

GOVERNMENTAL ACCOUNTING

Overview

Government accounting has many similarities to commercial accounting. For example, governmental accounting uses the double-entry system, journals, ledgers, trial balances, financial statements, internal control, etc. Differences arise due to the objectives and environment of government. The major differences include

- 1) The absence of a profit motive, except for governmental enterprises, such as utilities
2) A legal emphasis which involves restrictions both in raising and spending revenues
3) An emphasis of accountability or stewardship of resources entrusted to public officials
4) The recording of the budget in some funds
5) The use of modified accrual accounting in some funds

Fund Accounting

There are three principles that deal specifically with fund accounting. These principles cover 1) Definition of a fund 2) Types of funds 3) Number of funds.

A fund is defined by the Governmental Accounting Standards Board as a fiscal and accounting entity with a self-balancing set of accounts recording cash and other financial resources, together with all related liabilities and residual equities and balances, and changes therein, which are segregated for the purpose of carrying on specific activities or attaining certain objectives in accordance with special regulations, restrictions, or limitations.

The City of Memphis reports the following funds that are classified into three general types.

Table with 3 columns: Governmental Fund, Proprietary Funds, Fiduciary Funds. Rows include General, Special Revenue, Debt Service, Capital Projects, Enterprise, Internal Services, Pension Trust, Investment Trust.

The City does not currently utilize Permanent, Private-purpose Trust or Agency Funds.

In the governmental funds, the objective is to provide services to the public. All of these funds are expendable, i.e., they are not concerned with preserving capital or measuring "net income." Government funds are concerned with the availability of resources to provide services, and the emphasis is on working capital flows. Usually, only current assets and current liabilities are accounted for in the governmental funds. Fixed assets and long-term liabilities of governmental funds are reported only in the government-wide financial statement. The proprietary funds use accounting and reporting techniques similar to commercial enterprise. The fiduciary funds are accounted for like like proprietary funds.

Budgets and Their Impact upon the Accounting System

The GASB, in one of its basic principles, states 1) An annual budget(s) should be adopted for every government unit 2) The accounting system should provide the basis for appropriate budgetary control 3) A common terminology and classification should be used consistently throughout the budget, the accounts, and the financial reports of each fund.

Generally Accepted Accounting Principles (GAAP) require a budgetary comparison for the general fund and for each major individual special revenue fund for which an annual (or biennial) budget is legally adopted. The City Council annually approves a budget ordinance that includes the City of Memphis General, Special Revenue, Debt Service and Enterprise Funds. Internal Service Funds are also included in the Adopted Budget. These budgetary accounts are incorporated into the governmental accounting system to provide *legislative control* over revenues and other resource inflows and expenditures and other resource outflows.

In order to prevent the overspending of an item in the appropriations budget, an additional budgetary account is maintained during the year. The account is called “Encumbrances.” When goods or services are ordered, appropriations are encumbered. The “Encumbrances” account does not represent an expenditure, it is a budgetary account which represents the estimated cost of goods or services which have yet to be received. In effect, the recording of encumbrances represents the recording of executory contracts, which is essential to prevent overspending of an appropriation (normally, illegal act). Encumbrances of governmental funds outstanding at year end are re-appropriated during the subsequent fiscal year.

**Financial Statements for State and Local Governments**

The City of Memphis prepares a Comprehensive Annual Financial Report (CAFR) that includes Basic Financial Statements, Required Supplementary Information, Combining and Individual Fund Statements and Schedules, Supplementary Schedules, Single Audit, Statistical Section and the Management Discussion and Analysis (MD&A) as prescribed by GASB.

Accrual basis accounting is recognition of revenues in the accounting period the revenues are earned and recognition of expenses in the accounting period the expenses are incurred. In addition, revenues and expenses have to be measurable in order to be reported. The following funds use full accrual accounting:

**Proprietary Funds**

Enterprise  
Internal Service

**Fiduciary Funds**

Pension Trust Funds  
Investment Trust Funds

All of the funds that use accrual accounting (except the Trust Funds) are non-expendable, i.e., an objective of each of the funds is to maintain capital.

The modified accrual basis of accounting on the other hand, recognizes: 1) Revenues in the accounting period in which they are both measurable and available to finance expenditures made during the current fiscal period 2) Expenditures in the accounting period in which the liabilities are both measured and incurred.

The modified accrual basis is used in the following funds:

**Governmental Funds**

General  
Special Revenue  
Debt Service  
Capital Projects

All of the funds which use the modified accrual basis are expendable and do not, therefore, have a capital maintenance objective.

The General Fund is the most significant Government Fund. It accounts for all transactions not accounted for in any other fund. Revenues come from many sources and the expenditures cover major functions of government.

Special Revenue Funds account for earmarked revenue as opposed to many revenue sources which are accounted for in the General Fund. The earmarked revenue is then used to finance various authorized expenditures. Many federal and state grants are reported in Special Revenue Funds.

Debt Service Funds usually handle the repayment of general obligation long-term debt and interest. This type of debt is secured by the good faith and taxing power of the governmental unit. Repayment of enterprise and internal service long-term debt is accounted for in these individual funds. Consequently, the type of debt for which the Debt Service Fund is established usually is the result of issuing general obligation bonds for capital projects.

Capital Projects Funds account for the acquisition and use of resources for the construction or purchase of major, long-lived fixed assets, except for those which are financed by Enterprise, Internal Service, and Nonexpendable Trust Funds. Resources for construction or purchase normally come from the issuance of general long-term debt and from governmental grants.

Enterprise Funds account for activities by which the government provides goods and services which are (1) rendered primarily to the general public, (2) financed substantially or entirely through user charges, and (3) intended to be self-supporting. They are usually established for public utilities, transit systems, golf courses, etc.

Internal Service Funds are established to account for the provision of goods and services by one department of the government to other departments within the government on generally a cost reimbursement basis. Uses of Internal Service Fund services are budgeted through the budgets of the user departments.

Trust Funds are used to account for monies held for others, generally being used when assets are held for substantial periods of time. Trust Funds do not generally record their budgets formally.

### **Fund Balance**

Fund Balance (the difference between assets and liabilities in the governmental fund financial statements) is among the most widely and frequently used information in state and local government financial reports.

The City of Memphis strives to maintain a General Fund balance of 10% of expenditures as a standing fiscal policy. For FY2011 and FY2012 forecast, the spendable fund balance is \$81.2 million and \$82.5 million, respectively.

The City uses the classifications that have been developed by the Governmental Accounting Standards Board (GASB) and described in GASB Statement No. 54. Statement 54 is intended to improve the usefulness of information provided to financial report users about fund balance by providing clearer, more structured fund balance classifications, and by clarifying the definitions of existing governmental fund types.

The GASB developed Statement 54 to address the diversity of practice and the resulting lack of consistency that had evolved in fund balance reporting across governments. To reduce confusion, statement 54 establish a hierarchy of fund balance classifications based primarily on the extent to which government is bound to observe spending constraints imposed upon how resources in governmental funds may be used.

Statement 54 distinguishes fund balance between amounts that are considered completely “nonspendable” such as fund balance associated with inventories, and other “spendable” amounts that are classified based on the relative strength of the constraints that control the purposes for which specific

amounts can be spent. Beginning with the most binding constraints, fund balance amounts are reported in the following classifications.

*Nonspendable* - amounts that cannot be spend because they are either (a) not spendable form or (b) legally or contractually required to remain intact.

*Restricted* - amounts constrained by external parties, constitutional provision, or enabling legislation. Effectively, restrictions may only be changed or lifted with the consent of the resource provider.

*Committed* - amounts formally constrained by a government using its highest level of decision-making authority (i.e. City Council). The commitment of these funds can only be changed by the government taking the same formal action that imposed the constraint originally.

*Assigned* - amounts a government intends to use for a particular purpose. Intent can be expressed by the governing body or by an official or body to which the governing body delegates the authority (Finance Director).

*Unassigned* - residual amounts that are otherwise not constrained at all will be reported in the general fund. These are technically available for any purpose.

“

