

## CHAPTER 2

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

#### ANSWERS TO QUESTIONS

##### Question 2-1

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

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

Difficulty: 2

Learning Objective: 1

AACSB: Reflective thinking

##### Question 2-2

The measurement focus for the three fund categories are:

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

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

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

Difficulty: 1

Learning Objective: 2, 3

AACSB: Reflective thinking

### Question 2-3

For governmental funds:

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

For proprietary funds:

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

Difficulty: 1

Learning Objective: 2, 3, 5

AACSB: Reflective thinking

### Question 2-4

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

Difficulty: 2

Learning Objective: 4

AACSB: Reflective thinking

### Question 2-5

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

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

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

Difficulty: 1  
Learning Objective: 4  
AACSB: Reflective thinking

### Question 2-6

A Special Revenue Fund should be used to account for and report the proceeds of specific *revenue sources* that are restricted or committed to expenditure for specified purposes other than debt service or capital projects.

A Capital Projects Fund should be used to account for and report financial resources that are restricted, committed, or assigned to expenditure for capital outlays, including the acquisition or construction of capital facilities and other capital assets.

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

Difficulty: 1  
Learning Objective: 6  
AACSB: Reflective thinking

### Question 2-7

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

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

### Question 2-8

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

Difficulty: 1

Learning Objective: 6, 7

AACSB: Reflective thinking

### Question 2-9

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

Difficulty: 1

Learning Objective: 6, 7

AACSB: Reflective thinking

### Question 2-10

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

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

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

Difficulty: 1

Learning Objective: 2, 6

AACSB: Reflective thinking

### Question 2-11

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

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

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

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

Difficulty: 2

Learning Objective: 7

AACSB: Reflective thinking

### Question 2-12

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

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

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

Difficulty: 2

Learning Objective: 7

AACSB: Reflective thinking

### Question 2-13

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

Difficulty: 1

Learning Objective: 3

AACSB: Reflective thinking

### Question 2-14

The accounting equation for a governmental fund is:

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

Difficulty: 1

Learning Objective: 2

AACSB: Reflective thinking

### Question 2-15

The accounting equation for a proprietary fund is:

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

Difficulty: 1

Learning Objective: 2

AACSB: Reflective thinking

### Question 2-16

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

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

Difficulty: 2  
Learning Objective: 2  
AACSB: Reflective thinking

### **Question 2-17**

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

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

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

Difficulty: 2  
Learning Objective: 2  
AACSB: Reflective thinking

## **SOLUTIONS TO EXERCISES**

### **Exercise 2-1**

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

Difficulty: 1

Learning Objective: 2, 3, 4

AACSB: Reflective thinking

### **Exercise 2-2**

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

Difficulty: 1

Learning Objective: 2, 3, 4

AACSB: Reflective thinking

### **Exercise 2-3**

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



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

#### **Exercise 2-4**

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

Difficulty: 1  
Learning Objective: 5  
AACSB: Reflective thinking

#### **Exercise 2-5**

a, b, c, and d

Difficulty: 1  
Learning Objective: 3  
AACSB: Reflective thinking

## Exercise 2-6

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

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

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

\*The amounts reported for special items and extraordinary items would be proceeds received or expenditures incurred for those items, not gains and losses.

Note: Depreciation expense (j) is not recorded in this statement.

Difficulty: 2  
Learning Objective: 7  
AACSB: Analytical Skills

## Exercise 2-7

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

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

Net assets—end of period

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

Difficulty: 2

Learning Objective: 7

AACSB: Analytical Skills

### Exercise 2-8

Name of Government  
Governmental Fund  
Balance Sheet  
Fiscal Year-End

**Assets** a, d, g

#### **Liabilities and fund balance**

Liabilities j

Fund balance c, i

Total liabilities and fund balance

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

Difficulty: 2

Learning Objective: 7

AACSB: Analytical Skills

**Exercise 2-9**

Name of Government  
Proprietary Fund  
Balance Sheet  
Fiscal Year-End

**Assets**

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

**Liabilities**

Current liabilities	h, j
Noncurrent liabilities	f
Total liabilities	

<b>Net Assets</b>	<b>b</b>
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Total liabilities and net assets

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

Difficulty: 2

Learning Objective: 7

AACSB: Analytical Skills

**Exercise 2-10**

(1) Proprietary fund

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

\*Calculations for:

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

(2) Governmental fund and nonfund accounts

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

## Exercise 2-10 (Continued)

### Legend

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

Difficulty: 3

Learning Objective: 4

AACSB: Analytical Skills

## SOLUTIONS TO PROBLEMS

### Problem 2-1 (a)

#### Analysis of Transactions for General Government Activities

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

<sup>†</sup>The text (page 64) shows parenthesis around this number. It is an increase, therefore should not be in parenthesis.

\*Year-end entry.

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

#### Legend

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

#### Analysis of Transactions for Business-Type Activities

##### Airport Enterprise Fund

5.	<u>CA</u>	+	<u>NCA</u>	-	<u>CL</u>	-	<u>LTL</u>	=	<u>NA</u>
	\$8,000,000								\$8,000,000

### Problem 2-1 (b)

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

### Enterprise Fund Legend

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

Difficulty: 2

Learning Objective: 4

AACSB: Analytical Skills



**Problem 2-2 (a)**

**Governmental Funds**

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

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

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

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

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

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

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

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

**Proprietary Funds**

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

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

**Problem 2-2 (b)**

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

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

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

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

Difficulty: 3

Learning Objective: 4, 7

AACSB: Analytical Skills

**Problem 2-3 (1)**

**Governmental Funds**

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

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

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

**Proprietary Funds**

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

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

**Problem 2-3 (2)**

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

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

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

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

Difficulty: 2

Learning Objective: 4, 7

AACSB: Analytical Skills

**Problem 2-4 (a)**

**Governmental Funds**

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

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

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

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

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

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

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

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

**Problem 2-4 (b)**

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

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

Difficulty: 2

Learning Objective: 4, 7

AACSB: Analytical Skills

**Problem 2-5 (a)**

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

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

**Problem 2-5 (b)**

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

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

Computations:

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

Difficulty: 3

Learning Objective: 3, 4, 7

AACSB: Reflective thinking

**Problem 2-6 (a)**

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

**Problem 2-6 (b)**

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



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

## **SOLUTION TO CASES**

### **Case 2-1**

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

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

Difficulty: 2  
Learning Objective: 7  
AACSB: Reflective thinking

**Case 2-2 (a)**

**Governmental Funds**

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

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

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

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

\*\*\* To record grant proceeds from federal government.

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

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

**Case 2-2 (b)**

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

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

Difficulty: 2

Learning Objective: 4, 6, 7

AACSB: Reflective thinking