside the primary government.

Income Statement



Statement of Activities

Sample City Statement of Activities

(in thousands)

Program Revenues

Operating

Grants and

Contributions

446

1.044

1.044

Capital Grants

and

Contributions

4.047

4.162

1,431

1,431

5,539

Governmental

Activities

(1.579)

(6.586)

462

(5)

(1)

(1.909)

(11.848)

(11,848)

5.224

4,649

3,621

1,247

1,271

(50)

16,736

4.888

25,786

30.674

769

(428)

Net (Expense) Revenue and Changes in Net Position

Total

(1.579)

462

(5)

(1)

(1.909)

(428)

(11,848)

3.669

8,179

5.224

4,649

3,621

2,374

1,502

18,144

9,965

82,496

92,461

769

3,669

3.669

3,669

1,127

231

1.408

5.077

56,710

61,787

Component

Units

Primary Government

Business-type

Activities

The notes to financial statements are an integral part of this statement.

001

Balance Sheet

- The balance sheet will show the accounting equation is in balance
- All account balances are listed with assets equal to liabilities plus equity

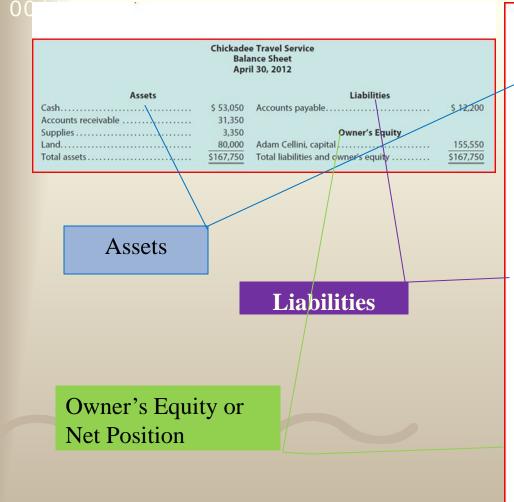
Statement of Net Position

- The governments have two format options to present net position:
 - Net Position format: Assets plus deferred outflows, less liabilities, less deferred inflows of resources, equals net position
 - Balance Sheet format: Assets plus deferred outflows of resources equals liabilities plus deferred inflows of resources, plus net position
- The statement of net position requires to distinguish between the governmental and business-type activities.

Balance Sheet

Statement of Net Position

SAMPLE CITY Statement of Net Position



	Prin	nary Government		en en en en en en en
	Governmental Activities	Business-type Activities	Total	Component Units
ASSETS				
Cash and cash equivalents	4,763	407	5,170	
nvestments	8,951	-	8,760	
Receivables (net)	7,363	3,005	10,368	
Internal balances	(2,620)	2,620		
inventories	-	119	119	
Capital assets not being depreciated				
Land	6,322	2,300	8,622	
Construction in progress	5,004	472	5,476	
Capital assets net of accumulated depreciation:				
Buildings	7,551	45	7,596	
Improvements other than buildings	713	38,444	39,157	
Machinery and equipment	2,007	774	2,781	
Infrastructure	33	- 2	33	
Intangible	166		166	
Total capital assets	21,796	42,035	63,831	
Total assets	40,253	48,186	88,439	
DEFERRED OUTFLOWS OF RESOURCES				
Accumulated decrease in fair value of hedging derivatives		4,043	4,043	
Deferred loss on refunding				3
Grants paid in advance				
LIABILITIES			-	
Accounts payable	1.561	1.650	3,221	
Other current liabilities	191	29	220	
Accrued expenses		18	18	
Due to primary government	82	12	24	
Other credits	85	(52)	33	
Liabilities payable from restricted assets	10.532		1000	
Noncurrent liabilities:				
Due within one year	1.450	1.039	2,489	
Due in more than one year	6.031	7,306	13,337	
Total liabilities	9,448	9,990	19,438	6
	3,110	2,274	15.150	
DEFERRED INFLOWS OF RESOURCES Accumulated increase in fair value of hedzing derivatives			-	
Deferred service concession arrangement receipts	105		105	
Deferred property taxes	105		105	6
Advance payments of property taxes				2
Advance payments of special assessments	1			
Deferred gain on refunding				
Grants received in advance				
Total deferred inflows of resources	130		130	
	150		150	
NET POSITION	14.203	42.239	66.10	
Net investment in capital assets Restricted for:	14,205	42,239	56,442	-
	120		420	
Capital projects	458		458	
Debt service		10.000	10.00	
Unrestricted (Deficit)	16,014	19,548	35,562	9
Total net position	30,675	61,787	92,462	

Value & Purpose of a Trial Balance

- After the transactions are recorded in the journal and then posted to the ledger, a trial balance will provide an accuracy check by showing whether total debits equal total credits.
- The trial balance is a useful tool because it shows the accounts and their balances on a specific date.

Trial Balance

Credit Balances

50

900

250

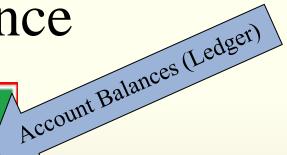
240

28,105

29,545

Debits = Credits

29,545



NetSolutions Post-Closing Trial Balance December 31, 2011										
	Debit Balances									
	2,065									
unts Receivable	2,720									
slies	760									
aid Insurance	2,200									
	20,000									
e Equipment	1,800									
mulated Depreciation.										
unts Payable										
es Payable										

Chris Clark, Capital

Cash. Accor

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Office

Accou

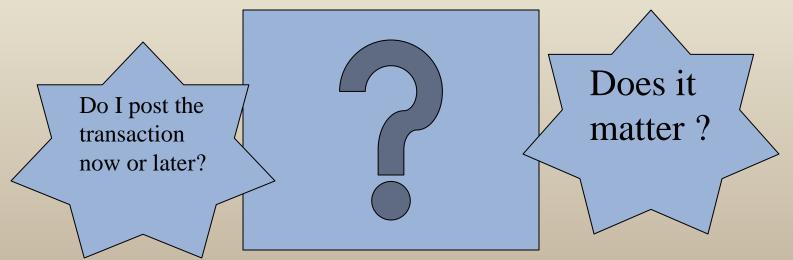
Wage

Unearned Rent

Account order follows accounting equation: Assets Liabilities Equity (Fund Balance)

The Basis of Accounting

Basis of accounting refers to when revenues and expenditures are recognized in the accounts and reported in the financial statements.



Cash Basis

The cash method of accounting records revenue when **cash is received**, and records expenses when **cash is paid**. For a business invoicing for an item sold, or work done, the corresponding amount will not appear in the accounting records until payment is received - and similarly, debts owed by the business will not appear until they have been paid.

Similar to your personal checkbook.....

Accrual Basis

• The accrual method records revenues when they are *earned* and records <u>expenses</u> when they are *incurred*. For a business invoicing for an item sold, or work done, the corresponding amount will appear in the accounting records even though no payment has yet been received - and debts owed by the business show as they are incurred, even though they may not be paid until much later.

Modified Accrual Basis

This method is a mixture of the cash and accrual basis and is typically used for governmental funds.

- <u>Revenues</u> must be both **measurable and available to pay** for the current periods liabilities. Revenues are considered available when collectible either during the current period or after the end of the current period but in time to pay year-end liabilities.
- <u>Expenditures</u> are recognized when a transaction or event is **expected to draw upon current spendable resources** rather than future resources.

Why Use Modified Accrual?

- A governmental entity is focused on currentyear obligations, and the modified accrual basis focuses mainly on short-term financial assets and liabilities.
- The goal is to report whether the entities current-year revenues were sufficient to pay current-year expenses, and to demonstrate whether the entity acquired and used its resources according to its legally adopted budget.

Compare the Methods

• Sale is made in January but payment is not expected until February

Accrual Basis

General Journal			Page: 1		
Date		Account Titles/Explanation Re		Debit	Credit
20XX Jan	5	Accounts Receivable Sales Revenue Sale on Account		450.00	450.00
Feb	5	Cash Accounts Receivable Payment on Account		450.00	<mark>450</mark> .00

Cash Basis

Gen	eral .	Journal			Page: 1
Date		Account Titles/Explanation	Ref	Debit	Credit
20XX Feb	5	Cash Sales Revenue Received Cash from Sale		450.00	450.00

Modified Accrual Method When to Recognize.....

• Revenue is recognized when earned, measurable, AND available.

• Expenditures are still recognized when the liability is incurred.

Why have a budget?

Budgets play an important role for organizations of all sizes and forms. For example, budgets are used in managing the operations of government agencies, churches, hospitals, small businesses, and manufacturing companies.

The expenditure levels in the budget are call appropriations and they represent spending limits.

Appropriated Budgets

- Appropriated budgets are mandatory in Washington State by RCW for Cities, Counties and Special Purpose Districts.
- Budgets are adopted by:
 - Cities: by Ordinance
 - Counties: by Resolution
 - Special Purpose District: by local policy

Budgeting affects the following managerial functions:

- <u>*Planning*</u>, which involves setting goals to guide decisions and help motivate employees.
- *Directing*, which involves decisions and actions to achieve budgeted goals.
- <u>Controlling</u>, which involves comparing actual performance against the budgeted goals.

Fiscal Year

- The budgetary period for operating activities normally follows the fiscal year.
- The appropriations budget authorizes expenditures for a defined fiscal period which expire at the end of the year.
 - Cities/Counties have a limited open period where appropriations can be charged to the prior year.

Analysis of the Budget

- It is important for an entity to have a computer system that will compare budget to actual results to show compliance.
 - The system should show information about current appropriations (expenditures) and revenues in order to see if the budget is tracking as expected.
 - Must have constant monitoring available for managers which includes ending fund balance.

Analysis of the Budget

- Users analyze financial statements using a variety of analytical methods. Two such methods are as follows:
 - Horizontal analysis
 - Vertical analysis

Horizontal Analysis

- The percentage analysis of increases and decreases in related items in comparative financial statements or budget vs. actual is called horizontal analysis.
 - Formula:

Base Year - Current Year = ResultResultPercentage IncreaseBase Yearor Decrease

Horizontal Analysis

Lincoln Company Comparative Balance Sheet December 31, 2014 and 2013						E X H I B I T 1 Comparative Balance Sheet—Horizontal	
	ſ	Dec. 31, 2014	Dec. 31, 2013	Increase (D Amount	Decrease) Percent	Analysis	
Assets Current assets Long-term investments Property, plant, and equipment Intangible assets	(net)	550,000 95,000 444,500 50,000	\$ 533,000 177,500 470,00 50,000	\$ 17,000 (82,500) (25,500)	3.2% (46.5%) (5.4%) —		
Total assets Liabiliti Current liabilities Long-term liabilities Total liabilities	Horizontal Analysis:						
Stockholders Preferred 6% stock, \$100 par	Differe	nce		¥ \$17	7,000 33,000	= 3.2%	
Common stock, \$10 par Retained earnings Total stockholders' equity Total liabilities and stockhold	Base year	r (20 ⁻	13)	\$53	33,000)	

Vertical Analysis

- A percentage analysis used to show the relationship of each component to the total within a single financial statement is called vertical analysis.
- Formula:

Line Item Total = Results

Vertical Analysis

EXHIBIT 6 Comparative Income	Lincoln Company Comparative Income Statement For the Years Ended December 31, 2014 and 2013						
Statement—		2014		2013			
Vertical Analysis		Amount	Percent	Amount	Percent		
	Sales	\$1,530,500	102.2%	\$1,234,000	102.8%		
	Sales returns and allowances	32,500	2.2	34,000	2.8		
	Net sales	\$1,498,000	100.0%	\$1,200,000	100.0%		
	Cost of goods sold	1,043,000	69.6	820,000	68.3		
	Gross profit	\$ 455,000	30.4%	\$ 380,000	31.7%		
	Selling expenses	\$ 191,000	12.8%	\$ 147,000	12.3%		
	Administrative expenses	104.000	9	97,400	8.1		
			<u>19.7</u> %	\$ 244,400	20.4%		
Vertical Ar			10.7%	\$ 135,600	11.3%		
	laryolo		0.6	11,000	0.9		
			11.3%	\$ 146,600	12.2%		
			0.4	12,000	1.0		
Selling exp	enses \$191,000		10.9%	\$ 134,600	11.2%		
. .		0 00/	4.8	58,100	4.8		
Net sales	\$1,498,000 = 1	2.8%	6.1%	\$ 76,500	<u> 6.4</u> %		

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Questions??

You are welcome to e-mail questions or comments: Elizabeth Alba ealba@cityoftoppenish.us ealba@yvcc.edu